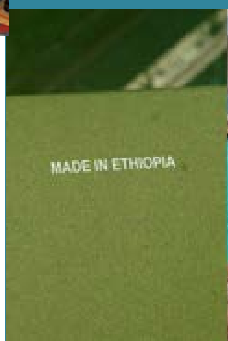
Progress Report:

Ethiopia Private Sector Development Initiative – Investment Climate

January–June 2014

Partnership with Canada, Italy, Sweden, and the United Kingdom
IFC Advisory Services in Africa



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Progress Report:
Partnership with Canada, Italy, Sweden, and the United Kingdom

Reporting Period	January–June 2014
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Contacts	Chris Gilbreth, chris.gilbreth@international.gc.ca
	Corry Vangaal, corry.vangaal@acdi-cida.gc.ca
	Yared Fekade, Yared.Fekade@cida-ecco.org
	Andrea Ghione, a.ghione@itacaddis.it
	Filippo Archi, f.archi@itacaddis.it
	Andrea Molnar, andrea.molnar@gov.se
	Anneka Knutsson, anneka.knutsson@gov.se
	Elin Carlsson, elin.carlsson@gov.se
	Emma Williams, E-Williams@dfid.gov.uk
	John Primrose, j-primrose@dfid.gov.uk
	Kerry Conway, k-conway@dfid.gov.uk
	Shewit Emmanuel, S-Emmanuel@dfid.gov.uk

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Executive Summary

On March 26, 2013, IFC signed an administration arrangement with the government of Canada, represented by the Minister for International Cooperation acting through the Canadian International Development Agency (CIDA). The agreement provides for the creation of a donors' trust fund (TF071999) to finance the Investment Climate (IC) component of the Ethiopia Private Sector Development Initiative.

For the same purpose,

- On June 18, 2013, IFC signed an administrative agreement with the government of Sweden represented by the Swedish International Development Cooperation Agency (SIDA);
- On October 4, 2013, IFC signed an administration agreement with the Italian Ministry of Foreign Affairs; and
- On December 2, 2013, IFC signed a memorandum of understanding with the United Kingdom acting through its overseas development agency, the Department for International Development (DFID).

By agreement, all funds contributed by all donors are commingled in the donors' trust fund.

The Ethiopia Private Sector Development Initiative – Investment Climate Component

The investment climate component is designed to strengthen Ethiopia's capacity to create an enabling environment for private sector development. It aims to do this by building the capacity of relevant government institutions to create and implement effective institutional frameworks and systems that support private sector development.

Through IFC, the program will support evidence-based dialogue, policy and regulatory review and reforms, and greater public-private partnerships. The program aims to create a more transparent and business-friendly environment for both women and men entrepreneurs, resulting in a 10 percent reduction in the cost of doing business.

The three key intermediate outcomes for the program are:

- Improved efficiency in trade logistics for exports and imports;
- Streamlined procedures and improved environment for registering and operating businesses owned by women and men; and
- A business taxation and appeals process that is more efficient, transparent, and user-friendly.

Program activities include the following:

- Reviewing policies and regulations related to trade and investment, business regulation and tax administration;
- Recommending improvements based on government and industry consultations and examples from other countries;
- Providing training and technical assistance to implement agreed-upon reforms;
- Engaging in outreach to business owners to encourage compliance and formalization; and
- Undertaking consultations and dialogue with stakeholders, including donors, governments and the business community to share information and identify and promote best practices.

Programs

In this reporting period, IFC allocated monies from the donors' trust fund to four programs. This section presents the objectives of each program as well as selected highlights from the reporting period.

The **Ethiopian Business Forum Program** aims to nurture and change policy dialogue around Ethiopia's private sector through the creation of a public-private consultative forum. The program also plans to support the adoption of 10 to 15 investment climate reforms. Some of the highlights of the reporting period are as follows:

- At the Second National Business Forum, Prime Minister Hailemariam Desalegn recognized that the 50 percent cash deposit required when appealing tax decisions effectively prohibits private firms from appealing. As a result, he agreed the deposit should be restricted to the principal, excluding interests and fines. He also accepted the importance of expanding the tax dispute tribunal to Ethiopia's regional states, to prevent taxpayers from having to travel to the capital to appeal. The conference was attended by more than 700 private sector representatives.

