COUNTRY FOCUS REPORT 2026

ETHIOPIA

Mobilizing Ethiopia's Development Financing at Scale in a Fragmented World



AFRICAN DEVELOPMENT BANK GROUP

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AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

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ABBREVIATIONS AND ACRONYMS

AfCFTA	African Continental Free Trade Area
AfDB	African Development Bank
AGOA	African growth Opportunity Act
AML/CFT	Anti Money Laundering / Combating the Financing of Terrorism
API / APIs	Application Programming Interface(s)
BEPS	Base Erosion and Profit Shifting
CBE	Commercial Bank of Ethiopia
COMESA	Common Market for Eastern and Southern Africa
CoP	Conference of the Parties (as in CoP 32)
CRGE	Climate Resilient Green Economy
DBE	Development Bank of Ethiopia
DFI / DFIs	Development Finance Institution(s)
DSA	Debt Sustainability Analysis
EAC	East African Community
EIB	European Investment Bank
ESG	Environmental, Social, and Governance
ESX	Ethiopian Securities Exchange
EthSwitch	Ethiopia's National Payment Switch
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FY	Financial Year
FX	Foreign Exchange
GDP	Gross Domestic Product
GoE	Government of Ethiopia
GGGI	Global Green Growth Institute
HGER	Home Grown Economic Reforms
IFC	International Finance Corporation
IGAD	Intergovernmental Authority on Development
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
KYC	Know Your Customer
LTO	Large Taxpayers Office
MDBs	Multilateral Development Banks

MFIs	Micro Financial Institutions (MFIs)
MAT	Minimum Alternative Tax (MAT)
MSME /MSMEs	Micro, Small, and Medium Sized Enterprise(s)
MRV	Monitoring, Reporting, and Verification
NDCs	Nationally Determined Contributions
NBE	National Bank of Ethiopia
ODA	Official Development Assistance
PFM	Public Financial Management
PPPs	Public Private Partnerships
SME / SMEs	Small and Medium Sized Enterprise(s)
SOE	State-Owned Enterprise
SDGs	Sustainable Development Goals
SWIFT	Society for Worldwide Interbank Financial Telecommunication
T bill	Treasury Bill
TYDP	Ten-Year Development Plan
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
WASH	Water, Sanitation, and Hygiene
WBG	World Bank Group
WTO	World Trade Organization

EXECUTIVE SUMMARY

Ethiopia's economy rebounded strongly, growing by 9.8% in FY2024/25, supported by industrial recovery, export expansion, easing inflation, and renewed external inflows. Fiscal and external balances improved markedly, with the deficit narrowing to about 1.6% of gross domestic product (GDP) and the current account close to balance. Reforms under Home-Grown Economic Reform 2.0, including exchange-rate liberalization and a transition toward interest-rate-based monetary policy, strengthened credibility. Yet vulnerabilities remain acute: debt distress persists, foreign-exchange buffers are thin, inflation remains elevated, and structural rigidities, conflict risks, climate shocks, and State-Owned Enterprise (SOE)-related fiscal pressures continue to constrain resilience, inclusion, and private-sector confidence.

Mobilizing development finance at scale is therefore less about new instruments than about credibility, sequencing, and execution. Completing debt restructuring under the G20 Common Framework is foundational to restoring confidence and lowering country risk. On this basis, domestic resource mobilization (DRM) must shift from episodic measures toward broadening tax bases, strengthening compliance, improving efficiency, and deepening public financial management. External financing should then play a catalytic role through multilateral development bank (MDB)-anchored budget support, blended finance, and carefully structured public, private partnership (PPP) platforms, once foreign-exchange risk, SOE liabilities, and contingent fiscal exposures are transparently managed. Public financial management (PFM) reforms are central to converting revenues and financing into results. Digital systems, integrated financial management information systems (IFMIS), treasury single accounts, and procurement reforms have improved control and transparency, but execution gaps remain, especially at subnational levels and in SOE oversight. Closing efficiency gaps can generate fiscal savings, improve budget credibility, and reallocate spending toward growth-enhancing infrastructure and social services, while reducing debt pressures.

Ethiopia's financial system remains bank-dominated and shallow, limiting long-term finance and risk sharing. A sequenced agenda, anchored in macro-financial stability, capital-market development, prudent liberalization, and regional payment integration is required to mobilize pensions, diaspora savings, and institutional capital without recreating instability. Digital finance should evolve from transactional inclusion to productive, risk-bearing services. Overall, stabilization first, mobilization second, and scaling last. If governance, delivery capacity, and policy predictability improve, Ethiopia can leverage the African Continental Free Trade Area (AfCFTA) integration, diaspora capital, natural assets, and MDB partnerships to crowd in long-term private finance and sustain inclusive, resilient growth nationwide sustainably.

GENERAL INTRODUCTION

Ethiopia is the 9th largest economy in Africa (nominal GDP), but a low-income country (with a low GDP per capita) characterized by limited structural transformation and economic diversification. With gross national income (GNI) per capita of US$1,144, growth remains robust, though it has slightly slowed down since 2019, due to mounting macroeconomic imbalances. After several years marked by conflict, climate shocks, macroeconomic imbalances, and external constraints, the economy has shown renewed momentum alongside cautious stabilization. Despite the recent gains, deep vulnerabilities persist, including macro imbalances such as high debt vulnerabilities, and pronounced structural constraints, particularly large infrastructure gaps, which are partly attributed to limited long-term development financing.

The purpose of this Country Focus Report (CFR) is to assess Ethiopia's macroeconomic performance and identify policy options to strengthen development financing for sustainable and inclusive growth. The report is aligned with the African Economic Outlook 2026 theme: "Mobilizing Africa's Development Financing at Scale in a Fragmented World," which underscores the urgency for African countries, including Ethiopia, to scale up innovative, diversified, and resilient financing mechanisms in an increasingly uncertain global environment marked by geopolitical tensions, tightening financial conditions, and fragmented capital flows.

The report identifies binding constraints, assesses financing gaps, and articulates priority reforms and policy actions to accelerate the mobilization of development financing in Ethiopia. The report also assesses Ethiopia's potential to close its development financing gap, focusing on a prioritized set of high-impact levers such as strengthening revenue systems, improving public financial management (PFM), deepening financial markets, and mobilizing private and non-traditional sources of finance. It concludes by examining the need to strengthen and modernize Ethiopia's financial architecture in a weakening global environment marked by tightening financial conditions. The approach used to develop the CFR combines both quantitative and qualitative methodologies. It relies on both desk analysis of secondary macroeconomic data as well as consultations with key stakeholders. This approach ensures that the report provides a balanced, evidence-based assessment of the country's economic landscape and financing options.

At the core of the CFR is a central analytical question: how can Ethiopia mobilize and effectively manage development finance at scale to address its macroeconomic vulnerabilities and achieve resilient, inclusive growth in a fragmented global system? This question guides the analysis of the domestic and external financing strategies to inform policy decisions and support Ethiopia's long-term development objective.

1 ECONOMIC PERFORMANCE AND OUTLOOK

KEY MESSAGES

- Ethiopia's economy recorded improved performance in 2025 despite multiple overlapping shocks over the past few years. Accordingly, the economy recorded a growth of 9.8% in 2024/25, up from 7.6% in 2023/24.
- Macroeconomic fundamentals are improving due to recent economic reforms. Inflation declined due to a prudent monetary policy, fiscal deficit narrowed with the aid of revenue growth, and the current account deficit dropped sharply supported by a surge in export revenue. The financial sector is stable but is primarily state-owned and dominated by the banking sector.
- To achieve sustainable macro stability, Ethiopia must tackle its deep macroeconomic imbalances, structural rigidities, and poor public service delivery (weak governance) to place the economy on a more resilient and sustainable growth path.

1.1 Introduction

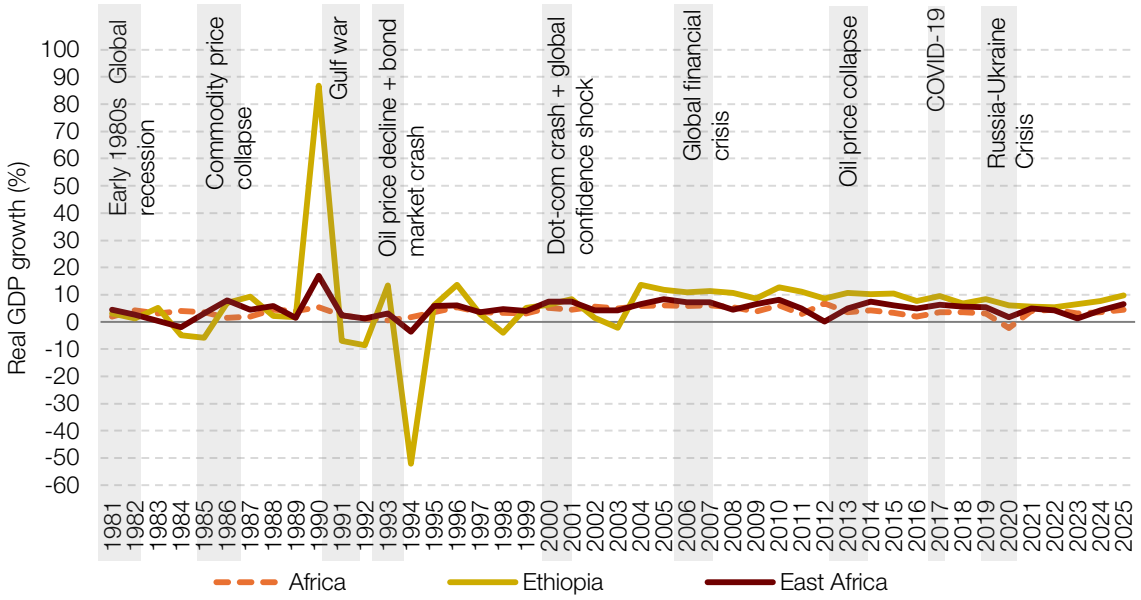
This chapter presents Ethiopia's recent economic performance and growth projections for 2026 and 2027. It discusses the main downside risks and upside triggers to the outlook. The chapter assesses macroeconomic trends including fiscal deficit, inflation, public debt, and the external sector. The chapter provides policy options to foster high and resilient growth, support macroeconomic stability and economic transformation, and deal with shocks that have continued to impact Ethiopia's economy. The chapter concludes with policy options to address the macroeconomic imbalances and how to address Ethiopia's current macroeconomic stability and growth.

1.2 Growth Performance

Ethiopia's economy recorded improved and steady performance over the past two decades despite multiple overlapping shocks in the recent past as shown in Figure 1. Ethiopia's economy grew by 9.8% in 2024/25, up from 7.6% in 2023/24 as shown in Table 1 despite multiple overlapping shocks over the past few years, including lingering macroeconomic imbalances, drought across much of the eastern and southern regions, spillover effects from global shocks (such as global conflicts and allied oil/commodity price hikes), and civil conflicts in the Tigray, Amhara, and Oromia regions. Growth in 2024/25 was led by the industry sector, which contributed 42.9% of overall growth and expanded by 13%, up from 9.2% in 2023/24, driven by recovery in mining, electricity, water, and manufacturing, and construction sectors. Services contributed 32.5% of overall growth and expanded by 7.5% in 2024/25. Agriculture expanded by 7.3%, accounting for 25.1% of GDP growth in 2024/25, driven primarily by an expansion in large-scale commercial irrigated farming, the promotion of cluster farming, and improved agricultural technology. The mining sector surged by 205.4% in 2024/25, up from

18.4% in 2023/24, aided by the formalization of artisanal mining, improved marketing systems, simplified licensing, tax incentives for investors, and stronger measures against illegal mining. The manufacturing sector recovered, growing by 10.3% in 2024/25 compared to 8.4% in 2023/24, primarily due to improved access to foreign exchange and credit, tax incentives, import-substitution, and export-promoting efforts. This notwithstanding, manufacturing's share of industry remained modest at 4.41% in 2024/25. Overall, agriculture, industry, and services contributed 31.3%, 30.2%, and 39.6% of GDP, respectively, in 2024/25. On the demand side, growth was primarily driven by private consumption and investment.

Figure 1 : Historical growth trends 1980-2025 and impacts of external shocks



Source: AfDB, Statistics Department, and IMF

1.3 Other Recent Macroeconomic and Social Developments

1.3.1 Monetary Policy, Inflation, and Exchange Rate

Ethiopia transitioned to an interest-rate-based monetary policy framework (and a floating exchange rate regime) in August 2024, away from a monetary aggregate-targeting framework, to ensure low and stable inflation. Inflation declined to 16% in 2024/25 from a peak of 33.8% in 2022/23, and 26.6% in 2023/24, owing to the government's adherence to a concessional monetary framework, easing food price inflation (particularly staples), and the impact of the cap on credit growth. The authorities raised the credit growth target for FY 2025/26 from 18% to 24%, cautioning that full removal of the credit ceiling would be premature. The decision to maintain interest rates and only moderately ease credit growth is seen as a cautious move to preserve disinflation gains. With the introduction of a floating exchange rate regime, foreign exchange (FX) availability has also improved.

