



Report

An 'age of choice' for infrastructure financing?

Evidence from Ethiopia

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Cover photo: A Chinese worker oversees his Djiboutian colleagues as construction continues on a new railway line linking Djibouti to its land-locked neighbour Ethiopia, a 700-km line being built by China Civil Engineering Construction (CCECC). Nichole Sobecki/Panos

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Abbreviations

AAAA	Addis Ababa Agenda for Action
ADF	African Development Fund
AfDB	African Development Bank
BADEA	Arab Bank for Economic Development in Africa
CPIA	Country Policy and Institutional Assessment
CRGE	Climate Resilient Green Economy
CSO	civil society organisation
DAC	Development Assistance Committee (of the OECD)
DAG	Development Assistance Group
DFID	Department for International Development (UK)
EU	European Union
EPRDF	Ethiopian People's Revolutionary Democratic Front
FDI	foreign direct investment
GDP	gross domestic product
GNI	gross national income
GoE	Government of Ethiopia
GTP	Growth and Transformation Plan
IAD	Institutional Analysis and Development (framework)
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
JICA	Japan International Cooperation Agency
LIC	low-income country
MDB	multilateral development bank
MOFED	Ministry of Finance and Economic Development
MOFEC	Ministry of Finance and Economic Cooperation (formerly MOFED)
MTDS	Medium-Term Debt Management Strategy
NCBP	non-concessional borrowing policy
NGO	non-governmental organisation
ODA	official development assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OOFs	other official flows
PPP	public–private partnership
SDG	Sustainable Development Goal
SOE	state-owned enterprise
SSA	sub-Saharan Africa
TSWG	Transport Sector Working Group
UNDP	United Nations Development Programme

1. Introduction

1.1. Background and motivation for this report

The development finance landscape has been changing over the past 15 years, driven by both supply-side and demand-side factors.

In terms of supply, there are many new actors in the development finance landscape. These include non-Development Assistance Committee (DAC) donors, such as India and China, and philanthropic organisations that have expanded their international grant-making, such as the Gates and the Ford foundations. Complex new finance tools have also been developed to foster the involvement of the private sector, such as public-private partnerships (PPPs).

On the demand side, most partner country governments now have more financing options available to them to support their national development strategies than at the beginning of the last decade. They are now in what Prizzon et al. (2016) and Greenhill et al. (2013) have defined as an ‘age of choice’ for development finance. In addition to the finance flows mentioned above, countries can also access finance by issuing international sovereign bonds, even countries that previously benefited from debt relief. Most partner countries have achieved record high growth rates, and several have graduated to middle-income country status. Over the medium term, the composition of a country’s external financing will change after graduation, from concessional loans to non-concessional resources from multilateral development banks (MDBs) and bilateral development partners. These agencies have been reviewing their financial efforts and the nature of their engagement with middle-income countries, with the aim of concentrating their resources on the poorest and most fragile countries.

Primarily implemented at the national and subnational levels, the 2030 Agenda for Sustainable Development sets out a range of ambitious goals. To achieve these goals, financial resources will have to be scaled, especially financing for infrastructure. Among all the sectors covered by the Sustainable Development Goals (SDGs) agenda, infrastructure development has the largest funding gap to be filled (Schmidt-Traub, 2015). For instance, the World Bank has estimated that \$1 trillion to \$1.5 trillion a year will be needed until 2020 (gross domestic product (GDP) in low- and middle-income countries was around \$25 trillion in 2014) to meet the demand for infrastructure investments in emerging markets and developing

economies (World Bank, 2013). The Addis Ababa Agenda for Action (AAAA) back in July 2015 placed a lot of emphasis on infrastructure development and financing, and included the establishment of a ‘new forum’ to bridge the infrastructure gap.

There is evidence of a lack of strategic management of sources (and providers) of finance to the infrastructure sector, despite the large volume of funds channelled and the priority attributed to this sector in national development strategies. When traditional sources of finance were limited, the main participants had an established coordination structure. But as sources of funding – including traditional and non-traditional sources and agencies and the private and public sectors – have become increasingly diversified and complex, the global and regional opportunities for collaboration and coordination are now less clearly defined (Gutman et al., 2015).

In addition to this, few studies have used sector-specific frameworks to analyse the changing finance landscape and the challenges it poses to recipient country governments (see for instance Pallas et al. (2015) on health; Addison and Anand (2012) on infrastructure; and Mogues and Rosario (2015) on agriculture).

Bilateral and multilateral banks (most notably the World Bank) conduct comprehensive sector reviews of individual countries. These studies, however, do not look in depth at the financing options at sector level beyond aid or at how these financing options have changed for the recipient country governments as a result of the arrival of new financiers and instruments.

This study focuses on the infrastructure financing landscape in Ethiopia – together with a companion report on Kenya (Greenhill and Mustapha, 2017). It aims to fill this gap by identifying the strategies that recipient country governments had in place when negotiating with different finance providers and what lessons can be learnt from the country case study.

This report analyses the evolution of the infrastructure financing landscape in Ethiopia and the government’s preferences for the terms and conditions of development finance to the infrastructure sector. Analyses of the challenges associated with project preparation and the effectiveness of public spending and external financing are beyond the scope of this paper.

The study analyses flows that, potentially: (i) are under direct influence, if not control, of the government; (ii) are accounted for, in principle, in government budgets,

independently of their level of concessionality; and (iii) have an impact on government budgets (such as contingent liabilities). We consider the broad spectrum of development finance flows, both cross-border and domestic.¹

Applying these criteria, the flows used to finance infrastructure that are considered in this report include: domestic taxation and domestic debt markets, bilateral and multilateral official development assistance (ODA), other official flows (OOFs)² from DAC/multilateral development partners, non-DAC sovereign donors (both ODA and OOF equivalent), international sovereign bond issuances and PPPs. PPPs are an exception – being an instrument not a source; however, they illustrate how government, development partners and the private sector can work together. In the report, a non-traditional donor is a sovereign financier that is not a member of the DAC.³

In this analysis we concentrate on financing for **three infrastructure sectors: roads, railways and energy**. These three sectors dominate sub-Saharan African governments' budget allocations to infrastructure. For instance, in 2013 Malawi, Namibia and Zambia allocated 70% of infrastructure expenditure to the transport sector, and Ghana and Tanzania allocated around 50% to the energy sector (ICA, 2014).

1.2. Research questions and methodology

The methodology for the case studies is adapted from Fraser and Whitfield (2008) and Ostrom et al. (2001) (the Institutional Analysis and Development (IAD) framework). The approach for the political economic analysis at the sector level was developed by Moncrieffe and Luttrell (2005), with some elements of the World Bank Poverty and Social Impact Analysis, the 2008 World Bank Political Economy of Policy Reforms (PEPR) and Pallas et al. (2015) (on positive analysis at the sector level). The summary report on Ethiopia and Kenya (Jalles d'Orey and Prizzon, 2017) elaborates on the methodology.

The key insight from Fraser and Whitfield (2008), in contrast to much of the literature on the political economy of aid, lies in seeing the engagement between a recipient country government and a donor as one of negotiation, since it is assumed that their objectives may diverge. Fraser and Whitfield also focus on the importance of both

the economic and political contexts in shaping country–donor negotiations, and thereby negotiation outcomes. Drawing on the IAD framework, we also emphasise the importance of the arena in which negotiation takes place. However, rather than take this as a given, we ask whether governments seek to engage with different kinds of providers of development finance in different fora. We focus particularly on arenas related to in-country aid coordination (e.g. sectoral or technical working groups, regular high-level donor–government meetings), as these are often key fora in which donors and government engage in discussion of sectoral strategies, project identification, policy dialogue and conditionalities.

The theoretical framework for the sector-level analysis is primarily based on that of Moncrieffe and Luttrell (2005). It takes into account the characteristics of the sector under investigation, the relationships between central agencies, relevant line ministries and state-owned enterprises (SOEs), including different roles, mandates and responsibilities – as well as the relations with different providers of funding and the composition of financing in terms of external and domestic resources.

A mixed-methods approach. The methodology for carrying out this country case study comprised a desk-based review and a country visit with semi-structured interviews and data gathering. First, the desk-based analysis consisted of a review of key documentation⁴ and data collection.⁵ Second, a two-week country visit was made to conduct semi-structured interviews with 39 of the stakeholders (a list of stakeholders who permitted their name to be mentioned in this report is included in Annex 2). The consultations with central and line agencies, SOEs, development partners and civil society organisations (CSOs) took place between 29 February and 12 March 2016.

Section 2 reviews the main elements of Ethiopia's country context, and highlights the economic, political and aid management factors that determine how much negotiating capital the Government of Ethiopia (GoE) holds vis-à-vis the various providers of development finance. It also outlines the overall strategy and main institutional arrangements in each of the sectors under investigation (roads, railways and energy). Drawing on the theoretical framework, Sections 3 to 6 seek to analyse the evolution of development finance to the infrastructure

1 The framework described in Prizzon et al. (2016) concentrated on external flows only.

2 We use the OECD definition of OOFs current at the time of writing: 'official sector transactions that do not meet the ODA criteria. OOFs include: grants to developing countries for representational or essentially commercial purposes; official bilateral transactions intended to promote development, but having a grant element of less than 25%; and, official bilateral transactions, whatever their grant element, that are primarily export-facilitating in purpose' (OECD, 2013).

3 We exclude foreign direct investment and personal remittances from this analysis. Governments have only an indirect responsibility for these flows (which are mainly for a private/for-profit motive); the same applies to export credits, which primarily target the private sector.

