AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

ETHIOPIA

Driving Ethiopia's Transformation

The Reform of the Global Financial Architecture

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LIST OF ACRONYMS AND ABBREVIATIONS

ADF	African Development Fund
AfCFTA	African Continental Free Trade Area
AfDB	African Development Bank
BaU	Business-as-Usual
CBE	Commercial Bank of Ethiopia
CDM	Clean Development Mechanism
CF	Common Framework
CFR	Country Focus Report
CRGE	Climate Resilient Green Economy
DFIs	Development Financial Institutions
DSA	Debt Sustainability Assessment
DSSI	Debt Service Suspension Initiative
ECMA	Ethiopian Capital Market Authority
EIH	Ethiopian Investment Holdings
eSW	Electronic Single Window
ESX	Ethiopia Securities Exchange
ETB	Ethiopian Birr
FDI	Foreign Direct Investment
G20	Group of 20 Industrialized Countries
GDP	Gross Domestic Product
GHG	Greenhouse Gas
HGER	Home-Grown Economic Reform
HIPC	Highly Indebted Poor Countries
IAIP	Integrated Agro-Industrial Parks
ICT	Information and Communication Technology
IDA	International Development Association
IIAG	Ibrahim Index of African Governance
IMF	International Monetary Fund
IPs	Industrial Parks
ISP-PPP	Institutional Support Project for Public Private Partnerships
ISP-SMM	Institutional Support Project for Strengthening Macroeconomic Management
LAMC	Liability and Asset Management Corporation
LT-LEDS	Long-term Low Emissions Development Strategy
MDBs	Multilateral Development Banks
MDRI	Multilateral Debt Relief Initiative
MSMEs	Micro, Small and Medium Enterprises
MW	Megawatts

NBE	National Bank of Ethiopia
NDCs	Nationally Determined Contributions
ODA	Overseas Development Assistance
PPG	Public and Publicly Guaranteed Debt
PPPs	Public Private Partnerships
PSNP	Productive Safety Net Program
SDGs	Sustainable Development Goals
SDRs	Special Drawing Rights
SoEs	State-owned Enterprises
TFP	Total Factor Productivity
TPLF	Tigray People's Liberation Front
TVET	Technical and Vocational Education and Training
TYDP	Ten-Year Development Plan
WTO	World Trade Organization

EXECUTIVE SUMMARY

The 2024 Country Focus Report (CFR) for Ethiopia underscores the country' recent growth trends, structural transformation and financing requirements to accelerate structural transformation. The report is prepared in three chapters and aligned with the Bank's continental annual African Economic Outlook report, 2024.

Chapter one highlights Ethiopia's recent macroeconomic performance and the medium-term outlook. Ethiopia's economy grew by 7.1% in 2022/23 compared to 6.4% in 2021/22, as the impact of shocks faced between 2020-2022 eased. While declining, inflation remained high at 29.2 percent in 2022/23, due to money supply growth, supply chain disruptions, and imported inflation. The fiscal deficit narrowed from 4.2% in 2021/22 to 3.3% of GDP in 2022/23 due to fiscal consolidation, the peace dividend, and improved tax revenues. The current account deficit narrowed from 3.9% in 2021/22 to 3.0% of GDP in 2022/23, on account of increased net services inflows.

Ethiopia's state-led growth model that was implemented since 2004 seems to have run its course from around 2018, even before the onset of COVID-19 pandemic, and internal conflict. Supported by large public investments in physical and social infrastructure and state-owned enterprises in key sectors, economic growth averaged 10.2 percent p.a. between 2004-2017 to about 7% p.a. between 2018-2019, as macroeconomic pressures (scarcity of foreign currency, high inflation, and public debt), and structural pressures (weak business environment, limited competition and innovation) emerged. Ethiopia's risk of external debt distress deteriorated from moderate to high in 2017. To address external debt vulnerabilities, the government imposed a moratorium on non-concessional external borrowing and is negotiating debt restructuring under the G20 CF.

The outlook is positive with growth projected at average of 6.7% p.a. between 2023/24-2024/25. Key downside risks include debt and climate vulnerabilities, internal conflict, and high global prices (especially oil and food prices), due to supply chain disruptions arising from geo-political tensions, and conflict. Tailwinds include the peace dividend following the conclusion of the war in Tigray, the gradual return to stability in most regions, a new IMF program to support macroeconomic stability, and conclusion of the G20 CF on debt restructuring.

In the short-term, the government needs to prioritize reform of the monetary policy, interest rate and exchange rate policies by transitioning to price- and market-based policy frameworks, revise the current account, and capital account policies to improve price stability, and the foreign currency reserves.

In the medium- and long-term, the government needs to sustain investments in the enablers of growth (infrastructure, agriculture value-chains, and promotion of trade) to expand the scope for tax revenue mobilization. To address structural rigidities, Ethiopia needs to sustain reforms to improve the business environment and attract investment in key sectors such as trade, tourism, mining, and industry. Accelerating the reforms underscored in the Home-grown Economic Reform Agenda 2.0, including fostering peace, prioritizing expenditures, broadening the tax base, and attracting concessional and private financing will help to facilitate inclusive growth.

Chapter two discusses trends in Ethiopia's economic transformation, amid a changing world. The chapter presents a comprehensive analysis of progress in Ethiopia's economic transformation. It underscores the key trends, outlines the characteristics, challenges, and estimates the financing requirements to fast-track structural transformation in Ethiopia. Between 2004-2019, Ethiopia's GDP grew at about 10.2 percent, which was propelled by large public investments in physical and social infrastructure. But growth decelerated to about 6.7% p.a. between 2020-2023, due to macroeconomic imbalances, structural constraints, and economic and climate-related shocks.

The pace of structural transformation has been slow and has favored services over manufacturing. The share of agriculture in GDP declined from about 54 percent in 2001-2005 to 32 percent in 2021-2023 as the share of industry increased from 10 percent to 28 percent and that of services fluctuated around 40 percent. However, agriculture still employs 65 percent of the total labor force, the services sector 25 percent, and the industrial sector 10 percent. Manufacturing contributed only 6.5% to GDP in 2023 compared to 4.5% in 2000. Consistent with trends in much of Africa, the primary beneficiary of the reallocation of the workers is the services sector rather than the industrial sector. Within the industrial sector, manufacturing employs about 9.5% of the workforce and construction employs only 3%, implying that the construction boom has been relatively more capital-intensive than it is thought to be. Much of the labor movement is from low-productivity informal agriculture to low-productivity processing and retail services, rather than to manufacturing and high-end services crucial for rapid transformation.

According to government estimates, the financing requirements to realize Ethiopia's national development priorities are projected in the range of USD257-USD397 billion between 2023/24-2029/30, and about USD608 billion is required to meet the Sustainable Development Goal (SDG) targets by 2030. The Long-Term Low Emissions Development Strategy (LT-LEDS), which is aligned to the NDCs, projected a financing need of USD5 billion p.a. between 2020 and 2050. According to the Bank's estimates for the 2024 Africa Economic Outlook, Ethiopia will need USD25.8 billion p.a. until 2030 to accelerate its structural transformation and position it at par with high-performing developing countries with comparable levels of development.

Accelerating structural transformation in Ethiopia requires a multipronged approach through: (i) building on current investments in infrastructure to strengthen connectivity and facilitate inclusive growth; (ii) improving the quality of education, developing relevant skills to prepare the workforce for the future and closing the demand-supply skills mismatch, considering the emerging growth and job creating sectors; (iii) improving the efficiency of public spending, tax collection and tax administration to mobilize sufficient domestic resources to close part of the financing gap; (iv) catalyzing and facilitating the private sector by improving the efficiency of public services, and rationalizing the scale and reach of State-owned Enterprises (SoEs), and leveraging new and existing innovative financing instruments; and (v) strengthening regional integration and trade to leverage the African Continental Free Trade Area (AfCFTA).

Strengthening macroeconomic management by implementing prudent monetary and fiscal policies is critical to ensuring macroeconomic stability and to fostering enablers for inclusive growth, and structural transformation.

Chapter three discusses the financing requirements for Ethiopia's structural transformation and the need for reforms of the international financial architecture. Ethiopia has large financing needs, to invest at scale and in the right sectors while dealing with the threats of climate change and global shocks in order to achieve structural transformation. The financial requirements to realize national development priorities are projected in the range of USD257 billion to USD397 billion between 2024-2030.

Without the support of the international financial institutions, Ethiopia (and most other African countries) will not achieve many of its SDG targets, which will be a failure of the international community, and thus, calling for a proportionate voice for the reform of international financial architecture that amplifies Africa's growing significance, and financing needs. With its large population and economic potential, Ethiopia is expected to benefit from reforms of the global financial architecture for a fairer and transparent system. The G20's CF has been slow in supporting orderly debt restructuring in the midst of global shocks. National debt management systems and international support need to ensure sustainable debt profiles and reflect the impacts of global economic shocks, and climate change on economies like Ethiopia. Debt relief for climate initiatives, sovereign debt management systems and the IMF/World Bank Debt Sustainability Framework need to ensure sustainable debt management and reflect the impact of shocks on economies like Ethiopia.

Ethiopia should add its voice to the calls for rechanneling the Special Drawing Rights (SDRs) of the International Monetary Fund (IMF) to Multilateral Development Banks (MDBs) to leverage more resources for structural transformation. Ethiopia needs to support the African Union in its participation in the G20 as observer and to participate in the debate on the reform of the global financial architecture. Optimizing the balance sheets and risk appetite of MDBs to maximize their capacity to finance development interventions in the developing countries, including Ethiopia. Ethiopia needs to engage more with the MDBs like the African Development Bank (AfDB) to influence the international credit rating agencies to improve the methodologies used to assess sovereign risk in order to reduce subjectivity in Africa's credit ratings.

GENERAL INTRODUCTION

With a population of about 120 million, Ethiopia is the 2nd most populous nation in Africa and among the poorest, with a per capita income of about USD1,370 in 2023. Between 2004-2018, Ethiopia recorded double-digit annual economic growth, averaging at about 10.2 percent, on account of a public sector-led growth more with large investments in physical and social infrastructure. However, due to emerging macroeconomic constraints, conflicts, climate change-related shocks, growth decelerated to about 6.7% p.a. between 2020-2023.

The Country Focus Report (CFR) for Ethiopia is aligned with continental annual African Economic Outlook report, 2024. The report is prepared in three chapters. Chapter one addresses the recent key macroeconomic trends and outlook over the medium-term. Chapter two discusses the trends in Ethiopia's structural transformation, key issues and challenges that need to be addressed to accelerate the movement of factors of production from low-productivity sectors to high-productivity sectors for inclusive and sustainable growth. Chapter three discusses the financing requirements for Ethiopia's structural transformation, and the need for reforms of the international financial architecture.

1

MACROECONOMIC PERFORMANCE AND OUTLOOK

Key Messages

- Ethiopia's economy grew by 7.1% in 2022/23 compared to 6.4% in 2021/22, as it emerged from multiple overlapping shocks. While declining, inflation remained high at 29.2 percent in 2022/23 (34 percent in 2021/22), due to money supply growth, supply chain disruptions and imported inflation. A tight monetary policy stance was applied to contain inflation. The fiscal deficit narrowed from 4.2% in 2021/22 to 3.3% of GDP in 2022/23, and the primary balance declined from -2.9% of GDP to -1.9%, due to fiscal consolidation, the peace dividend, and improved tax revenues. The current account deficit narrowed from 3.9% in 2021/22 to 3.0% of GDP in 2022/23, due to a 60.3 percent increase in net services, and 5.3% reduction in imports.

- Ethiopia defaulted on its Eurobond interest payment in December 2023, triggering a credit rating downgrade by Fitch from 'CC' to Restricted Default. Ethiopia's risk of external debt distress deteriorated from moderate to high since 2017. To address external vulnerabilities, the government imposed a moratorium on non-concessional external borrowing; is negotiating debt restructuring under the G20 CF; and investing in enablers of growth, manufacturing, and export promotion.

- Accelerating the reforms underscored in the Home-grown Economic Reform Agenda 2.0, including fostering peace, ensuring macro-financial stability, reforming fiscal policy and tax administration, prioritizing expenditures, broadening the tax base, expanding domestic savings mobilization, improving the country's debt carrying capacity and debt sustainability, and attracting concessional and private financing will foster high and resilient growth, and structural transformation.

1.1 Growth Performance

In 2022/23, Ethiopia's economy grew by 7.1% compared to 6.4% in 2021/22 (Table 1), slowly emerging from the multiple overlapping shocks of the past three years. These include drought in much of the eastern and southern regions, multiple crises, including internal and regional conflicts and the lingering effects of the COVID-19 pandemic. Growth was led by services, by 7.9%, above the 7.6% in 2020/21, as transport and the hotel sectors recovered; agriculture grew by 6.3% in 2022/23, above the 6.1% in 2021/22, mainly due to expansion of irrigated large scale commercial farming, promotion of cluster farming, and use of improved agricultural technology; and industry grew by 6.9% in 2022/23, up from 4.9% in 2021/22, due to improving capacity utilization in manufacturing, recovery of the construction sector, and an increase in electricity production, and exports. The share of the manufacturing sector remains low at 6.7% of GDP in 2022/23, signaling slow structural transformation. In 2022/23, agriculture, industry, and services accounted for about 32.0 percent, 28.0 percent, and 40.0 percent of GDP, respectively. On the demand side, growth was driven by private consumption, and investment.

Ethiopia's economy grew by 7.2% in 2022/23 compared to 6.4% in 2021/22, as it emerged from multiple overlapping shocks. Accelerating reforms underscored in the second Home-grown Economic Reform Agenda will foster high and resilient growth and structural transformation.

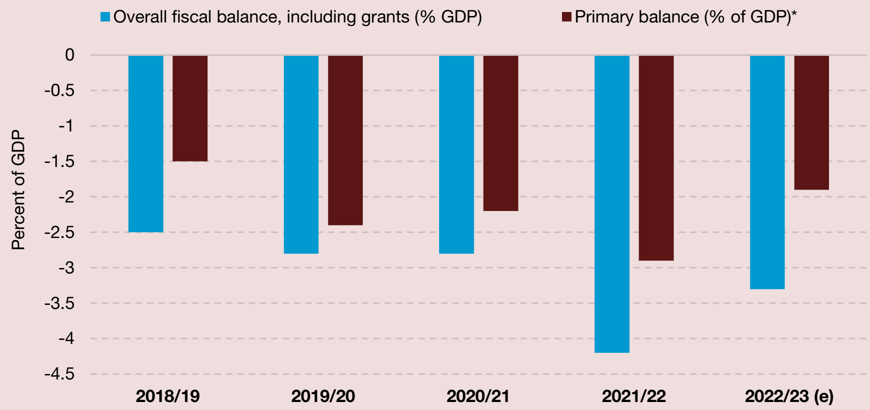
Over the past two decades, Ethiopia ran a state-led growth model that seems to have run its course from around 2018, even before the onset of COVID-19 pandemic and conflict in Tigray region. Supported by large public investments in physical and social infrastructure and state-owned enterprises in key sectors, economic growth averaged 10.2 percent p.a. between 2004-2017 to about 7% p.a. between 2018-2019, as macroeconomic pressures (scarcity of foreign currency, high inflation, and public debt) and structural pressures (weak business environment, limited competition, and innovation) emerged. Between 2020-2023, growth averaged about 6.7% p.a., buoyed by growth in the services, agriculture, and industry sectors as well as economic, and financial reforms. The growth model did not yield sufficient decent jobs to absorb the large youth population and did not facilitate rapid structural transformation.