1.3.2 Financial Sector

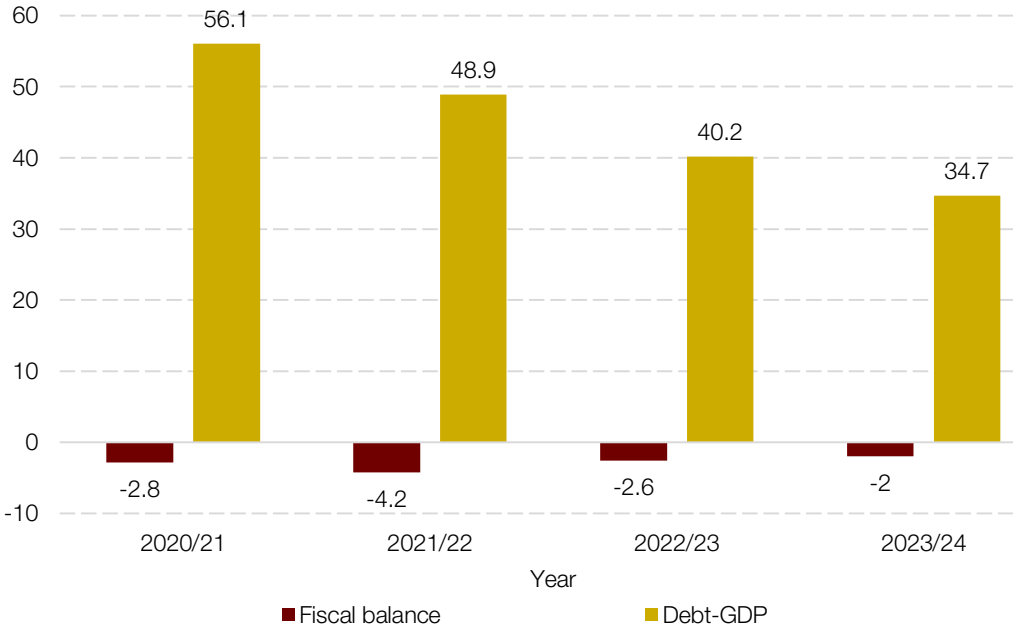
The financial sector is stable but primarily state-owned and dominated by the banking sector. Commercial banks and Micro Finance Institutions (MFIs) hold nearly 99% of total financial assets. The banking sector is highly concentrated, with the state-owned Commercial Bank of Ethiopia holding 51% of assets (five times more than the next largest bank). The financial sector includes 32 commercial banks (two of which are state-owned), 58 MFIs, 18 insurance companies (one state-owned), 6 leasing companies, 18 system operators, and 13 foreign exchange (FX) bureaus. Recently, the Government of Ethiopia (GoE) opened the banking sector to international competition and established the Ethiopian Securities Exchange. The country's fintech market is just developing

and mainly provides digital payment services. Overall, the financial industry is stable, with only 4.3% non-performing loans (NPLs), a figure well below the 5.0% regulatory requirement.

1.3.3 Fiscal Policy and Public Debt

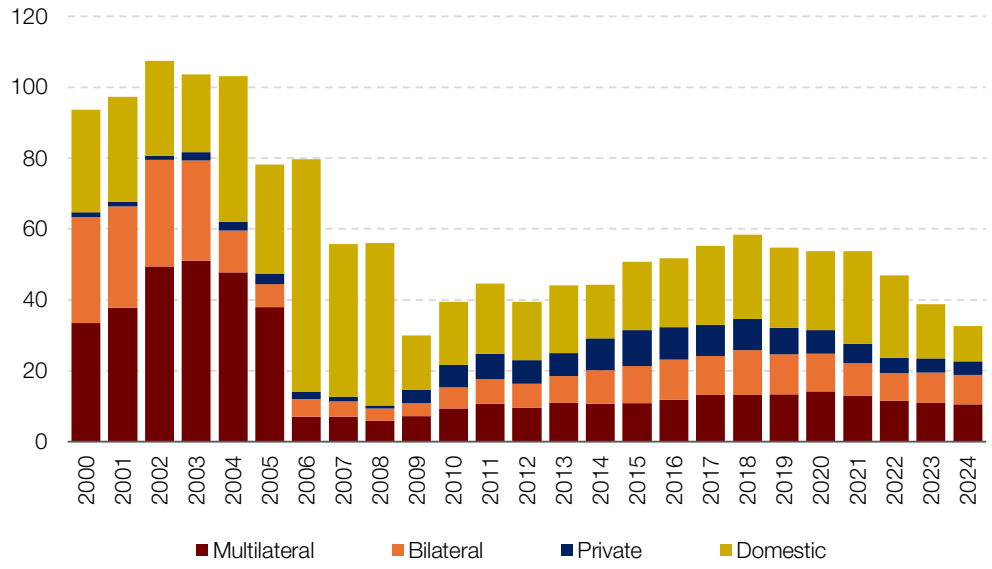
The fiscal deficit, including grants, narrowed to 1.6% of GDP in 2024/25, down from 2.0% of GDP in 2023/24 due to improved revenue as shown in Figure 2. Revenue grew by 77.1% in 2024/25 (tax revenue by 61.9% and non-tax revenue by 64.7%), while public spending increased at a lower rate of 57.5%, a key factor in slowing the fiscal deficit. Tax revenue grew by 61.9% in 2024/25 compared to 22.0% in 2023/24. Consequently, the tax-to-GDP ratio increased to 7.8% of GDP in 2024/25 compared to 6.2% in 2023/24, owing to a combination of tax policy reforms (i.e., a surtax on imports and excise duties on telecom services), administrative reforms, alongside macroeconomic recovery. Ethiopia's total public and publicly guaranteed debt stood at US$71.34 billion (approximately 34.8% of GDP), with external debt accounting for US$31.3 billion (15.5% of GDP). However, all the debt components (Multilateral, Bilateral, Private and Domestic have been on the decline between 2018-2024 as shown in Figure 3. It is notable that debt service takes up about a third of the annual GDP, as shown in Figure 4. External debt servicing accounts for about 15% of government revenues between 2020-2023, as shown in Figure 4. Again, it is likely that interest payments on debt negatively affect the expenditure on on social sectors such as health, as is depicted in Figure 5. Moreover, Ethiopia's debt is assessed as unsustainable, and the country remains in debt distress. Nevertheless, efforts to secure debt treatment and restore debt sustainability continue to make progress. Ethiopia agreed to a Memorandum of Understanding (MoU) on key terms for a debt treatment with the Official Creditor Committee under the G20 Common Framework in July 2025, and with the Ad-hoc Committee of Eurobond holders in January 2026. The next step is to reach bilateral agreements with these creditors. The relationship between its debt-to-GDP ratio and worker productivity in Ethiopia is defined by a "crowding out" effect: high debt burdens limit fiscal space for education, healthcare, and infrastructure, which historically depresses human capital development and slows labor productivity growth, as shown in Figure 6.

Figure 2 : Trends in Fiscal Balance and Public Debt in Ethiopia (2020-2024)



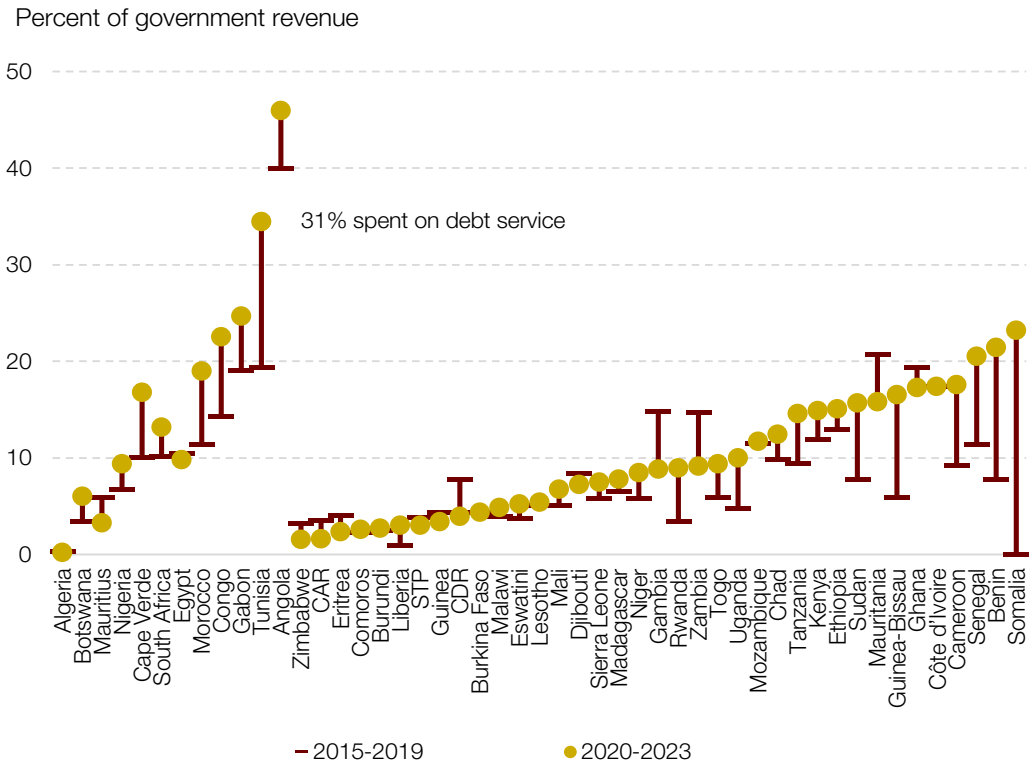
Source: IMF and Ethiopian Authorities calculations on Public Debt (2026), & AfDB Fiscal Balance Data (2026)

Figure 3 : Gross debt and decomposition by creditor type, 2000-24 (% of GDP)



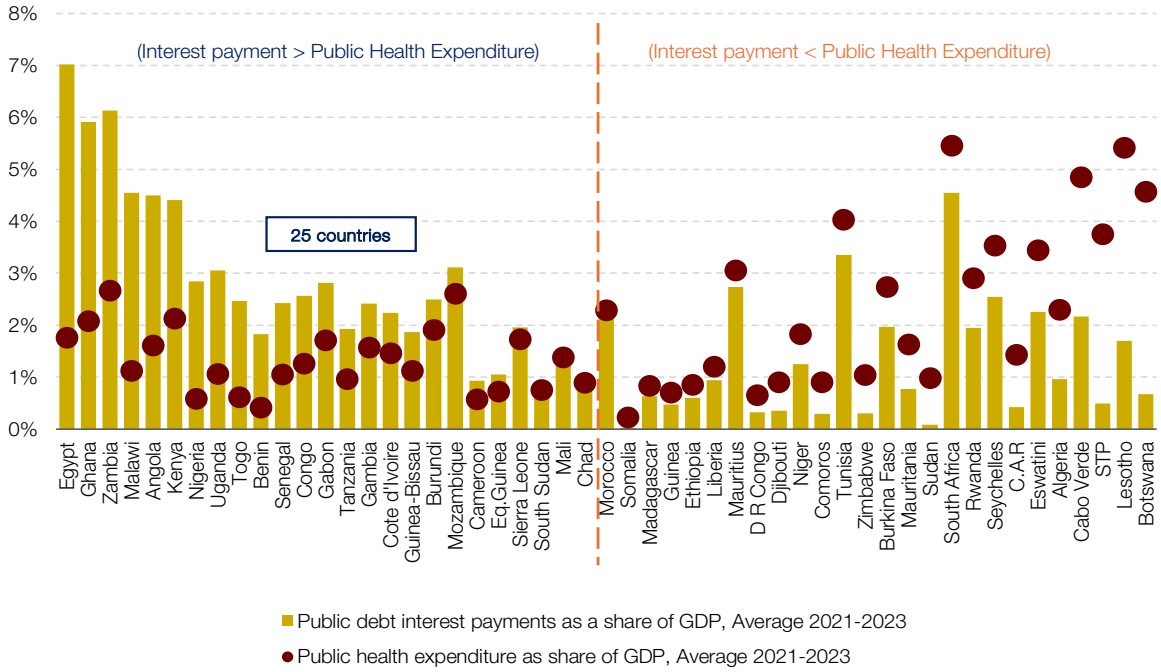
Source: Staff calculations based on data from IMF World Economic Outlook database and International Debt Statistics database
Note: Domestic debt is calculated as the difference between gross public debt (IMF WEO) and external public and publicly guaranteed (PPG) debt. External PPG debt is defined as the sum of bilateral, multilateral, and private external debt.