4 These include Paris Declaration survey chapters and Busan commitments progress report, national development cooperation reports (if available), aid management strategies and country assistance strategies of the main development finance providers, national development strategies and sector plan, recent budget documents, debt management strategies, IMF Article IV documents, PPP and sovereign bond issuance policies, if available, and the country strategies of the largest development partners to the sector.

5 Data were obtained from OECD, AidData database, SAIS-CARI and Ethiopian national budgets.

sector, the arenas where such negotiations take place, the priorities for the types of development finance that the GoE would like to access to support infrastructure development, and the extent to which the GoE has been successful in achieving those objectives. The evaluation of debt sustainability implications will be particularly relevant for the infrastructure sector as it is largely funded by loans. More specifically:

- **Composition and volumes of flows and financing instruments at the country level (Section 3):** How has the composition of financing to the infrastructure sector (railways, roads and energy) evolved over the past decade? Who are the main financiers? What are the terms and conditions of the different financing options? What are the main financing instruments?
- **Arenas of negotiation (Section 4):** In which fora does the GoE seek to engage with providers of development finance in the infrastructure sector, and what strategies does it employ to negotiate with them?
- **Priorities and characteristics of development finance flows (Section 5):** What are the GoE's priorities for the different types of development flows that are received for the infrastructure sector?
- **Negotiation outcomes (Section 6):** What are the outcomes, i.e. does the GoE manage to achieve its priorities while negotiating with finance providers and, if so, how?

1.3. Why Ethiopia?

There are several reasons why Ethiopia was chosen as a case study.

- First, **Ethiopia has given a high priority to public infrastructure development in its national strategy** (the Growth and Transformation Plan 2016-2020), especially for roads, railways (which were dismissed until a few years ago) and energy. This importance has translated into a substantial increase in public investment in infrastructure development. Ethiopia is among the top 20% of countries in terms of speed of infrastructure growth over the past decade, with infrastructure growth rates exceeding those of fast-growing regional peers with similar income levels (World Bank, 2016a).
- Second, **Ethiopia is the third largest recipient of external finance (from 2009 to 2012) to the infrastructure sector in sub-Saharan Africa (SSA)** (when telecommunications is excluded) (Gutman et al., 2015). Ethiopia is also the second largest recipient of Chinese infrastructure investment commitments, after Ghana.
- Third, **Ethiopia is one of the few low-income countries (LICs) in SSA that has issued international sovereign bonds to finance infrastructure development** (intended to fund power transmission projects, and also industrial parks and the sugar industry). This is remarkable considering that the country benefited from debt relief only a decade ago.
- Finally, we only considered countries that had already been investigated in Prizzon et al. (2016), so that the priorities identified at the sector level could be compared with those identified in the first case studies.

In this case study, we concentrated our analysis on the federal government only. This is because most of the regional budgets are financed by the federal government via transfers (which are determined by a block grant formula).

2. Country and sector contexts

In this section we review key elements of Ethiopia's economic, governance and aid management structure – elements that can shape and influence the country's negotiation capital and strategies vis-à-vis different providers of development finance. We then shift the perspective of our political economy analysis to the sector level (roads, railways and energy), highlighting the GoE's priorities and the main institutions involved.

2.1. Country context⁶

2.1.1. Economic context

Ethiopia is currently classified as a low-income country, but has a strategy in place to become a middle-income country by 2025. The Growth and Transformation Plan (GTP) II (2016-2020) sets out directions and priorities to implement this strategy. Its scope is twofold: to achieve an annual average real GDP growth rate of 11% within a stable macroeconomic environment and, at the same time, adopt aggressive measures towards rapid industrialisation and structural transformation (MOFED, 2015). GTP II follows GTP I (2011-2015) (MOFED, 2010) in prioritising infrastructure development; in particular, road construction, education, agriculture, potable water supply, health and rural electrification programmes. As part of its ambitious plans, GTP II aims to nearly double the length of roads in the country (up to 220,000 km, from the target of 120,000 km defined in GTP I). The plan target for energy is to increase electricity service coverage from 60% (in 2014/15) to 90% in 2019/20. In the social sectors, the plan envisions that coverage in primary healthcare services and the gross primary school enrolment ratio will both be 100% by the end of GTP II (MOFED, 2015: 23-26).

Ethiopia has a strong public state ideology and it is pursuing a development strategy that focuses on promoting growth through high levels of public investment. This strategy includes giving public enterprises a dominant role in infrastructure investments, and concentrating

government expenditures on human capital and social sectors (IMF, 2014). Ethiopia has increased its public investment as a share of GDP, from 14.1% in 2008 to 20.2% in 2013, outperforming SSA over the same period (average share of 7.1%).

Ethiopia has recorded strong economic performance and remarkable results when it comes to poverty reduction. Ethiopia has registered rapid economic growth over recent years – averaging 10.8% per year over 2003/04 to 2013/14, compared with the regional average of 5% (World Bank, 2016a). The country has translated this into a fall in the incidence of poverty as measured by the national poverty line, which fell from 38.7% in 2005 to 30% in 2011, and was projected to have fallen to around 23% in 2015. Despite ranking 173 out of 186 countries in the latest UNDP Human Development Report, Ethiopia is among the 10 countries that have attained the largest absolute gains in Human Development Index scores over the past few years (UNDP, 2014).

The ability of the GoE to mobilise resources is still low. This is despite vigorous tax policy and administration reforms during the past two decades, aimed at strengthening tax collection and administration. The GoE wants to improve the tax-to-GDP ratio from 12.9% in 2014/15 to 17.2% by 2019/20 (and to keep the deficit at a sustainable level). This is still below the SSA average of about 20% (e.g. in Kenya the ratio is 23%) (Wondifraw et al., 2015). In addition, according to data from the International Monetary Fund (IMF) (2016), the GoE's overall budget deficit was 2.6% of GDP in 2013/14, but the latest estimates for 2015/16 envisage it hovering at around 3% of GDP. Domestic bond markets are not well developed (World Bank, 2016a).

Ethiopia is still an aid-dependent country. The ODA-to-gross national income (GNI) ratio was 10.8% on average between 2007 and 2013, slightly below the LIC group average (11.9% in 2013) (World Bank, 2015a). ODA gross disbursements to Ethiopia in nominal terms rose from \$2.5 billion in 2007 to \$3.9 billion in 2013.⁷ However,

6 For reasons of data compatibility, the analysis of SSA uses data from the period 2000 to 2013/14. Data from outside this time period are only used when analysing finance flows in isolation.

7 From 2012 to 2013 the largest provider of ODA across sectors was the IDA (\$847 million), followed by the USA (\$610 million), the UK (\$466.3 million), the African Development Fund (ADF) (\$222 million) and the Global Fund to Fight AIDS, Tuberculosis and Malaria (\$182.7 million) (DAG 2015).

Ethiopia's large and increasing population⁸ contributed to lower ODA per capita figures compared with LIC and SSA averages (\$40 in Ethiopia, compared with \$72 in LICs and \$50 in SSA in 2013).

Other sources of external finance – foreign direct investment (FDI) inflows and workers' remittances – have increased, but they are still below the averages for LICs (as a share of GDP). FDI inflows to Ethiopia were half the LIC average in 2014 (2.2% of GDP versus 4.4%); workers' remittances to Ethiopia were 1.4% of GDP in 2012 versus the LIC average of 4.4% (World Bank, 2015a). These statistics are significant because one of the GoE's main concerns is the lack of sufficient foreign exchange, particularly for infrastructure.

There are increasing concerns about public debt sustainability. The risk of external debt distress has increased from 'low' to 'moderate' due to weak export performance and higher than expected non-concessional borrowing, in particular the surge in public enterprise borrowing in the energy and railways sectors (see IMF, 2015).⁹ Ethiopia's external debt-to-GNI ratio fell from 83% in 2004 (before the Heavily Indebted Poor Countries initiative) to 11% in 2008, but the ratio has since more than doubled, reaching 30% in 2014. Following heavy non-concessional borrowing in the past, the International Development Association (IDA) reduced Ethiopia's ceiling for new non-concessional borrowing, first to \$1 billion in July 2015 and then to \$750 million for 2015/16, in light of the rising risk of external debt distress (IMF, 2015). Ethiopia issued its first international sovereign bond of \$1 billion in 2014, with a 10-year maturity and 6.625% coupon. The bond was oversubscribed by 160%. The proceeds were intended to finance industrial parks, the sugar industry and power transmission infrastructure (IMF, 2015).

2.1.2. Political/governance context

A geopolitically important country for DAC and non-DAC donors. Ethiopia is conscious of its geopolitical position in the Horn of Africa, its proximity to the Middle East and the role of Addis Ababa as a regional diplomatic hub, strengthening the position of the Ethiopian government regarding access to development assistance. In particular, Ethiopia has a special engagement with China that is different from China's relationships with other resource-rich SSA economies. China has a long history of engagement with Ethiopia, dating back to 1971. It sees Ethiopia as playing a leading role in the region and as a country with growth and market potential (Prizzon and Rogerson, 2013). China is also one of the biggest markets for Ethiopian exports (UNCTAD WITS, 2014). India, like China, has longstanding bilateral diplomatic relations with

Ethiopia, stretching back to 1949 (Gebre-Egziabher, 2009). Ethiopia is one of India's largest development partners, having received more than \$1 billion in lines of credit to support power and infrastructure needs.