1.2 Other Recent Macroeconomic and Social Developments

Monetary policy, inflation and exchange rate: In 2022/23, monetary policy was mostly contractionary to contain inflation, while maintaining economic growth. Recent measures include a ceiling on domestic credit growth at 14 percent, limiting central bank direct lending to the government, increasing the interest rate that the National Bank of Ethiopia (NBE) charges commercial banks for loans. Broad money grew by 24.6 percent in 2022/23, compared to 27.2 percent in 2021/22, mainly due to expansion of domestic credit by 24.7 percent, compared to 30.3 percent in 2021/22. Inflation remained high at 32.5 percent in 2022/23, food at 31.7 percent, and non-food inflation at 33.5 percent, due to supply-side constraints, imported inflation (global inflationary pressure), and demand side pressure (deficit monetization) fueled by value-chains disruptions (due to external and internal conflicts). The exchange rate depreciated by 5.3% on the official market, due to slow exports growth.

Fiscal policy and public debt: The overall fiscal deficit including grants improved from 4.2% of GDP in 2021/22 to 3.3% of GDP in 2022/23, due to the decline in the primary balance from -2.9% of GDP in 2021/2022 to -1.9% in 2022/2023 (Figure 1.1), and the implementation of the fiscal consolidation policy. The peace dividend and declining defense expenditure, from 1.7% of GDP in 2021/22 to 0.9% of GDP in 2022/23, have also contributed to the improving fiscal position. While public spending increased by 24.7 percent in 2022/23, domestic revenue grew by 36.5 percent. External financing increased by 20.4 percent in 2022/23, as development partners resumed aid disbursements following the November 2022 Peace Agreement with the Tigray People's Liberation Front (TPLF).

Figure 1.1: Overall Fiscal Balance and Primary Fiscal Balance (Percent of GDP), 2018/19-2022/23



Data sources: Domestic authorities; estimates (e) and prediction (p) AfDB Statistics Department, April 2024

Ethiopia's Public and Publicly Guaranteed (PPG) debt reached USD63.0 billion (USD28.1 billion external) (about 40 percent of GDP) in 2022/23. Almost 81 percent of Ethiopia's external debt is from official sources, notably multilateral creditors (66.6 percent of the official creditors, with the World Bank accounting for 76 percent of official creditors), and the rest from bilateral creditors. Ethiopia's risk of external debt distress deteriorated from moderate to high in 2017, with two external debt sustainability indicators breaching the threshold: the present value of external debt-to-exports and debt service-to-exports. Weak business enablers, slow exports growth, financial constraints, and slow payback of infrastructure projects elevated public debt. Ethiopia officially withheld the USD33 million coupon payment in December 2023 on its USD1 billion Eurobond, arguing for equitable treatment of all creditors. This prompted sovereign rating downgrades by Fitch Ratings of Ethiopia's Long-Term-Foreign Currency Issuer Default Rating from C to Restricted Default.

Table 1.1: Key Macroeconomic Indicators

Indicators	2018/19	2019/20	2020/21	2021/22	2022/23 (e)	2023/24 (p)	2024/25 (p)
Real GDP Growth	9.0	6.1	6.3	6.4	7.1	6.7	6.7
Real GDP Growth per Capita	6.3	3.4	3.6	3.8	4.5	4.2	4.2
Inflation	15.7	20.4	26.6	34.0	29.2	21.0	15.8
Overall Fiscal Balance, Including Grants (% GDP)	-2.5	-2.8	-2.8	-4.2	-3.3	-2.7	-2.5
Current Account (% GDP)	-5.3	-4.4	-3.2	-3.9	-3.0	-2.0	-1.2
Total Population (Million)	114.1	117.2	120.3	123.4	126.5		
Life Expectancy at Birth (Years)	65.8	65.4	65.0	65.6	66.6		

Source: Data from domestic authorities; Estimates (e) and prediction (p) AfDB Statistics Department, April 2024
*Note: *Data in fiscal year 11 July (n-1)/ 10 July(n).*

External position and external financial flows: The current account deficit improved from 3.9% of GDP in 2021/22 to 3.0% of GDP in 2022/23, on account of a 5.1% decline in imports bills, counterbalancing a 11.8 percent decline in export revenues. The government's fiscal consolidation policy depresses import bills in 2022/23, mainly due to trade chain disruptions caused by multiple crises. Net private transfers declined by 6.3%, of which remittances declined by 6% to USD4.9 billion in 2022/23 from USD5.3 billion. Net services increased by 60.3 percent in 2022/23, financing the current account deficit, partially offsetting the 14.8 percent decline in net official transfers.

Social developments: The latest national survey data showed a decline in national headcount poverty from 29 percent in 2011 to 23.5 percent in 2016; and the World Bank assessment using the international poverty line of USD1.90 per person per day, noted that poverty declined from 31.1 percent in 2016 to 27 percent in 2019. However, the 2019 Multidimensional Poverty Index shows a high prevalence of vulnerability: 68.7 percent of the population (about 82.7 million) is multidimensionally poor (deprived of at least one or more basic necessities) and 18.4 percent (22.1 million) is vulnerable to multidimensional poverty. About 31.4 million people require humanitarian support due to conflict and climate-related shocks. Inclusive growth is constrained by low productivity and weak value-chains, limited diversification, high cost of doing business, and few employment opportunities for the youth. While total unemployment is estimated at 8%, youth unemployment is almost threefold, at 23.1 percent (2022). About 2.5 million new jobs are needed annually to absorb the new labor entrants.

Box 1.1 : Impact of Tighter International Financial Conditions

Ethiopia relies heavily on Overseas Development Assistance (ODA) and trade with Asia, the Americas and Europe, which exposes its development financing to the global economic, and geopolitical conditions as well as the prevailing international financial conditions. Tighter global financial conditions, and increased demand for financing imply limited resource availability and higher cost of financing for countries such as Ethiopia.

Almost 65 percent of Ethiopia's export revenue comes from semi-processed agricultural products, including coffee, oilseeds, and sunflower, which exposes the country to vulnerability to fluctuating terms of trade. Ethiopia's exports to rest of the world accounts for almost 80 percent of its merchandise exports, with exports to Africa accounting for only 21 percent. This implies that the economic and financial conditions in the rest of the world have significant implications for exports revenue flows to Ethiopia. Indeed, tighter global financial conditions adversely impact the flows of Foreign Direct Investment (FDI) with negative implications for Ethiopia's already weak external reserves position, and the scarcity of foreign exchange. In 2022, Ethiopia received about USD3.7 billion compared to USD4.3 billion in 2021, in part due to the tighter global economic, and financial conditions as well as weak domestic business environment.

1.3 Macroeconomic Outlook and Risks

1.3.1 Outlook

Economic growth: Growth is projected to slow down to 6.7% in 2023/24 and in 2024/25, due to a slowdown in public investment, a shift in public spending towards economic recovery and humanitarian interventions, slow pace of negotiations on debt restructuring and associated impediments on access to development finance. Growth will be led by services and agriculture, on the supply side, and private consumption and investment, on the demand side.

Monetary policy and inflation: Contractionary monetary policy, focusing on the growth of broad money supply, is expected to be sustained in the medium-term in order to reduce inflation to 21.3 percent by the end of 2023/2024, and 15.4 percent in 2024/25. Recent measures taken by the central bank include a ceiling on domestic credit growth at 14 percent, limiting central bank lending to the government, increasing the interest rate that the NBE charges commercial banks for loans. The persistent droughts and supply disruptions, due to internal conflicts adversely impact inflation in Ethiopia.

Fiscal and current account balances: The fiscal deficit is expected to decline to 2.7% and 2.5% of GDP in 2023/24 and 2024/25, respectively, due to fiscal consolidation, improvements in tax collections, and a potential scale down of security-related expenditures. The fiscal deficit will be financed by domestic resources, including the sale of treasury bills as well as external concessional financing. The current account deficit is projected at 2.0% and 1.2% of GDP in 2023/24, and 2024/25, respectively, as merchandise and service exports expand, and imports grow slowly, due to lower public investment. The current account deficit will be financed mostly by FDI, remittances, and grants.

1.3.2 Risks

Key downside risks include debt and climate vulnerabilities, intercommunal conflicts, and sustained high global prices (especially oil and food prices), due to supply chain disruptions arising from geo-political tensions, and conflict. Structural rigidities including inefficient public services, and weak private sector environment remain as headwinds to inclusive growth. Tailwinds include the peace dividend following the conclusion of the war in Tigray, the gradual return to stability in most regions, a new IMF program to support macroeconomic stability, and conclusion of the G20 CF on debt restructuring. Recovery of tourism and liberalization of the telecoms, financial, and sugar sectors are expected to boost the growth outlook.

1.4 Policy Options to Foster High and Resilient Growth Supporting Macroeconomic Stability and Economic Transformation

Even though Ethiopia slowly emerged from the multiple overlapping shocks of the past three years, it severe macroeconomic imbalances (foreign currency scarcity, high rates of inflation, and public debt), structural rigidities (weak business environment and limited competitiveness), and inefficiency of public services. To put economy back on the path of sustained, higher and resilient growth to facilitate economic transformation, Ethiopia needs to implement a mix of short-medium-term, and long-term policies.

In the short-term, the government needs to prioritize reform of the monetary policy, interest rate, and exchange rate policies by transitioning to price- and market-based policy frameworks, revise the capital account policies to improve price stability, and the foreign currency reserves position. Market-based exchange and interest rates will help to improve Ethiopia's competitiveness and exports growth. Reforms to improve the efficiency of public services and strengthen institutional capacity in macroeconomic and project management are needed to attract more financing. The government must take measures to improve domestic resource mobilization by strengthening tax revenue management and broadening the tax base. Strengthening capacity for public debt management, analysis and negotiations with partners and creditors as swell as and systems for data management are key to improve monitoring, and mitigating risks. Ethiopia needs to sustain negotiations for debt payment suspension under the CF and other debt treatment initiatives under the G20 for favorable external debt treatment. Reforms to promote the use of policy-based tools of monetary policy, strengthen central bank independence, and limit the tendency of state-owned banks extending unsecured loans to state-owned enterprises will help to reduce quasi-fiscal burdens.

In the medium- and long-term, the government needs to sustain investments in the enablers of growth (infrastructure, agriculture value-chains, and promotion of trade) to expand the scope for tax revenue mobilization. The government could also explore ways to widen the tax base and new options to raise tax revenue by identifying economic activities not covered by tax law and applying information technology to improve tax payments, and compliance. Pursuing innovative and sustainable external concessional and long-term financing will help to expand resource mobilization.

To address structural rigidities, Ethiopia needs to sustain reforms to improve the business environment and attract investment in key sectors such as trade, tourism, mining, and industry. This will help to enhance productivity growth, capacity utilization, and competitiveness. Building on the ongoing reforms of the financial sector to strengthen the capital markets and allow foreign financial banks to operate in Ethiopia will help to attract both domestic and foreign investment, increase economic activity, jobs, and competition. These measures will help to improve the scope for more tax revenue mobilization as well as to ease pressure on public expenditure, and to address public debt vulnerabilities. Ethiopia has been implementing a number of measures to address the public debt position, and a new debt sustainability assessment and data reconciliation with the IMF are needed to ascertain the debt ratios, and risk of external debt distress. A moderate risk of debt distress could help Ethiopia to access additional financing.

The Bank and other development partners need to sustain financial support and technical assistance to Ethiopia to build capacity in economic policy management and negotiations on debt treatment under the CF of the G20. The ongoing Bank-financed Institutional Support Project for Strengthening Macroeconomic Management (ISP-SMM) is supporting macroeconomic stability and can be a catalyst for other partners to support ongoing reforms.

2

TAKING STOCK OF ETHIOPIA'S STRUCTURAL TRANSFORMATION PROGRESS

Key Messages

- Between 2004 and 2019, Ethiopia recorded GDP growth rates of about 10.2 percent, which was propelled by large public investments in physical and social infrastructure. But growth decelerated to about 6.7% p.a. between 2020-2023, due to macroeconomic imbalances, structural constraints as well as economic and climate-related shocks.

- The pace of structural transformation has been slow and has favored services over manufacturing. The share of agriculture in GDP declined from about 54 percent in 2001-2005 to 32 percent in 2021-2023 as the share of industry increased from 10 percent to 28 percent, and that of services fluctuated around 40 percent. However, agriculture still employs 65 percent of the total labor force, the services sector 25 percent, and industrial sector 10 percent. Manufacturing contributed only 6.5% to GDP in 2023, compared to 4.5% in 2000.

- Accelerating structural transformation in Ethiopia requires a multipronged approach by (i) building on current investments in infrastructure to strengthen connectivity and facilitate inclusive growth; (ii) improving the quality of education, developing relevant skills to prepare the workforce for the future and closing the demand-supply skills mismatch, considering the emerging growth and job creating sectors; (iii) improving the efficiency of public spending, tax collection and tax administration to mobilize sufficient domestic resources to close part of the financing gap; (iv) catalyzing and inclusively facilitating the private sector by improving the efficiency of public services and rationalizing the scale and reach of SoEs, and leveraging new and existing innovative financing instruments; and (v) strengthening regional integration and trade to leverage the AfCFTA.

- Strengthening macroeconomic management by implementing prudent monetary and fiscal policies is critical to ensuring macroeconomic stability, and to fostering enablers for inclusive growth and structural transformation.

2.1 Introduction

This chapter presents a comprehensive analysis of progress in Ethiopia's economic transformation, amid a changing world. The chapter underscores the key trends, outlines the characteristics, challenges, and estimates the financing requirements to fast-track structural transformation in Ethiopia. The chapter outlines the policy options and recommendations at national, regional, and MDBs levels to accelerate Ethiopia's structural transformation.

Ethiopia is a low-income country with nominal GDP per capita of about USD1,370 in 2023, from about USD150 in 2004, compared to Ghana's and Kenya's increase, respectively, from USD405 to USD2,200 and USD462 to USD2,099 over the same period. In purchasing power parity terms, Ethiopia's GDP per capita increased from USD560 in 2004 to about USD2,800. However, growth of GDP per capita in the purchasing power parity terms show the lack of convergence, possibly due to different policy choices. Ghana's and Kenya's GDP per capita (in purchasing power parity) increased, respectively, from USD2,580 to USD6,470 and USD2,060 to USD5,765 over the same period.

2.2 Taking Stock of Economic Performance and Transformation in Ethiopia

Between 2004 and 2019, Ethiopia recorded double-digit economic growth rates, averaging 10.2 percent p.a., well above Africa's average of about 4.0% p.a. and comparators like Ghana (6.5%), Kenya (4.9%) or Rwanda (7.7%) (Figure 2.1). Ethiopia's growth has been driven by large public investments in physical and social infrastructure under a state-led growth model. While growth decelerated to about 6.7% p.a. between 2020-2023, due to macroeconomic imbalances, structural rigidities as well as economic and climate-related shocks, it remained above Africa's average of 2.0% p.a. Real GDP per capita grew by about 6.6% p.a. between 2004-2019 compared to Africa's average of about 2%, Ghana (3.8%), Kenya (2.0%) or Rwanda (4.5%) (Figure 2.2).

However, the growth recorded since 2004 has mostly been driven more by physical capital accumulation, than by structural transformation. The predominance of the state-led investments overshadowed and provided limited space for private sector growth. Growth has not been supported by capital accumulation linked to innovation to propel Ethiopia's transition into an industrial economy.