Figure 4 : Debt service on external debt in Africa, 2015–23



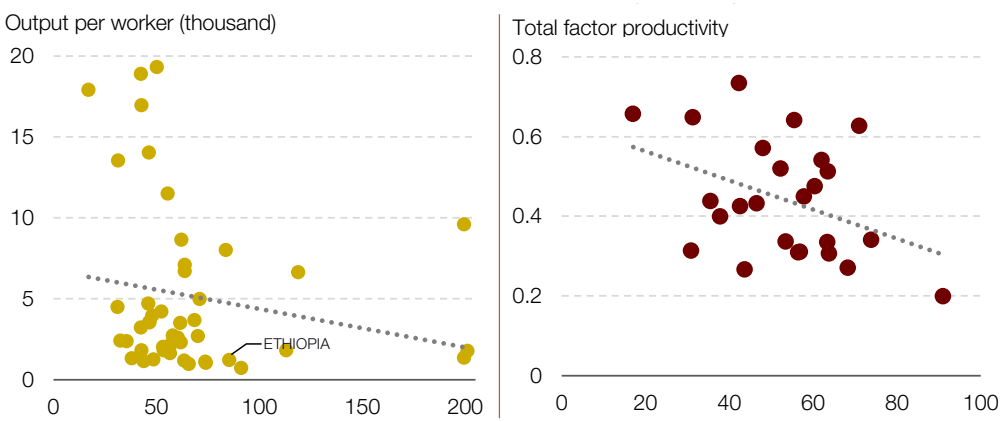
Source: Staff calculations using data from World Bank International Debt Statistics

Figure 5 : Interest payments on public debt and health expenditure, 2021–23



Source: UNCTAD, A World of Debt Database (2025).

Figure 6 : Debt-GDP and productivity relationship in Africa (1990-2024)



Source: Staff calculations based on data from Penn World Tables, the International Labour Organization, and World Economic Outlook

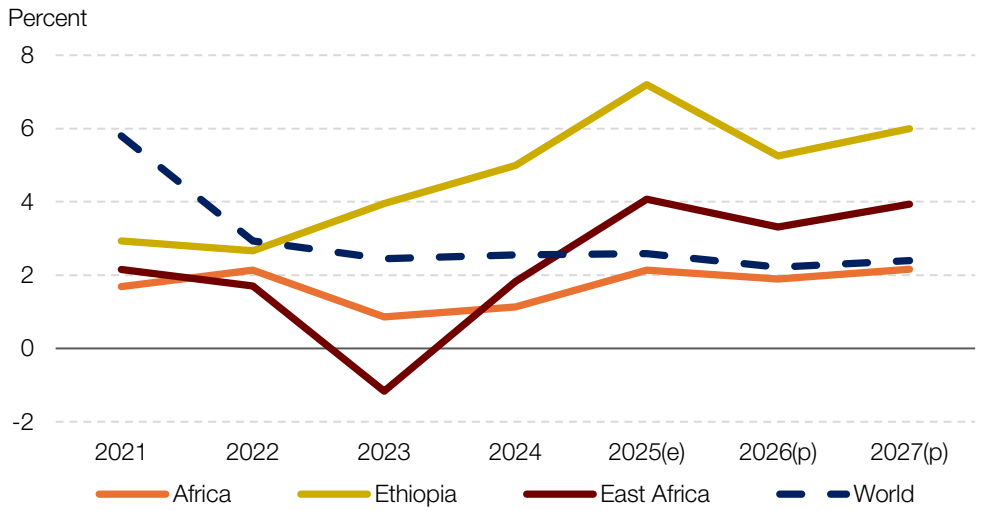
1.3.4 External Position and External Financial Flows

Ethiopia's current account deficit narrowed sharply to 0.2% of GDP in 2024/25 (from 2.9% of GDP in 2023/2024), mainly due to a surge in export revenue, which grew by 119%, thereby improving the trade balance by 28.5%. Export gains were led by gold, electricity, coffee, and live animals, supported by higher global prices and improved competitiveness following the shift to a floating exchange rate in mid-2024, which also helped reduce the foreign exchange (FX) premium and curb contraband activities. Imports rose slightly, driven by currency depreciation as well as higher food and fuel prices. Several export items underperformed, including khat, pulses, leather products, oilseeds, and textiles, due to lower global prices, a suspension of the African Growth Opportunity Act (AGOA), and domestic logistical disruptions. Remittances (+13.5%) and net official transfers (+61.6%) increased, while net services grew modestly (+1.9%), helping to partially finance the current account.

1.3.5 Social Developments

Poverty, inequality, and unemployment remain high in Ethiopia, exacerbated by ongoing internal conflict. The 2024 Multidimensional Poverty Index indicates that 68.7% of Ethiopia's population is multidimensionally poor, with acute deprivations in nutrition, child survival, and access to basic services. Unemployment remains elevated at 8%, with youth unemployment at 23.1%, reflecting skills mismatches, limited formal job creation, and widespread informality. Urban unemployment stands at 19.2% and disproportionately affects women relative to men. Income inequality is moderate due to real GDP per Capita growth above the regional average, as shown in Figure 7. The Gini Index rose from 28 in 2011 to 31.1 in 2021. These developments constrain inclusive growth and heighten vulnerability, requiring coordinated policy measures to expand employment and strengthen social protection systems.

Figure 7 : Real GDP per Capita Growth (2021-2027)



Source: African Development Bank Statistics, World Economics Outlook. October 2025, United Nations Population Division estimates

Table 1 : Key Macroeconomic Indicators

Key Indicators	2020/21	2021/22	2022/23	2023/24	2024/25 (e)	2025/26 (p)	2026/27 (p)
Real GDP Growth	5.6	5.3	6.6	7.6	9.8	7.0	8.5
Real GDP Growth per Capita	2.9	2.7	4.0	5.0	7.2	4.5	6.0
Inflation	20.2	33.8	32.5	26.6	15.8	14.7	8.7
Fiscal Balance, Including Grants (% GDP)	-2.8	-4.2	-2.6	-2.0	-1.7	-2.5	-2.1
Current Account (% GDP)	-2.8	-4.0	-2.9	-2.9	-0.2	-1.3	-1.2
Total Population (Million)	101.9	104.1	105.7	108.4	110.6	112.8	115.0
Life expectancy/Years	65.3	66.9	67.3	68.1	68.4	70.0	71.6

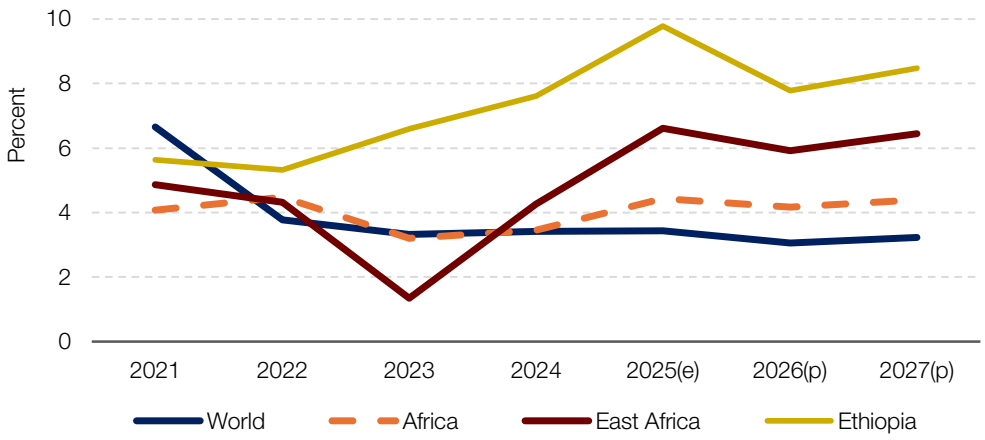
Source: Data from Domestic authorities; estimates (e) and predictions (p) based on authors' calculations. AfDB Statistics Department, April 2026
*Note: *Data in fiscal year 08 July (n-1)/ 07 July (n)*

1.4 Macroeconomic Outlook and Risks

1.4.1 Outlook

Growth is projected to remain robust at 7.0% in 2025/26, albeit against a backdrop of risks arising from social tensions and security challenges. Against expectations of progress in reforms, the resumption of external financing, and improved domestic stability, growth is projected to remain steady at 8.5% in 2026/27 as shown in Figure 8. Inflation is projected to decline to 14.7% in 2025/26 and 8.7% in 2026/27, driven by continued prudent monetary policy. The fiscal deficit is projected to widen to 2.5% of GDP in 2025/26, driven by rising debt-service costs, security and crisis-response spending, and a weak tax administration. The deficit is expected to slightly ease to -2.1% of GDP in 2026/27, supported by fiscal consolidation, improved tax collection, and debt relief under the G20 Common Framework. The current account deficit is projected to be -1.3% of GDP in 2025/26 and -1.2% in 2026/27, as the import bill will remain subdued due to a slowdown in public investment, and as merchandise and services exports expand.

Figure 8 : Real GDP Growth Outlook (2021-2027)



Source: African Development Bank Statistics, World Economics Outlook. April 2026,
Note::e-estimated; p-projected

1.4.2 Risks

Ethiopia faces significant downside risks from climate shocks, escalating conflicts in Amhara and Oromia, renewed tensions in Tigray, diplomatic frictions with Somalia over Somaliland, and commodity price volatility linked to the Middle East conflict, as highlighted in Box 1. Structural rigidities and cross-border spillovers may further undermine stability. Ensuring fiscal sustainability through 2026/27 requires carefully balancing reforms with fiscal pressures by strengthening revenue mobilization, managing rising debt and foreign exchange risks, rationalizing spending and subsidies, improving public financial management (PFM), deepening financial markets, and attracting investment. Given capacity constraints and an unconducive business environment, addressing supply-side bottlenecks is critical to effective reform implementation.

Box 1 : Impact of the Middle East Conflict on Ethiopia

Ethiopia is not directly involved in the Middle East conflict, but its economy is highly exposed through trade routes, energy imports, remittances, and labor migration. Over 90 % of international trade transits Djibouti, making disruptions in the Red Sea and Bab el Mandeb Strait severe risks. Conflict-driven shipping delays, rerouting, and higher insurance costs raise prices of fuel, food, and fertilizers, intensifying inflation and macroeconomic vulnerability. Ethiopia imports nearly all fuel and over 90% of nitrogen fertilizer from the Gulf states, exposing food security to supply shocks. Gulf states are also key trade, investment, export, and remittance partners. Higher oil prices are rapidly transmitted through transport, logistics, and manufacturing, thereby widening fiscal and current account pressures. A major oil price spike could raise inflation by around three percentage points and significantly increase the import bill. Aviation disruptions and reduced remittances add further stress. Under a contained conflict, impacts are moderate and temporary; prolonged or escalating conflict risks severe shortages, reserve depletion, and macroeconomic reversal. For AfDB, heightened risks reinforce priorities on energy transition, resilience, fiscal stabilization, contingency planning, and strengthened policy dialogue.

1.5 Policy Options to Accelerate Ethiopia's Economic Development

Ethiopia must tackle its deep macroeconomic imbalances, structural rigidities, and weak public service delivery (reflecting governance challenges) to place the economy on a more resilient and sustainable growth path. As the country transitions to a floating exchange rate regime, building adequate foreign-exchange reserves is essential to protect the economy from external shocks and currency volatility. Strengthening official remittance channels and diversifying the export base beyond primary commodities will be critical. Expanding light manufacturing, agro-processing, and tourism, supported by reliable infrastructure such as electricity, water, and efficient logistics, can broaden export capacity and create more stable sources of foreign earnings. Greater regional integration and a more dynamic private sector also offer invaluable opportunities for competitiveness and market expansion. Improving the business climate is vital. Streamlining customs procedures, reducing administrative bottlenecks, and enhancing trade logistics will help ease trade costs and improve productivity. At the same time, deepening financial markets through the development of currency trading platforms and hedging tools—will allow firms to manage exchange rate risks more effectively. Building on the ongoing capital market reforms and the opening of the banking sector to foreign participation, the Government of Ethiopia (GoE) can attract both domestic and international investment, boost competition, and support job creation. Together, these measures will enhance revenue mobilization, reduce pressure on public expenditure, and strengthen Ethiopia's capacity to manage public debt vulnerabilities.

2 MOBILIZING ETHIOPIA'S DEVELOPMENT FINANCING AT SCALE IN A FRAGMENTED WORLD

KEY MESSAGES

- Ethiopia faces a large development financing gap driven by ambitious SDG, climate, and structural transformation needs, against weak domestic revenues and shallow capital markets. Financing flows remain fragmented and insufficient, with limited intermediation of remittances and external inflows into productive investment.

- The main constraint is weak macroeconomic credibility, reflecting unresolved debt restructuring, FX shortages, inflation, and rising SOE risks. Although HGER 2.0 reforms have advanced exchange rate, disinflation, and PFM improvements, implementation gaps continue to limit investor confidence and capital inflows.

- Scaling finance requires sequenced reforms: completing debt restructuring, strengthening tax-base broadening and compliance, and improving PFM efficiency in the immediate term. This should enable MDB-anchored blended finance, PPP pipelines, AfCFTA platforms, and deeper financial markets to mobilize long-term and catalytic capital.