Governing structures and policy-setting mechanisms. While Ethiopia has led an ambitious reform to decentralise authority (see Prizzon and Rogerson, 2013, for more details), the country's governing structures and policy-setting mechanisms follow a highly centralised decision-making structure and control over policy formulation. The highest policy-making body is the Council of Ministers, but other institutions also play central roles in setting national policy that influences the negotiation process for external mobilisation within the executive and the Ethiopian People's Revolutionary Democratic Front (EPRDF), such as the Prime Minister's Office and the EPRDF Central Committee (Furtado and Smith, 2009).

Domestic private companies and civil society have a limited role. What emerged from the interviews for this case study is that domestic private investment is small, with some stakeholders raising concerns about the increasing role of the state in the economy. The role of the state has been considerable since the Derg regime (the Marxist regime of Mengistu Haile Mariam) (see Prizzon and Rogerson, 2013, for more details on the political history and institutions in Ethiopia). It has been argued that the official line is that Ethiopia pursues a democratic development state model, and that the space for participatory and inclusive governance by non-state actors has gradually narrowed as the economy continues to show signs of improvement (Rahmato et al., 2016).

Ethiopia has a leading role in the climate change debate. Ethiopia is one of the few countries to have formally merged its aims of developing a green economy with building greater resilience to climate change under a single policy framework: the 2011 Climate Resilient Green Economy (CRGE) Strategy (Eshetu et al., 2014: vi). This was followed by the creation of the CRGE Facility, an innovative funding mechanism to support the implementation of the priorities set out in the CRGE Strategy (Eshetu et al., 2014). The country was also actively engaged in international debates, with the late Prime Minister Meles Zenawi co-chairing the United Nations' High-level Advisory Group on Climate Change Financing. The new approach to climate change is visible in GTP II. While in GTP I climate change was treated as a cross-cutting issue, according to the interviewees, GTP II makes it one of the main priorities, with proper targets (e.g. reduce greenhouse gas emissions, increase forest coverage, etc.), with the purpose of building a climate-resilient green economy.

8 Nearly 97 million in 2014 and a 2.5% population growth rate in 2014 (World Bank, 2015a).

9 However, the GoE disputes the IMF evaluation of moderate risk of debt distress (the only indicator that increased in the simulations was the debt/export ratio). The GoE also disputes the IMF's measurement of public debt, as the GoE excludes liabilities owned by SOEs, despite the guarantees it provides.

2.1.3. Aid management context

The GoE does not have an explicit written aid policy or partnership strategy (see also Prizzon and Rogerson, 2013). However, the Development Assistance Group (DAG) and the Ministry of Finance and Economic Development (MOFED) (now Ministry of Finance and Economic Cooperation (MOFEC)) have agreed on an aid effectiveness action plan, with clear indicators to measure progress. The High-Level Forums, together with various sector working group and programme meetings, regularly discuss the implementation of sector strategies and national priorities and meet twice a year. Non-governmental organisations (NGOs) and CSOs are involved through participation in ad hoc sector working group meetings (DAG, 2015).

Progress towards the Paris Declaration on Aid Effectiveness. According to Nebebe and Bosch (2015), the annual predictability of assistance from DAC and multilateral donors is very high: close to 90% of funds were disbursed as planned in 2013. In 2010 only 49% of aid was recorded in the GoE's annual budget, but great progress was made in the latest round of monitoring, with 66% of aid being on budget. On public sector management and institutions, Ethiopia's overall Country Policy and Institutional Assessment (CPIA) score has improved slightly, from 3.1 in 2005 to 3.5 in 2013, which is above the LIC average (3.2) (World Bank, 2015b). However, since 2010, there has been an overall decrease in use of the country's public financial management and procurement systems by development partners in Ethiopia, from 66% to 51% of total ODA. The share of untied aid in Ethiopia as reported to the DAC in 2013 was 87%, compared with 70% in 2010 (Nebebe and Bosch, 2015).

Arab donors to Ethiopia include Saudi Arabia and Kuwait, which, according to the best recent estimates (from AidData), provided \$210.75 million and \$28.1 million, respectively, in development assistance between 2000 and 2011, showing a continued commitment to the country (see Prizzon and Rogerson, 2013, for more details on the role of these donors in Ethiopia).

2.2. Sector context

2.2.1. Roads

The GoE considers transport infrastructure to be the crucial catalyst for sustainable development and broad and inclusive growth. The GoE has a plan to increase the domestic resources given to the road sector, as stated in GTP II. Since 1997, there have been important investments to expand and modernise the road network, through four consecutive Road Sector Development Programmes. The road network increased from 48,800 km in 2009/10 to

60,466 km in 2013/14. Under the Universal Rural Road Access Programme, 39,070 km of all-weather roads were constructed throughout the country (MOFED, 2015: 11).

In addition to the standard actors involved in the infrastructure sector, such as development partners and MOFEC (previously MOFED), the Ministry of Transport and the Ethiopian Roads Authority are also key. We should note that although the Ministry of Transport is responsible for the sector and for the Road Sector Working group, the Ethiopian Roads Authority was considered by the stakeholders to be a powerful institution.

2.2.2. Railways

The GoE also has an ambitious plan regarding development of the railways: to build Africa's leading railways by linking Ethiopia with other countries. The country gave priority to railway infrastructure development in order to reduce the high costs of transportation while helping to simplify trade logistics – one of the challenges affecting Ethiopia's competitiveness (Export Gov, 2016). Projects have included the Addis Ababa–Dire Dawa–Djibouti corridor (750 km long) and the Addis Ababa Light Rail Transit; the latter began operating in December 2015. Construction work for the Awash–Kombolcha–Hara Gebyea (Woldiya) railway started in 2015. Contracts have also been awarded for the Mekele–Hara–Gebeya (Waldya) (268 km) and the Hara Gebeya–Semera–Assayita (229 km) lines.

In addition to the stakeholders mentioned in the road sector, the Ethiopian Railways Corporation (an SOE) is a key actor. It was considered by interviewees to be a very powerful institution, having a large degree of autonomy and authority.

2.2.3. Energy

Energy is also a priority in GTP II, with strong prospects for hydroelectric and geothermal power generation. The country's hydropower and geothermal potentials are estimated at 45,000 MW and 5,000 MW, respectively. According to GTP II, the country's installed electricity generating capacity is expected to reach 17,346 MW by the end of 2019/20, from the current level of around 4,200 MW. The investment in energy and the emphasis on forms of clean energy sources are very much linked to the CRGE Strategy that integrates accelerated economic growth with climate resilience and alternative energy technologies (Scott et al., 2016).

The GoE has a monopoly over the energy sector, with the main SOEs being Ethiopian Electric Power and Ethiopian Electric Utility. The Ministry of Transport and the Ministry of Water, Irrigation and Electricity are responsible for overseeing these agencies, but several interviewees noted that their roles are rather limited.¹⁰

10 The GoE has monopoly control over electricity distribution.

3. Development finance flows to the infrastructure sector

This section reviews the main volumes and terms and conditions of development finance flows disbursed in the roads, railways and energy sectors. It starts by providing an overview of the infrastructure financing landscape at an aggregate level in these three sectors, then goes into more detail on the sources of financing for each sector.

3.1. Infrastructure financing to Ethiopia: an overview

In absolute terms, Ethiopia ranks third in SSA in terms of the amount of external finance it has received for the infrastructure sector (when telecommunications are excluded), with total commitments of around \$7.5 billion (from 2009 to 2012) (Gutman et al., 2015).¹¹

In relative terms, Ethiopia is the 12th largest recipient of external commitments to the infrastructure sector as a share of GDP. The share increased from around 3% of GDP between 2005 and 2008 to more than 5% between 2009 and 2012, which is higher than the SSA average (about 3.9%) (Gutman et al., 2015). Ethiopia spent about \$1.7 billion in terms of absolute national budget allocation on infrastructure in 2014, which corresponds to around 3.1% to 4% of GDP.¹² This is much less than was spent by other SSA countries that are in a fragile situation, such as the Central African Republic and Mali, which spent between 7.1% and 8% in 2014.

Chinese finance to the infrastructure sector has been quite substantial and China is one of the largest, if not the largest, development partners in the infrastructure sector in Ethiopia. China has invested \$4.4 billion in roads and railways and around \$2.3 billion in energy since 2007 (SAIS-CARI, 2016). In particular, it grew from an average of \$213.5 million between 2007 and 2010 to \$1.4 billion between 2011 and 2014. According to Gutman et al.

(2015), Ethiopia was the second largest recipient of Chinese infrastructure investment commitments from 2009 to 2012.

Multilateral donors – the World Bank, the European Union (EU) and the African Development Bank (AfDB) – have been substantially increasing their support to the infrastructure sector (roads, railways and energy) both in terms of volume and as a share of ODA. Whereas in 2005 their contribution represented 58% of total ODA to the sector (energy, railways and roads), or \$130 million, in 2014 they accounted for around 80% of total support, or \$319 million (OECD, 2016).

When it comes to energy, roads and railways specifically, DAC donors' disbursements since 2005 have been fairly 'erratic' (reflecting general trends in infrastructure financing). Disbursements peaked in 2006, at around \$105 million. They then fell considerably until 2010, when DAC donors only disbursed around \$10 million, but subsequently they increased to a value of \$80 million in 2014 (see Annex 1, Figure A1).

OOFs from bilateral and multilateral DAC actors are small. Ethiopia still does not access non-concessional flows from the International Bank for Reconstruction and Development (IBRD) window and only exceptionally on non-concessional terms from the AfDB for the infrastructure sector. According to the stakeholders, at the time of the case study analysis in March 2016 Ethiopia had started accessing non-concessional loans from the AfDB in the water sector, but only for small amounts.