To respond to these economic challenges and support economic transformation, Ethiopia introduced the first Homegrown Economic Reform (HGER 1.0) in September 2019 to improve the efficiency of public services and increase private sector engagement in the economy. Some progress has been achieved, including the sale of a telecommunications license to Safaricom Ethiopia in June 2021 for USD850 million. However, liberalization of SoEs including those in the logistics, electricity, sugar, and aviation sectors has been slowed by the conflict, the COVID pandemic, and weak confidence in the economy. A second generation HGER 2.0 was launched in March 2024 to sustain these reforms.

Figure 2.1: Ethiopia Real GDP Growth vs Africa and Peer countries

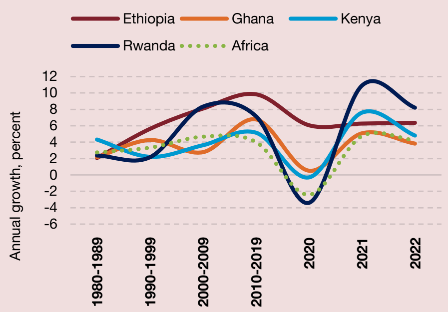
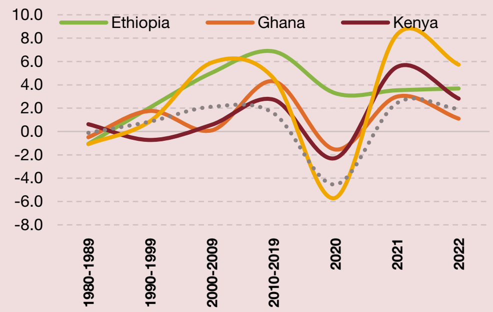


Figure 2.2: Ethiopia Real GDP per Capita Growth vs Africa and Peer countries



Data sources: AfDB Statistics, 2024; World Bank, 2024.

2.3 Ethiopia's Structural Transformation: Drivers, Bottlenecks and Opportunities

2.3.1 Ethiopia's Structural/Economic Transformation

Structural transformation is understood as the shift of an economy's structure from low-productivity, labor-intensive activities to higher productivity, capital and skill intensive activities. Key indicators show that the pace of structural transformation in Ethiopia has been slow and has favored services over manufacturing. The share of agriculture in GDP declined from an average of 54 percent in 2001-2005 to 51 percent in 2006-2010, and from 43 percent in 2011-2016 to 32 percent in 2021-2023 as the economy expanded (Figure 2.3). Over this period, the share of industry in GDP increased from an average of 10 percent in 2001-2005 to 10.4 percent in 2006-2010, and 11.8 percent in 2011-2016. The share of the industry increased rapidly from 2016-2020 to 27 percent, and to 28 percent in 2021-2023, due mainly to the expansion of the construction sector, fueled by large public investments in physical and social infrastructure, and to a lesser extent, as the implementation of industrial policies gained pace, including the development of industrial parks. On the other hand, the share of the services has fluctuated around 40 percent, initially increasing from 37.6 percent in 2001-2005 to 40.2 percent in 2006-2010, and 45.5 percent in 2011-2016. The share of services declined to around 40 percent in 2016-2020, and 2021-2023.

Over the 2001-2023 period, agriculture was the main driver of growth, averaging 7.2% p.a. in 2001-2005 before doubling to 15 percent p.a. in 2006-2010, and 19 percent p.a. between 2011-2015 (Figure 2.3). Agricultural growth decelerated to 7.9% p.a. between 2016-2020 and 7.3% p.a. in 2021-2023, due to political tensions and internal conflicts, COVID-19 pandemic, and droughts. This was followed by the industry, which grew at an average of 8.2% in 2001-2005, 10.1 percent p.a. in 2006-2010, 11.2 percent in 2011-2015, and 11.9 percent p.a. in 2016-2020. Industrial growth decelerated to 6.4% p.a. in 2021-2023, due to the COVID-19 pandemic, and internal conflicts. Growth of the services sector averaged 5.5% in 2001-2005, 7.9% p.a. in 2006-2010, 6.6% in 2011-2015, and 4.5% p.a. in 2016-2020. The growth of services rebounded to 6.0% p.a. in 2021-2023 as service exports (Ethiopian Airlines) rebounded in the aftermath of the COVID-19 pandemic.

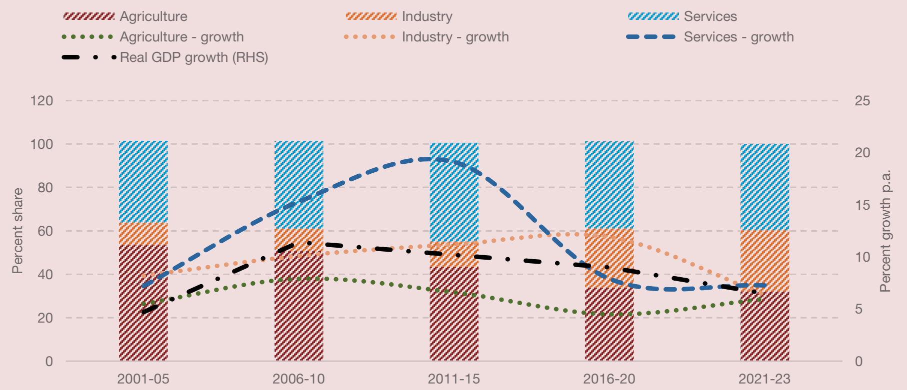
Between 2018-2023, the crop sub-sector was the primary driver of growth in

The pace of structural transformation has been slow and has favored services over manufacturing. While the share of agriculture in GDP has declined and that of industry increased, agriculture remains the main driver of economic growth and employs most of the adult population.

agriculture: it accounted for 21.5 percent, and grew at 5.3% p.a., due to ongoing policy reforms, introduction of large-scale irrigation, cluster farming, mechanization, and drought-resistant crops to expand productive capacities. Despite its potential, the livestock sub-sector accounts for only 8.5% of GDP.

While the industry sector grew at an average of 9% p.a.,[1] the manufacturing sub-sector has been modest, with contribution increasing from 5.8% of GDP in 2018 to 6.5% in 2023. Almost three-quarters of manufacturing growth come from large, capital-intensive firms with limited ability to rapidly expand employment opportunities. Medium and large-scale manufacturing industries contributed about 4.5% of GDP, while small and cottage manufacturing industries contributed 2%. The construction sub-sector contributed about 19.7 percent of GDP in 2023 but recorded declining growth rates, especially around 2020-2022 due to COVID-19, and the conflict. The mining sub-sector accounts for 0.3% of GDP and recorded volatile growth. The service sector grew at about 7.8% p.a. between 2018-2023. Wholesale and retail trade account for 14.6 percent of GDP, followed by transport and communications at 5.8%, due mainly to the rapid urbanization rate and public investment-led demand driven growth. Financial intermediation, real estate, and rental services account for 5% of GDP.

Figure 2.3: Sectoral Distribution of GDP and Growth Rates



Data sources: AfDB (2024); World Bank, (2024).

Labor allocation is a key indicator of structural transformation. Agriculture still employs almost two-thirds (65 percent) of the total labor force, the services sector 22 percent, and the industrial sector 13 percent (Figure 2.4). Consistent with trends in much of Africa, the primary beneficiary of the reallocation of the workers is the services sector rather than the industrial sector. Within the industrial sector, manufacturing employs about 9.5% of the workforce and construction employs only 3%, implying that the construction boom has been relatively more capital-intensive than it is thought to be. In the services sector, productivity is highest in real estate, followed by financial services (Figure 2.5) sub-sectors that are skill-intensive but employing fewer people. On the other hand, agriculture, personal services, and to some extent manufacturing employ the largest shares of workers. The productivity differentials within and between sectors suggest the potential for faster structural transformation if private sector-oriented reforms are executed.

Much of the labor movement is from low-productivity informal agriculture to low-productivity processing and retail services,

[1]Decomposing industry value-added into the manufacturing and construction sectors shows that growth in industry is driven primarily by the construction sector rather than manufacturing.

rather than to manufacturing and high-end services crucial for rapid transformation. The weak manufacturing growth underlies the slow pace of structural transformation, reflecting limited wage-paying jobs to pull workers out of agriculture (World Bank 2019). This seems to be a pattern that is common in Africa where labor transition from agriculture is mostly to services without much change in manufacturing (AfDB 2016). However, this raises concern about the early transition to the service sector with lower productivity growth (Box 2.2)

Figure 2.4: Sectoral Employment Shares in Ethiopia, 1990–2022

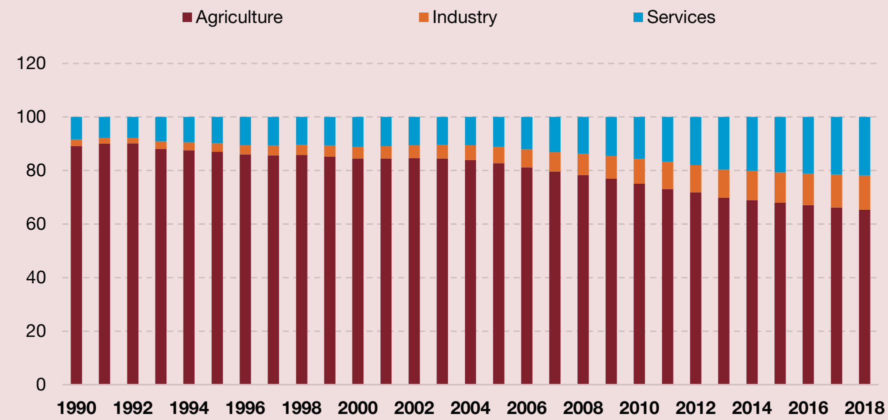
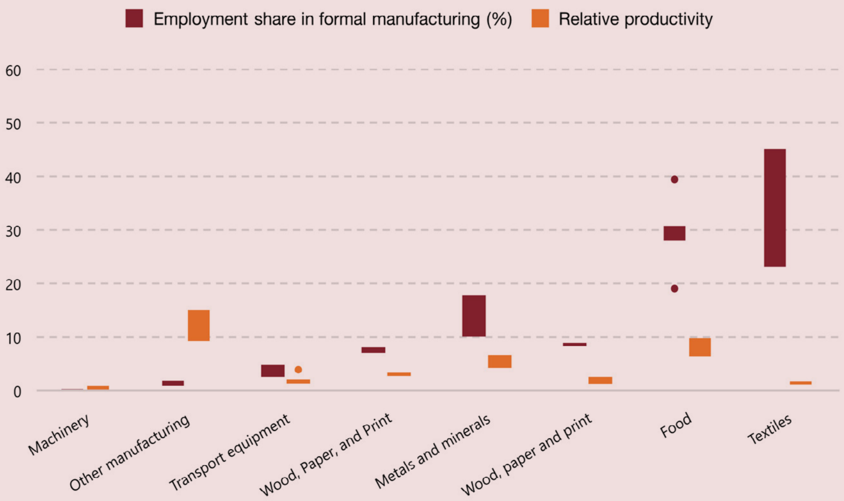


Figure 2.5: Relative Sectoral Productivity and Employment Shares in Ethiopia



Data sources: AfDB (2024); World Bank, (2024).

Ethiopia's ambition to attain lower-middle-income status by 2025 is within site, given its growth trajectory, poverty reduction, and improvements in human development indicators over the past 15-years. As the second most populous nation in Africa, with a population of approximately 120 million as of 2023, landmass of 1.1 million km2, Ethiopia has the potential to attain its next income frontier and sustain inclusive growth, and structural transformation. To achieve this, Ethiopia needs to address a number of macroeconomic challenges and structural rigidities as well as ethnic-based conflicts. Ethiopia has maintained a relatively closed economy, with limited integration in the global, and regional economies. The Ten-Year Development Plan (TYDP) 2021-2030 and the HGER 2.0 underscore the reforms needed to steer the economy towards private-sector-driven growth for increased competitiveness, and transformation. Both the TYDP and HGER 2.0 aim to improve the efficiency in public services delivery and capacity for policy making and implementation to foster growth and competitiveness in key growth-enabling sectors such as energy, financial, logistics, and telecoms.

2.3.2 Unpacking Ethiopia's Structural Transformation Through Labor Productivity Decomposition

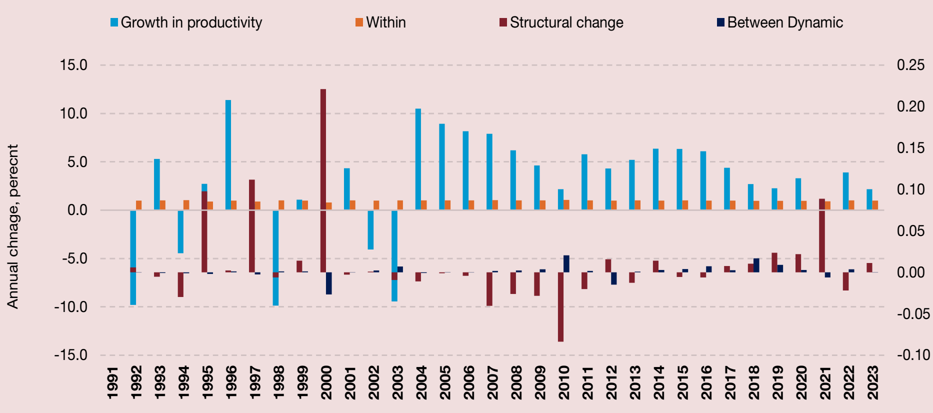
Changes in labor productivity, 1991-2023. Ethiopia's labor productivity growth for the period 1991-2023 averaged about 3.2%, which is higher than the average from a sample of 18 African countries, which was about 2% over the period between 1960–2015 (Mensah et al., 2022). When breaking the period into five-year periods, labor productivity growth was generally marginal from 1991 to 2005, averaging about 1.3% (Table 2.1). This was a period associated with conflict (1991-1993), and the initial first attempt at industrial policy development (1997-2000). Growth in labor productivity accelerated to[2] an average of 5.7% from 2006-2015, as the state-led infrastructure developments and industrial policies gained momentum. However, labor productivity growth declined to 3.7% and 2.4% from 2016-2020, and 2021-2023, owing to a number of shocks including internal conflicts, the COVID-19, and droughts. Ethiopia's structural transformation appears to have been growth-neutral, although it somewhat appears to have turned a corner around 2012 (Figure 2.6). Over most of the period analyzed, the within-sector effect contributed more and positively to total productivity growth, with impacts greater than that of structural change (Annex 1, Fig A1). Box 2.1 provides a summary of the methodology for estimating labor productivity. Labor productivity[2] in the industrial and services sectors is, respectively, 3 and 4 times higher compared to agriculture, which can be attributed to the relative skill- and capital-intensity in these sectors.