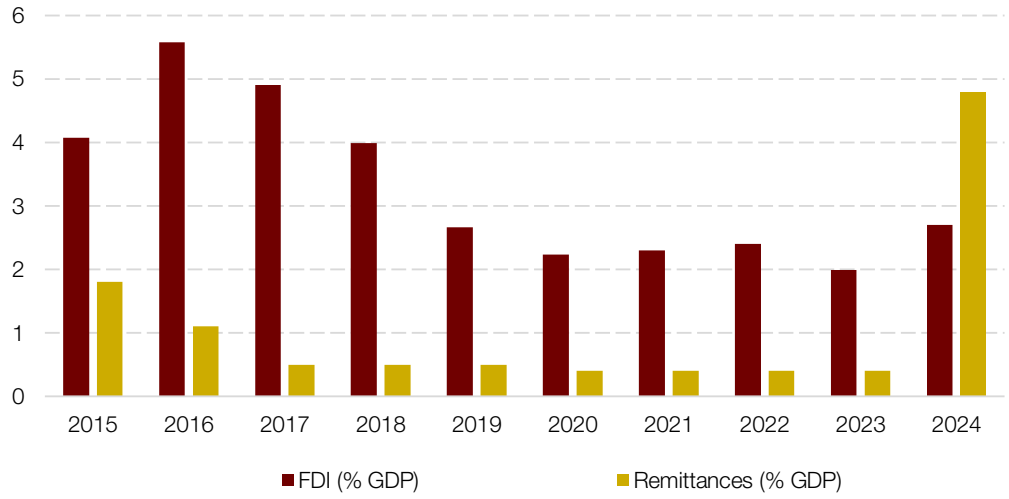
2.1 Introduction

Ethiopia's development financing landscape is constrained by unsustainable external debt, delayed restructuring, and persistent foreign-exchange shortages within a fragmented global financial system. These binding constraints are further compounded by low domestic revenue mobilization, reflected in a weak tax-to-GDP ratio rooted in structural weaknesses in tax administration, which significantly limits fiscal space. Nascent capital markets and FX scarcity further restrict access to long-term and external finance, undermining investor confidence. Additional barriers include weak PPP execution, limited carbon market readiness, concentrated exports, fragile remittance intermediation, and localized conflict, all of which elevate country risk but remain secondary to credibility constraints. Mobilizing finance at scale therefore requires restoring macroeconomic credibility by completing debt restructuring and advancing the Home-Grown Economic Reform agenda (HGER 2.0). On this foundation, Ethiopia must strengthen domestic resource mobilization (DRM) through tax-base broadening, compliance, and efficiency reforms supported by stronger public financial management (PFM). External finance should therefore play a catalytic role, with MDB-anchored blended finance, public private partnerships (PPPs), and the African Continental Free Trade Area (AfCFTA)-aligned platforms deployed effectively.

2.2 Quantifying Ethiopia's Development Financing Needs

Ethiopia faces substantial financing needs as it targets a tax-to-GDP ratio of 15%, the level typically required to achieve the objectives and stipulated targets of the UN Sustainable Development Goals (SDGs). Ethiopia must mobilize US$608 billion by 2030 and about US$5 billion annually between 2025 and 2050 to implement its Long-term Low Emissions Development Strategy (LT-LEDS), while additional financing equivalent to 13.2% of GDP is required annually to support structural transformation, despite fluctuating inflows (see Figure 2). The Ten-Year Development Plan highlights large, interconnected investment needs across productive, social, climate, and infrastructure sectors. Agriculture dominates the US$316 billion Nationally Determined Contributions (NDC) financing requirement and accounts for 75% of emissions. Energy, transport, logistics, water, sanitation and hygiene (WASH), manufacturing, mining, and human development sectors also face multibillion-dollar gaps. Despite these pressures, the fiscal deficit narrowed to 1.6% of GDP in 2024/25, supported by strong revenue and foreign assistance growth.

Figure 9 : Ethiopia FDI and Remittances (% GDP) 2015-2024



Source: World Bank Data (2025)

2.3 Mobilizing Fiscal Resources at Scale: Expanding Fiscal Space and Efficiency in Public Revenue

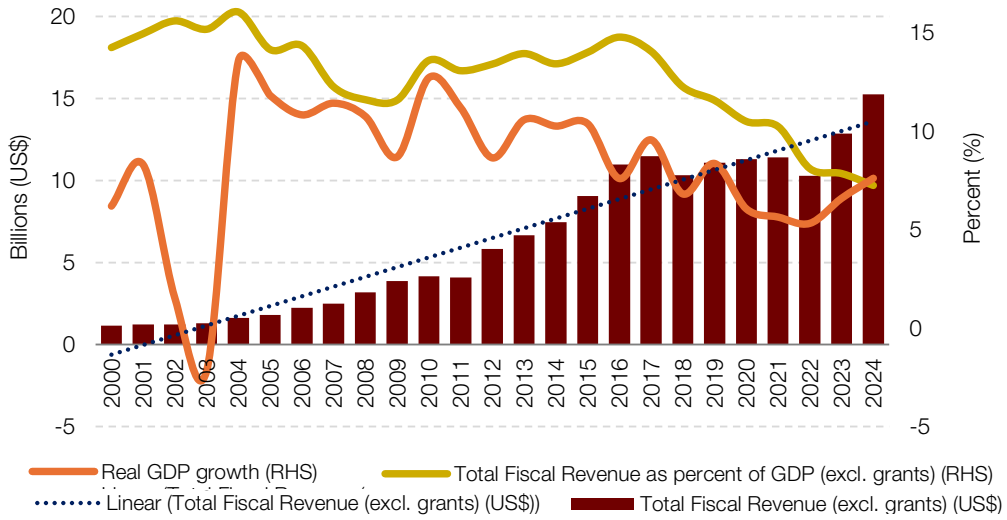
2.3.1 Introduction

Ethiopia is strengthening revenue mobilization through tax, non-tax, natural resource, and external sources, though major constraints persist. Despite the strong growth in GDP, the fiscal revenue and revenue-GDP ratio remain misaligned as shown in Figure 10.

Recent tax policy measures, modest administrative improvements, and economic recovery raised the tax-to-GDP ratio to about 7.8% in FY2024/25 from 6.8% in FY2023/24, driven largely by stronger import duties, excises, and customs revenues. Non-tax revenue have increased through higher SOE dividends and administrative fees.

The government is prioritizing the monetization of natural capital from mining, land, and forests, as well as emerging carbon finance and payments for ecosystem services, as medium-term catalytic sources of financing. Remittances remain the largest and most stable external flow, supporting FX availability, but with limited fiscal transmission. Constraints remain significant nationwide.

Figure 10 : Trends in Ethiopia'sTotal Fiscal Revenue (excluding grants) 200-2024

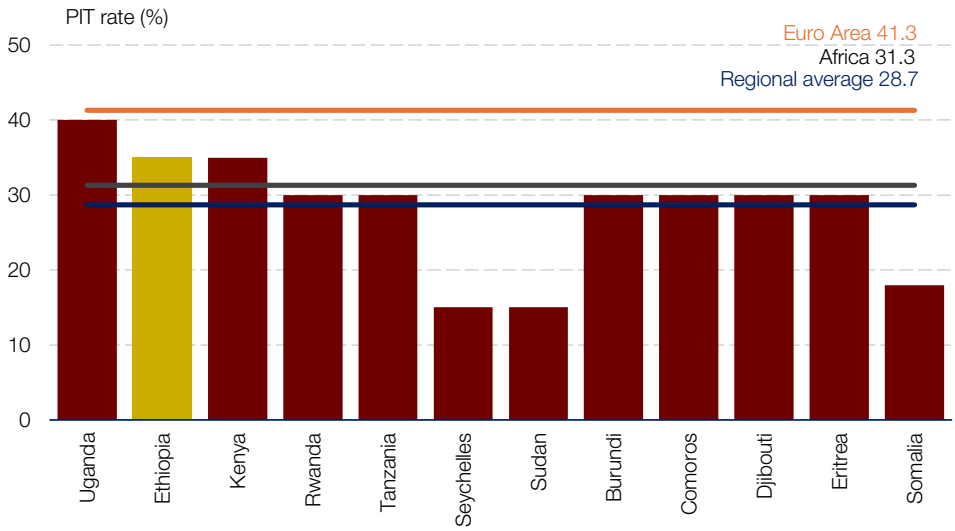


Source: African Development Statistics ECST Data 2025

2.3.2 Country's Tax Structure and Revenue Administration: Patterns, Gaps, and Challenge

Ethiopia's tax structure remains narrow and uneven, relying mainly on border taxes, excise duties, and indirect taxation, while personal income tax — peaking at 35% (see Figure 3) — and business profits contribute relatively little. Recent gains, reflected in the rise of the tax-to-GDP ratio to 7.8% in FY2024/25 from 6.8% in FY2023/24, were driven largely by import surcharges, telecom excise duties, and stronger customs performance rather than broad-based tax expansion. Revenue administration has improved through digitalization, e-tax systems, and business licensing reforms, but institutional and technical capacity gaps persist, including weak compliance, limited risk-based audits, and fragmented subnational systems. Macro constraints — debt distress, FX shortages, and shallow markets — continue to suppress revenue growth and investment.

Figure 11 : Statutory Personal Income Tax (PIT) Rates in Ethiopia

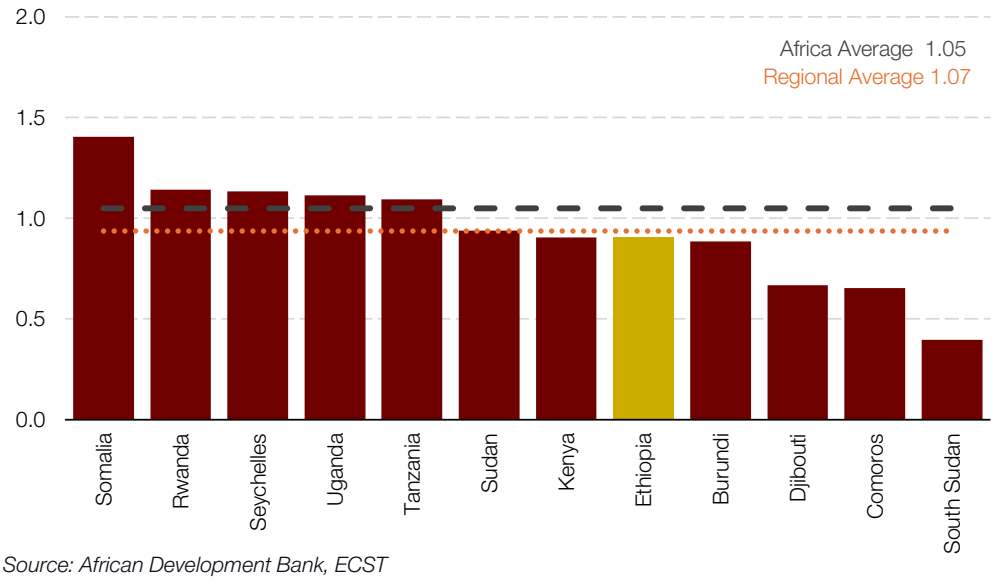


2.3.3 Tax Efficiency, Buoyancy and Structural Revenue Gaps in Ethiopia

Ethiopia's tax efficiency remains low, reflecting deep structural weaknesses. With a tax-to-GDP ratio of about 7.8% in FY2024/25, Ethiopia ranks among the lowest in sub-Saharan Africa. This indicates large tax effort and efficiency gaps, as revenues have stagnated across major tax categories despite strong nominal GDP

growth. Overall tax buoyancy is weak at 0.91, below the African average of 1.05 (see Figures 11 and 12), with recent gains driven mainly by discrete measures such as import surcharges, telecom excise taxes, and customs-related effects. Core constraints reflect narrow tax bases, informality, and weak administration, while debt distress and FX shortages further exacerbate outcomes.