- At the public-private dialogue forum on access to finance, attendees discussed challenges related to one of the major constraints to private sector development: accessing credit. The National Bank of Ethiopia accepted three recommendations, the most important of which was to boost the effectiveness of the credit registry bureau in two ways: (a) revising the $5,000 maximum advance payment allowed for an import transaction without either a letter of credit or "cash against documents" (the seller retains ownership of the product until payment is made), and (b) substituting a required 30 percent cash contribution for an in-kind alternative when providing long-term loans. The other recommendations were referred to a technical working group for further work.
- The public-private dialogue forum on the protection of property rights consulted on a number of issues. After discussing the findings of a commissioned study, the government decided to review current practices to make sure they encourage the proper valuation of land, as well as agreeing to undertake a major initiative to provide title deeds for more than 500,000 land holdings (free holds) in the municipality.
- At the public-private dialogue forum on tax appeal and VAT refund, recommendations to simplify the VAT refund process were accepted immediately, while the 23 remaining recommendations were referred to a technical working group for further work.
- The adoption and implementation of various recommendations continued steadily during the reporting period.

The three other programs **– Ethiopia Business Regulation**, **Ethiopia Business Taxation,** and **Ethiopia Trade Logistics** – together aim to streamline and simplify high priority regulations, processes and practices that are burdensome to private businesses while addressing investment climate issues holding back investment and productivity growth in Ethiopia. Highlights during the reporting period include the following:

Business Regulation

- Estimates indicate that a 15 percent reduction in the number of licenses required would save businesses $3.7 million in compliance costs in the first year of implementation. To this end, the project team finalized an inventory of business licenses and an assessment of compliance costs to the private sector, then presented its recommendations to the Ministry of Trade, which accepted many of them. Discussions subsequently took place on how to take the process forward.
- With IFC's support, the Online Trade Registration and Licensing System (OTRLS) was upgraded by addressing its frequent interruptions and failures. Furthermore, many important features were added, including the electronic processing of payments and tax clearance data, so that businesspeople needing to renew business licenses should no longer have to visit tax offices to obtain the required forms. The upgraded version has been deployed in the more than 130 sites both in Addis Ababa and in four regions: Amhara, Tigray, Oromiya, and Dire Dawa City. Dire Dawa City's data system has been merged with that of the Ministry of Trade so data from all nine of the city's third-level administrative divisions are shared in real time. This means the registering offices can use similar and better formats for entering and keeping data and are able to share and access each other's data.
- The OTRLS has decentralized and improved trade name registration, which until recently was the exclusive responsibility of the Ministry of Trade. Currently, trade name registration services are offered at many sites in Addis Ababa and all of the registration points in Dire Dawa. This has facilitated real-time data exchange on registered trade names, as well as faster service because of the several registration points.
- Because IFC's client sits on a committee tasked with revising Ethiopia's Commercial Code, some of our recommendations have informed the committee's policy discussions on revising the code.

Business Taxation

- Addis Ababa University, under IFC supervision, is about to complete a large-scale survey of 1,500 businesses that analyzes both the compliance costs of taxes and taxpayers' perceptions of the tax system.
- The project team reviewed the MSME tax regime based on international good practices and made recommendations for improvements. These included revising the current threshold, reducing the compliance burden on small businesses, and replacing the current complex presumptive tax regime with a more simplified regime.
- The tax team conducted a brief review of the VAT refund system and made recommendations including the use of risk scoring in VAT refund processing, accepting bank guarantees, and the need to examine the effectiveness of the VAT withholding system.

- IFC's assessment of the tax incentive regime produced a number of recommendations. They include taking an inventory of tax incentives, estimating tax expenditures, reviewing the administration and control procedures, and providing recommendations on them. The tax team also reviewed the 2014 Draft Council of Ministers Regulation to amend investment incentives and investment areas reserved for domestic investors.
- Following a preliminary assessment, the tax team recommended a number of ways to improve the risk-based audit system, which currently experiences significant time delays. The recommendations include updating the risk-scoring criteria, upgrading the system to reflect the structural changes in the tax authority, and introducing the random selection of cases.

Trade Logistics

- The government issued a new customs proclamation. IFC had been involved in reviewing and commenting on the draft versions, taking into consideration current international principles of customs procedures and administrations. This ensured the new customs proclamation is, to a large extent, in line with the Revised Kyoto Convention (RKC). In particular, the law's declaration and clearance provisions, which are the most important from a trade facilitation perspective, were directly based on the RKC. The new proclamation provides the legal basis for developing a modern customs administration with strong enforcement powers that focus on clearance as opposed to control.
- IFC continued to advise on the use and application of risk management principles for import cargos. The Ethiopian Revenue and Customs Authority has started implementing some of these principles in its own risk management system, the goal being to lower the number of days traders generally need to comply with import regulations. Following a partial implementation, the percentage of cargo inspected at the border has decreased from 57.2 percent to 50.55 percent.
- Similarly, with IFC's support, the Revenue Authority employed risk management principles when crafting its new Directive No. 96/2014 on Customs Clearance for Incoming Passengers. The Revenue Authority reported a significant improvement in passenger movement through the airport resulting from a new "red channel/green channel" process.
- In collaboration with the Revenue Authority and the Investment Climate Facility for Africa, IFC has begun implementing an electronic single window (ESW) for international trade in Ethiopia. The government projects an estimated cost saving of about $800 million within five years of implementation.
- IFC helped finalize a memorandum of understanding that defines the role and responsibilities of key ESW stakeholders. Relevant border agencies and ministries that are members of the steering committee have finally signed the memorandum, which will significantly improve inter-agency coordination.