Table 2.1: Ethiopia Labor Productivity Growth for the Period 1991-2023

	Productivity Growth, %	Within	Structural Change	Dynamic
1991-1995	1.19	0.98	0.02	-0.001
1996-2000	0.77	0.94	0.07	-0.005
2001-2005	2.05	1.00	0.00	0.002
2006-2010	5.81	1.03	-0.04	0.006
2011-2015	5.60	1.00	0.00	-0.001
2016-2020	3.75	0.98	0.01	0.008
2021-2023	2.37	0.97	0.03	-0.001
1991-2023	3.2	0.99	0.01	0.001

Sources: AfDB (2024) Statistics Department; World Bank (2024)

Figure 2.6: Structural change in Ethiopia, 1991–2022

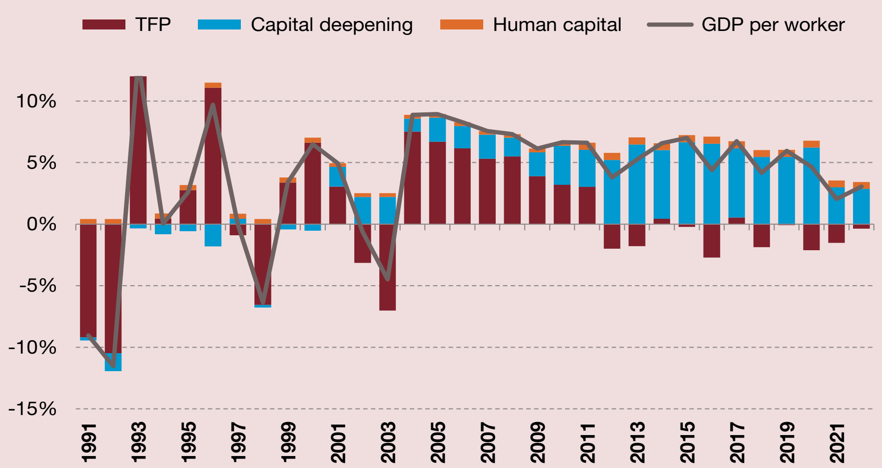


Sources: AfDB (2024) Statistics Department; World Bank (2024)

[2]Defined as value-added per employed person

Total Factor Productivity (TFP). Disaggregation of TFP[3] shows that Ethiopia's TFP growth since 1991 can be divided in three periods. The first, 1991-2003, was characterized by very erratic growth, with large swings in TFP from strongly negative (1991-1992, 1998, 2003) to strongly positive (1993, 1995, 2000) (Figure 2.7). This pattern is characteristic of economies facing numerous shocks (economic or political) as was the case for Ethiopia during most of the 1990s. The second period, 2004-2011, was characterized by strong gains in TFP, averaging 5.2% p.a. However, in the third phase, 2012-2022, TFP was again erratic, with an average decline of 1.1% p.a. This is consistent with the shocks the economy has faced, including political discontent since around 2012, conflict in Tigray (2020-2022), the COVID-19 pandemic and its aftermath (2020-2022), drought and the geo-political tensions.[4] Some of that decline was compensated by capital deepening, which contributed 5.3% to GDP-per-capita growth since 2012.

Figure 2.7: **Sources of Total Factor Productivity Growth in Ethiopia, 1991-2022**



Sources: AfDB (2024) Statistics Department; World Bank (2024)

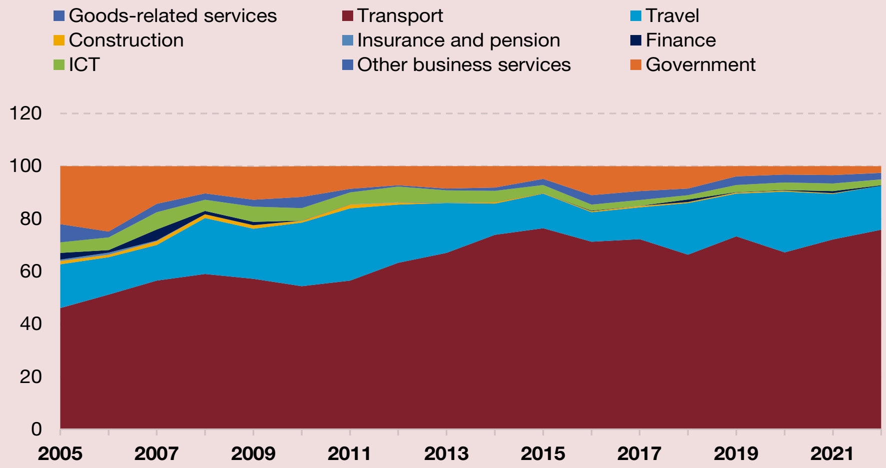
2.3.3 Growth in Income and Jobs Embodied in Services Exports: New Evidence

This section applies the Mensah and de Vries (2024) framework to analyze and highlight the distribution of value-added in Ethiopia's exports of services, underscoring the income and jobs embodied in exports.[5] Transport services exports account for the bulk of value addition in services exports, with the shares increasing from 63 percent in 2012 to 76 percent in 2022 (Figure 2.7). Transport services exports are led by Ethiopian Airlines, which earned USD6.1 billion (about 5% of GDP) in revenue and employed about 17,000 workers in 2023. Relatedly, travel services exports account for about 20 percent of services exports. On the other hand, government services and construction account for a negligible proportion of services exports, which is expected, considering the fact that these are mostly non-tradeable goods.

[3] TFP measures the aggregate production efficiency and is considered the most sustainable source of long-term growth.
[4]The persistent fall in TFP is a sign of something amiss in Ethiopia's economic expansion and questions its sustainability. The conflicts, weak business environment, rising inflation, and public debt and forex shortages could explain part of it. These figures should be interpreted with caution because TFP is calculated as a residual and relies on strong assumptions regarding the production function.
[5]Mensah and de Vries (2024) calculate the domestic value-added and jobs embodied in exports using the hypothetical extraction method introduced by Los et al. (2016). The method considers the ratio of value-added to gross output, and the ratio of employment to gross output, to compute the value-added and the number of jobs embodied in exports, respectively.

The negligible contribution of the financial services to exports revenue underscores the closed nature of Ethiopia's financial sector to international investment. While the share of unprocessed agricultural products in Ethiopia's merchandise exports declined from 80.4 percent in 2020 to 76 percent in 2023, the share of manufactured and processed products also declined from 12 percent to 10.9 percent. It is the share of minerals and energy that increased from 7.5% to 12.9 percent. Annex 2, Table A1 highlights the values and shares of major merchandise exports for Ethiopia for the period, 2020-2022.

Figure 2.8: Sectoral Distribution of Services Exports (Percent of GDP), 2005, and 2022



Sources: AfDB (2024) Statistics Department; World Bank (2024).

Box 2.1: Learning from the Successful Experiences in Supporting Growth and Structural Transformation

Comparing the composition of Ethiopia's economy and pace of structural transformation and other countries with relatively similar level of development shows similar trends (e.g., declining shares of agriculture as GDP grows) and variations due to different policy choices and resource endowments. Compared with Ghana or Kenya, lower levels of GDP per capita are associated with higher relative contributions of agriculture to GDP. Ethiopia seems to lag behind, with agriculture's share of GDP higher. Some of the bottlenecks to faster structural transformation such as dependency on a few primary commodities are similar among these countries.

While capital accumulation, underpinned by rapid industrialization, has been central to many success stories in Asia, Ethiopia seems to have prematurely transitioned from agriculture to services, at lower levels of income per capita. This is somewhat similar to India, which relied more on services as opposed to the case of China whose transition process relied more on manufacturing. Between 2000 and 2014, manufacturing and services in China accounted for 34 percent and 46 percent, respectively, of economic growth while in India, manufacturing accounted for 18 percent of economic growth, and services for 61 percent in 2000–2014 (APO, 2020).

A key challenge of such premature transition to services is that services do not usually exhibit the same technological dynamism as industry, and therefore makes them poor substitutes for export-oriented industrialization (Rodrik, 2015). Second, absent of a robust industrial sector, growth of the services sector can be limited both in its job creation opportunities and value addition. Third, because services are not as tradable as manufactured goods, they neither benefit as much from technological spillovers nor from foreign exchange earnings. Fourth, a strong manufacturing base offers export possibilities during downturns. In the case of Cambodia, for instance, exports of textiles, clothing, and footwear increased rapidly after the 2008 crisis, while exports of raw materials softened, which would not have been possible in a services-dominated economy.

2.3.4 Drivers to Accelerate Structural Transformation

This section underscores the main drivers of Ethiopia's structural transformation over the past decades. The section outlines policy options for Ethiopia to fast-track structural transformation.

Governance: The role of good governance and strong institutions in facilitating a conducive environment such as macroeconomic stability for accelerating structural change is well underscored in the literature. Ethiopia operates a federal system of governance, with 12 regional states and two chartered cities having autonomy in the delivery of essential services. The government plays a contributory role to structural transformation through investing in the enablers of growth such as key public infrastructure and social services as well as economic and financial governance to ensure stability, and a conducive environment for investment. Since 2004, the government has increasingly invested in public infrastructure projects (transport, energy systems, and agro-industrial parks) to promote economic growth and exports for jobs creation. Agricultural sector policies and investments aim to boost production, household incomes, and stabilize food prices. Social programs like the Productive Safety Net Program (PSNP) address poverty and inequality, promoting social stability.

Since 2018, the government has implemented a number of political and media reforms, including release of political prisoners, revision of the media and civil society laws, to promote inclusiveness and participation. In the 2022 Ibrahim Index of African Governance (IIAG), Ethiopia scored 46 out of 100 on overall governance performance and ranked 32nd out of 54 African countries. In the accountability and transparency and disclosure of Public Records, Ethiopia improved by 49.4 points to score 69.5/100. In political power and representation of Women, it improved by 42.9 points to score 75.1/100. However, some of the political actors interpret the reforms to mean unchecked freedom, leading to friction between the federal government and regional players.

Exchange rate policy: Ethiopia operates a managed float exchange rate regime and since 2019, the authorities indicated commitment to transition to a market-determined exchange rate through gradual devaluation of the Ethiopian birr (ETB). The premium between the official and parallel exchange rates has increased from 27 percent in 2019 to about 103 percent in 2024, underscoring the exchange rate misalignment. Official foreign currency reserves declined from USD3.6 billion (covering about 2.2 months of imports) in June 2021 to about USD0.8 billion (2 weeks of imports) in December 2023. The shortage of foreign exchange forces the authorities to apply import restrictions, foreign exchange allocations to priority goods and foreign currency declaration and surrender requirements by exporters, which hurt Ethiopia's competitiveness, investment, and structural transformation. Transitioning to a market determined exchange rate remains a key element of the new program under discussion between the authorities, and the IMF.

Trade policy: Ethiopia's openness to international trade is low and lags its peers in competitiveness, which together with a weak private sector environment, undercuts manufacturing and exports growth, and job creation. Ethiopia scored 44.4 out of 100 on the 2019 Global Competitiveness Index (latest available) compared to Ghana (51.2/100), Kenya (54.4/100), and Rwanda (53/100).[6] While tariff bands have been reduced from 30 in the 1990s to 5 currently, the prevalence of non-tariff barriers is still high, scoring 3.6 out of 7. The Ethiopian Shipping and Logistics Services Enterprise operates a monopoly in logistics management that undermines the quality of services. While Ethiopia initiated negotiations to join the World Trade Organization (WTO) in 2020, progress has been slow. WTO accession will expand exports by providing the private sector with better market access, as 98 percent of global trade is between WTO members. The authorities need to address the governance of intellectual property and brand piracy, and adherence to rules-based trade in order to attract foreign investment.

Ethiopia exports mostly low-tech products, which face declining terms of trade and vulnerability to regional and global shocks as well as financial conditions in the developed world. Figure 2.8 shows that while the share of high-tech manufactured products increased from about 28 percent in 2015 to about 41 percent in 2017-2018, the share declined thereafter to only 16 percent in 2021. This decline can be attributed to the global and local shocks, including the COVID-19 pandemic and associated lockdowns as well as internal and regional conflicts that resulted in reduced foreign investment in the country.

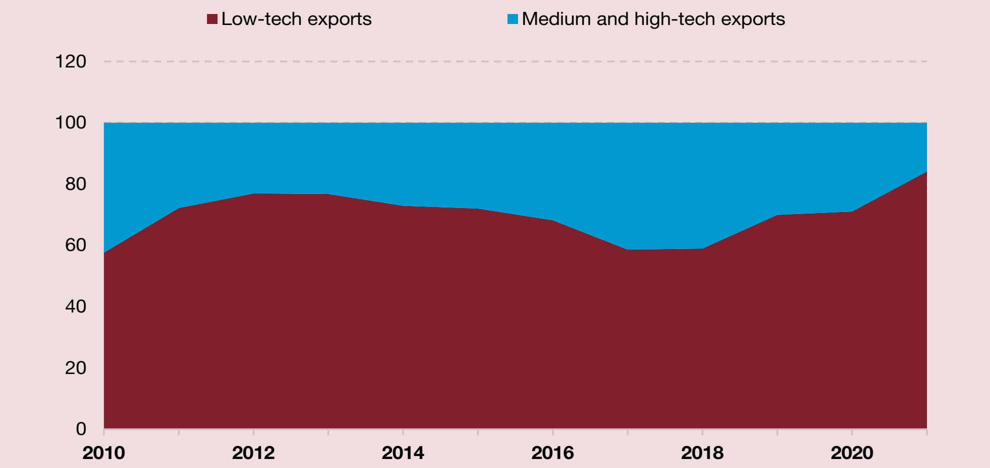
Business environment and labor market flexibility: Ethiopia's business environment is not attractive to the private sector because of several bureaucratic regulations. Reforms are ongoing to improve Ethiopia's business environment to attract the private sector. These include privatization of SoEs, allowing international banks to operate in Ethiopia, and opening up of the capital account. In the financial sector, the Ethiopian Capital Market Authority (ECMA), and the Ethiopia Securities Exchange (ESX) were established in 2022 to facilitate the mobilization of long-term capital for private sector growth. A transition towards a market-clearing foreign exchange regime and reforms to improve the business environment will help to expand the role of the private sector and attract FDI. Weak trade logistics have remained a constraint on the country's competitiveness, and its participation in international trade. Trade, especially exports, is also constrained by a range of non-tariff measures. A recent survey found that 96 percent of trading companies in Ethiopia report facing burdensome situations related to the application and implementation of trade-related rules and regulations (International Trade Centre, 2018).

Key challenges in Ethiopia's labor market include low skills and skills mismatch in terms of quality and competencies and limited internal mobility. Addressing the skills mismatch requires expanding access to quality technical and vocational education and linking the supply to demand. The 2019 Labour law addresses the need to strengthen the skills of the workforce to facilitate private investment, especially in the industrial sector. The law allowed for the establishment of a wage board, comprising of representatives of key stakeholders to generate information for setting and revising minimum wages. The Ethiopia Doing Business Initiative, chaired by the Prime Minister, the one-stop service system and Electronic Single

[6] It takes up to 194 hours, at a cost of USD750, for traders to comply with import documents—compared with the average for Africa of 96 hours at USD287 (World Bank 2020).

Window (eSW) aim to facilitate trade by improving service efficiency, transparency, coordination among actors, and eliminating opportunities for corruption.

Figure 2.9: Manufacturing Trade by Technology Intensity in Ethiopia, 2010-2021



Sources: AfDB (2024) Statistics Department; World Bank (2024).

Urbanization in Ethiopia is growing at about 4.6% per year, which partly explains the growth of employment in the industry (mostly the construction sub-sector) and service sectors. Drivers of growth in the services include wholesale and retail trade, financial intermediation, hospitality, and tourism. Harnessing the potential of urbanization to facilitate structural transformation requires urban planning to improve the provision of and access to basic services. Decent wages for urban workers will also contribute to the growth of agriculture through increased demand for food, investment, and remittances to relatives in the rural areas.

Technology: Technological progress can be a strong driver of Ethiopia's structural transformation by improving production methods, and conduct of business, transportation and access to information, among others. The spread and increased use of Information and Communication Technology (ICT) will enhance competition and innovation and thus increase productivity across all sectors. However, Ethiopia's ICT Development Index is estimated at 33.8 out of 100, a low level compared to Ghana's (66.2/100), Kenya 58.5/100) or Rwanda (46.8). Technology diffusion is slow due to restrictive policies, weak business environment, limited competition, and scarcity of foreign currency. However, ICT alone is inadequate for Ethiopia's overall technological progress. Ethiopia, and all other African countries, need to expand and deploy appropriate technology in production and value-chain development in agriculture, basic processing and manufacturing as well as in the services sector in order to benefit from efficiencies gains. This implies the need for increased access to ICT and to electricity.