Figure 12 : Tax Buoyancy in Ethiopia



Source: African Development Bank, ECST

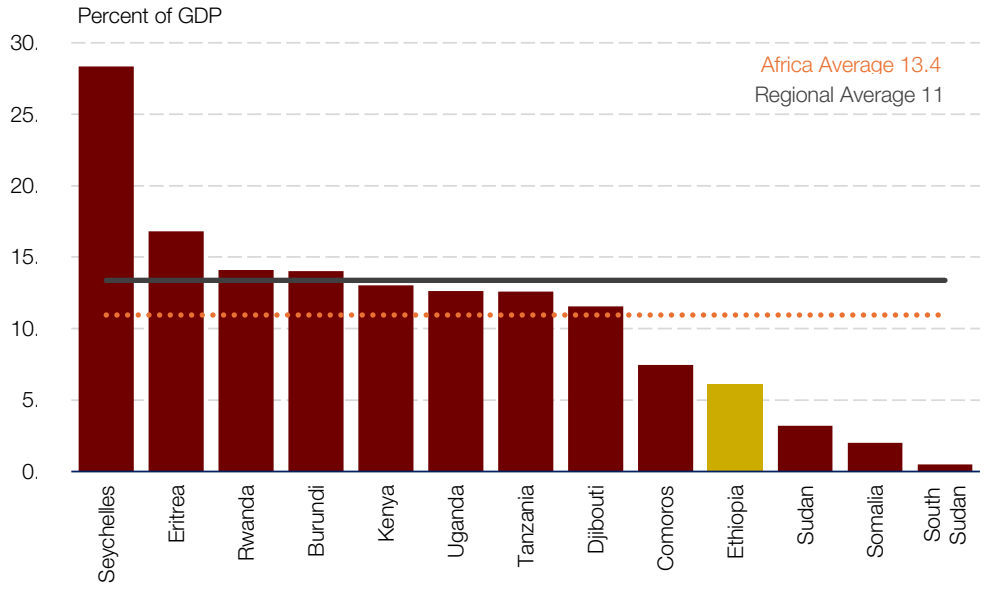
2.3.4 Operationalizing Ethiopia's Untapped Revenue Potential

Ethiopia can turn substantial unrealized revenue potential into actual collections by shifting from ad hoc measures to systemic reforms that broaden tax bases and strengthen enforcement as shown in Table 2. With a tax-to-GDP ratio of only 7.8% as shown in Figure 13, constraints lie more in implementation than policy design. Immediate priorities include rationalizing tax exemptions, strengthening personal and corporate income taxation, and improving customs and excise administration to reduce reliance on border taxes. Administrative reforms must move beyond digitalization toward risk-based compliance, stronger Large Taxpayer Office capacity, unified taxpayer registries, and better coordinated subnational systems. Property taxation and informal-sector integration should be pursued in the medium term, once administrative capacity improves through simplified regimes and digital payments.

Table 2 : Policy Instruments for Effective Revenue Mobilization in Ethiopia

Policy Lever	Key Instruments	Objective
Tax Policy	Exemption rationalization; MAT; property tax; stronger PIT/CIT; BEPS measures	Broaden tax base and reduce reliance on border taxes
Revenue Administration	Risk-based audits; stronger LTO; unified taxpayer registry; digital tax systems	Raise compliance, efficiency, and collections
Informal Sector	Simplified presumptive regimes; digital payments; compliance-service linkages	Gradual formalization and base expansion
Natural & Non-Tax Revenues	Mining/land valuation and licensing; SOE dividends; carbon finance, PES	Improve resource-rent and non-tax revenue capture
Macro Enablers	Debt restructuring; FX reform; capital-market deepening	Restore investment and taxable activity

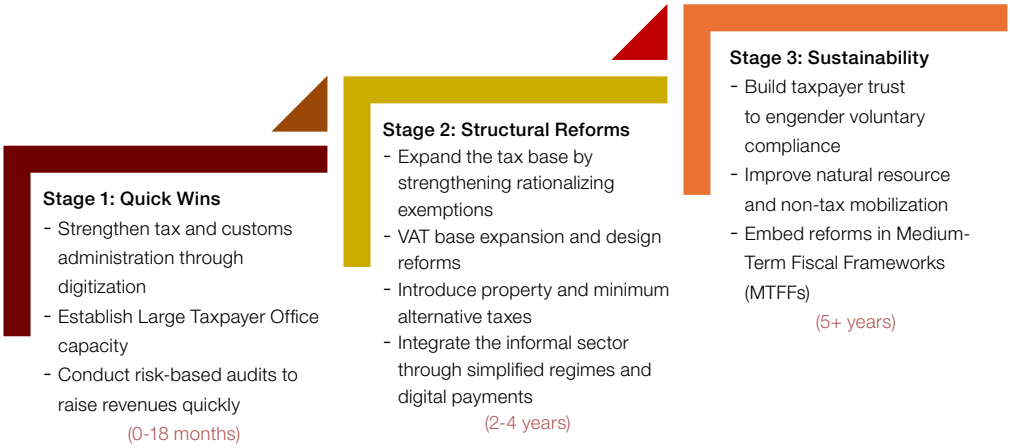
Figure 13 : Trend of Ethiopia's Tax-GDP Ratio (2019-2024)



2.3.5 Revenue Reforms and Sequencing

Ethiopia could strategically sequence revenue reforms to maximize effectiveness while managing political, economic, and administrative risks as shown in Figure 14. In the short term, priorities should focus on low-distortion, high-yield actions, including strengthening tax and customs administration, Large Taxpayer Office capacity, excise enforcement, and risk-based audits to raise revenues quickly. Exemption rationalization should start with a focused short-term review to identify high-cost, low-impact incentives. In the medium term, reforms should shift toward base broadening through value added tax (VAT) expansion, property and minimum alternative taxes, and informal-sector integration via simplified regimes and digital payments as shown in Boxes 2 and 3. Natural resources and non-tax revenue offer less distortionary benefits but require strong governance and institutionalization within fiscal frameworks.

Figure 14 : Reform Sequencing Timeline – from Quick Wins to Sustainable Fiscal Capacity



Source: AfDB Staff elaboration

2.3.6 Institutional Enablers and Digitization of Revenue Collections Systems

Ethiopia's institutional framework for revenue mobilization, anchored in the National Medium-Term Revenue Strategy, provides a coherent basis for improving efficiency, accountability, and effectiveness, but implementation gaps remain. Stronger coordination among federal tax authorities, customs, and subnational governments, supported by unified taxpayer registries, is critical for compliance and oversight. Basic digital rollout of e-filing, e-payments, electronic business registration, and customs automation will reduce discretion, compliance costs, and leakages, while supporting revenue gains. However, partial coverage, weak data integration, and limited analytics constrain impact. The next phase must focus on deeper system integration, data sharing, and advanced analytics linked to enforcement.

Box 2 : Key Tax Reforms to strengthen Domestic Resource Mobilization

Ethiopia's recent tax reforms are anchored in the Ethiopia Revenue Mobilization Strategy–Final 2024, which implements the National Medium Term Revenue Strategy (FY2024/25–FY2027/28) to raise the tax to GDP ratio toward 15%, the level generally required to sustainably finance the SDGs. Reforms have focused mainly on tax policy adjustments, notably import surcharges and telecom excise duties, which have delivered short term revenue gains and helped raise the tax to GDP ratio to 7.8% in FY2024/25. However, these measures remain narrow and discretionary, reinforcing reliance on border and consumption taxes rather than structurally expanding income and property tax bases. On the administrative side, reforms have emphasized digitalization, expanded e-filing and e payments, and strengthened the Large Taxpayer Office, contributing to an average 24.8% increase in revenues over three years. Yet fragmented taxpayer registries, weak risk based audits, and uneven subnational capacity persist. Broader base broadening measures, stronger natural resource rent capture, and improved macroeconomic stability are needed to deliver durable domestic resource mobilization..

2.3.7 Role of International Cooperation and Development Partners

International cooperation and development partners play a catalytic role in mobilizing resources for Ethiopia, especially given three ranked constraints: a) debt distress and delayed restructuring; b) limited fiscal space amplified by SOE fiscal risks and post-conflict reconstruction needs; and c) weak private capital inflows reflecting export concentration and elevated country risk. Multilateral institutions, notably the African Development Bank (AfDB), International Monetary Fund (IMF), and the World Bank, provide concessional finance, budget support, and policy anchors that underpin macroeconomic stability and reform credibility. The IMF's Extended Credit Facility has unlocked coordinated partner support and advanced debt treatment under the G20 Common Framework, easing near-term pressures. Development partners also crowd in co-financing for infrastructure and climate sectors.

Box 3 : Key Actions and Reforms aimed at Modernizing Revenue Collection

1. **Digitalization of Revenue Administration**
   Ethiopia is modernizing revenue collection by expanding e-filing and e-payment systems, integrating tax platforms with business registration and licensing, automating customs processes, strengthening taxpayer identification through data matching, and reducing administrative discretion through system-based processing.

   The authorities are reinforcing the Large Taxpayer Office, introducing risk based compliance management, shifting from blanket audits to targeted enforcement, simplifying regimes for MSMEs, linking compliance to digital payments, and strengthening arrears and non-filer management.

2. **Broadening the Tax Base**
   Revenue reforms focus on rationalizing tax exemptions, introducing a minimum alternative tax, strengthening property and presumptive taxation, implementing BEPS related measures, reducing reliance on border taxes, and gradually expanding direct income and profit taxes.

3. **Improving Institutional Coordination and Capacity**
   Ethiopia is implementing the National Medium Term Revenue Strategy to align tax policy and administration, strengthen coordination between institutions, build subnational revenue capacity, reduce fragmentation under fiscal federalism, professionalize ECC, and better integrate revenue reforms with PFM systems.

4. **Expanding Non-Tax and Natural Resource Revenues**
   The government is strengthening SOE dividend frameworks, adjusting administrative fees and service charges, improving capture of mining and land rents, using natural capital accounting to inform policy, developing carbon finance and ecosystem services, and diversifying revenues beyond narrow tax instruments

5. **Improving Taxpayer Trust and Voluntary Compliance**
   Efforts to improve compliance emphasize simplifying procedures, reducing face to face interactions, increasing transparency through digital systems, embedding reforms in medium term fiscal frameworks, improving taxpayer services, and fostering a culture of voluntary compliance over time.

2.3.8 Other relevant issues in Ethiopia's Resource Mobilization

Ethiopia has strong opportunities to mobilize resources by capitalizing on the current economic growth, reform momentum, and vast natural capital, but debt distress, FX shortages, informality, weak institutions, and shallow capital markets constrain financing-at-scale. Success hinges on completing debt restructuring, strengthening domestic revenues, and crowding in private investment.

2.4 Improving Public Financial Management Systems

2.4.1 Where Ethiopia Stands: Progress with Persistent Institutional Gaps

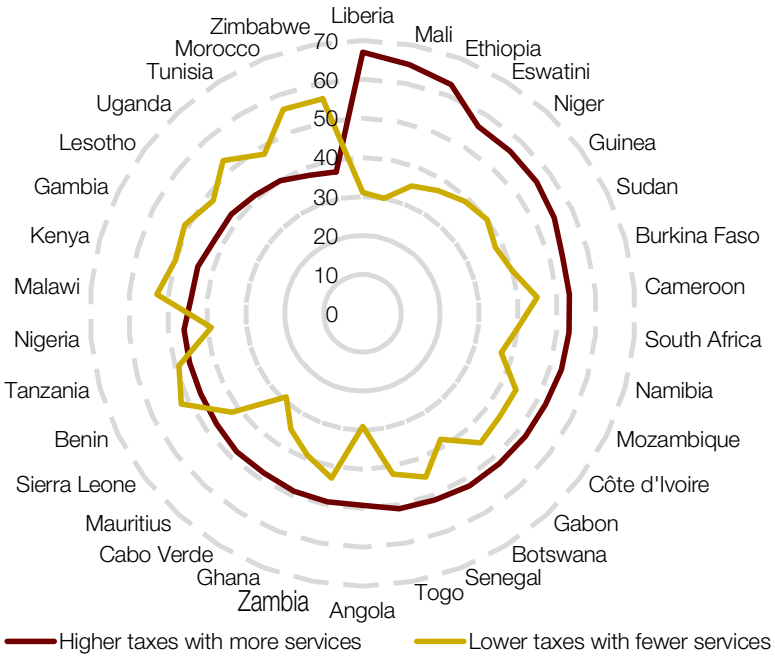
Ethiopia's fiscal and public financial management system shows strengths, weaknesses, and ongoing reforms. Strengths include a coherent framework under the National Medium-Term Revenue Strategy, increased tax-to-GDP ratio to approximately 7.8%, expanding digital financial management systems, and improved transparency and expenditure controls. However, weaknesses persist: fragmented federal–regional institutions, uneven subnational capacity, limited enforcement of audit findings, fiscal risks from SOEs, and debt distress constraining the macro-fiscal space. Priority reforms focus on strengthening budget credibility, expenditure control, and fiscal risk management; deepening digital and risk-based PFM systems; improving public investment and procurement; enhancing subnational oversight; and restoring macro-fiscal credibility through debt restructuring, SOE reform, and expenditure efficiency.

2.4.2 Improvements in Transparency and Fiscal Accountability

Ethiopia has improved transparency and oversight in public finances through sustained PFM reforms under the Ten-Year Development Plan. Transparency reforms include regular publication of Citizens' Budgets, consolidated fiscal statements, and thematic budget tagging, improving public scrutiny and budget credibility. Digital control reforms, IFMIS rollout, digital payments, and Treasury Single Account (TSA) implementation have strengthened controls, cash management, and audit trails. Procurement reforms, notably updated procurement law and e-government

procurement, have reduced corruption risks. Audit and accountability were reinforced through establishment of the Ethiopian Institute of Certified Public Accountants and stronger internal and external audits. However, reforms remain uneven at the subnational level, constrained by capacity gaps, turnover, and cybersecurity risks. It is pertinent to improve efficiency in public service delivery to strengthen the fiscal social contract between the government and citizens as shown in Figure 15.