Financial Report

The Ethiopia Private Sector Development Trust Fund (TF071999) is a multi-donor trust fund that was created on March 26, 2013, with Canada, Italy, Sweden, and the United Kingdom as donors. As of June 30, 2014, these donors had committed a total of $10.5 million and disbursed $6.03 million. The final section of this report provides an overview of the initiative's finances.

Ethiopian Business Forum

Project Leader	Mamo Mihretu	**Donor Partner(s)**	Canada, Italy, Sweden, United Kingdom
Start Date	March 2011	**Countries**	Ethiopia
End Date	December 2014	**IFC Project ID**	553065

Project Description

Ethiopia's private sector is still at a nascent stage. The current policy dialogue is often characterized by entrenched positions and a lack of shared assumptions and objectives, when a more pragmatic, evidence-based approach would be more appropriate.

The program's main objective is to nurture a change and improve this dialogue by:

- Creating a Public-Private Consultative Forum, including a secretariat and various sub-forums; and
- Supporting the adoption of 10-15 investment climate improvements, resulting in $20 million in cost savings.

Development Results

The following tables summarize project outputs and outcomes as of June 30, 2014, including this reporting period:

Outputs

Component	*Indicator*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
		Target	*Result*	*Target*	*Result*
Creation/improvement of the public- private dialogue process	Number of new laws or regulations drafted	0	0	3	2
	Number of entities receiving advisory services	0	0	2	9
	Number of participants in workshops	0	0	200	135
	Number of reports completed	0	1	5	4
	Number of workshops or training events held	0	0	5	10
Promotion of investment climate improvements through the public-private dialogue mechanism	Number of media appearances	0	24	20	49
	Number of new laws or regulations drafted	0	1	15	13
	Number of participants in workshops	0	1,450	300	3,971
	Number of reports completed	0	10	5	22
	Number of procedures or firm-level policies recommended for improvement or elimination	0	75	5	112
	Number of entities receiving advisory services	0	2	4	4

Outcomes

Component	*Indicator*	*Baseline*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
			Target	*Result*	*Target*	*Result*
Creation/improvement of the public-private dialogue process	Number of entities that implemented recommended changes	0	0	0	4	2
	Number of recommended laws and regulations enacted or adopted	0	0	0	3	2
	Number of recommended procedures or firm-level policies improved or eliminated	0	0	0	4	1
	Number of new entities created	0	0	0	1	2
Promotion of investment climate improvements through the public-private dialogue mechanism	Number of entities that implemented recommended changes	0	0	0	4	5
	Number of recommended laws or regulations enacted or adopted	0	0	4	10	8
	Number of recommended procedures or firm-level policies improved or eliminated	0	0	6	12	15

Highlights

- At the Second National Business Forum, Prime Minister Hailemariam Desalegn recognized that the 50 percent cash deposit required when appealing tax decisions effectively prohibits private firms from appealing. As a result, he agreed the deposit should be restricted to the principal, excluding interests and fines. He also accepted the importance of expanding the tax dispute tribunal to Ethiopia's regional states, to prevent taxpayers from having to travel to the capital to appeal. The conference was attended by more than 700 private sector representatives.
- At the public-private dialogue forum on access to finance, attendees discussed challenges related to one of the major constraints to private sector development: accessing credit. The National Bank of Ethiopia accepted three recommendations, the most important of which was to boost the effectiveness of the credit registry bureau in two ways: (a) revising the $5,000 maximum advance payment allowed for an import transaction without either a letter of credit or "cash against documents" (the seller retains ownership of the product until payment is made), and (b) substituting a required 30 percent cash contribution for an in-kind alternative when providing long-term loans. The other recommendations were referred to a technical working group for further work.
- The public-private dialogue forum on the protection of property rights consulted on a number of issues. After discussing the findings of a commissioned study, the government decided to review current practices to make sure they encourage the proper valuation of land, as well as agreeing to undertake a major initiative to provide title deeds for more than 500,000 land holdings (free holds) in the municipality.
- At the public-private dialogue forum on tax appeal and VAT refund, recommendations to simplify the VAT refund process were accepted immediately, while the 23 remaining recommendations were referred to a technical working group for further work.
- In May 2014, at a Chamber of Commerce forum attended by more than 250 business community members from all over the country, the National Business Agenda (NBA) was validated and endorsed.
- The adoption and implementation of recommendations continued steadily during the reporting period. The following are the major highlights:
    - Implementing agencies accepted nine recommendations on company formation, including one on simplifying the procedure for authenticating company formation documents.
    - Three national business conference recommendations were implemented: the recognition of workers' meal expenses in the flower farming sector as tax deductible, the establishment of the manufacturing sector competitiveness council, and increasing the supply of land available for flower farming.
    - A tourism sector recommendation for the establishment of a tourism council was implemented.
    - Four rules – a memorandum of understanding, two regulations, and one directive – were adopted.