Quality of Public Infrastructure as an Enabler of Structural Transformation: Between 2013-2023, freight and passenger transport demand increased by 10.4 percent p.a. At least, about 43 percent of the population live with 2 kilometers of all-weather road. In 2023, the road network was about 145,000 kilometers, with road density of about 130 kilometers per 1,000 km2. Good quality infrastructure is a key enabler of sustainable growth and structural transformation. Despite the steady increase in public infrastructure investments from 5% of GDP in the 1990s to 16 percent in 2023, the deficit remains large. Annual infrastructure investments of 18 percent of GDP are required in roads, water, energy, and telecommunications between 2020-40. An estimated USD40 billion is needed in 2020-30 for Ethiopia to achieve the SDGs targets for infrastructure development. Only about 25 percent of the population have access to the internet. Although the state plays a big role in key sectors (telecom, finance, energy, logistics and transport, manufacturing), reforms to attract private capital (both domestic and foreign) are needed to increase competition, and the quality infrastructure. In order to meet the growing demand for electricity (for both domestic and export markets), Ethiopia aims to expand its generation capacity from about 5,000MW currently to 17,100MW by 2030. The government also aims to diversify from hydropower, by reducing its share to 75 percent (currently 95 percent) and increasing the shares of solar, wind, and geothermal to 25 percent. The PPPs framework has also created opportunities for private investment in infrastructure development, especially in the renewable energy sector.

Human capital development: Ethiopia's score on the World Bank's human capital index has remained at 0.38 since 2017, below the 0.48 average for lower-middle income countries (World Bank 2020).[7] This means that a child born today in Ethiopia will achieve only 38 percent of his or her human capital development at 18 years, similar to Rwanda (38 percent), but below Ghana (45 percent) or Kenya (55 percent). Shocks such as the COVID-19 and conflicts exacerbate the weak human capital development. Increased investment in education and education planning, training of teachers, and equipping learning institutions are needed to improve the quality of learning and learning outcomes. Stronger collaboration among government departments and with development partners and the private sector will help to mobilize additional resources and ensure their optimal utilization as well as to produce the skills required for inclusive growth, and structural transformation.

Box 2.2: Potential and Existing Opportunities in Agriculture and Agribusiness and Investment in Renewable Energy

Agriculture is the largest sector, contributes 32 percent of GDP, employs 65 percent of the population, and accounts for 79 percent of exports. The TYDP identifies unused arable land, and other natural resource endowments as critical to its success. Ethiopia has comparative advantage in coffee, oil seeds, pulses, cotton, horticultural crops (fruits and vegetables), and livestock products. Investments in improved farming methods, modern inputs and mechanization, and extension services have the potential to increase agricultural production and productivity. Only 12 percent Ethiopia's 5 million hectares of irrigable land is developed. Improving water use systems among small-scale and medium-size farmers by developing skills to design, build and operate irrigation schemes at scale will help Ethiopia to exploit its large agricultural potential, create jobs, and increase exports. The Integrated Agro-Industrial Parks (IAIP) and development of value-chains offer opportunities for investment in agribusiness. Agro-industries (mostly food and beverages processing) account for 5% of GDP. Developing agro-industries and transitioning from trade in raw products to value addition through processing and quality standards for global markets is key to transforming Ethiopia's agriculture sector.

[7] The index measures, on a scale of 0-1, the level of human capital a child is expected to attain by age 18 and conveys important information on the next generation of the workforce.

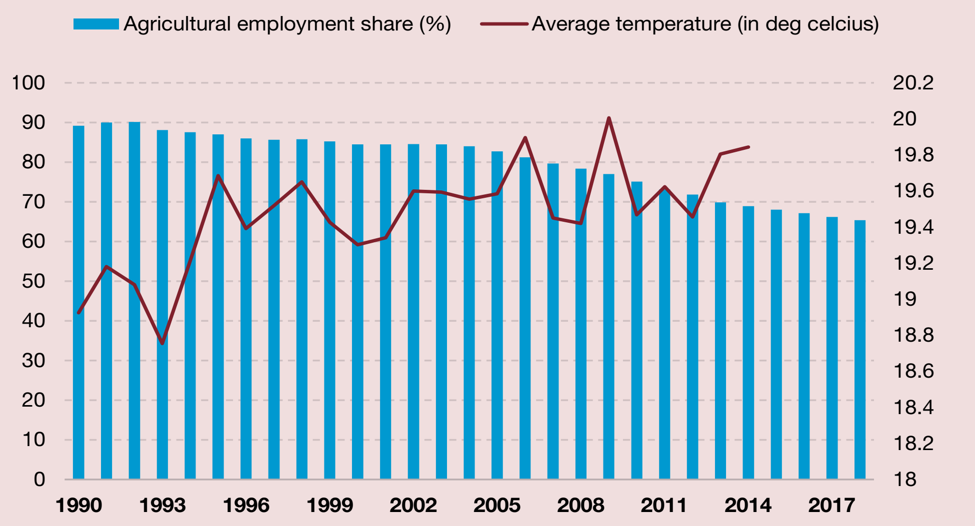
2.3.8 Key Bottlenecks to Fast-Paced Structural Transformation

A key challenge to Ethiopia's structural change is the reallocation of labor and economic activities from agriculture to other relatively low-productivity sectors, such as personal, and retail services. Because of the low skill and capital requirements, these are potential sectors suited to workers leaving agriculture. It is also possible that the movement from agriculture could reflect "push" factors rather than "pull" factors, including demographic challenges, climate change, informality, political issues, and financing constraints.

Demographic challenges: Ethiopia faces demographic pressures, with about 70 percent of the population under 30 years and over 2 million youth entering the labor market annually. Youth unemployment is estimated at about 25 percent (31 percent females and 19 percent males), and the dependency ratio at 75 percent. Interventions to build skills, entrepreneurship to bridge the gap between their skills and industry needs, to support inclusive growth, and structural transformation.

Climate change: Climate change impacts in Ethiopia include persistent droughts, flooding, water scarcity, and increased incidence of pests. These affect agriculture, livestock, energy, and the health sectors, with adverse implications for productivity and structural transformation. Climate change vulnerability is driven by dependence on rain-fed agriculture, use of traditional technology and rapid but unplanned urbanization. Figure 2.10 and ongoing events underscore correlation between the increase in average temperature in Ethiopia and declining agricultural employment since 1990. The drought that was experienced in eastern and southern parts of Ethiopia between 2021-2023 affected almost 21 million people and killed nearly 3.5 million livestock. Climate-smart innovations in agriculture will help to increase resilience to extreme weather events.

Figure 2.10: Climate Change and Agricultural Employment Shares in Ethiopia, 1991-2018



Sources: AfDB (2024) Statistics Department; World Bank (2024).

Informal sector: The informal sector is the main source of the majority of employment in Ethiopia, and it is particularly relevant for the youth.[8] Both the industrial and service sectors in Ethiopia are characterized by informality, with a growing number of

[8] In 2008, the informal sector accounted for 59.1 percent of private sector in the GDP (Kolli, 2010) and almost 66 percent of urban businesses were informal (Abegaz, 2010). The informal economy accounted for about 50-60 percent of urban employment in 2012 (Kebede, 2015).

small firms that create jobs and support livelihoods, but with little or negative productivity growth, consistent with much of Africa. Despite the contributions to value-added and export growth, employment growth in the formal manufacturing sector is low. Instead, manufacturing is growing in the informal sector where productivity growth is minimal.[9] Informal manufacturing firms tend to be small, with few workers and are less capital intensive, and businesses sprout without policy or fiscal support from the government.

Political issues: Political issues and conflict due to feelings of limited participation in the economy constrain Ethiopia's inclusive growth and structural transformation as public expenditures and policy focus are diverted from basic services to defense. For example, since 2020, the country has faced internal conflicts leading to increased defense expenditure from about 0.5% of GDP to almost 1.7% in 2022.

Financing constraints: Limited financial inclusion and access are key constraints to investment in Ethiopia. The financial sector is dominated by the banking sector, with the state-owned Commercial Bank of Ethiopia (CBE) accounting for over 50 percent of the banking sector assets. In addition, interest rates are managed by the authorities, limiting the intermediation role of the financial sector. The exchange rate is fixed by the authorities, and given the foreign currency scarcity, this has led to a misalignment between the official and parallel exchange rates. Inflation has remained in the range of 20-30 percent since 2019, eroding the value of money and constraining investments.

2.4 Finance to Fast-Track Ethiopia's Structural Transformation: How Much is at Stake? Ethiopia's Commitments to Structural Change

2.4.1 The Structural Change Strategy in Ethiopia's National Development Plan

Through the TYDP 2021-2030, the government is committed to facilitating structural transformation, with the shares of agriculture reaching 22.0 percent, industry 35.5 percent, and services 42.5 percent by 2030. This will be supported through efficient civil services, sustainable development financing, private sector-led growth, and resilient green economy to increase productivity and competitiveness, technological capabilities, institutional transformation, social inclusion, access to justice and regional peace-building and economic integration. Employment of graduates will be increased from 59 percent to 90 percent, and the share of private sector jobs in technology and digitalization from 50 percent to 80 percent. To promote inclusiveness, pay differentials between men and women for similar jobs, currently at 44 percent will be eliminated.

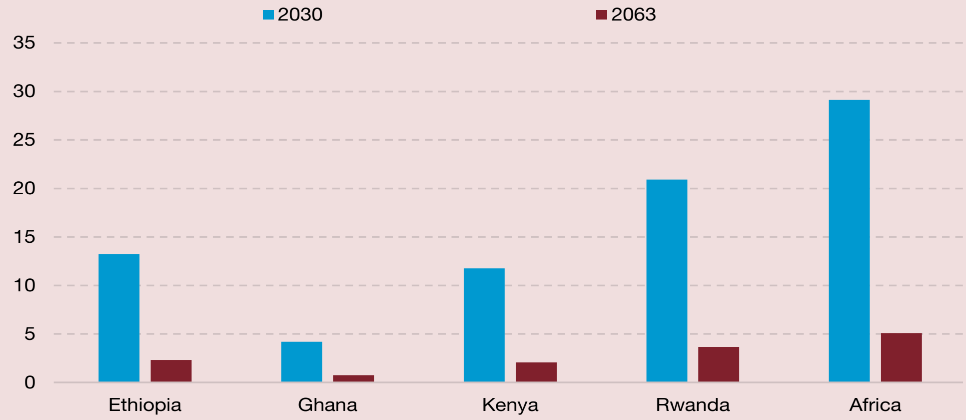
2.4.2 Financing Needs and Financing Gap

Meeting Ethiopia's development aspirations of inclusive growth, structural transformation and middle-income status requires large amounts of financing[10] as well as strategic orientation in policymaking, capacity building as well as maintaining peace and stability. Despite the high GDP growth rates, Ethiopia has not reached the 15 percent of GDP that developing countries need to adequately finance progress to meet the SDGs. According to government estimates, the financing requirements to realize Ethiopia's national development priorities are projected in the range of USD257-USD397 billion between 2023/24-2029/30, and about USD608 billion is required to meet the SDG targets by 2030. The LT-LEDS, which is aligned to the NDCs, projected a financing need of USD5 billion p.a. between 2020 and 2050.

[9] Diao et al, 2024.
[10] The estimates differ by source and the specific issues considered.

As a share of GDP, the additional financing requirements for Ethiopia to realize its ambition of structural transformation are estimated at 13.2 percent by 2030 and expected to decline to 2.3% by 2063 (Figure 2.11). A detailed description of the required financing in nominal terms is presented in chapter three.

Figure 2.11: Estimated Annual Financing Needs to Fast-Track Structural Transformation in Ethiopia and Among Peers by 2030 and 2063



Sources: AfDB (2024) Statistics Department.

According to the estimates for the Bank's 2024 Africa Economic Outlook, Ethiopia will need USD25.8 billion p.a. until 2030 to accelerate the realization of the SDGs, focusing on road infrastructure, education, energy and investment in decent work and economic growth, and position it at par with high-performing developing countries with comparable levels of development. As shown in Figure 2.12, the bulk of these resources are needed in transport infrastructure (USD11 billion, 42.7 percent of total), followed by education (USD7.4 billion, 28.8 percent), energy (USD4.4 billion, 17.2 percent), and investment in decent work and economic growth (USD2.9 billion, 11.3 percent). Given the current performance in these critical sectors and their projected values, in line with GDP per capita, the annual financing gap to fast-track the realization of these SGDs is estimated at USD23.5 billion (Figure 2.13).

Figure 2.12: Estimated Annual Financing Needs to Fast-Track Key SDGs in Ethiopia by 2030 and 2063

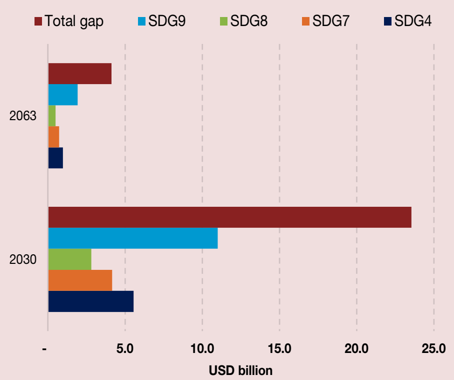
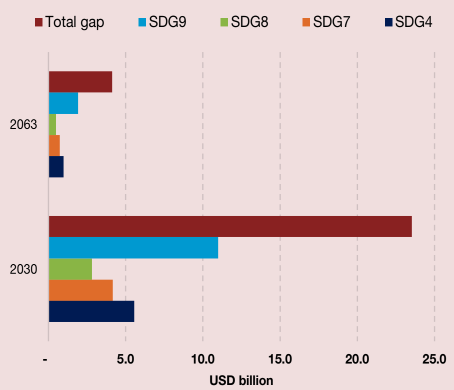


Figure 2.13: Estimated Annual Financing Gaps to Fast-Track Key SDGs in Ethiopia by 2030 and 2063



Sources: AfDB (2024) Statistics Department.

The large financing needs and gaps in these critical sectors reflect Ethiopia's underperformance in key SDGs linked to structural transformation, and indeed across other development indicators as well. On infrastructure, the largest financing needs and gap reflect the need to upgrade existing infrastructure and build new energy and transport infrastructure, to match the connectivity requirements for a growing population, and economy. On education, fast-tracking structural transformation will require that not only Ethiopia ensure full enrolment of its school-age population and sustain these rates, but also increase spending per student to upgrade education equipment and facilities (buildings, transport vehicles, virtual learning equipment, etc.), increase salaries of education professionals, and enhance access to Technical and Vocational Education and Training (TVET). A new paradigm to planning and public resource allocation for development interventions is needed to increasingly draw in the participation of the private sector to better understand and address its priority concerns.