Figure 15 : Higher taxes with more services vs. lower taxes with fewer services



Source: Staff calculations using data from the 2022 Afrobarometer surveys

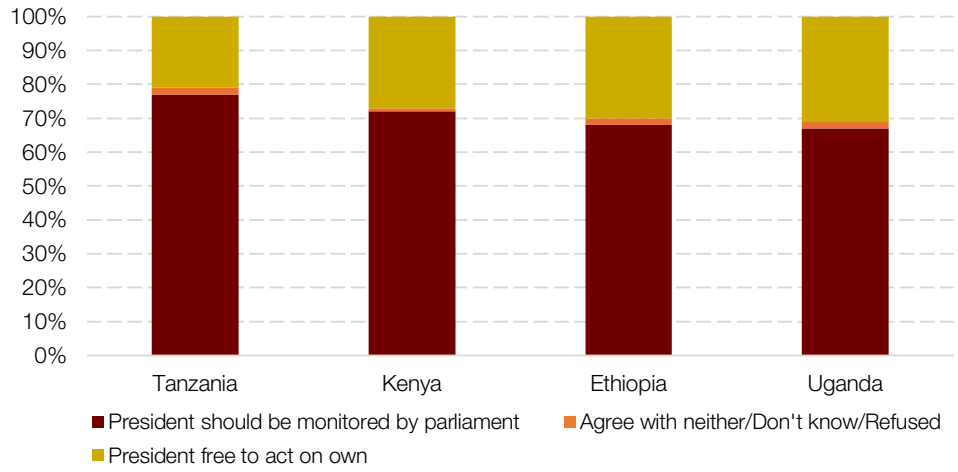
2.4.3 Budget Transparency and Credibility

Greater budget transparency has strengthened fiscal credibility and technical reliability, but trust in fiscal management remains uneven. Publication of Citizens' Budgets, consolidated fiscal statements, and thematic tags improved information access, while program-based budgeting and timely account closures strengthened planning discipline. Digital PFM reforms, especially IFMIS, the TSA, and cashless payments reduced discretion and improved consistency of fiscal aggregates, supporting more credible budgets. However, transparency has translated less into trust at the subnational level due to incomplete systems, delayed reporting, capacity constraints, and weak enforcement of audit findings. Overall, transparency improved credibility, but durable trust depends on stronger enforcement, audit follow-up, and subnational implementation and consistent accountability mechanisms nationwide.

2.4.4 Strengthening Oversight, Audit and Public Accountability

Ethiopia can strengthen oversight, audit, and public accountability by deepening implementation of existing PFM reforms and closing institutional gaps. Expanding IFMIS, TSA operations, and e-procurement to all regions and woredas would improve consistency, coverage, and reliability of fiscal data (AfDB CFR 2025). Audit institutions should move decisively toward risk-based and performance audits, supported by stronger staffing, retention, and independence. Parliamentary scrutiny should be reinforced, reflecting public demand as shown in Figure 16, through mandatory follow-up on audit findings and time-bound corrective actions. Stronger coordination among auditors, procurement bodies, anti-corruption agencies, and the judiciary is essential to ensure that sanctions are applied where warranted.

Figure 16 : Strong Public Demand for Legislative Oversight Over Executive Power in Ethiopia



Source: African Development Bank, ECMR

2.4.5 Digital Transformation of Public Financial Management Systems

The shift to digital tools has reshaped Ethiopia's Public Financial Management (PFM) by strengthening control, transparency, and fiscal discipline, although challenges remain. Systems such as IFMIS, the TSA, digital payments, and e-procurement have reduced fragmentation, limited discretion, and improved cash management, audit trails, and reporting consistency. These platforms support more credible budget execution, tighter expenditure controls, and stronger federal oversight. However, moving from progress to transformation requires completing subnational rollout across regions and woredas, strengthening institutional and skills capacity, addressing rising cybersecurity risks, and enforcing controls consistently. Without effective enforcement and accountability, digital reforms risk remaining technical upgrades rather than becoming fully transformative nationwide.

2.4.6 Economic Dividends and Fiscal Gains from Closing the Efficiency Gap

Closing efficiency gaps in Ethiopia's public financial systems can deliver substantial fiscal and economic dividends amid tight fiscal space and debt distress. Full implementation of IFMIS, the TSA, digital payments, and procurement modernization can generate recurrent savings by reducing leakages, idle cash, arrears, and costly short-term borrowing. Stronger cash and commitment controls improve budget predictability and lower financing needs. Efficiency gains in procurement, public investment management, and SOE oversight raise value for money, increasing the growth impact of each Birr spent. Improved PFM efficiency also strengthens macro-fiscal credibility, helping crowd in concessional funding and private investment. Over time, reallocating savings toward infrastructure and social services boosts human capital.

2.4.7 Other Relevant Issues in Ethiopia regarding Mobilizing Fiscal Resources at Scale

Mobilizing fiscal resources at scale in Ethiopia is constrained less by policy design than by execution and governance gaps. First, weak cash management and commitment controls fragment budget credibility: delayed releases, arrears, and off-system commitments undermine enforcement and credible ceilings, as documented in Public Expenditure and Financial Accountability (PEFA) and IMF diagnostics. Second, procurement and public investment management failures slow tendering, land acquisition delays, and poor project preparation drive chronic capital under execution, reducing growth and delaying tax base expansion. Third, fiscal risks outside the core budget remain insufficiently controlled: limited SOE oversight, quasi-fiscal activities, extra-budgetary funds, and PPP and contingent liabilities are weakly integrated into fiscal frameworks, constraining future

space. Fourth, spending composition remains misaligned, with insufficient reallocation toward growth-enhancing infrastructure and basic social services. Finally, Ethiopia underutilizes natural capital and climate finance revenues due to institutional gaps, while compliance and enforcement weaknesses, tax incentives, mis-invoicing, uneven audits dilute returns.

2.5 Formalizing the Informal Sector

2.5.1 Economic Costs of Informality and the Returns to Formalization

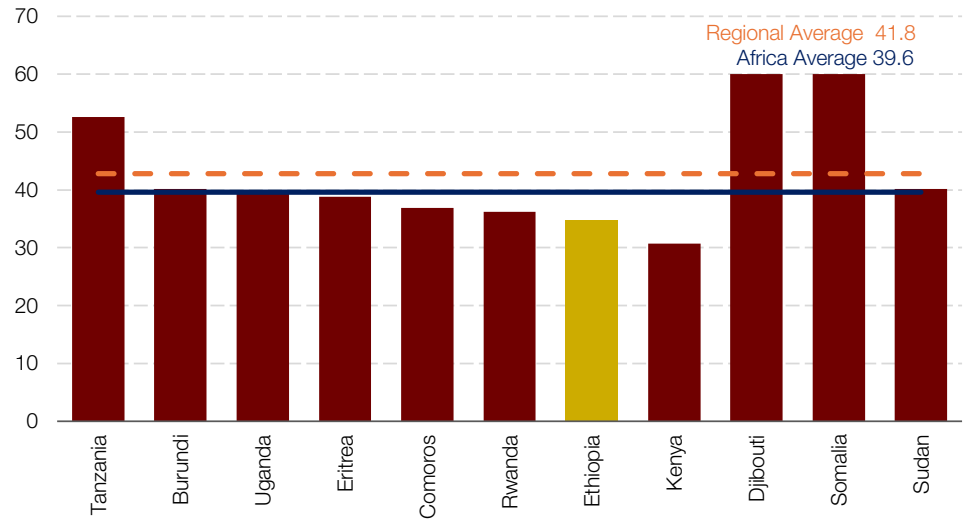
Ethiopia's informal economy is large and structural, accounting for an estimated 30–35% of GDP as shown in Figure 17, and 70–80% of total employment, concentrated in urban trade, services, construction, and small manufacturing. Informality reflects limited formal job creation, rapid labor force growth, high tax and compliance costs, uneven regulation, weak access to finance, and persistent governance and skills gaps. At the macro level, informality imposes major economic and developmental costs. Ethiopia's tax-to-GDP ratio declined to about 7.1% in FY2021/22 during COVID-19 and conflict shocks, before partially recovering to around 7.8% in recent years. Both figures remain well below the sub-Saharan African average of roughly 18%. IMF estimates place Ethiopia's tax capacity closer to 17–20% of GDP, implying large revenue losses linked to informality and compliance gaps. A narrow tax base forces high effective tax burdens on a small pool of formal firms and workers, reinforcing incentives to remain informal, while informality depresses productivity as firms stay small and undercapitalized to avoid regulation, contributing to labor and capital misallocation. Formalization can yield net gains if carefully sequenced and incentive-based: reforms should begin with simplified registration, licensing, and digital payment inclusion; expand next to access finance, business services, infrastructure, and skills; and only subsequently introduce taxation and enforcement using low presumptive rates for micro-firms and gradual progression to support formal job creation while protecting livelihoods and sustaining equitable, long-term productivity growth nationwide economy.

2.5.2 Digitization as a Catalyst for Formalization

Digitization and mobile money are reshaping Ethiopia's economy by lowering barriers to formality and creating transaction footprints for households and firms. Reforms since 2019 expanded digital financial services, with mobile money accounts exceeding one hundred million by 2024/25 and transaction values reaching trillions of Birr. Evidence from National Bank of Ethiopia data shows that mobile banking, digital wallets, agent banking, POS, and ATMs increase account ownership among formerly unbanked households and microenterprises. Mandates requiring public institutions to accept digital payments for taxes, fees, and utilities anchor users in payment rails, reduce cash reliance, and improve traceability, generating data for financial inclusion and credit assessment (Zikargie and Cochrane, 2024).

However, digitization alone does not guarantee formalization. Usage remains concentrated in payments and savings rather than productive credit, while interoperability gaps, limited rural connectivity, low digital literacy, data privacy concerns, cybersecurity risks, and uneven consumer protection constrain trust and scale. Weak integration across digital ID systems, payment platforms, tax administration, and business registries allows enterprises to transact digitally while remaining legally informal. Therefore, sequencing matters. Digital payments should initially prioritize inclusion, reliability, and SME credit access through transaction-based risk scoring supported by interoperable infrastructure and safeguards. Only once systems mature, governance improves, and trust is established should authorities leverage digital trails for stronger tax enforcement. Complementary reforms, including simplified registration, presumptive tax regimes, shared digital infrastructure, and incentives linking formality to finance, markets, and public services are essential nationally.

Figure 17 : Contribution of the Informal Sector to GDP in Ethiopia (2015-2020)



Source: African Development Bank, ECST

2.5.3 Other Relevant Issues regarding Formalizing the Informal Sector in Ethiopia

Formalizing Ethiopia's informal sector is constrained by structural, social, and political factors beyond registration and taxation. A key blind spot is land tenure informality, which enables many firms operate without secure land or housing rights, especially in peri-urban areas, making registration risky amid threats of eviction. Closely linked is negotiated informality, where tolerance depends on brokers and local power networks, rendering informality rational. Social norms and informal institutions can crowd out formal systems by providing trust, finance, and dispute resolution at low cost. Gendered care burdens and home-based production further misalign women's activities with fixed-premise licensing and rigid tax tools. Concrete responses include mobile licensing units in markets, market-based registration desks, tenure documentation or use-right certificates, and childcare-linked business support for women entrepreneurs. Sustainable formalization therefore requires land regularization, trust-building, gender-responsive instruments, and political economy realism alongside tax reforms to enable durable transitions.

2.6 Scaling-Up Public-Private Partnerships (PPPs)

2.6.1 Building Credible PPP Enabling Framework and Project Ecosystem

Ethiopia's PPP framework is legally sound, but execution remains constrained by bankability challenges. The centralized model under the Ministry of Finance has helped screen projects and ring-fenced fiscal risks, yet it has slowed delivery. Although many projects, mainly in energy and transport, entered the pipeline, only a few reached financial close, reinforcing concerns over implementation capacity. Core bankability constraints include foreign exchange risk, off-taker creditworthiness, especially of SOEs, uncertainty around guarantees, and limited use of user-pay and performance-linked revenue structures. Weak SOE governance and long-tenor risk exposure raise contingent liabilities and deter investors despite competitive procurement rules.

A separate challenge is capital-market mobilization and refinancing. Ethiopia lacks deep local-currency markets capable of supporting long-tenor debt for infrastructure, limiting refinancing options after construction. Domestic investors prefer short-tenor instruments, while regulatory and pipeline

uncertainty constrains institutional participation. The ACWA Power solar projects demonstrated an Ethiopia-specific proof of concept by combining guarantees, standardized contracts, and risk allocation to reach financial close, but this approach is not a benchmark across sectors with different demand, tariff, and risk profiles.