Risks and Challenges

There is a potential lack of client commitment, particularly given the government's competing priorities. In addition, the government has declared a policy of developmental state, in effect confirming its active role in guiding the direction and pace of economic development. This appears to undermine the role of a robust private sector in sustained economic growth. In response, IFC now only engages where it sees a credible chance of the government carrying through the proposed and agreed reforms.

Lessons Learned

A useful lesson the project team has learned is that building a dialogue culture is an ongoing process. Despite the maturing public-private dialogue platform in the country, still more needs to be done to create awareness about the importance of the public-private dialogue culture. This is particularly true when it comes to some institutions that are generally weary of public engagement. The National Bank of Ethiopia and the Ethiopian Customs and Revenue Authority are good examples in this regard. The poor level of trust and commitment displayed by the customs and revenue authority and central bank thus far has hampered the full realization of the proposed reforms in their public-private dialogue facilities.

Next Steps

Over the next six-month period the project team will continue to organize more dialogue forums and work towards the implementation of reform proposals. Specifically, it will:

- Help three regional chambers of commerce organize regional public-private dialogue forums;
- Continue to encourage the implementation of recommendations from such forums; and
- Support stakeholders to ensure the sustainability of the public-private dialogue culture.

Ethiopia Business Regulation

Project Leader	Mamo Mihretu	**Donor Partner(s)**	Canada, Italy, Sweden, United Kingdom
Start Date	January 2013	**Countries**	Ethiopia
End Date	December 2015	**IFC Project ID**	599468

Project Description

The positive headline statistics about Ethiopia's economic progress conceal many regulatory and investment climate–related shortcomings that impede its sustained growth and productivity.

For instance, in 2010 the government introduced a new commercial registration and licensing regime that aimed to fill various regulatory gaps and establish defined administrative procedures. However, the private sector perceives the law as draconian and highly restrictive as it imposes onerous licensing pre-conditions.

The overall objectives of the program are to streamline and simplify high priority regulations, processes, and practices that are burdensome to private businesses and to address investment climate issues that are holding back investment and productivity growth in Ethiopia. This will be achieved by securing:

- A 25 percent reduction in overall compliance costs for licenses subject to simplification;
- A 10 percent increase in the number of newly registered businesses; and
- A 25 percent reduction in compliance time and cost required to starting a business.

Development Results

The following tables summarize project outputs and outcomes as of June 30, 2014, including this reporting period:

Outputs

Component	*Indicator*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
		Target	*Result*	*Target*	*Result*
Business Regulations	Number of entities receiving in-depth advisory services	0	5	2	6
	Number of new laws or regulations drafted	0	1	2	2
	Number of reports completed	2	2	3	6
	Number of procedures of firm-level policies recommended for improvement or elimination	4	11	7	15
	Number of workshops or training events held	3	4	3	5

Outcomes

Component	*Indicator*	*Baseline*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
			Target	*Result*	*Target*	*Result*
Business Regulations	Number of recommended laws or regulations enacted or adopted	0	2	0	2	1
	Number of recommended procedures or firm-level policies improved or eliminated	0	3	2	5	5
	Average cost to comply with business regulation ($)	86	0	0	55	86
	Number of entities that implemented recommended changes	0	1	5	1	6

Highlights

- Estimates indicate that a 15 percent reduction in the number of licenses would save businesses $3.7 million in compliance costs in the first year of implementation. To this end, the project team finalized an inventory of business licenses and an assessment of compliance costs to the private sector. The resulting report:
    - Thoroughly investigates whether a given license is legal and business friendly, and whether it serves any legitimate public interest in the areas of health, environmental safety, and security;
    - Recommends reducing the number of licenses from the current 1,353 to about 400; and

- Makes a case for further simplifying licenses earmarked for retention, scrapping altogether any “competency certification” requirements that serve no regulatory purpose or have no legal basis for existence.