Other non-DAC donors. Arab donors, such as the Kuwait Fund for Arab Economic Development, the Arab Bank for Economic Development in Africa (BADEA) and Saudi Arabia, have been increasing their presence in the infrastructure sector, but still provide only small amounts (their aggregate contributions totalled \$136.42 million between 2010 and 2014) (AidData database, 2016).

11 Infrastructure in Gutman et al. (2015) includes electricity, natural gas, telecommunications, airports, railways, roads, seaports, water treatment and water utilities.

12 This is different from the consolidated budget, which includes infrastructure financing through SOEs.

The international sovereign bond (\$1 billion) issued in 2014 was intended for on-lending to SOEs, the sugar industry, industrial parks and power transmission projects.

PPP projects are still to be implemented. According to the interviewees, there have not yet been any PPPs in the infrastructure sector.¹³ In addition, we were told that there is a big push by the government to create an environment for PPPs with a PPP framework being developed at the time of the country visit. (For instance, the federal proclamation has been amended several times to encourage PPPs, and the federal investment agency has been upgraded to commission status with the same aim. Moreover, the commission board of directors is led by the Ethiopian prime minister to enable it to make quick decisions in this regard.) The AfDB is working with MOFEC to support this PPP framework. According to the stakeholders, the energy sector is the best candidate for the use of PPPs, which would involve mostly foreign private companies.

3.2. Analysis by sector: roads, railways and energy

3.2.1. Roads

Domestic sources

Roads are essentially a public investment (around 78% of the total budget envelope), with the remaining coming from external assistance. In terms of capital expenditure, Ethiopia has been increasing its spending on road construction. Spending went from approximately \$100 million in 2002/03 to \$1.6 billion in 2012/13, which was invested in nearly 300 road and bridge projects. Road construction accounts for the largest share of spending, averaging 32% of total capital expenditure¹⁴ since 2002 according to the 2012/13 budget (MOFED, 2016).

External finance

The main ODA contributors to the sector are multilateral organisations, which have been providing more than 80% of total ODA, at an average of around \$200 million per year, since 2005 (OECD, 2016). The main traditional financiers have been the World Bank, the AfDB and the EU (in the form of concessional loans with low interest rates). These donors are regarded as having a comparative advantage in infrastructure, including cross-border infrastructure networks (DAG, 2015).

China is also a major financier in the road sector in Ethiopia, with its engagement largely on a quasi-commercial

basis, through loans from the China Exim Bank. In 2011 it committed \$68 million to the Meskel Square–Bole road, and in 2014 it invested \$187 million in the Dire Dawa–Dewalle road (SAIS-CARI, 2016). In addition, according to the AidData database (2016), there was some sporadic grant financing from China for transport and storage, of around \$111 million, between 2003 and 2012.

Over the past decade DAC donors have started paying more attention to financing roads, but from a low base. The latest estimates from OECD.Stat (OECD, 2016) show an increase in disbursements, from \$16 million in 2005 to \$36 million in 2014. Germany and Japan also provide some grant assistance, with the latter now planning to move from grants to concessional loans, as is common practice where recipient countries have shown considerable progress in economic growth.

Non-DAC donors include Saudi Arabia (\$19 million in 2005), Kuwait (\$51 million in loans in 2008 and 2010) and BADEA (\$52 million between 2000 and 2010).

3.2.2. Railways

Domestic sources

According to the interviewees, resources to the railways sector come mainly from external sources. Railway infrastructure development was only very recently reintroduced into the development plans.

External finance

Most of the external finance (and resources) to the railways sector comes from non-DAC donors (China, Turkey and India), mostly on a quasi-commercial basis (contractors). China Exim Bank has pledged loans totalling \$4.1 billion (from 2009 to 2013), with around \$2.5 billion going to support the 756 km line from Addis to Djibouti, and \$475 million going to the Addis Ababa Light Rail (see Annex 1, Figure A2).¹⁵ Yapi Merkezi has been appointed the sole contractor for the Awash–Weldia/Hara Gebeya Railway Project, constructing the 389 km of railway line under a three-year \$1.7 billion contract. In addition, the Türk Exim Bank provided parallel financing of \$300 million (African Capital Markets News, 2014). In June 2013, the India Exim Bank also opened a credit line, worth \$300 million, to finance a link from Asaita to Djibouti (DAG 2015).

Traditional development partners are not involved in this sector, which is essentially because the costs and risks are high and the rates of return are low.¹⁶

In terms of multilateral partners, the GoE would like to access finance (in particular concessional loans) from

13 The World Bank Private Participation in Infrastructure Database lists two PPPs in the railways sector (valued at \$2 million each), but according to the World Bank interviewees in Ethiopia these should not be considered as PPPs.

14 Total capital expenditure includes federal and regional expenditure.

15 These figures also include \$682 million to the Addis–Adama Expressway.

16 Only the EU has been involved in this sector, in rehabilitation projects (grant-based), following a request from the GoE.

more traditional multilateral partners, such as the World Bank and the AfDB. However, interviewees were somewhat sceptical of seeing that happening in the short term. Development partners are concerned about the low volume of traffic on the main railways, which makes it difficult to recover the cost of infrastructure projects.

3.2.3. Energy

Domestic sources

Energy (and mining)¹⁷ spending increased steeply in 2006, then stabilised at a value of approximately \$52 million in 2012/2013 (MOFED, 2016). However, it is projected to increase in the future, according to GTP II and insights from the interviews. The GoE was the main financier of the Renaissance Dam, and in addition to selling bonds, has used some innovative funding mechanisms, such as a lottery game played through SMS.

External finance

China has been the main financier to the energy sector in Ethiopia. China committed \$2.205 billion to energy between 2007 and 2013, with \$810 million going to hydropower projects, \$392 million going to wind farm projects and around \$1 billion to power transmission and distribution. Most of the funding is in the form of loans from the China Exim Bank, with the exception of the

Grand Ethiopian Renaissance Dam power transmission project, which is financed by China Electrical Power (SAIS-CARI, 2016). In 2006 **India provided its first line of credit** of \$65 million for energy transmission and distribution programmes (India Exim Bank, 2016). No other non-traditional donors have become significantly involved in this sector.

In terms of multilateral institutions, the World Bank (through the IDA) is a major player in the energy sector, along with the AfDB (through the ADF), which together provided almost \$90 million in 2014, an increase from \$20 million in 2005 (see Annex 1, Figure A3). The World Bank has emerged as the lead donor in the energy sector and is playing a leadership role in establishing a formal energy sector partnership structure. The AfDB and the World Bank closely collaborate in infrastructure, notably in water and sanitation, power and roads.¹⁸ Recently, the EU included energy as a priority sector in Ethiopia in the 2010–2014 framework. The energy sector development has mainly been financed by loans.

DAC donors' support to the energy sector fell from \$79 million in 2005 to \$45 million in 2014.¹⁹ The main DAC donors in 2014 were France, Norway and South Korea (OECD, 2016) (see Annex 1, Figure A3). However, the interviewees were optimistic that, in light of the energy sector again being prioritised in GTP II, external assistance is likely to increase in the medium term.

17 The budget is not separated between energy and mining spending.

18 The WASH (Water, Sanitation and Hygiene) and Rural Electrification Access programmes, for example, are co-financed by the AfDB and the World Bank.

19 One of the reasons for this decline appears to have been that Italy, which was a major player between 2005 and 2010, withdrew from the sector.

4. Arenas of negotiation

MOFED (now MOFEC) has the exclusive mandate to negotiate bilateral and multilateral assistance programmes for the GoE (Furtado and Smith, 2009), including regional state governments, as well as to scrutinise loan agreements prior to their approval by Parliament. There are four directorates within MOFED, each with its own system of coordination with its respective ministries and national authority offices: the Bilateral, EU, International Finance Institutions and Ethio-China Directorates, with the latter created in response to China's increasing importance to Ethiopia's development. None of Ethiopia's other development partners has a separate office and department within MOFED (the EU is an exception, but this is driven by the requirement to have a National Authorising Officer in order to receive assistance under the European Development Fund). According to the interviewees, the four directorates meet every quarter.

MOFED is also in charge of the aid management system, tracking development partners' commitments and disbursements in country. Most donors provide the information directly to MOFED, with the exception of China, which delegates to the Ethio-China Directorate. Although this is a useful platform for mapping the flows in country, it is not yet available to the public and does not include contributions to NGOs or projects not counted as ODA.

The DAG is responsible for dialogue with the GoE on development programming, policies and processes using formal government–donor dialogue structures. The DAG comprises 29 multilateral and bilateral partners that provide development assistance to Ethiopia, mostly OECD donors. What emerged from the interviews is that China is not currently interested in joining the DAG structure.

Arenas of negotiation in the infrastructure sectors differ from the coordination mechanisms in the social sectors. Stakeholders interviewed for this project said that working groups in the social sectors (such as health and education) are usually more dynamic than those in the infrastructure sectors. This is because of the larger number of development partners involved in the social sectors and because they are funded via sector budget support, requiring a greater degree of coordination between development partners and government. From the higher-level interviews conducted, we understand that the Prime Minister and special advisers play a major role in negotiating investments that focus on the energy sector and the industrial parks.

The presence and effectiveness of both formal and informal fora for policy dialogue and coordination vary

substantially across the infrastructure sectors investigated (roads, railways, energy). Most negotiations and coordination between the GoE and development partners take place in bilateral fora. Donors that are not part of the DAC (such as China and Turkey) or have only recently joined it (such as South Korea) do not actively participate in any of these fora.