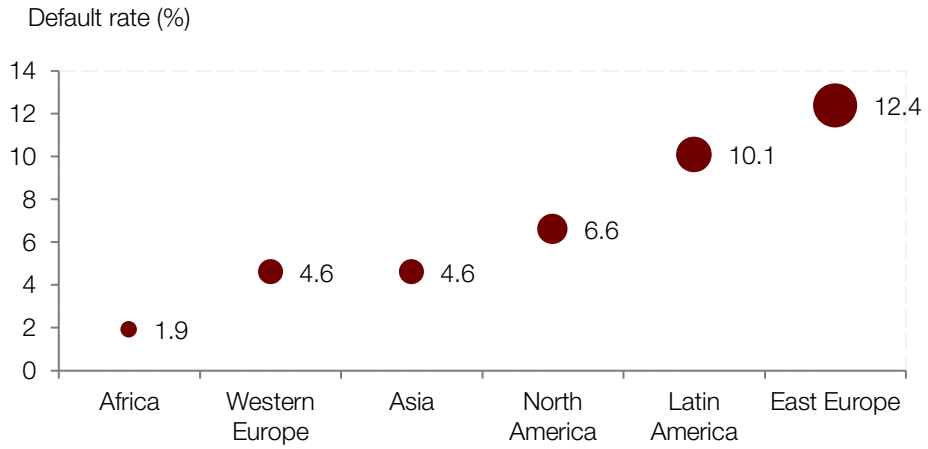
Overall, the PPP system is ambitious but institutionally stretched. Addressing constraints require clearer risk-sharing frameworks, stronger SOE reforms, disciplined use of direct negotiation, and gradual development of local-currency financing to translate legal strength into assets on the ground. This reform agenda must align incentives, rebuild credibility, and restore investor confidence under macroeconomic volatility and constrained-public-balance sheets nationwide over time.

2.6.2 Making Marginal Projects Bankable and Connecting them to Capital Markets

Marginal PPPs in Ethiopia can become bankable when cash flows are predictable, major risks are credibly mitigated, and contracts are standardized to reduce enforcement uncertainty. The upside advantage that Ethiopia and other African countries have is comparatively lower default rate of 1.9% on infrastructure projects as compared to other countries and regions globally as shown in Figure 18. This requires redesigning revenue models away from pure user-pay structures, where demand volatility is high, toward performance-linked availability payments, supplemented by limited viability gap funding where justified. Payment security against off-taker and SOE risk is essential and should rely on ring-fenced revenues, reserve accounts, and transparent budgetary backing. A binding Ethiopia-specific constraint is foreign exchange risk. NBE Directive FXD/86/2023 allows eligible strategic PPPs, notably in power and infrastructure, to open offshore accounts and access convertibility guarantees for debt service and dividend repatriation, materially strengthening bankability when applied consistently. Early solar IPPs illustrate this logic as a proof of concept rather than a universal benchmark. The ACWA Power 250 MW projects, priced at US$2.526 cents per kWh, show how disciplined risk allocation, standardized documentation, and competitive procurement can attract high-quality sponsors, while the expansion of direct negotiation must remain tightly governed to safeguard credibility and transparency.

Beyond bankability, scaling marginal PPPs requires a credible pathway to capital-market refinancing. To attract long-tenor, local-currency finance, projects need credit enhancement as markets mature. Ethiopia's capital market architecture is emerging, with government securities trading on the Ethiopian Securities Exchange since 2025. A staged approach is pragmatic: construction financed by banks, DFIs, and guarantees, followed by bond refinancing once operations stabilize, supported by partial credit guarantees and anchor investors.

Figure 18 : Default Rate on Infrastructure and Related Projects



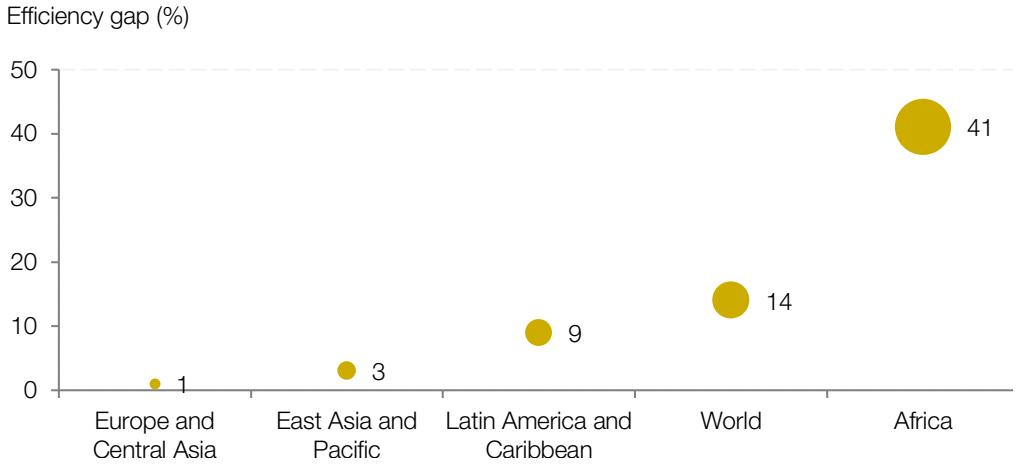
Source: (a) Moody's Analytics; (b) African Development Bank Staff Calculation

2.6.3 Managing Fiscal Risks and Safeguarding Value for Money

Managing PPPs in Ethiopia requires treating fiscal risk as a core macro-fiscal issue rather than a project-level afterthought. PPP obligations ultimately sit on the sovereign balance sheet, yet guarantees, availability payments, and SOE commitments are still weakly integrated into fiscal frameworks. Effective control therefore depends on strong Ministry of Finance gatekeeping. All PPPs should be appraised alongside traditional public investment using unified tools that incorporate debt sustainability analysis, medium-term fiscal ceilings, cash-flow profiling, and stress testing of contingent liabilities, including off-taker risk and foreign-exchange commitments. This is all justified by the considerable public investment efficiency gap in African countries including Ethiopia. Africa has a wide public investment efficiency gap of 41% as compared to 1%, 3%, 9% and 14% of Europe and Central Asia, East Asia and Pacific, Latin America and Caribbean, and the rest of the world respectively as shown in Figure 19. It is therefore pertinent that full-lifecycle costs must be transparently disclosed, budgeted ex ante, and explicitly capped. This prevents PPPs from becoming off-budget substitutes that erode fiscal credibility in the context of limited buffers, debt distress, and large SOE exposure.

Safeguarding value for money (VfM) is primarily an institutional challenge rather than a financing choice. Weaknesses in project preparation, procurement, and capital budget execution distort comparisons between PPPs and public procurement, making PPPs appear cheaper while shifting risk back to the state. Robust VfM requires competitive project selection based on realistic risk pricing, enforceable allocation of construction and operational risks to private parties through performance-linked payment mechanisms and termination regimes, and disciplined government management of policy and force majeure risks. Expanded direct negotiation can accelerate delivery, but it risks opaque pricing and excessive guarantees unless subject to mandatory VfM disclosure, independent review, and standardized contracts. Aligning VfM discipline with fiscal-risk controls strengthens investor confidence and ensures scarce public resources.

Figure 19 : Public Investment Efficiency Gaps by Region



Source: (a) Moody's Analytics; (b) African Development Bank Staff Calculation

2.6.4 Other Relevant Issues for Scaling-Up PPPs in Ethiopia

Ethiopia's ability to scale PPPs is constrained less by legal frameworks than by second-generation institutional and political-economy weaknesses. Subnational capacity gaps matter because many PPP-relevant assets depend on regional and municipal authorities with weak contract management, fiscal reporting, and land administration, raising renegotiation and payment risks. Post-award enforcement is a critical blind spot. Limited monitoring capacity can turn performance-based contracts into implicit cost-plus arrangements, undermining value for money and inflating future fiscal exposure. Scaling is further constrained by a shallow domestic sponsor and operator base,

leaving PPPs dependent on foreign developers and limiting competition, learning, and local spillovers. Macroeconomic sequencing risks also persist. Foreign exchange convertibility reforms improve bankability, but widespread guarantees can create contingent liabilities when buffers remain weak. Governance credibility is pivotal: faster deals through direct negotiation, risk discretion, renegotiation, and investor hesitation. Addressing these constraints requires investment in subnational capacity, contract management, domestic sponsors, and transparent governance policy.

2.7 Mobilizing Long-Term Capital from Regional and Institutional Investors

2.7.1 Pension Funds as Patient Capital: What Ethiopian Data Implies for Reform

Private Organizations Employees Social Security Agency (POESSA) has expanded alongside formal employment, yet pension assets remain small relative to GDP. Unlike regional peers, where pension assets are estimated at about 13% of GDP in Kenya and 9% in Uganda, Ethiopia lacks a reliably published estimate. This data gap constrains policy analysis, weakens accountability, and obscures the system's macroeconomic relevance. Available evidence indicates that portfolios are heavily concentrated in domestic government securities and deposits in state-owned banks, reflecting regulatory conservatism, shallow capital markets, and a limited supply of investable instruments. This concentration exposes funds to inflation and fiscal risks, delivers persistently low real returns, and reinforces the sovereign–bank nexus rather than supporting long-term, productive investment.

Structural constraints are binding. Capital markets are underdeveloped; a modern prudent-person and risk-based prudential framework is absent; and asset–liability management capacity remains weak. Governance and disclosure practices are limited. There is no routine public reporting of aggregate pension assets, liabilities, investment returns, duration mismatches, or portfolio allocations by asset class. Without standardized, audited, and regularly published data, assessing funding adequacy, intergenerational equity, and performance relative to benchmarks is not feasible. Macroeconomic volatility, debt distress, and acute foreign exchange shortages further discourage diversification into private, long-term, or foreign assets. As a result, pension funds function largely as captive domestic financiers, generating constrained risk-adjusted returns and contributing little to capital-market deepening or broader development-finance objectives within Ethiopia's financial system.

2.7.2 Sovereign Wealth Funds: Feasibility in Ethiopia

Ethiopia's current macro-fiscal conditions make a typical sovereign wealth fund (SWF) only weakly feasible, though a narrowly defined developmental role is possible. Successful SWFs are typically built on sustained fiscal or external surpluses, yet Ethiopia faces debt distress, a recent sovereign default, and still-fragile reserve buffers. Although post-2024 reforms have improved growth, inflation, and FX availability, reserves remain below comfort levels and are needed primarily for macroeconomic stabilization rather than long-term saving. Establishing a savings- or stabilization-oriented SWF under these circumstances would risk diverting scarce public resources away from debt reduction, social spending, and priority investment, potentially amplifying macroeconomic risks.

Within this context, Ethiopian Investment Holdings (EIH) represents a more realistic, second-best model. Its strategic developmental role lies not in managing surplus wealth, but in optimizing state-owned enterprise portfolios, strengthening corporate governance, imposing commercial discipline, and crowding in private and foreign co-investment. EIH can also support capital-market development by acting as an anchor investor in domestic debt and equity markets, helping diversify funding sources away from banks. However, because it is funded largely through SOE assets and privatization proceeds rather than excess savings, EIH cannot substitute for a true SWF. Its effectiveness depends on transparent governance, strict separation from fiscal financing needs, and hard budget constraints for SOEs. Absent sustained surpluses and strong macro-fiscal buffers, Ethiopia's priority

should remain stability-first reforms, with any SWF-like role tightly circumscribed to asset management and development catalysis rather than intergenerational wealth preservation or fiscal stabilization.

2.7.3 Other Relevant Issues for Ethiopia in Mobilizing Long-Term Capital from Regional and Institutional Investors

Mobilizing long-term capital from regional and institutional investors for Ethiopia is constrained less by lack of interest than by second-order structural and institutional frictions. A key issue is the mismatch between institutional investors' long-term, local-currency liabilities and the scarcity of long-dated, liquid instruments, reflecting the absence of a benchmark yield curve and shallow secondary markets. Regulatory fragmentation further raises perceived risk, as weak coordination among financial, capital-market, and fiscal authorities undermines consistent disclosure and supervision. Project pipeline constraints are also critical: limited investment-ready projects, weak preparation, land and contract enforcement challenges, and insufficient risk-sharing mechanisms deter non-bank institutional investors. Macroeconomic volatility reinforces these barriers by increasing prudential capital charges, biasing portfolios toward short-term government paper. Finally, underdeveloped exit and refinancing pathways given a nascent securities exchange and limited bond take-out options restrict capital recycling. Addressing these issues is essential for sustained institutional participation.

2.8 Leveraging Diaspora Capital

2.8.1 State of Financial Resources from the Diaspora

Ethiopia's diaspora remittances represent the country's largest and most stable source of external finance. Official inflows reached about US$7.1 billion in 2024, equivalent to roughly 4–5 % of GDP, exceeding foreign direct investment of around US$4.0 billion and rivaling official development assistance of about US$5.4 billion. Unlike FDI and ODA, which fluctuate with conflict, donor priorities, and global financial conditions, remittances have remained resilient through foreign exchange shortages and macroeconomic stress. They provide a continuous supply of foreign currency, support household consumption, and ease balance-of-payments pressures. This resilience makes the diaspora a de facto shock absorber for the economy, underscoring its strategic importance in Ethiopia's macro-financial landscape.

Despite their scale, remittances are predominantly used for consumption smoothing, such as food, housing, health care, and education, limiting productivity gains and structural transformation. Weak intermediation into savings, micro, small and medium enterprises (MSMEs), or infrastructure reflects shallow capital markets, high informality, limited trust in formal institutions, and a shortage of long-dated, investable instruments. Recent reforms, including foreign exchange liberalization, diaspora foreign currency accounts, and digital onboarding platforms, aim to keep inflows in formal channels and strengthen confidence, but risk-mitigated investment options remain scarce.