  The team presented the report to the Ministry of Trade, which accepted many of its recommendations. Discussions subsequently took place on how to take the process forward.

- With IFC’s support, the Online Trade Registration and Licensing System (OTRLS) was upgraded by addressing its frequent interruptions and failures. Furthermore, many important features were added, including the electronic processing of payments and tax clearance data, so that businesspeople needing to renew business licenses should no longer have to visit tax offices to obtain the required forms. The upgraded version has been deployed in the more than 130 sites both in Addis Ababa and in four regions: Amhara, Tigray, Oromiya, and Dire Dawa City. Dire Dawa City’s data system has been merged with that of the Ministry of Trade so data from all nine of the city’s third-level administrative divisions are shared in real time. This means the registering offices can use similar and better formats for entering and keeping data and are able to share and access each other's data.
- The OTRLS has decentralized and improved trade name registration, which until recently was the exclusive responsibility of the Ministry of Trade. Currently, trade name registration services are offered at many sites in Addis Ababa and all of the registration points in Dire Dawa. This has facilitated real-time data exchange on registered trade names, as well as faster service because of the several registration points.
- Because IFC’s client sits on a committee tasked with revising Ethiopia’s Commercial Code, some of our recommendations have informed the committee’s policy discussions on revising the code.

Risks and Challenges

The potential lack of client commitment, particularly given competing priorities, is a risk given the government’s declared intentions to intervene in the economy both as a regulator and as a market participant. A cabinet reshuffle might also delay the project’s implementation.

In general, IFC engages only when there is a credible chance of government carrying through with the proposed and agreed reforms. The team assesses this through the following mechanisms:

- Formal letters or requests from government to IFC specifying their commitment and interest in working with us;
- A legally binding cooperation agreement once we have defined the program’s focus; and
- Identification of specific institutional support mechanism for the program in question.

Lastly, the team will set clear deadlines for all parties with regard to deliverables and will state the consequences if deadlines are missed.

Lessons Learned

Even though initial buy-in may have been secured, we have realized that continued and sustained engagement with the client is essential. Continuously engaging the client and forging a good relationship helps to address pre-conceived ideas, simplistic views of the whole reform enterprise, a lack of seriousness and trust, and entrenched positions.

Next Steps

- The relevant stakeholders are scheduled to approve the license inventory report and compliance cost survey. A core technical committee is already working on proposals to amend existing legislation, including draft provisions and directives.
- Work on the information technology component of the reform program will continue in line with the recommendations, especially those regarding the e-registry portal, according to the roadmap developed earlier in the project period. The online portal will, among other things, allow firms to determine what they need for licensing and registration, provide company information, and consult databases (such as reserved and registered trade names) without physically visiting the registration offices. It will also facilitate the electronic exchange of data with other agencies.

Ethiopia Business Taxation

Project Leader	Mamo Mihretu	**Donor Partner(s)**	Canada, Italy, Sweden, United Kingdom
Start Date	January 2013	**Countries**	Ethiopia
End Date	December 2015	**IFC Project ID**	599467

Project Description

The headline statistics about Ethiopia's economic progress conceal many regulatory and investment climate-related shortcomings that impede the country's sustained growth and productivity. A key area in which businesses in Ethiopia are held back is the costly and unpredictable tax administration, which is characterized by high compliance costs, low collection levels, and poor voluntary compliance.

The overall objectives of the program are to (a) streamline and simplify high-priority regulations, processes, and practices that are burdensome to private businesses and (b) to address investment climate issues holding back investment and productivity growth in Ethiopia. This will be achieved by:

- Simplifying and streamlining the tax administration, especially for micro, small and medium businesses (MSMEs), and improving taxpayer outreach, communication and education;
- Reducing the time and cost of dealing with business taxes by 15 percent for businesses and broadening the tax base by increasing the number of businesses registered for tax purposes by 10 percent;
- Achieving $15 million in compliance cost savings; and
- Reducing the number of firms identifying tax administration and the tax system as a whole as a major constraint by 15 percent.