- **Roads.** Road sector interventions and dialogue are coordinated within the framework of the Road Sector Development Programme and the Transport Sector Working Group (TSWG). **The TSWG is the main forum for policy dialogue in the transport sector.** It plays a key role in closely reviewing the formulation and implementation of sectoral policies, analysing results, identifying shortcomings and discussing possible ways forward. At the time of the country visit, the TSWG was co-chaired by the Ministry of Transport and the EU. All governmental agencies under the ministry and the development partners active in the sector share their respective programme results and discuss progress in the implementation of national policies. Although this group should meet every quarter, interviewees reported that this does not always happen, and that the group is not as active as it used to be. This is attributed to most donors financing single projects (with the exception of the EU, which provides sector budget support). Interviewees reported that they meet more often informally and bilaterally than within the working group.

According to the interviewees, the most active partners in the working group are the World Bank and the AfDB. As donors, China and South Korea are invited but they do not participate, and Japan has not been very active in the group. Chinese authorities deal bilaterally with the Ethio-China Directorate in MOFED, even though development partners would like to see China participating directly in the coordination fora (according to the interviews conducted). China has a big infrastructure programme in the country and usually works on its own, without interaction with other development partners.

- **Railways.** There is no coordination among financiers of the railways sector, even though in principle this sector should be under the aegis of the TSWG. There are two reasons for this: first, traditional development partners are not involved in the railways sector; and second, Chinese and Turkish funding for railway development is either on a commercial basis or is non-concessional

funding towards their own companies. ‘Coordination’ in this context is about fundraising and pooling resources from different financiers, rather than avoiding duplication and increasing development impact. Most relations in this sector are managed bilaterally, either via MOFED or via the SOE (Ethiopian Railways Corporation).

- **Energy.** As with the railways sector, **there was not an energy sector working group** at the time of the case study analysis. We were informed that there have been some discussions about creating one; however, the GoE does not yet think that it is necessary because of the small number of development partners involved

in the sector. This situation is likely to change soon as some donors have shown interest in increasing their contributions to this sector and others have shown interest in investing in the sector.

There have, however, been informal meetings between development partners involved in the sector, but without the GoE’s participation. We understand that Chinese representatives do not participate in these informal meetings, even though traditional development partners have reached out to them. This informal group used to take place every two months, but interviewees mentioned that the group no longer meets regularly, but only occasionally to discuss specific issues.

5. Priorities for the terms and conditions of development finance

This section sets out the GoE's priorities for the terms and conditions of development finance in the infrastructure sector (roads, railways and energy); specifically, it describes the qualitative objectives that the GoE seeks to achieve in negotiating with the providers of development finance, including bilateral and multilateral donors and commercial partners. Section 6 reviews and analyses the evidence on whether and how the GoE has managed to meet these priorities.

The priorities illustrated in this section are largely and primarily informed by interviews with senior government officials and triangulated with consultations with other stakeholders (development partners and CSOs). The GoE has implicit priorities for the terms and conditions of development finance that it will accept from development partners, as well as principles for the division of labour among financiers (see also Section 4). These priorities and principles are widely shared and understood within the GoE and the senior civil service.

Unlike in other reports for this project, the priorities listed below are only partly based on publicly available documents. A now outdated Medium-Term Debt Management Strategy (MTDS) 2013–2017, published in 2012, provides a good snapshot and scenario analysis of future public debt trends. However, it lacks a clear framework on how best to employ financing sources with different financial terms and conditions (grant component, interest rate, maturity), such as matching them with projects with similar lengths and which are able to generate sufficient returns to service debt obligations. The GoE has no aid or resource mobilisation strategy that is publicly available.

Finally, we also consider how the analysis in this paper compares with the findings of a study conducted by ODI in 2012, which looked at development finance and the GoE's priorities across all sectors (see Prizzon and Rogerson, 2013).

The GoE has expressed six key priorities for the terms and conditions of development finance needed to support infrastructure development. These are summarised below.

More and diversified external finance to support infrastructure development. The availability of development finance, both in terms of quantity and quality, is one of the

key risk factors identified in the implementation of GTP II. While the GoE had not specifically identified a funding gap for infrastructure sector development, the ambitious GTP II undoubtedly requires a surge in resources. As a rough idea of the scale of the challenge, Foster and Morella (2011) estimated that Ethiopia's infrastructure deficit would require spending at a level equivalent to 40% of the country's GDP, or three times the \$1.3 billion spent annually in the mid-2000s. These figures should also be interpreted as underestimates as they are based on GTP I, which was less demanding than GTP II.

Most senior government officials are certainly aware of the budget constraints faced by most development partners, as well as the borrowing ceilings of the MDBs. Nonetheless, government officials interviewed stressed that they would like resources to the infrastructure sector to increase – whether from external sovereign lenders or from commercial lenders. Similar arguments were also found in Prizzon and Rogerson (2013). This priority will require a strategic diversification of funding sources, by expanding the number of financiers (including less traditional ones) and by looking to the international capital markets, as exemplified by the decision to issue a sovereign bond back in 2014.

However, the GoE does not only seek to expand and diversify its funding resources. There is a deliberate strategy to attract external funding sources because of a shortage of foreign exchange (IMF, 2015: Article IV) – a major constraint in infrastructure development. GTP II expects two thirds of borrowing by public enterprises (the major driver of its implementation) to be borrowed externally. Domestic financial markets are also underdeveloped because of low per capita income and the distortive negative real interest rates, which do not incentivise domestic savings (IMF, 2015).

Ownership and alignment with national priorities. In the round of interviews with government officials, two other top priorities emerged, ranked just below additional finance. The first was ownership of development programmes, i.e. projects should be demand-led and originated by the government itself. The second was alignment with national priorities, meaning that projects

should be concentrated in the sectors and areas prioritised in GTP II. **The GoE does not accept policy conditionalities**, i.e. policy conditions on external financing from sovereign donors, and is less willing to compromise on this than other partner country governments reviewed for this project. The remarkable improvement in human development indicators in Ethiopia, the GoE's strong negotiation capital and the variety of financing options that the GoE can access (see Section 2) mean that policy conditionality is becoming less effective, which explains why it is not perceived as an issue and/or a priority. At the same time, development partners' funding for the infrastructure sector is expected to be channelled to capital expenditure only, rather than recurrent spending. Ownership and alignment with national plans were also identified as key priorities in the cross-sectoral analysis of Ethiopia conducted previously (Prizzon and Rogerson, 2013).

Maximise concessional finance. Securing the maximum amount of resources for infrastructure development, but in concessional terms only, was another priority identified by government officials (and was also indicated in the MTDS 2013–2017) (GoE, 2012). By 'concessional terms' the GoE means a project whose financing package has at least a 35% grant element, applying the IMF approach to assess loan concessionality. In Prizzon and Rogerson (2013), government officials stated that the aid modalities given the highest priority were grants and budget support. This shift in approach derives from the GoE's awareness that there is more limited availability of (and higher demand for) grant financing, as well as the increasing share of concessional loans in total ODA to Ethiopia (albeit from a low base). At the same time, the GoE is subject to the IDA non-concessional borrowing policy (NCBP) limit. In countries that do not have an IMF programme in place, which includes Ethiopia, the IDA could establish a non-concessional borrowing limit if it was consistent with the maintenance of low debt vulnerability and if the planned investments are critical and growth-enhancing. It is no coincidence that the amount of the NCBP corresponds to the volume of the international sovereign bond issuances in 2014.

The MTDS 2013–2017 states that semi-concessional borrowing (i.e., loans with less than a 35% grant element) should only be used to finance investments by SOEs in priority sectors that will have significant impact on economic growth and poverty reduction in the country.

The rationale is that these projects should, in principle, generate sufficient returns to repay the loan. Domestic borrowing and resources are expected to cover residual financing needs (MTDS 2013–2017).

Speed of delivery. Another priority that most government officials referred to when prompted – albeit far less strongly than in the previous analysis by ODI (Prizzon and Rogerson, 2013) – was the need for fast contract negotiations and project implementation; what Prizzon et al. (2016) referred to as *speed of delivery*. Senior government officials often mentioned their concerns about the long durations of project cycles, both the time taken to conduct contract negotiations and feasibility studies, and the length of the project implementation phase.

Low administration costs. Another priority for the terms and conditions of development finance was for projects to have the lowest administration costs and least burden for government staff. This translates into two different approaches to project financing. First, several government officials mentioned that they encourage financiers to set up co-financing arrangements or pooled funds, so that they can work together rather than on parallel projects. The main driver for this arrangement is the harmonisation of safeguards and procurement policies and procedures: under a parallel arrangement, the GoE is required to comply with the policies of each separate financier. Second, again to reduce the administrative burden, the GoE prefers to work with the largest financiers, which can fund and implement a project alone. However, this conflicts with the first priority, to expand funding in the infrastructure sector and diversify funding sources.

Non-financial project components: knowledge-sharing and capacity-building. Last, but not least, several government officials said they value the knowledge transfer and expertise (including capacity-building and training) that the largest and most established donors in the infrastructure sector (notably the World Bank, the AfDB and the EU) can bring to a project. It was mentioned that knowledge transfer was among the criteria driving the selection of financiers. It is worth noting that such a priority did not emerge in the previous ODI analysis on Ethiopia (Prizzon and Rogerson, 2013).

There were also some elements of the aid effectiveness agenda that were not mentioned in the round of interviews with government officials. These include untied aid, mutual accountability and the results agenda.

6. Negotiation outcomes

This section evaluates the extent to which the GoE has been successful in achieving the priorities outlined in section 5.