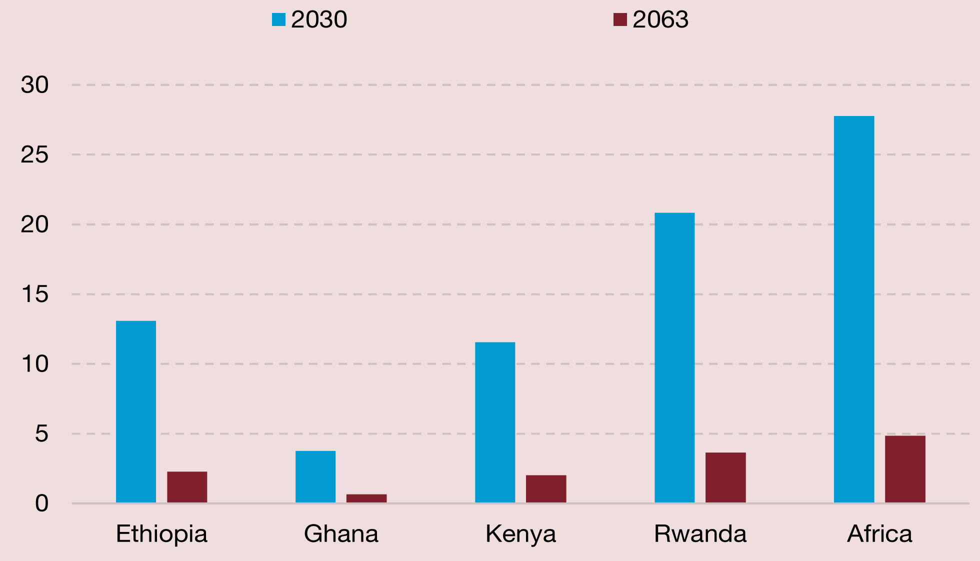
2.4.3 Closing the Financing Gap Through Domestic Resource Mobilization

The magnitude of the estimated financing needs and gaps cast doubt on the ability of Ethiopia to mobilize the required resources, in particular within the 2030 timeframe and the international financial constraints. This is a genuine concern, especially given Ethiopia's current macroeconomic challenges and limited fiscal space, which are exacerbated by climate change-related shocks, internal conflicts, and reconstruction needs as well as the rising costs of fuel and food. Closing the estimated financing gap will therefore require strong political will to strengthen national cohesion, maintain peace and security, boost tax revenues, and enhance public spending efficiency.

However, despite Ethiopia's high economic growth record, tax revenues have not reached the 15 percent of GDP that developing countries require to adequately finance progress toward the SDGs. In fact, tax-to-GDP ratio has been declining since the 2010s from about 12.7 percent to about 7% in 2022/23. More effort is needed to improve domestic resource mobilization, as well as through expanding the tax base and applying information technology in tax revenue management for Ethiopia to accelerate its structural transformation. As noted in Figure 2.14, Ethiopia will need to increase its current tax-to-GDP ratio by a median value of about 13.2 percent p.a. in order to close its structural transformation financing gap by 2030, assuming that all the mobilized additional tax revenues are efficiently deployed and allocated to that objective. [11] Ethiopia will need to maintain an increase in its tax-to-GDP ratio of 2.3 percentage points by 2063. Given Ethiopia's current tax-to-GDP ratio of about 7%, there is room to achieve these targets through expanding the tax base, improving tax revenue collection by modernizing systems, and tax administration.

[11] To assess whether such tax efforts could be reasonably made by African countries, the AEO 2024 compares each country's estimated level of tax-to-GDP ratio compatibility with the need to fast-track structural transformation, i.e., the tax-to-GDP ratio that allows for closing the financing gap for each country's tax capacity. Out of the 39 African countries with data on tax capacity, 18 (46.2 percent) display unattainable tax-to-GDP ratios required for structural transformation if 2030 is considered as the target year, Ethiopia slightly being on the margin (Annex 4, Figure A3). This finding suggests that, regardless of the targeted deadline, domestically mobilized resources might not be sufficient in some African countries to close the existing financing gap for structural transformation. This underscores the calls for reform of the international financial architecture and contribution from the private sector to support the financing of structural transformation.

Figure 2.14: Required Increase in Tax-to-GDP Ratio to Close the Estimated Annual Financing Gap



Sources: AfDB (2024) Statistics Department.

2.5 Concluding Remarks and Policy Recommendations

This chapter has presented a detailed analysis of the trends, key characteristics, challenges, and estimates of the financing requirements to fast-track structural transformation in Ethiopia. This section underscores the policy options, and recommendations to accelerate Ethiopia's structural transformation.

a. **Fast-track Implementation of the Second Homegrown Economic Reform (HGER 2.0).** The government developed HGER 2.0 in 2023, whose key objectives are to: (i) establish a modern and sound macroeconomic policy framework that supports and ensures stability, resilience, and sustainability; (ii) transform investment and trade environment to boost competitiveness through a favorable environment that promotes and enhances innovation and entrepreneurship; (iii) expand productive capacity and productivity growth by increasing investment and unlocking economic growth potentials; and (iv) improve public sector capabilities to ensure quality and efficient service delivery. To achieve these, coordinated national and sectoral programing, good governance, stronger institutional capacity, resource mobilization, and partnerships are important.

b. **Sustain Reforms to Shift from Public Investment-Led Demand Driven Growth to Private Sector-Led Supply Driven Growth.** A new growth model that supports increased private sector participation in the economy is required for Ethiopia to accelerate structural transformation. The current state-led growth model seems to have run its course, with the emerging macroeconomic challenges in the midst of local and global shocks and financing constraints. Public investments and government policy need to focus on strengthening the environment for private sector participation in the economy through human capital development and correcting market failures, policy distortions as well as addressing the social and cultural impediments to inclusive growth including rent seeking.

c. **Reform Fiscal and Monetary Policies to Foster Macroeconomic Stability.** Prudent fiscal and monetary policies are key to promoting economic stability and improving the business environment that is needed to accelerate structural transformation.
   - Use of modern and policy-based instruments of monetary policy such as open market operations and standing facilities as well as the independence and transparency of the NBE in the conduct of monetary policy will help to contain inflation. Transitioning to a competitive exchange rate will help to increase confidence in the economy.
   - Prudent fiscal policy and sustained public investment in enablers of growth as well as expanding the scope for domestic revenue mobilization by sustaining tax reforms and improving tax administration are needed to facilitate structural transformation. Sustaining the fiscal consolidation strategy that was initiated in 2019 is important to containing the fiscal deficit.
   - Fast-tracking financial sector reforms, including allowing foreign banks to operate in Ethiopia, operationalization of the Ethiopian Stock Exchange (ESX), and the capital market are needed to increase competition, innovation and options for long-term financing for the private sector
   - Measures to expand exports revenue such as sustained investments in cross-border infrastructure (roads, railways, one stop border posts, and electric-ways), promotion of investment and tourism, etc. are key to increasing economic activity and foreign currency receipts to facilitate structural transformation.

d. **Articulate a Policy for Rural to Urban Population Movement and Transformation.** Planned and orderly urban growth, decent wages, and accommodation are needed to promote the transition from rural to urban areas, free up agricultural land, and increase demand for food and the scope for agricultural processing, and value chain developments. Adequate transport infrastructure linking areas of high production to markets (both domestic and regional) is needed to facilitate the movement of people, and goods for accelerated structural transformation.

e. **Sustain Investments in the Enablers of Structural Transformation.** Human capital development, high-quality and sustainable infrastructure, agricultural productivity, and efficiency of institutions will help to increase economic activity. Reforms to promote private sector participation in all stages of the value-chain will accelerate investment, and economic growth. Improving logistics management and trade facilitation, overcoming foreign exchange shortages, and ensuring reliable energy supply will support industrialization, and manufacturing. Competition and innovation in the services sector are crucial to increasing financial access for micro, small, and medium-size enterprises.

f. **Translate the Manufacturing Industry Policy into Action:** The government endorsed a comprehensive and dynamic industrial policy in 2023 that promotes private sector participation for increased competition and innovation. Implementation of the industrial policy should facilitate sectoral development, based on comparative advantage and not choosing specific industrial winners. The current Industrial Parks (IPs) development approach, with government owning 18 out of the 24 parks needs to be reviewed to expand private ownership and operation to improve efficiencies, and value-for-money.[12]

g. **Develop a Trade and Regional Integration Policy and Strategy:** Strengthening regional integration and reform to diversify trade and exports, including lifting trade barriers and increased processing of agricultural products and light manufacturing (e.g., pharmaceuticals) will help Ethiopia to accelerate structural transformation by taking advantage of the WTO, AfCFTA, and COMESA to expand markets for its products. Such measures will also cushion Ethiopia from external shocks and increase job opportunities in agriculture, industry, and services. Harnessing the country's tourism potential through increased investments in air, road, and communications networks as well as improved quality of services will promote structural transformation, and foreign exchange earnings.

h. **Enhance the Role of Private Sector in Driving Structural Transformation** The private sector has a critical role in driving structural change in Ethiopia through mobilization of private capital and investing in high-end strategic sectors, promoting competition, and innovation for the efficient allocation of resources. The private sector can seize the opportunities of Ethiopia's strategic location in the Horn of Africa, the AfCFTA, and ongoing reforms to expand production, trade, and investment in tourism.

i. **Harness the Potential Benefits from the Development Financial Institutions (DFIs) and Multilateral Development Banks (MDBs) in Supporting Ethiopia's Structural Transformation.** The DFIs and MDBs including the African Development Bank, the World Bank, the Asian Development Bank, and the IMF have an important role in supporting sustainable growth and accelerating structural transformation in Africa through provision of financial resources, technical assistance, and capacity building as well as best practice, and lessons learned from other countries. The support and participation of DFIs and MDBs in national strategic planning, and technical reviews of development programs are important to strengthening quality, and laying the ground for provision of financial, and technical support.

[12] Only 13 IPs are fully operational, and most of the companies operating in the IPs are involved in the processing of leather and textile products especially for export as well as pharmaceutical, and construction products for the domestic market.

3

FINANCING STRUCTURAL TRANSFORMATION IN ETHIOPIA: THE NEED FOR REFORMS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

Key Messages

- To achieve structural transformation and increased factor productivity, Ethiopia requires large amounts of financing, to invest at scale and in the right sectors while dealing with the threats of climate change, and global shocks.

- According to government estimates, the financing requirements to realize Ethiopia's national development priorities are projected in the range of USD257-USD397 billion between 2023/24-2029/30, and about USD608 billion is required for to meet the SDG targets by 2030. The LT-LEDS, which is aligned to the NDCs, projected a financing need of USD5 billion p.a. between 2020 and 2050.

- An additional USD8 billion p.a. is required for Ethiopia to meet the SDGs. With declining trends in external assistance, achieving these global and regional goals is increasingly challenging.

- With its large population, economic potential, and growing political significance, Africa, in general, and Ethiopia, in particular, need to amplify their voice towards the reform of the global financial architecture for a fairer and transparent system. The reforms must enhance the participation of developing countries like Ethiopia in shaping the global agenda and ensuring the credibility of international financial institutions.

- The G20's CF has been slow in supporting orderly debt restructuring in the midst of global shocks. National debt management systems and global financial architecture need to ensure sustainable debt profiles and reflect the impacts of global economic shocks, and climate change on economies like Ethiopia.

3.1 Introduction

Ethiopia needs significant investments to meet the challenge of achieving structural transformation while dealing with the threat of climate change, and global shocks that have negative spillover effects on Ethiopia. The financing requirements to realize Ethiopia's national development priorities are projected in the range of USD257-USD397 billion between 2023/24-2029/30[13]. An assessment of the investment requirements to achieve SDGs to inform the TYDP, 2021-2030 noted that about USD608 billion[14] is needed for their successful implementation. At least 84 percent of this amount could be obtained from existing domestic and international sources.

Despite Ethiopia's high economic growth record, tax revenue has not reached the 15% of GDP needed for developing countries to adequately finance progress toward the SDGs, which calls for increased domestic resources mobilization.

The global financial architecture used to play a pivotal role in financing Ethiopia's development. Between 2005 and 2018, Ethiopia mobilized almost USD65 billion in ODA to finance key infrastructure projects, which was instrumental in driving the high growth record. However, amidst ongoing conflicts within the country, there has been a noticeable decline in external support. Total ODA declined to USD3.3 million in 2021/22 (a 42 percent reduction) compared to its peak of USD5.7 million in 2019/20. External loans also declined to USD45 million in 2023/24 (a 98 percent reduction) from the 2019/20 levels,[15] mostly due to the moratorium on non-concessional borrowing that was imposed in 2019. The reduction in external assistance poses a significant challenge for Ethiopia, which has traditionally relied on external support to fund its developmental endeavors. The decline in ODA has not only reduced the available resources for development projects but has also necessitated increased domestic borrowing. The situation has also contributed to shortages of foreign currency, further complicating Ethiopia's economic challenges.

The volume of climate resources mobilized in recent years is small and declining. Between 2011-2019, Ethiopia mobilized between USD0.67–3.2 billion per year, mostly from domestic sources and ODA, with a limited share of private financing. External resources have declined since 2020, as indicated above. Implementation of the LT-LEDS and projects aligned to the NDCs require USD5 billion p.a. between 2020-2050 (USD 1 billion (20 percent)), and is expected to come from domestic and unconditional external resources. The financing gap of USD4 billion p.a. could rise substantially if shocks reduce the share that the government allocates for climate-related projects[16]. In addition, the financing requirements for the reconstruction of the Tigray region that was impacted by the 2020-2022 conflict are estimated at about USD20 billion.

The categorization of Ethiopia in the high-risk of external debt distress in 2017 reduced its access to non-concessional external borrowing. Downgrades of Ethiopia's credit risk rating by the international credit rating agencies since 2020, and the slow progress in the debt restructuring under the G20's CF have heightened the situation, stifling the investor confidence.

The scale of resources needed to support Ethiopia's structural transformation requires increased international financing. This calls for a reform of on the global financial architecture to provide for orderly restructuring of existing debt and for the financial and technical resources at scale, at affordable terms, and in a timely manner. The global financial system needs to be responsive to the needs of developing countries to finance the requirements for structural transformation, realization of the

[13] Ministry of Planning and Development (2024). Ethiopia Sustainable Financing Strategy (ESFS) 2024-2030.
[14] Ministry of Planning and Development (2022). Ethiopia National Voluntary Review 2022, page 69.
[15] Ministry of Planning and Development (2024). Ethiopia Sustainable Financing Strategy (ESFS) 2024-2030.
[16] The World Bank (2024). Ethiopia Country Climate and Development Report, page 69.

SDGs, climate action, and other global public goods.

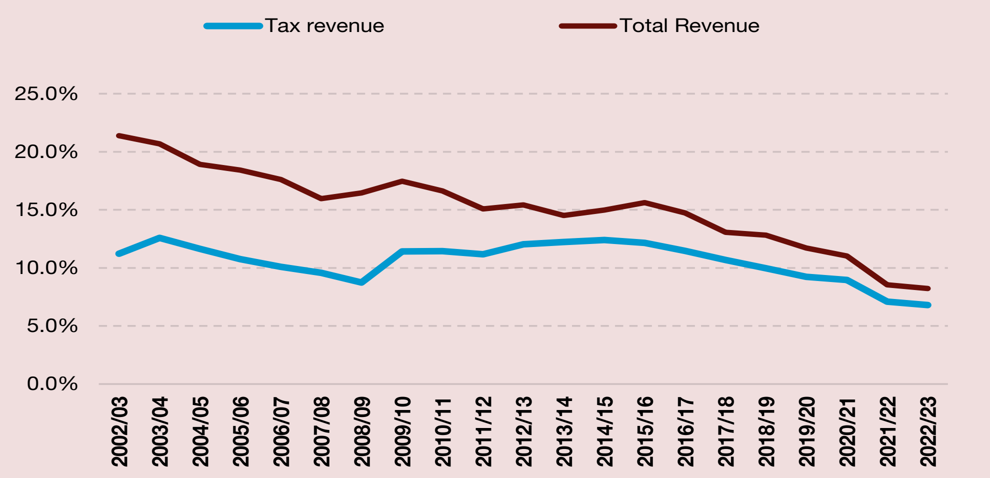
As Ethiopia grapples with the declining international financing (a 42 percent decline between 2019/20 and 2021/22), alongside the slow returns from infrastructure investments (delay in sugar projects implementation), debt sustainability issues have emerged (a default of USD33 million coupon payment on its USD1 billion Eurobond). The pressing of domestic demand for capital, alongside the liquidity challenges and prohibitive cost of domestic finance (treasury bill rates increased from under 1% in the late 1990s to about 10 percent in 2023), stifles structural transformation.