Development Results

The following tables summarize project outputs and outcomes as of June 30, 2014, including this reporting period:

Outputs

Component	*Indicator*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
		Target	*Result*	*Target*	*Result*
Improve tax laws, regulations, administration efficiency, and reduce compliance costs.	Number of entities receiving advisory services	1	1	2	3
	Number of reports completed	1	11	6	18
	Number of new laws or regulations drafted	1	1	3	1
	Number of procedures or firm-level policies recommended for improvement or elimination	1	14	6	23
	Number of workshops or training events held	1	0	5	7
	Number of participants in workshops or training events	100	0	300	40

Outcomes

Component	*Indicator*	*Baseline*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
			Target	*Result*	*Target*	*Result*
Improve tax laws, regulations, administration efficiency, and reduce compliance costs.	Number of recommended laws or regulations enacted	0	3	0	3	0
	Number of recommended procedures or firm-level policies improved or eliminated	0	3	0	6	0
	Number of firms that benefit from improved tax administration	1,266,860	0	0	1,393,546	1,266,860
	Average number of days to comply with a business regulation	39	0	0	33	39
	Average cost to comply with a business regulation (US$)	34	0	0	28	34

Highlights

- Addis Ababa University, under IFC supervision, is about to complete a large-scale survey of 1,500 businesses that analyzes both the compliance costs of taxes and taxpayers' perceptions of the tax system.
- The project team reviewed the MSME tax regime based on international good practices and made recommendations for improvements. These included revising the current threshold, reducing the compliance burden on small businesses, and replacing the current complex presumptive tax regime with a more simplified regime.
- IFC hired a consultant to review the existing tax dispute resolution system and recommend ways to reduce the burden the current system imposes on taxpayers through fair and timely dispute resolution.
- The tax team conducted a brief review of the VAT refund system and made recommendations including the use of risk scoring in VAT refund processing, accepting bank guarantees, and the need to examine the effectiveness of the VAT withholding system. When implemented, these – alongside recommendations to be made following the completion of the comprehensive review of the refund system – are expected to reduce the burden on taxpayers of the current refund system (in terms of the time it takes to process refunds and other procedural difficulties).
- The Ministry of Finance and Economic Development agreed to incorporate recommendations regarding transfer pricing into the ongoing review of primary legislation. (*Transfer pricing* refers to the determination of prices for transactions between associated parties, such as subsidiaries of a multinational company. Transfer *mispricing* arises as a result of abusive or inappropriate transfer pricing practices; for example, when transfer prices are intentionally manipulated to achieve certain outcomes.) When implemented, the recommendations are expected to make the regime more transparent and predictable. Some of the major undertakings during the reporting period are as follows:
    - IFC assisted the joint Ethiopian Revenue and Customs Authority/Ministry of Finance and Economic Development transfer-pricing taskforce in drafting the associated directive.
    - IFC explored the possibilities of harmonizing transfer pricing rules pertaining to regular income taxes with those governing mining and petroleum operation income taxes;
    - IFC assisted with the discussion and drafting of "safe harbor" rules – that is, rules exempting companies that meet certain conditions from the application of transfer pricing rules. The transfer pricing directives and safe harbor rules are expected to make the tax regime more transparent and predictable. In particular, the safe harbor rules are expected to reduce the burden on both the tax administration and eligible taxpayers.
    - As part of IFC's capacity-building program, two three-day training workshops were held with officials from the Revenue Authority and the Ministry of Finance and Economic Development.
- IFC's assessment of the tax incentive regime produced a number of recommendations. They include taking an inventory of tax incentives, estimating tax expenditures, reviewing the administration and control procedures, and providing recommendations on them. The tax team also reviewed the 2014 Draft Council of Ministers Regulation to amend investment incentives and investment areas reserved for domestic investors.
- Following a preliminary assessment, the tax team recommended a number of ways to improve the risk-based audit system, which currently experiences significant time delays. The recommendations include updating the risk-scoring criteria, upgrading the system to reflect the structural changes in the tax authority, and introducing the random selection of cases.

Risks and Challenges

There is a potential lack of client commitment, particularly given the government's competing priorities. As a result, IFC engages only where it sees a credible chance of the government implementing the agreed reforms. The team assessed this through the following mechanisms:

- Formal letters or requests from the government to IFC specifying their commitment and interest in working with us;
- A legally binding cooperation agreement; and
- Identification of a specific institutional support mechanism for the program in question.

The team will continue to set clear deadlines for all parties with regard to deliverables and will state the consequences if deadlines are missed.

Lessons Learned

The difficulty of getting the Ministry of Finance and Economic Development's full support for the overall tax simplification project has caused delays. This is because the project needs the full commitment and support of not only the Revenue Authority, but also of the Ministry of Finance and Economic Development, on such components as transfer pricing, legal review, and rationalizing tax incentives.

So far, the team has managed to secure the full support of the Ministry of Finance and Economic Development on the transfer pricing and legal review components, and efforts are being made to get its full commitment and support to work on rationalizing tax incentives. It is critical to involve all project stakeholders from the program's inception.