More diversified external finance to support infrastructure development. While the GoE seeks to diversify financing sources in the infrastructure sectors, the strategy has only been partially achieved. The oversubscribed \$1 billion international sovereign bond issuance of 2014 helped to fund activities of SOEs in sectors that traditional donors might not have supported, such as the sugar industry and the industrial parks, and provided sought-after foreign exchange. The bond issuance also signalled to international finance markets the ability of the GoE to raise (at least in current conditions) financing in the international financial markets. However, the appetite for such international bonds is buoyed by the prevailing low interest rates in international markets, and these conditions might not persist in the medium term. At the same time, as we have seen in Section 2, the capacity of the GoE to mobilise domestic tax revenues is limited.

Furthermore, the number of financiers to the infrastructure sector has remained relatively small since the mid-2000s (principally the World Bank, the AfDB, the EU and Japan), and China and South Korea have both scaled up their assistance (see Section 3). However, interviewees did mention that the GoE has approached other donors, such as Brazil and Russia, but that flows are yet to materialise.

Traditional development partners do not operate in the railways sector. The large volumes of funds required, the risk profiles of the projects and the low returns were mentioned in the interviews as among the explanations for this. While the GoE would like to access more resources from the World Bank and the AfDB – in part because of the knowledge transfer and capacity-building that such arrangements would involve – the scope for these institutions to substantially expand their envelope to Ethiopia is constrained, at least in the short term (based on IDA and ADF replenishments and Ethiopia's allocation).

In early 2016, the GoE borrowed on non-concessional terms from the AfDB to support a project in the water sector, even though Ethiopia is ADF eligible. This option is available to countries with a low or moderate risk of debt distress (so is open to Ethiopia, at the time of writing).²⁰

Ownership and alignment with national priorities. As mentioned in Section 2, the strong human development

results achieved by Ethiopia over the past 15 years and the development state approach driving its economic policies, with clear priorities under GTP II, mean that the GoE finds itself in a very strong negotiating position (see Prizzon et al., 2016). In interviews with both government officials and development partners, examples were provided demonstrating the role of the GoE as 'initiator' of discussions about development projects – discussions were not simply supply-driven by development partners. It was reiterated that the GoE would not go ahead with projects that do not support national priorities identified in GTP II. Government interviewees referred to projects that had been turned down because they were not aligned with the national development plan. For example, the negotiations over a project in the energy sector were terminated because of what was referred to as 'misalignment' between the GoE and the development partner.

While all donors are aware of the GoE's priorities, as summarised in GTP II, an interviewee among the government officials mentioned that Chinese officials usually have a different approach than the more traditional partners. Chinese officials were described as having a better understanding of the GoE's priorities and *of which projects would have been of interest to the Ethiopian government.*

In the round of interviews, no evidence was brought up about development partners funding recurrent expenditure. However, several development partners expressed concerns about the GoE's ability to afford maintenance costs in the future. For example, the World Bank also argues whether the shift towards capital spending in the government budget is such that adequate recurrent resources are being allocated, at least in the road sector (World Bank, 2016b).

The GoE approach to the division of labour among donors underlines its strong ownership of the development agenda. There is no formally established division of labour between donors within the infrastructure sector. However, interviewees (both government officials and development partners) reiterated that not only is the government very much aware of the comparative advantage of each development partner, but it also has an implicit strategy with clear priorities of which sectors and programmes each donor should contribute to. The GoE also enforces this implicit division of labour, limiting the potential for competition among donors in the infrastructure sector.

²⁰ It is also subject to the IMF's Debt Sustainability Assessment, a sustainable macroeconomic position and stringent oversight by the Bank's Credit Risk Committee, among other safeguards.

Maximise concessional finance. The GoE achieved mixed results when it comes to maximising its resources at concessional terms. The GoE certainly increased its concessional envelope with the soft windows of the World Bank and AfDB and accessed resources from India and Arab donors at concessional terms.

However, we have mentioned how the GoE started accessing AfDB funds at non-concessional terms, and how it issued an international sovereign bond to support the energy sector, but on far less favourable terms than concessional finance. The GoE funded the completion of the Renaissance Dam by issuing domestic bonds. The share of loans to Ethiopia from development partners has increased relative to grant financing. Japan (in particular, the Japan International Cooperation Agency (JICA)) – one of the largest bilateral donors to Ethiopia – is considering shifting its aid modalities from grant to loan finance. Financing from Turkey (via its Exim bank), other European Exim banks and Credit Suisse for the Awash–Weldia/Hara Gebeya Railway Project, and from the China Exim Bank for a railway on the Addis Ababa–Dire Dawa–Djibouti corridor is, however, either on commercial or non-concessional terms. Non-concessional lending in the railways and energy sectors requires semi-concessional borrowing (so loans with less than a 35% grant element) to be used only to finance investments by SOEs in priority sectors, and on projects that will have a significant impact on economic growth and poverty reduction in the country. However, non-concessional loans have a government guarantee, meaning that the GoE is ultimately responsible for loan repayment. Shifting from a low to a moderate risk of debt distress calls for greater prudence in taking up new loans, and in debt management overall.

Speed of delivery. Concessional finance remains the preferred option, especially from MDBs in the infrastructure sector. However, the negotiations and project preparation underlying these contracts, which require compliance with social and environmental safeguards, and the awarding of contracts on the basis of international public procurement procedures, drive longer project cycles, as we reflected upon in the previous section. To fund the most urgent and critical projects, the GoE has been willing either to borrow at less concessional terms from development partners who are in a position to complete project preparation and implementation quickly (e.g. from the China Exim Bank) or to fund the projects directly (e.g. the Renaissance Dam, via treasury bills and a national lottery). Interviewees gave examples of concessional loans that had been turned down because of lengthy project preparation. In turn, the GoE agreed to access less concessional funding options that would be quicker to negotiate and implement, notably from the Chinese and Turkish Exim banks. Examples include one of the most recently constructed dams (driven by environmental

concerns) and a project led by the Ethiopian Electric Power Corporation.

When it comes to speed of delivery (especially fund disbursements), international sovereign bonds are usually issued because the funds will be immediately available in the Central Bank accounts. This can outweigh the disadvantage that such bonds are more expensive (6.625% annual interest rate in the case of Ethiopia, with a maturity of only 10 years) than other options, such as IDA concessional loans. This key advantage of international sovereign bonds led them to feature strongly in other case studies for this project (Prizzon and Hart, 2016), although not in the consultations in Ethiopia.

Knowledge-sharing and capacity-building. The interviewees mentioned several instances of projects where the support of the largest and most established MDBs would have been preferred, because one of the expectations for the project was to enable knowledge-sharing and capacity-building. However, several of the priority sectors are not supported by the MDBs (notably railways), and in some instances speed of delivery is prioritised over both the securing of concessional terms (as illustrated above) and the opportunity for knowledge-sharing/capacity-building (the China Exim Bank usually funds ‘turnkey’ projects, which offer little opportunity for knowledge-sharing compared to traditional donors).

Low administrative costs. There is mixed evidence on whether the GoE managed to reduce administrative costs. For example, pooled funding and co-financing arrangements are modalities that can help to reduce the administrative burden and costs for the recipient country government. In the road sector, the GoE has arranged for Arab donors to pool funds, given the smaller size of their funding compared with that of other development partners (see Section 2). However, the division of labour in the road sector is very often based on splitting the project into sections, with the government allocating a specific section of the road to each development partner. While in co-financing arrangements one financier leads the project and there is one single procurement system, in parallel arrangements the use of more than one system represents a challenge for the government.

According to our interviewees, the GoE prefers large partners (such as the World Bank) to finance projects that are more complex and require higher standards, with other partners being involved in different parts of the project, such as feasibility studies, design, implementation and capacity-building, or in the financing of small projects.

Non-traditional donors are usually involved in fewer projects, but these are typically of higher value (e.g. expressways and toll roads in the case of China, and railway expansion in the case of Turkey). In addition, non-traditional donors tend to work independently as they are usually the single financier in a project (see also Section 4).

7. Main findings and recommendations

With this case study analysis we wanted to illustrate how the GoE manages development finance to support the infrastructure sector, focusing on roads, railways and energy. The case of Ethiopia offers some lessons for other partner country governments, to help them better exploit the comparative advantages of these players in terms of both financial resources and knowledge-sharing. Ethiopia has been prioritising infrastructure development in its national strategy, the GTP II (2016–2020), and it is among the largest recipients of external finance to the infrastructure sector in SSA.

7.1. Main findings

The analysis in this report aimed to address four sets of questions. Key findings are summarised below.

The evolution of development finance to the infrastructure sector (roads, railways and energy)

- In absolute terms, Ethiopia is the third largest recipient of external finance (from 2009 to 2012) for the infrastructure sector in SSA (when the infrastructure sector excludes telecommunications), with total commitments of around \$7.5 billion (Gutman et al., 2015).
- Chinese finance to the infrastructure sector has been quite substantial, at a total of \$6.5 billion since 2007, and China is one of the largest, if not the largest, development partners in the infrastructure sector in Ethiopia. Chinese finance to the infrastructure sector has been quite substantial and China is one of the largest, if not the largest, development partners in the infrastructure sector in Ethiopia. China has invested \$4.4 billion in roads and railways and around \$2.3 billion in energy since 2007 (SAIS-CARI, 2016). In particular, Chinese investment increased from an average of \$213.5 million between 2007 and 2010 to \$1.4 billion between 2011 and 2014. According to Gutman et al. (2015), Ethiopia was the second largest recipient of Chinese infrastructure investment commitments from 2009 to 2012.
- Multilateral donors, in particular the World Bank, the EU and the AfDB, have been substantially increasing their support to the infrastructure sector, both in terms of volume and as a share of ODA. Most of the ODA-eligible assistance to the infrastructure sector comes from multilateral institutions.
- OOFs from bilateral and multilateral DAC actors are small. Ethiopia still does not access non-concessional flows from the IBRD window, although it did so from the AfDB in the infrastructure sector but only under specific circumstances.
- DAC donors' disbursements to energy, roads and railways have been fairly 'erratic' since 2005. In particular, no DAC donor or multilateral development partner is involved in the railways sector, and contributions by DAC donors to the energy sector have been declining over time.