3.2 Internal Financing of Structural Transformation and Constraints

3.2.1 Domestic Resource Mobilization

While Ethiopia initiated reforms of its tax policy and administration in early 2000s[17], mixed results in terms of revenue generation and tax-to-GDP ratio have been realized. Key areas of reform include introduction of value-added tax in 2003, modernization of the tax administration system since the late 1990s, and introduction of the tax information technology system and use of electronic sales registries in 2008. The Home-Grown Economic Reform (HGER 1.0) also further introduced tax policy reforms, including customs duty and excise tax reforms, and removal of ad-hoc exemptions. The HGER 1.0 also introduced several administrative measures aimed to ease taxpayer permits, empowering the tax authority to follow up and monitor local excisable goods manufacturers. While tax revenue grew at an annual average rate of 17.9 percent from ETB210 billion (USD3.7 billion) in 2016/17 to ETB593.2 billion (USD10.4 billion) in 2022/23, tax to GDP ratio declined from 12.7 percent in 2013/14 to 7% in 2022/23[18] (Figure 3.1), underscoring the lack of buoyance and declining tax base. More effort is therefore required in improving domestic resource mobilization for Ethiopia to accelerate structural transformation of its economy in the coming years. Measures to expand economic activity (especially export-oriented production activities), including sustaining investments in critical infrastructure, skills development, and peace and stability will help to increase the sources of revenue and the tax base.

Figure 3.1: Trends in Total and Tax Revenue as Percentage of GDP



Data source: National Bank of Ethiopia (2024).

[17] Policy Study Institute (2023). Assessment Report of the Homegrown Economic Reform (HGER) Agenda (2019-2022), pages 4-5.
[18] This is significantly lower than the sub-Saharan Ethiopian average of about 16 percent of GDP.

The government needs to implement measures to improve domestic resource mobilization by reforming fiscal policy and tax administration, and broadening tax base. The government needs to explore the new economic activities that are not covered by tax law, and the application of information technology in tax management and foster a culture of tax compliance.

3.2.2 Private Capital for Structural Transformation

A key objective of the TYDP 2021-2030 is building a prosperous country by creating a pragmatic market-based economic system, and by expanding private sector participation in the economy. To realize this, HGER 2.0 underscores reforms to ease constraints to doing business by streamlining business licensing requirements, simplifying procedures, clarifying mandates of different regulatory agencies, and improving inter-agency coordination to promote private sector-led growth.

Despite the efforts to promote the private sector, its investment and performance remain weak, due mainly to the crowding out effect of financial repression. A decline in private fixed capital formation was recorded between 2017-2022, from 24.5 percent of GDP to 20 percent, as gross domestic investment to GDP ratio declined from 38.4 percent in 2016/17 to 22.2 percent in 2022/23[19]. This stagnation, particularly the downturn in private investment, can be attributed to several factors, chief among them being the continued uncertainty and insecurity within the country. Many businesses in Ethiopia have limited access to credit and suffer from foreign exchange shortages. Acquiring land is a cumbersome process, and logistics remains a hurdle to trade. The lack of reliable infrastructure raises production costs. The reduced availability of raw materials and the need to import under restrictions limit business performance. The regulatory framework is opaque and affected by bureaucratic procedures and delays in transactions with institutions.

The private sector is a key contributor to and enabler of structural transformation through increased economic activities, employment creation, provision of goods and services, and removing constraints to labor force participation, enhancing household incomes, and increasing tax revenue. A more comprehensive approach and involvement of the private sector in decision-making, revision of current regulatory frameworks, strong coordination among institutions, and alignment of interventions are issues to be addressed. The government needs to reduce direct interventions in the economy, except when there are clear justifications for such, and following transparent rules. Improved efficiency of the regulatory and oversight institutions is key to creating a level playing field to facilitate private sector growth.

3.3 External Financing of Structural Transformation, Constraints and the Need for Reforming the International Financing Architecture

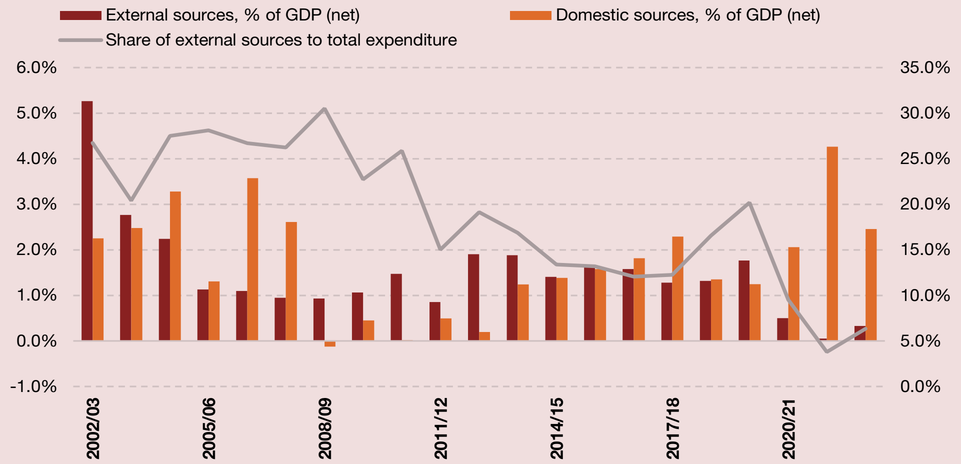
3.3.1 Contribution of External resources in Financing Economic Development and Structural Transformation in Ethiopia to Date and Additional Resources Required to Speed up Structural Transformation.

While international development financing has played a pivotal role in Ethiopia's development trajectory, it has been declining in the recent past, due to both domestic and external challenges. Between 2005 and 2018, Ethiopia mobilized a total of USD65 billion ODA, which was mostly channeled into infrastructure projects that have facilitated the high growth record over the same period. The reliance on

[19] This gross domestic investment is far below the required 33percent or more for a rapid, sustainable and inclusive GDP growth rate of 7 to 8%.

external financing led to the accumulation of substantial debt burden: total public and publicly guaranteed debt increased from USD2.7 billion in 2007 to about USD57 billion in 2018. In the recent past, this situation has been exacerbated by the maturing government-guaranteed, non-concessional loans. However, external financing of the fiscal deficit declined from 1.2% in 2020 to 0.3% in 2023 (Figure 3.2), partly due to reduced donor inflows on account of the conflict and concerns about human rights in northern Ethiopia.

Figure 3.2: Sources of Deficit Financing as Percentage of GDP



Data source: National Bank of Ethiopia (2024).

In recognition of these challenges, the government issued a moratorium on non-concessional borrowing in 2019, as part of a broader strategy to manage public debt. Consequently, new debt inflows have declined. For example, in 2023 only USD45 million of new debt was acquired compared to USD2.7 billion in 2020. The reform period also initially attracted international partners' increased participation, with programmatic support programs. However, the conflict in Tigray region (2020-2022) led to a pull back by development partners and a reduction in the resource envelope available to the government. The decline in ODA has reduced the resources that are for development projects, and necessitated increased domestic borrowing, as well as contributed to shortages in foreign currency reserves. An additional USD8 billion p.a. is needed for Ethiopia to meet the SDGs. With declining trends in external assistance, achieving the global and regional goals becomes increasingly challenging for countries like Ethiopia (the projected financing gap to realize critical SDGs for fast-tracking structural transformation is summarized in Annex 3). Increased ODA inflows are needed to bridge the financing gap to meet Ethiopia's developmental objectives as well as the SDGs by 2030.

Ethiopia's current financing structure is unsustainable, and gaps need to be addressed. Moving away from debt-based infrastructure investment, ODA grants and humanitarian aid require major shifts in the way development finance is used for public investment and crowding in private capital. Demand for finance far outstrips supply; equity and bond markets, and PPPs are just emerging; insurance and risk management markets are weak; and SoEs and Micro, Small and Medium Enterprises (MSMEs) financing models have considerable gaps. Humanitarian assistance has not built resilience in rural communities after decades did not make it more resilient. For instance, of the USD3,981 billion in net ODA received in 2021, almost 40 percent went to humanitarian assistance, and 26 percent to health and social infrastructure. The quota system used to determine country eligibility for concessional loans, based on money metric indicators like per capita income, does not consider the shortcoming of these indicators. These metrics only provide a short-term snapshot of economic conditions and do not account for long-term sustainability or the quality of economic growth. For instance, short-term economic upswing due to factors such as commodity price spikes or short-term foreign investments could misleadingly elevate a country's economic status above the threshold for concessional loans, despite underlying vulnerabilities. The approach overlooks whether GDP growth is inclusive or resilient to economic shocks. The inequities of the global financial architecture result in inefficient and costly financial resources for developing countries. The current debt architecture often places undue strain on countries with limited resources, hindering their ability to invest in crucial areas such as healthcare, education, and infrastructure. Effective debt restructuring and lower exposure to external debt stock can help lower debt service obligation, and free up resources for key development projects.

Given the gaps in financing for structural transformation, and the rising public debt, more integrated financing solutions and optimal use of existing resources are needed. This calls for policies that crowd in private capital, both through blended and non-blended solutions and public investment programs that actively engage the private sector in delivering durable market-based solutions. Identifying the most optimal financing instruments, modalities, and partnerships to leverage the national budget resources, and reduce risks for private capital are needed.

If IFIs changed their allocation systems from the money-metric quota to a needs-based model focused on supporting countries requiring additional financing to accelerate structural transformation, Ethiopia could reap significant benefits. This reform would enable targeted and effective resource deployment to address specific developmental challenges, crucial for Ethiopia's transition from an agriculture-based economy to one centered on industry and services. For instance, Ethiopia could gain enhanced support for sectors like manufacturing and technology, which would drive robust economic growth, higher productivity, and job creation, directly impacting poverty reduction, and economic stability. Ethiopia could also receive more focused investments in key enablers of growth, including transport infrastructure, telecommunications, energy projects, and water systems. These will help to improve the business environment and attract FDI. A needs-based approach will help to address regional disparities by channeling resources to the most underdeveloped areas, thus promoting equitable growth, and mitigating internal migration pressures.

Further improvements to debt management practices to enhance transparency and accountability will help to build trust among lenders, leading to lower perceived risks, and potentially lower costs of borrowing. Strengthening debt management also underscore Ethiopia's commitment to managing debt levels prudently, reassuring lenders, and improving the country's creditworthiness.

Promoting good governance, macroeconomic stability and fiscal discipline will help to increase investor confidence in Ethiopia. Improved financial management capacity can help lower perceived risks of borrowing costs in the long-term.

By prioritizing national developmental

needs over economic indicators like GDP or per capita income, these reforms could help Ethiopia build a more resilient economy, capable of withstanding economic shocks, including those related to climate impacts on agriculture. More funding could be allocated to human capital development, allowing for increased investments in education and healthcare that are key to fostering a skilled workforce, and reducing disease burden to boost long-term growth.

3.3.2 Rise of External Debt as Important Source of Development Finance

Following the Highly Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI), Ethiopia's external debt stock increased twelvefold, from 2.3 billion in 2007 to USD27.8 billion in 2023, driven by import-intensive public investments in infrastructure (highways, railways, power, telecom, and industrial parks). External debt is largely from the World Bank's IDA (about 18.4 percent of the total debt), non-Paris creditors (10.8 percent), commercial banks (5%), AfDB (3.4%), Euro bonds (1.6%), and suppliers (1.6%). The share of non-concessional private creditors also increased, at least up to 2015, raising non-concessional debt servicing costs. The role of bilateral creditors also increased, between 2010-2016, with the share of less-concessional non-Paris Creditors increasing to about 90 percent of bilateral debt, adding to the debt servicing burden.

Domestic debt has also increased both in nominal terms and as a share of total public debt. Domestic debt accounted for 56.1 percent of total debt in 2023. Domestic debt is composed mainly of bonds (about 73.5 percent), treasury bills (19 percent), and direct advances to the government (7.5%). The debt burden is exacerbated by the fact that many government-guaranteed, non-concessional loans have reached maturity, and the low return on investments from debt-financed SoE projects.

To address the debt burden and ensure long-term fiscal sustainability, a moratorium on non-concessional borrowing was issued in 2019. In 2020, the government engaged in the Debt Service Suspension Initiative (DSSI) of the G20 and received temporary debt payment suspension of about USD200 million. In 2021, the government requested for debt treatment under the CF, which is still being negotiated, with official bilateral creditors agreeing to temporary debt payments suspension in 2023, subject to staff-level agreement on a new IMF program.

Other measures to contain public debt include establishing the Liability and Asset Management Corporation (LAMC) to mop-up residual debt of SoEs, and establishment of the Ethiopian Investment Holdings (EIH) as one of the largest sovereign wealth funds (including managing Ethiopia Stock Exchange), and the introduction of sustainable financing instruments (seed capital, market stabilization, risk mitigation, leveraging partnership, capacity building, PPPs, direct investment, and corporate governance). Efforts to reform SoEs to enhance their sustainability and operational efficiency are ongoing. These include redefining SoE operations, privatization, and opening previously restricted industries to private sector participation. For example, the first international telecom license was issued to Safaricom Ethiopia in June 2021.

Ethiopia's experience with debt restructuring underscores the need for a nuanced understanding of its debt dynamics, despite relatively low and declining debt-to-GDP ratios. The country's financing needs, especially for infrastructure development to meet the SDGs, necessitate careful consideration of both current requirements and future growth potential. Coordinating with a diverse set of creditors, including multilateral institutions, bilateral lenders, commercial banks, and bondholders, is crucial during times of financial distress caused by both domestic and external shocks.

Engagement with international financial institutions should be strategic to ensure favorable terms that align with its long-term economic growth objectives. Building capacity and advocating for more dynamic and fairer DSA frameworks can better reflect Ethiopia's debt profile in line with its economic potential and development needs. Collaborating with other African countries facing similar challenges can provide valuable insights and strengthen negotiating positions.

3.3.3 Benefits of Reforms to the International Financial Architecture to Ethiopia

Since the first credit rating in May 2014, all three rating agencies had kept their ratings on Ethiopia stable all through 2020 - B for Standard and Poor's; B1 for Moody's; and B for Fitch Ratings. Downgrading started in February 2021, following the government's request for debt treatment under the G20 CF. Fitch and S&P downgraded Ethiopia's sovereign rating from 'B' to 'B-', and 'B' to 'CCC', respectively. On November 3rd, 2023, Fitch Ratings announced a further downgrade of Ethiopia's long-term foreign currency issuer default rating from 'CCC-' to 'CC' and to Restricted Default on 27 December 2023, on account of Ethiopia's default on the USD33 million Eurobond coupon payment.[20] The key driver for the downgrading is the lack of progress in the G20's CF, not economic fundamentals.

Without the support of the international financial institutions, Ethiopia (and most other African countries) will not achieve many of its SDG targets. The failure of Ethiopia, as well as other developing countries, to meet their SDG targets will be a failure of the international community, calling for a proportionate voice in the governance structure of international financial institutions that amplifies Africa's growing significance and financing needs. For example, the G20's CF for debt restructuring is slow, challenging its credibility. Reforms are needed to enhance the participation of countries like Ethiopia in shaping the global agenda, while maintaining the credibility of the international bodies. Debt relief for climate initiatives, sovereign debt management systems and the IMF/World Bank Debt Sustainability Framework need to ensure sustainable debt management and reflect the impact of shocks such as pandemics and climate change on economies like Ethiopia's.