Next Steps

Over the next six-month period the project team will:

- Follow up and supervise the conduct and quality of the Tax Compliance Costs and Perception Survey and get it finalized according to schedule;
- Informed by the survey's findings, simplify and streamline the MSME tax regime;
- In response to the finance ministry's formal request for technical assistance in reviewing business tax laws, start providing the required support;
- Follow up the diagnostic work on the tax dispute resolution system and VAT refund system and use the results together with the outcomes of the survey to inform the legal review;
- Work on recommendations related to risk-based audits by reviewing the risk assessment criteria and introducing random case selection; and
- Follow up on the implementation of the transfer pricing–related recommendations and support the finance ministry in enacting the transfer pricing directive.

Ethiopia Trade Logistics

Project Leader	Mamo Mihretu	**Donor Partner(s)**	Canada, Italy, Sweden, United Kingdom
Start Date	January 2013	**Countries**	Ethiopia
End Date	December 2015	**IFC Project ID**	599466

Project Description

Ethiopia's economic progress is being held back by many regulatory and investment climate-related shortcomings that impede its sustained growth and productivity. A recent World Bank study on light manufacturing highlighted the local trade logistics challenge faced by businesses, particularly in the apparel sector.

Challenges such as burdensome documentation, manual clearance processes, inadequate boarder agency coordination, and onerous inspection regimes force businesses to hold larger inventory with potentially higher losses and damages. Aside from tying up precious working capital, they also need to service the debt on high interest loans.

The overall objective of the program is to streamline and simplify high priority regulations, processes, and practices that are burdensome to private businesses and address investment climate issues holding back investment and productivity growth. This will be achieved by:

- Achieving $15 million in private-sector savings due to trade logistics improvement within two years of project completion;
- Reducing the time it takes to export goods from 42 to 36 days;
- Reducing the time it takes to import goods from 44 to 38 days; and
- Reducing the documents required for export clearance from 15 to 10.

Development Results

The following tables summarize project outputs and outcomes as of June 30, 2014, including this reporting period:

Outputs

Component	*Indicator*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
		Target	*Result*	*Target*	*Result*
Trade logistics	Number of reports completed	1	13	3	19
	Number of workshops or training events held	1	2	2	4
	Number of entities receiving advisory services	1	0	2	3
	Number of procedures or firm-level policies recommended for improvement or elimination	100	13	20	36
	Number of new laws or regulations drafted	2	6	3	6

Outcomes

Component	*Indicator*	*Baseline*	*Current Period (Jan-June 2014)*		*Cumulative for the entire project*	
			Target	*Result*	*Target*	*Result*
Trade logistics	Average number of days to comply with business regulation	44	0	44	38	44
	Number of entities that implemented recommended changes	0	1	1	2	2
	Number of recommended laws or regulations enacted or adopted	0	1	3	2	3
	Number of documents required to trade (export)	11	0	10	10	10
	Number of documents required for trade (imports)	25	0	24	15	24
	Average number of days to comply with export regulation	42	0	0	36	42
	Percentage of cargo inspected by border clearance agencies	94	0	0	74	94

Highlights

- The government issued a new customs proclamation. IFC had been involved in reviewing and commenting on the draft versions, taking into consideration current international principles of customs procedures and administrations. This ensured the new customs proclamation is, to a large extent, in line with the Revised Kyoto Convention (RKC). In particular, the law's declaration and clearance provisions, which are the most important from a trade facilitation perspective, were directly based on the RKC. The new proclamation provides the legal basis for developing a modern customs administration with strong enforcement powers that focus on clearance as opposed to control. Among other things, these reforms:
  - Provide a legal basis for authorized traders to use simplified customs procedures;
  - Introduce the concept of pre-arrival clearance;
  - Allow certain traders to defer payments; and
  - Prescribe clearly defined appeal mechanisms.
- IFC continued to advise on the use and application of risk management principles for import cargos. The Ethiopian Revenue and Customs Authority has started implementing some of these principles in its own risk management system, the goal being to lower the number of days traders generally need to comply with import regulations. Following a partial implementation, the percentage of cargo inspected at the border has decreased from 57.2 percent to 50.55 percent.
- Similarly, with IFC's support, the Revenue Authority employed risk management principles when crafting its new Directive No. 96/2014 on Customs Clearance for Incoming Passengers. The Revenue Authority reported a significant improvement in passenger movement through the airport resulting from a new "red channel/green channel" process.
- In collaboration with the Revenue Authority and the Investment Climate Facility for Africa, IFC has begun implementing an electronic single window (ESW) for international trade in Ethiopia. The government projects an estimated cost saving of about $800 million within five years of implementation.
- IFC helped finalize a memorandum of understanding that defines the role and responsibilities of key ESW stakeholders. Relevant border agencies and ministries that are members of the steering committee have finally signed the memorandum, which will significantly improve inter-agency coordination.
- As part of the ESW project, IFC conducted an extensive review of existing import and export procedures and data requirements. Based on this review, the following documents were completed:
  - An analysis of business processes and data requirements;
  - Functional and technical website architecture for the ESW;
  - A change management and communication plan; and
  - A report on data harmonization.
- IFC finalized its assessment of the Ethiopian legal framework's readiness for launching the ESW.
- IFC also reviewed draft laws relevant to electronic commerce, and the laws have been revised accordingly.