Arenas where negotiations take place

- MOFED – now re-named MOFEC – is in charge of negotiations with external financiers and of the aid management system, and has a dedicated office to manage the portfolio with China. The size and growth of Chinese support motivated the creation of this office: no other development partner in Ethiopia has a separate office within MOFED (the EU is an exception, but this is driven by the requirement for a National Authorising Officer in order to receive assistance under the European Development Fund).
- The presence and effectiveness of both formal and informal fora for policy dialogue and coordination vary substantially across the sectors we investigated (roads, railways and energy). Most negotiations and coordination between the GoE and development partners take place at the bilateral level. Donors that are not part of the DAC or which recently joined it (such as China, South Korea and Turkey) do not actively participate in any of these fora.
- *Roads.* The joint GoE–development partners Transport Sector Working Group, the main forum for policy dialogue in the transport sector, is not as active as it used to be. This is because most donors tend to finance single projects (with the exception of the EU, which provides sector budget support).
- *Railways.* There is no coordination among financiers, even though in principle it should be under the aegis of the Transport Sector Working Group. There are two reasons for this: first, traditional development partners are not involved in the railways sector; and second, Chinese and Turkish funding for railway development is either on a

commercial basis or is non-concessional funding towards their own companies. ‘Coordination’ in this context is about fundraising and pooling resources from different financiers, rather than avoiding duplication and increasing development impact. Most relations in this sector are managed bilaterally, either via MOFED or the SOE (Ethiopian Railways Corporation).

- **Energy.** There is not an energy sector working group at the moment. There is ongoing discussion about the creation of one, but the GoE feels it is not necessary because of the small number of development partners involved in this sector. There are, however, informal meetings between development partners involved in the energy sector, but without any participation by the GoE.

Priorities for the types of development finance that the GoE would like to access to fund projects in these sectors, and negotiation outcomes

Some of the priorities for development finance are very specific to the infrastructure sector and so did not feature in the ODI’s previous cross-sector analysis (Prizzon and Rogerson, 2013). We can summarise them as follows.

- **More diversified external finance to support infrastructure development.** While the GoE seeks to diversify financing sources in the infrastructure sector, its strategy has only been partially achieved. The oversubscribed \$1 billion international sovereign bond issuance in 2014 was part of this strategy. However, there is limited scope for further expansion of this source of finance because the GoE could easily hit the IDA’s non-concessional borrowing policy limit of \$1 billion. In addition, offering higher volumes on the market could put pressure on debt management and debt servicing: the country’s risk of debt distress has already been reclassified from low to moderate because of lower than expected export performance. The number of donors involved in the infrastructure sector has not been increased, so sources of financing remain concentrated in the largest and most established donors. The GoE has made some attempt to approach other sovereign financiers, such as Brazil and Russia.
- **Ownership and alignment with national priorities.** The GoE has certainly showed strong leadership, driving its development strategies and being the ‘initiator’ of development programmes. In the round of interviews with both government officials and development partners it was clear that the GoE negotiates projects that fit with its national strategy, so supporting the main pillars of GTP II. We were told of instances when the GoE turned down projects that were not aligned with national priorities. Albeit not explicit or publicly available, the GoE has a strong vision and understanding of the division of labour between donors and enforces it.

- **Maximise concessional finance and speed of delivery.** Concessional finance, especially from MDBs, remains the preferred option for the infrastructure sector. However, the negotiations and project preparation underlying these contracts drive longer project cycles. These negotiations and preparations require compliance with social and environmental safeguards, and for contracts to be awarded based on international public procurement procedures. To fund the most urgent and critical projects, the GoE has been willing either to borrow at less-concessional terms from development partners who were in a position to complete project preparation and implementation quickly (e.g. from the China Exim Bank) or to fund the projects directly (e.g. the Renaissance Dam, via treasury bills and a national lottery). Interviewees gave examples of projects funded with concessional resources that had been turned down because of lengthy project preparation.
- **Low administrative costs.** To reduce the administrative burdens of government officials, pooled funding and co-financing arrangements are the preferred modality in the infrastructure sector. While co-financing is a reality for smaller donors in the road sector (such as by Arab donors), the division of labour in the road sector is very often based on splitting projects into sections, with the government allocating a specific section of a road to each development partner (and with its own safeguards and procurement processes). Non-traditional donors are usually involved in fewer, higher value projects (e.g. expressways and toll roads in the case of China, and railway expansion in the case of Turkey), and the donor also tends to be the single financier of the project.

7.2. Recommendations

Based on the analysis in this paper, there are some areas where the GoE could strengthen its policies and practices when it comes to infrastructure financing. The most notable are as follows:

- **Develop a fully fledged debt management strategy.** Ethiopia’s first debt management strategy dates back to 2012 and it has not been updated since then. In the round of interviews, the interviewees mentioned a few times that the GoE has an implicit strategy on debt management (a preference for grant financing, a cap on non-concessional loans, and using non-concessional loans only for projects by SOEs). However, there would be scope to formalise such strategic directions on the composition of development finance (external and domestic, concessional and non-concessional) to inform policy decisions, and to set an explicit debt-to-GDP ratio target. We would also recommend, based on Prizzon et al. (2016), that the GoE prepares a structured debt management strategy, identifying which sectors and

projects should be funded by each source. In addition, even though only SOEs can take up non-concessional loans, these loans are guaranteed by the GoE and so should clearly feature among contingent liabilities. Their terms and conditions are also at non-concessional/commercial terms. In the case where loans are not met by the SOEs, the GoE would ultimately be responsible for their repayment, putting pressure on an already rising public debt burden.

- **Increase information-sharing on public and external finance and related projects.** One of the big challenges in this analysis was the lack of publicly available information on budget data and SOEs' consolidated budgets, as well as on resources from some development partners. We would recommend the aid management platform be externally accessible and available. Such an approach would offer an important tool and a starting point for policy dialogue between development partners and the GoE.
- **Increase efforts to foster more inclusive coordination between development partners and to promote co-financing arrangements among development partners.** In Section 4 we reviewed how the coordination mechanisms are either not operational (roads) or are totally absent (energy). This is partly motivated by the

small number of financiers involved and the parallel arrangements applied. However, establishing and managing these mechanisms would help the GoE to meet some of its priorities for development finance, e.g. to expand the number of donors involved in the infrastructure sectors and promote co-financing arrangements to reduce the administrative burden on government officials. The effectiveness of these mechanisms would increase if they were more inclusive, i.e. this would create the incentives for less traditional donors, such as China and Turkey, to actively join the discussions.

- **Evaluate the opportunity costs of speed of delivery and implementation: knowledge-sharing and safeguarding/procurement processes.** We found evidence that the GoE opted for less concessional financing options that were disbursed (or whose projects were implemented) more quickly than those offered at concessional terms but whose safeguards and procurement processes extended the project cycle beyond the GoE's preferences. However, when assessing the trade-off between favourable financial terms and speed of delivery, other dimensions should be factored in, such as the ability of the project to provide knowledge-sharing and capacity-building.