Ethiopia needs to add its voice to the calls for the reform of the global financial architecture to lend credence to the debate for a fairer and transparent system, and to strengthen the call for rechanneling the SDRs of the IMF to MDBs to leverage more resources for structural transformation. Channeling the SDRs through MDBs including the Bank and reforming the MDB's capital adequacy and risk appetite could increase the financing envelope for developing countries, as well as Ethiopia.

In addition, Ethiopia needs to support the African Union in its participation in the G20 as observer and to participate in the debate on the reform of the global financial architecture. Optimizing the balance sheets and risk appetite of MDBs to maximize their capacity to finance development interventions in the developing countries, including Ethiopia. Ethiopia needs to engage more with the MDBs like the AfDB to influence the international credit rating agencies to improve the methodologies used to assess sovereign risk in order to

[20] The coupon payment on Ethiopia's USD1 billion Eurobond was due on 15th December 2023. The authorities explained that non-payment was due to the need for equal treatment of all creditors, and not due to liquidity constraints.

reduce subjectivity in Africa's credit ratings. This will reduce the perceived risk of private investment and lending costs to facilitate Ethiopia's structural transformation.

Support for increases in the replenishments of concessional windows of the African Development Fund (ADF), and the IDA will help to increase access to low-cost concessional resources to enable Ethiopia to finance critical expenditures and catch up with its relatively high performing peers in other developing regions. In addition, support for reforms to contain illicit financial flows and tax evasion as well as profit-shifting could help to halt the loss to Ethiopia of approximately USD3 billion p.a. Debt forgiveness will help Ethiopia and other developing countries to improve their fiscal space. Reforming credit rating agencies could reduce debt service costs and release additional financing for Ethiopia's structural transformation. The Bank and other development partners need to support Ethiopia to strengthen its capacity to prepare bankable projects to access debt relief for climate purposes, improve its debt management systems and discussions with the IMF/World Bank Debt on debt sustainability assessment to ensure sustainable debt management, and reflect the impact of shocks such as pandemics and climate change on the economy.

Ethiopia needs capitalize on its domestic resources, including leveraging its abundant natural capital and people, improving the collection of tax and non-tax revenues, enhancing public spending efficiency, and fighting illicit financial flows, and tax avoidance. For instance, by improving domestic surveillance systems and accountable tax mechanisms to prevent leakages to tax havens, Ethiopia can retain about USD3 billion p.a. that is siphoned through illicit financial flows.[21].

Since 2021, Ethiopia has been pursuing debt restructuring through the G20's CF. In 2023, the Paris Club bilateral creditors agreed to suspend debt repayments, contingent on a staff-level agreement with the IMF on a new program. Discussions with the IMF on the new program are continuing. China also agreed to suspend debt repayments.

3.4 Financing Climate Action

According to Ethiopia's NDCs update of 2021, the financing requirements to meet its adaptation and mitigation targets for 2021-2030 is estimated at USD316 billion. USD275.5 billion (87 percent) is for mitigation, while USD40.5 billion (12 percent) is for adaptation. Of the USD316 billion, USD63.2 billion is expected to be mobilized from domestic sources and the rest from international sources[22]. Ethiopia is committed to a low carbon pathway, and its 2011 Climate Resilient Green Economy (CRGE) Strategy is the main framework for lowering Greenhouse Gas (GHG) emissions. Ethiopia targets GHG emissions of below 145MtCO2e by 2030, equivalent to a 68 percent reduction under the combined conditional and unconditional contributions, compared to the Business-as-Usual (BaU) scenario. The unconditional pathway would result in GHG emissions of 347.3MtCO2e by 2030, a 14 percent reduction, relative to the BaU, but to realize these targets, Ethiopia will require international support, given its limited fiscal space.

Ethiopia has put in place multifaceted institutional architectures for climate financing. The CRGE Facility was established in 2011. The institutional set up reflects a cross-sectoral, multidisciplinary approach, and inter-ministerial, and steering committees, allowing sub-national level stakeholders engagement.

[21] Anti-corruption Resource Centre (2018). Illicit financial flows in Ethiopia, page 5.
[22] AfDB (2022). Country Focus Report: Supporting Climate Resilience and a Just Energy Transition in Ethiopia, page 20.

Rules, procedures, operating manuals, guidelines, tools, and protocols to implement and facilitate the CRGE strategy and facility are developed to facilitate resource mobilization, and implementation. The strategy aims to strengthen national capacity to mitigate the impacts of climate change through improving crop and livestock production, afforestation, expanding renewable energy generation, and using modern and energy-efficient technologies.

Ethiopia needs to deepen domestic climate finance by re-aligning its national budget formulation and allocations to respond to climate change. National commitments to climate action, such as through public spending allocation, can crowd-in international support towards climate financing. The government must strengthen the integration of climate financing in national development frameworks by mainstreaming climate action in national development plans including infrastructure development as critical paths. Ethiopia should harness the mechanisms of Paris Agreement Article 6 to mobilize significant resources and fill the climate financing gaps. Ethiopia could harness opportunities presented through Loss and Damage Fund, Convention on Biological Diversity, Carbon Border Adjustment Mechanism (investment in green hydrogen), and Adaptation Benefit Mechanism. Ethiopia must develop bankable climate finance proposals, as well as tapping into the Clean Development Mechanism (CDM) projects. To benefit more from the climate finance, Ethiopia needs to and strengthen its capacity to the design and implementation of green growth policies and projects.

3.5 Conclusions and Policy Recommendations

Ethiopia needs significant investments to meet the challenge of achieving structural transformation, while dealing with the threat of climate change, and global shocks that have negative spillover effects on the country. The financial requirements for realizing Ethiopia's national development priorities are projected in the range of USD257-USD397 billion between 2023/24-2029/30. With declining trends in external assistance, achieving the global and regional goals becomes increasingly challenging for countries like Ethiopia. The declining tax-to-GDP ratio from 12.7 percent in 2013/14 to 7% in 2022/23 is worrisome because improving tax collection is at the heart of correcting the macroeconomic imbalances that the country is facing. Ethiopia's increase participation on the global arena to influence the reform of the global financial architecture could unlock additional financing for its development.

In addition, Ethiopia also needs to strengthen its capacity for debt sustainability analysis and discussions with the IMF and World Bank, as well as negotiations with creditors on the debt payments suspension to improve its fiscal space. The methodology for debt sustainability assessments needs to be transparent and consider climate risks, as well as the resources needed to scale up investment in climate resilience, transition to a green economy and spending to meet critical regional, and global public goals. Ethiopia can capitalize on domestic opportunities and available resources from the current global financial architecture. Public expenditure needs to be leveraged to yield maximum value that accelerates recovery and restores productive capacities. This requires careful budget design and reallocation of resources to more impactful projects. The ongoing rationalization and reform of state-owned enterprises and planned sale of unexploited assets owned and commercially managed by SoEs will help to ease pressure on public expenditures and crowd in the private sector. Ethiopia also has large potential in natural resources including gold, oil, and gas, which can be exploited to provide financing for structural transformation. Ongoing reforms to the financial sector including the establishment of the ECMA and ESX as well as well as permitting foreign banks to operate in Ethiopia will help to attract increased FDI. In addition, building on the resumption of aid flow, the strong support of Ethiopians living in the diaspora, Ethiopia can attract additional resources to finance its development needs.

Accelerating implementation of the ongoing reforms to improve the efficiency of public services and expand private sector participation in the economy is also critical. Ethiopia needs to (i) sustain reforms to improve the business environment including eliminating unnecessary bureaucracies to promote both domestic and FDI, especially in the manufacturing sector, (ii) apply a monetary policy regime that supports price stability; (iii) move towards a competitiveness exchange rate; (iv) promote exports growth, especially in the manufacturing sector; (vi) promote domestic savings growth; and (vi) enhance efficiency of the financial sector. The Bank and other development partners need to support Ethiopia to strengthen its capacity to design and implement green growth policies and projects to attract financing, as well as from the private sector. These measures will help to provide incentives for increased FDI inflows into Ethiopia. The issues of market structure, competition in key markets, and sectors as well as the protection of property rights are critical for business, and the industrial take off.

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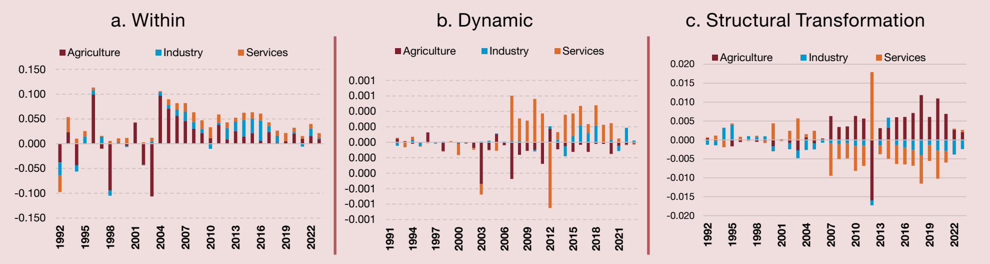
Annexes

Annex 1: Ethiopia – Sources of Labor Productivity

Figure A1: Within, Dynamic and Structural Transformation Changes



Annex 2: Ethiopia Value and Shares of Major Merchandise Exports, 2020-2022

Table A1: Value and Shares of Major Merchandise Exports, 2020-2022

	2020	2021	2022			
	USD, m	% share	USD, m	% share	USD, m	% share
Unprocessed Agriculture Products	2,802.3	80.4	3,044.5	72.0	3,772.9	76.1
Coffee	855.9	25	909.4	21.5	1,430.7	29.0
Oilseeds	345.0	9.9	335.5	7.9	265.7	5.0
Chat	324.4	9.3	402.5	10.0	391.6	8.0
Pulses	234.8	6.7	233.8	5.5	218.9	4.0
Flowers	422.3	12.1	470.6	11.0	541.6	11.0
Spices	507.0	14.5	578.5	14.0	807.4	16.0
Live Animals	54.1	1.5	44.9	1.0	29.2	1.0
Fruits and Vegetables	58.8	1.7	69.3	2.0	87.8	2.0
Manufactures and Processed Goods	421.3	12.1	439.4	10.4	542.3	10.9
Meat and Meat Products	67.4	1.9	75.3	1.8	109.6	2.0
Leather and Leather Products	72.0	2.1	36.5	1.0	33.2	1.0
Textiles	168.9	4.8	147.1	3.0	175.6	4.0
Beverages	113.0	3.2	180.5	4.0	223.9	5.0
Minerals and Energy	262.9	7.5	742.1	17.6	639.9	12.9
Gold	196.5	5.6	651.6	15.0	546.4	11.0
Electricity	66.4	1.9	90.5	2.0	93.5	2.0
Total Merchandise Exports	3,486.5	100.0	4,226.0	100.0	4,955.1	100.0

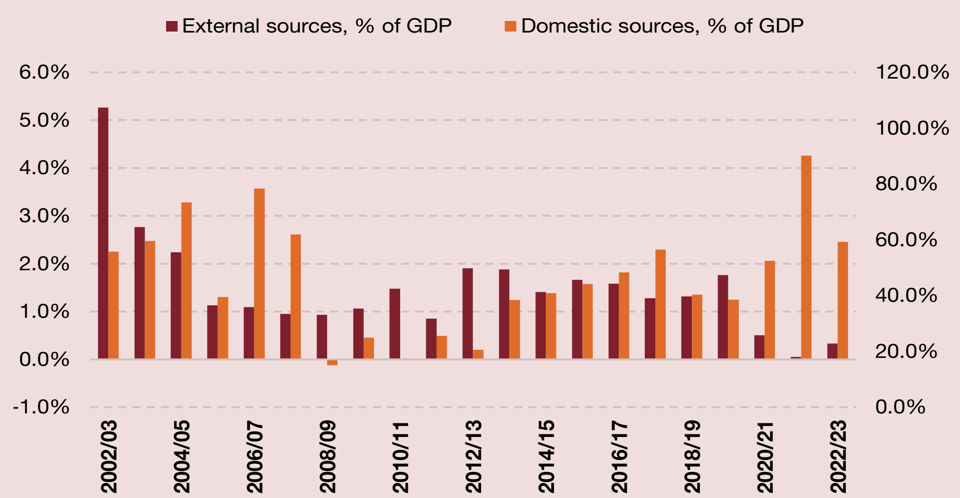
Annex 3: Ethiopia's Performance on Structural Transformation Related SDG Targets Compared to Africa's Average and Other Countries, 2022

Ethiopia's progress towards achieving the SDGs reveals both areas of advancement and challenges. While the current achievement on the overall SDG index is about 55 percent, that on decent work (SDG8) is 66 percent, achievement on infrastructure development (SDG9) is only 26 percent (Figure A2). Ethiopia's performance on the overall SDG index is close to the average for Africa at 57 percent, but lower than the indexes for Ghana (62 percent), Kenya (61 percent), and Rwanda (60 percent).

Progress on SDG4 (Education) is impressive, but gender disparities exist. Efforts to promote gender equality and enhance access to education for all are essential. On SDG7 (Energy access), Ethiopia is making good progress with about 50 percent of the population accessing electricity. On SDG8 (decent work), labor rights issues, and migration require attention. Infrastructure development (SDG9) shows mixed progress, with 52.3 percent of the rural population having access to all-season roads in 2022 but low internet usage at 16.7 percent in 2021.

To accelerate reforms and achieve the SDGs by 2030, Ethiopia must enhance its social protection programs, invest in sustainable agriculture, improve healthcare and education systems, and expand access to clean water, sanitation, and energy. Strengthening infrastructure, fostering economic growth, and reducing inequalities through inclusive policies are also crucial. Enhanced partnerships, transparent governance, and international cooperation will be vital in driving these reforms and ensuring sustainable development across all sectors.

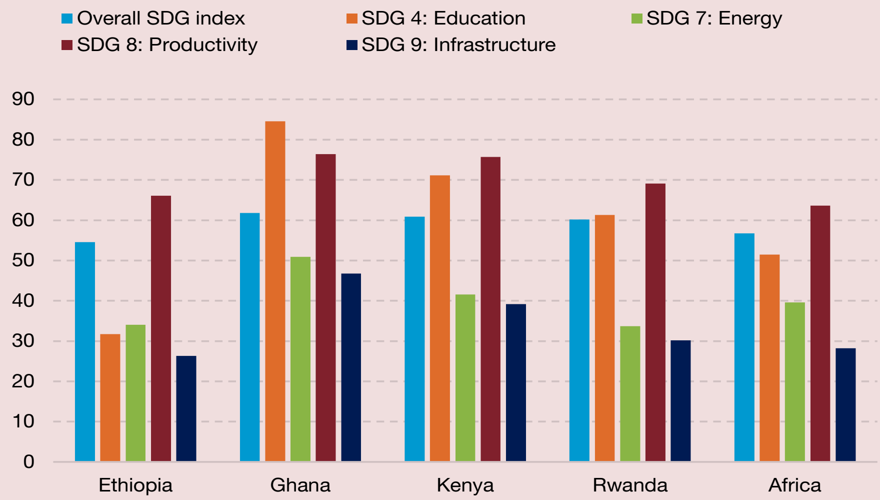
Figure A2: Performance on Structural Transformation Related SDG Targets Compared to Africa's Average and Other Countries, 2022



Data source: AfDB (2024).

Annex 4: Required Increase in Tax-to-GDP Ratio to Close Financing Gaps Among African Countries

Figure A3: Required Increase in Tax-to-GDP Ratio to Close the Estimated Annual Financing Gap in Africa



Data source: AfDB (2024).

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