Risks and Challenges

The successful implementation of an information technology project on the scale of a national electronic single window requires individuals with excellent management, leadership skills, and experience. In this context, the limited capacity of the Revenue Authority could pose a challenge. Although the Revenue Authority is recruiting a project team that will facilitate and coordinate the rollout of the electronic single window, there have been significant delays in this process.

In January the project team learned of a Ministry of Transport initiative to develop a national logistics management system. This initiative was initially outsourced to the Information Network Security Agency (INSA) with the understanding that it would develop a system for managing, monitoring, and accessing information on goods, vehicles, and information. However, the INSA team expanded the scope of the assignment – thus creating the risk that certain features and functions may overlap with the electronic single window IFC is implementing. However, it should be noted that INSA's failure to conduct a proper business-process reengineering plan, or to consult international best practice, means the national logistics management system is not a suitable replacement for the electronic single window in the areas of potential overlap.

Lessons Learned

- While it was a remarkable success to collaborate with both the Revenue Authority and the Investment Climate Facility for Africa on the electronic single window, it was also a challenge because the Facility set its own timeline for procuring software. At times this was pursued at a pace that could have compromised the quality of the final deliverable (the electronic single window). However, the project team was able to convince all parties involved of the importance of first developing a business re-engineering process that will ensure the project's success.
- Implementing a national electronic single window requires a high level of commitment – not just from the Revenue Authority, but also from others stakeholders that are equally important to the initiative. Since this process does not aim merely to automate an otherwise manual process, it requires a significant level of process re-engineering as well as data harmonization. This is achievable only if all key actors show sufficient levels of commitment. As a preliminary legal review revealed, the issuance of a regulation establishing the electronic single window is crucial to enhancing the level of cooperation and commitment required from the various stakeholders. The client continues to have a considerable level of staff turnover that impedes the pace and scope of reforms.
- Although key agencies involved in the electronic single window project have shown commitment, they tend to regard it as something that will solve all trade logistics issues. It is therefore imperative to manage these agencies' expectations as well as those of other stakeholders.

Next Steps

Over the next six-month period the project team will:

- Provide quality-assurance support to the Revenue Authority as it seeks to procure a vendor that will meet the technical and functional specifications of the electronic single window;
- Advising on draft laws, regulations, and memorandums of understanding that may be needed for the effective implementation of the electronic single window;
- Continue to support the implementation of the recommendations that came out of the risk management review, both for cargo and passenger goods;
- Assist the Risk Management Directorate of the Revenue Authority in finalizing the compliance management strategy in line with accepted international risk management principles;
- Assist with efforts to simplify the transit regime; and
- Support the implementation of a new customs proclamation expected to be issued shortly.

Financial Report

The Ethiopia Private Sector Development Trust Fund (TF071999) is a multi-donor trust fund that was created on March 26, 2013, with Canada, Italy, Sweden, and the United Kingdom as donors. As of June 30, 2014, these donors had committed a total of $10.5 million and disbursed $6.03 million.

Donor Cash Flow Statement (cumulative, up to the reporting date)	From Inception $	Item
Funds Committed by the donor(s)		
Canada - Department of Foreign Affairs, Trade and Development	4,703,005	
Italy - Ministry of Foreign Affairs	1,238,985	
Swedish International Development Cooperation Agency (SIDA)	1,756,618	
United Kingdom - Department for International Development (DFID)	2,807,521	
Total Funds Committed	**10,506,129**	(1)
Funds received from the donor(s)		
Canada - Department of Foreign Affairs, Trade and Development	2,534,615	
Italy - Ministry of Foreign Affairs	1,232,010	
Swedish International Development Cooperation Agency (SIDA)	935,702	
United Kingdom - Department for International Development (DFID)	1,329,662	
Total Funds Received	**6,031,988**	(2)
TF Admin fee deduction	(301,599)	(3)
Investment Income	14,490	(4)
Other Income		(5)
Total Funds Available	**5,744,879**	(6) = (2)+(3)+(4)+(5)
Total Expenditures	2,279,893	(7)
Donor Funds Balance at the end of the reporting period	**3,464,986**	(8) = (6) - (7)
Outstanding donor commitments	**4,474,141**	(9) = (1) - (2)