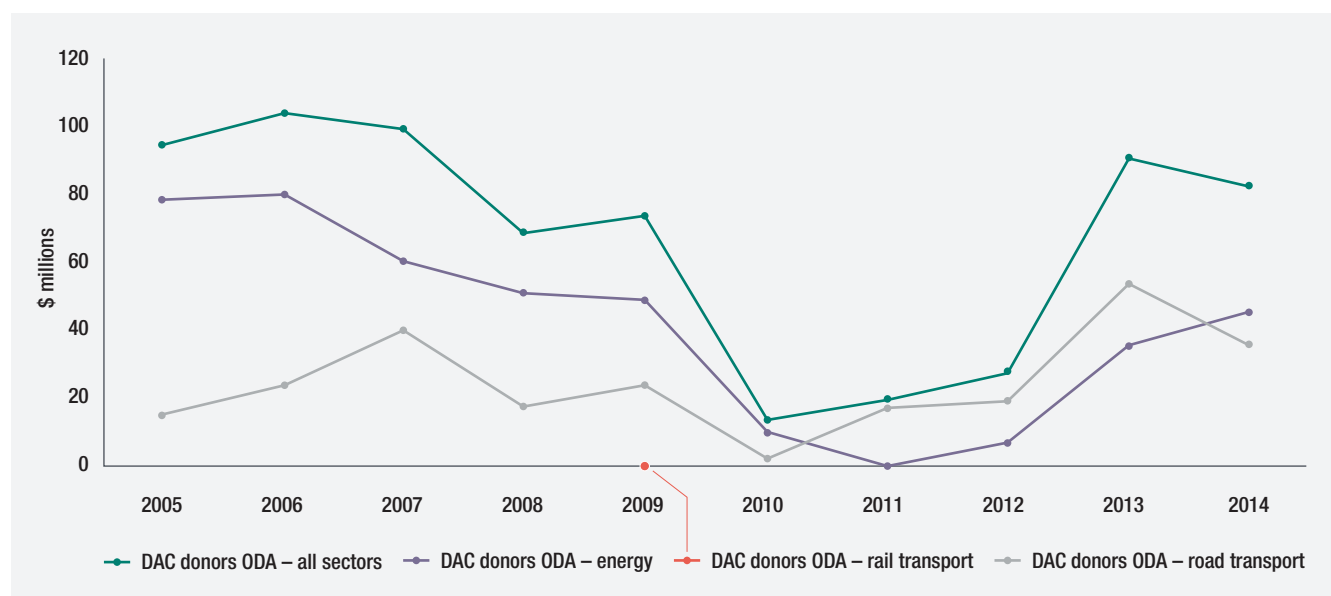
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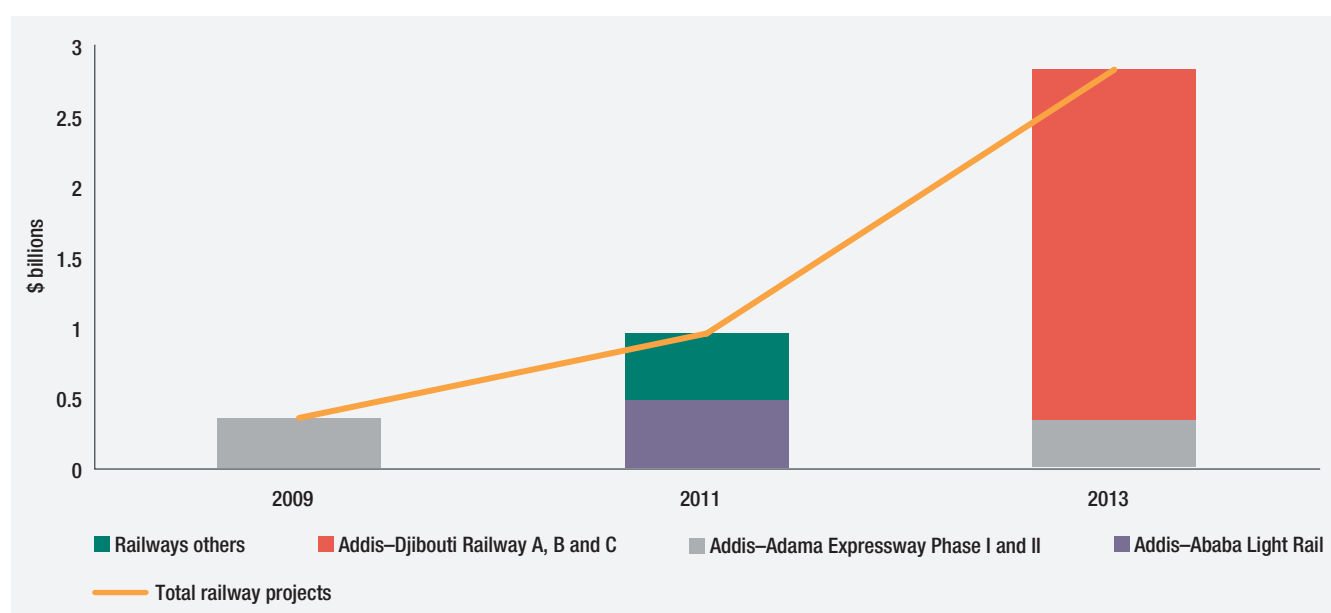
Annex 1: Development finance flows

Figure A1: DAC donors' disbursements to roads, railways and energy, 2005-2014, current prices



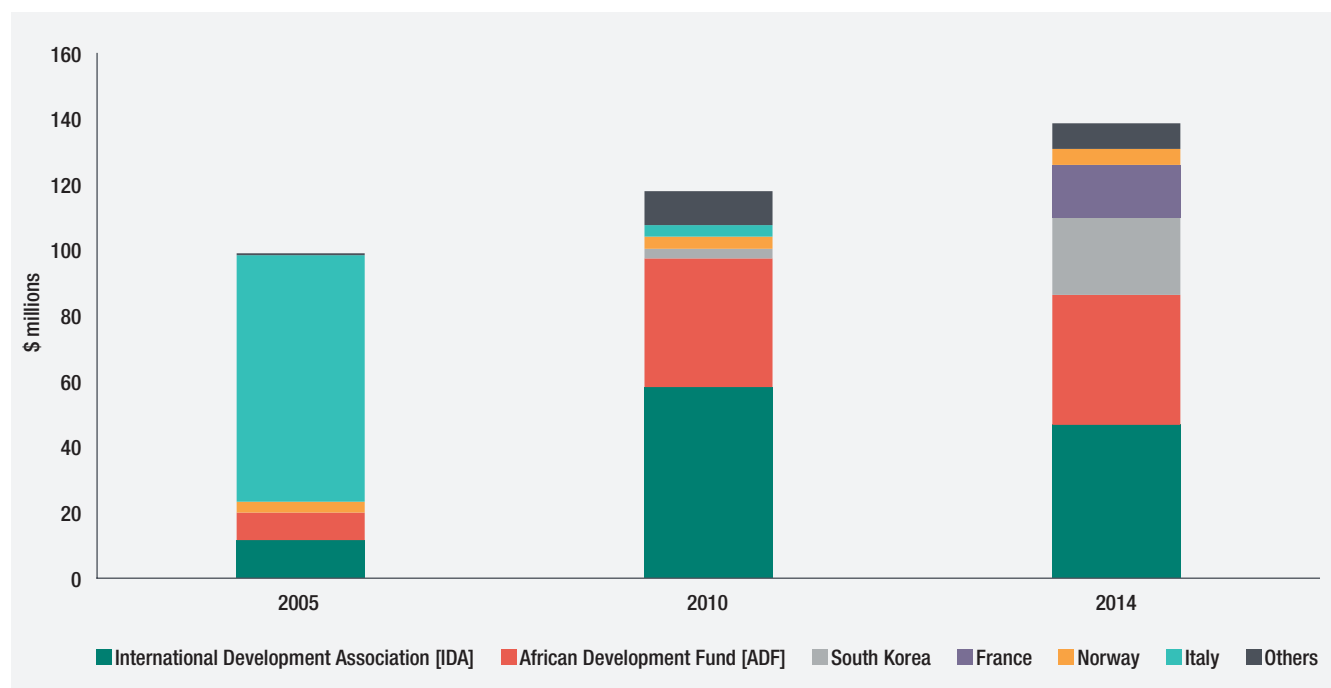
Source: OECD (2016).

Figure A2: China's investments in the railways sector, 2009-2013



Source: SAIS-CARI (2016).

Figure A3: DAC donors' disbursements to the energy sector, 2005-2014



Source: OECD (2016); disbursements, current prices.

Annex 2: List of interviewees

Name	Job title	Organisation
Adane Shibru	Chief Finance Officer	Consortum of Christian Relief & Development Associations CCRDA
Admassu Nebebe	Director, UN Agencies and Regional Economic Cooperation Directorate and Head of CRGE Facility	MOFED (UN agencies)
Antonio Capone	Second Secretary, Head of Infrastructure Section	European Union
Belachew Beyene	Head, National Authorising Office	MOFED (EU)
Daniel Mengestie	Director, Planning and Programme Management Directorate	Ethiopian Roads Authority
Eriso Garbado	Senior Transport Engineer	African Development Bank
Eyob Tekalign		Chamber of Commerce
Fekadu Terefer	Policy Specialist, Inclusive Growth and Human Development, Policy Advisory Unit	UNDP
Fisseha Aberra	Director, International Financial Institutions Cooperation Directorate	MOFED (International Financial Institutions Directorate)
Girma Mekuria	Senior Energy Officer	African Development Bank
Ismail Durhat	Head of Office	TIKA
Issa Diaw	Senior Power Engineer	World Bank
James Markland	Senior Transport Specialist	World Bank
James Wakiaga	Economics Adviser, Policy Advisory Unit	UNDP
Jemal Ahmed	Country Director	Action Aid
Jin Kimiaki	Chief Representative	JICA
Matt Butler	Senior Economic Adviser	DFID
Dr Meheret Ayenew	Executive Director	Forum for Social Studies
Mekuria Lemma	Strategy and Investment Head	Ethiopian Electric Power Corporation
Melaku Kifle	Senior Program Specialist	MOFED (Channel One Programme Coordinating Unit COPCU)
Meron Tekola	Programme Analyst, Aid Effectiveness	UNDP
Mezgebu Amha	Director, Macro Economic Policy and Management Directorate	MOFED (Macroeconomic Directorate)
Murat Kosal	General Manager, East Africa Regional Manager	Yapi Merkezi
Seyoum Techane	Head, Corporate Planning	Ethiopian Electric Utility
Silvia Cardascia	Programme Officer – WASH	Italian Cooperation
Teferi Demeke		MOFED (Budget Preparation)
Teferi Menkir	Senior Water and Sanitation Specialist	African Development Bank
Teka Gebreyesus	Deputy Commissioner	MOFED (Ethiopian Investment Commission)
Dr Tesfaye Alemu	Director, Debt Management Directorate	MOFED (Debt Management)
Tilahun Tadesse	Head	MOFED (Ethio-China)
Zenegnaw Abiy	Economist	IMF



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Cover photo: A Chinese worker oversees his Djiboutian colleagues as construction continues on a new railway line linking Djibouti to its land-locked neighbour Ethiopia, a 700-km line being built by China Civil Engineering Construction (CCECC). Nichole Sobecki/Panos

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