Mobilizing diaspora capital for development requires careful sequencing. The priority is sustaining FX credibility, lowering transfer costs, and keeping flows formal. The next stage is building trusted savings and investment products to channel remittances productively. Only once governance, liquidity, FX convertibility, and exit mechanisms are credible should Ethiopia scale diaspora bonds strategically.

2.8.2 Other Relevant Issues to Leveraging Diaspora Capital in Ethiopia

Issues affecting Ethiopia's ability to leverage diaspora capital go well beyond remittance facilitation. A central constraint is a persistent trust deficit driven by political uncertainty, policy reversals, and concerns over property rights and contract enforcement, which often outweigh patriotic motivation. Diaspora engagement frameworks also insufficiently recognize heterogeneity, relying on one-size-fits-all instruments that fail to match differing incomes, risk appetites, skills, and locations. Underdeveloped capital markets and delayed intermediation platforms limit the pooling of small diaspora savings into scalable

investments, despite recent progress toward a securities exchange and collective investment schemes. Practical gaps include the absence of diaspora savings accounts linked to domestic investment, regulated diaspora funds, and SME co-investment platforms that share risk credibly. Weak project preparation and last-mile constraints—land access, licensing delays, partner disputes, and ineffective dispute resolution—further deter participation. Finally, policy remains narrowly focused on financial inflows, underutilization of diaspora advisory networks, professional return programs, and technology.

2.9 Harnessing Ethiopia's Natural Resource Assets

2.9.1 Moving Beyond the Extractive Model

Ethiopia's natural-resource potential is large but remains under-monetized. Renewable natural capital was valued at about US$195.8 billion (2018), natural capital accounts for roughly 28 percent of national wealth (2023/24), and natural-resource rents contribute about 5% of GDP—signaling substantial upside if assets are managed rather than depleted (AfDB CFR 2024, 2025). Translating this endowment into jobs and productivity requires prioritization.

First, energy system reliability and agro-processing offer the broadest economy-wide payoffs. Ethiopia's hydropower potential is estimated at 48,030 MW, yet less than 11.7% is exploited; geothermal potential exceeds 10,000 MW, with under 1% developed. However, the binding constraint is not generation alone but system performance: distribution losses near 22% and aging networks undermine industrial competitiveness. Grid upgrades and scalable baseload geothermal are therefore as critical as new capacity. Agro-processing offers fast employment multipliers: coffee generated about US$ 2.6 billion from roughly 470,000 tons, and recent guidelines enabling value-added exports can expand processing, packaging, and quality jobs provided logistics, standards, and institutions deliver.

Second, mining should focus on formalization and local service ecosystems. Despite diverse minerals, mining contributes only about 1% of GDP and revenues, 14% of exports, and around 54,000 jobs—far below ambitions of 10% of GDP by 2030. Priorities include formalizing artisanal activity, improving exploration data and regulatory consistency, and building domestic service and processing ecosystems before heavy beneficiation. Third, carbon markets and natural-capital accounting are medium-term financing channels. Ethiopia's Natural Capital Accounting Initiative and Article 6-aligned carbon strategy which have already issued about 1.6 million credits and target the restoration of 22 million hectares can scale only with robust MRV systems, registries, and investable project pipelines.

2.9.2 Natural Capital, Economic Performance and Macroeconomic Stability

Ethiopia's natural capital dynamics generate significant negative spillovers for agriculture and manufacturing, with economy-wide consequences. In agriculture, degradation of soils, forests, and watersheds weakens ecosystem services, depresses productivity, and heightens reliance on rain-fed systems, magnifying climate shocks. Recurrent supply disruptions raise food prices, expand import demand during droughts, and worsen external balances, transmitting rural vulnerability to the macroeconomy. Manufacturing is affected indirectly but forcefully. Hydrological stress and ecosystem loss undermine hydropower reliability, increasing outages and costs, while agricultural underperformance constrains the quantity and quality of inputs for agro-processing. At the same time, climate-driven food imports and weak monetization of natural capital intensify FX shortages, limiting access to machinery and intermediates and reducing capacity utilization. These interactions lock the economy into a low-productivity equilibrium, constraining export diversification, fiscal revenues, and job creation, explaining episodes of growth without durable structural transformation. Breaking this cycle requires a clear reform sequence: first, protect and restore critical watersheds and soils underpinning agriculture and hydropower; next, embed natural-capital risks systematically in public investment appraisal and sector.

2.9.3 Natural Capital as a Source of Financing

Natural capital offers Ethiopia an important but constrained avenue for financing economic development needs in a context of debt distress, weak domestic revenue mobilization, and limited market access. Assets such as forests, land, water, biodiversity, and renewable energy can, in principle, be monetized through carbon credits, green and sustainability-linked bonds, blended climate finance, and nature-based solutions, helping diversify financing away from debt. However, this potential is largely catalytic rather than fiscally substitutive. Revenues from carbon markets and conservation finance are currently modest, project-based, and insufficient to fund core budget needs or debt service. Their main value lies in crowding in private and concessional capital, de-risking investment in agriculture, energy, and infrastructure, and reducing climate-related macroeconomic shocks. Weak institutions, limited MRV systems, thin project pipelines, and shallow capital markets constrain scalability and predictability of these flows. Without integrating natural capital accounting into budgeting, public investment management, and debt sustainability analysis, green instruments risk remaining fragmented add ons. Natural capital can therefore complement—but not replace—tax reform, export diversification, and debt restructuring as foundations of Ethiopia's development financing strategy.

2.9.4 Governance, Institutions and Macroeconomic Stability

Natural capital offers Ethiopia an important but constrained avenue for financing development in a setting of debt distress, weak domestic revenue mobilization, and limited market access. Forests, land, water, biodiversity, and renewable energy can in principle be leveraged through carbon credits, green and sustainability-linked bonds, blended climate finance, and nature-based solutions, helping diversify funding away from traditional debt. Yet this potential is primarily catalytic rather than fiscally substitutive. Carbon and conservation revenues remain modest, project-based, and insufficient to fund core budget needs or debt service. Their principal value lies in crowding in private and concessional capital, de-risking investment in agriculture, energy, and infrastructure, and dampening climate-related macroeconomic volatility. Realizing this role requires a clearer reform hierarchy. First, establish a strong central coordination mechanism to align ministries, regulators, and sub nationals around natural-capital strategies. Second, strengthen measurement, reporting and verification (MRV) systems and carbon-market registries to ensure credibility, scale, and price discovery. Third, integrate natural-capital accounting into budgeting, public investment appraisal, fiscal-risk analysis, and debt sustainability frameworks. Fourth, deepen green and sustainability-linked finance instruments and pipelines. Even then, complementary.

2.9.5 Other Relevant Issues in Ethiopia to harness Natural Capital Assets

Beyond institutions and finance, managing Ethiopia's natural capital for development requires addressing several critical cross-cutting challenges. Insecure land tenure and unclear usufruct rights weaken incentives for long-term conservation and private investment, particularly in agriculture and forestry, while increasing risks of displacement and conflict. Social inclusion and benefit-sharing mechanisms remain weak; without credible ways to channel carbon, conservation, and resource revenues to communities, natural capital initiatives risk undermining social cohesion, especially in fragile regions. Conflict sensitivity and regional inequality are central, as competition over resources in Oromia, Afar, Benishangul-Gumuz, and Amhara can escalate if projects ignore local political economy dynamics. Weak data systems, digital land registries, and climate information constrain planning, monitoring, and enforcement, while limited human and technical capacity reduce project quality. Finally, embedding resilience, disaster risk management, and biodiversity protection into development planning is essential to prevent natural capital from becoming fiscal and social liabilities.

2.10 Crowding in Global Private Capital in a Fragmented World

2.10.1 Foreign Direct Investment in Ethiopia

Foreign direct investment remains a vital driver of Ethiopia's structural transformation

by providing capital, technology, managerial expertise, and market access. The country's large domestic market, youthful workforce, strategic location, expanding infrastructure, industrial parks, and recent macroeconomic reforms strengthen its attractiveness to investors. Continued liberalization, foreign-exchange reforms, and stronger public-private partnerships can channel investment into manufacturing, agribusiness, renewable energy, logistics, digital services, mining, and tourism. These investments can accelerate industrialization, create jobs, diversify exports, boost productivity, facilitate technology transfer, and support private-sector-led growth and investor confidence.

However, Ethiopia's FDI model remains fragile, with inflows constrained by conflict, foreign-exchange shortages, inflation, regulatory uncertainty, land-access difficulties, infrastructure gaps, and weak linkages between foreign investors and domestic firms. As a result, technology transfer, local supplier development, and productivity spillovers remain limited, reducing FDI's contribution to industrial upgrading, export competitiveness, and broad-based economic transformation. To maximize developmental benefits, Ethiopia should build an integrated financing ecosystem that connects foreign investment with domestic enterprise growth. Expanding collateral-free lending, partial credit guarantees, blended-finance facilities, and risk-sharing mechanisms can ease financing constraints for MSMEs and local suppliers. Digital credit assessment using mobile money, transaction histories, and e-commerce data can deepen financial inclusion, especially for women- and youth-owned businesses. Strengthening venture capital, angel investor networks, diaspora investment platforms, and indigenous private-equity funds can expand access to growth capital, while gender-responsive and youth-focused financing programs can promote more inclusive and sustainable development.

Improved access to loans, grants, equity, and credit can accelerate business formalization and strengthen participation in formal value chains. By enhancing regulatory predictability, property-rights protection, foreign-exchange availability, investment facilitation, and linkages between foreign investors and domestic firms, Ethiopia can attract higher-quality FDI. This would foster innovation, knowledge transfer, job creation, competitiveness, productivity growth, export diversification, and resilience while strengthening domestic enterprises, supporting inclusive prosperity, and advancing long-term economic transformation.

2.10.2 De-risking and Blended Finance: Building Bankable Pipelines

Ethiopia can leverage blended finance and de-risking instruments from development finance institutions to advance its Ten-Year Development Plan, Home-Grown Economic Reform agenda, and climate commitments under NDC 3.0. With public debt constraints and high country risk limiting private investment, concessional capital, guarantees, and technical assistance from DFIs can crowd in private finance by reducing political, FX, and off-taker risks. World Bank and AfDB guarantees for renewable energy by Independent Power Producers (IPPs) demonstrate how risk backstopping can mobilize large-scale private capital while aligning with power-sector reform and green growth objectives. Concessional and first-loss capital from facilities such as the Sustainable Energy Fund for Africa (SEFA) and International Development Association (IDA) can support agribusiness, decentralized energy, and climate-resilient infrastructure, especially in fragile and drought-prone regions prioritized in national plans. Strengthening the Development Bank of Ethiopia would enable blended instruments such as partial-credit guarantees, co-financing, and FX liquidity-windows. To be effective, Ethiopia should shift from project-by-project blending to programmatic platforms, improve project preparation, embed conflict sensitivity and land security, and track leverage ratios, ensuring blended finance translates into jobs, exports, resilience, and fiscal sustainability nationwide.

2.10.3 External Portfolio Flows

Ethiopia attracts cross-border capital through a state-directed framework designed to align inflows with development priorities rather than liberalized portfolio mobility. The anchor is Investment Proclamation No. 1180/2020, which uses a negative list, minimum capital thresholds, and centralized licensing by the Ethiopian Investment Commission to channel foreign capital toward export-oriented, capital-intensive activities. Spatial instruments, industrial parks and special economic zones structure inflows

by bundling land, infrastructure, customs facilitation, and one-stop services, lowering operational risk while preserving regulatory oversight. For portfolio-relevant flows, incentives have shifted from broad tax holidays toward performance-based regimes. Reduced corporate tax rates, customs exemptions, and capital allowances are conditional on verifiable exports, employment creation, and technology transfer, with claw-back provisions to limit fiscal leakage and signal policy credibility. Foreign-exchange (FX) reforms since 2024 have strengthened market-based pricing, eased profit and dividend repatriation, simplified FX accounts, and delegated approvals to banks which is important for investor confidence while capital account controls remain binding. This architecture has supported manufacturing-linked inflows but limits diversified portfolio flows. Administrative intensity, residual FX risk, land-lease insecurity, and continued SOE dominance constrain secondary-market depth and the development of tradable instruments.

2.10.4 Leveraging Fragmentation to Build Strategic Platforms

Ethiopia can turn global financial fragmentation from a constraint into an opportunity by positioning itself as a credible, neutral node in reconfigured capital, trade, and technology networks, conditional on restoring macroeconomic stability and foreign-exchange credibility. Fragmentation has shifted global flows away from efficiency-driven globalization toward security, resilience, and geopolitics-driven allocation. While this disadvantages many low-income economies, it creates space for prospective "connector" countries that can combine neutrality with reliability. Ethiopia's non-alignment, large labor force, and proximity to African, Middle Eastern, and European markets give it potential to act as a diversification platform for firms seeking to de-risk supply chains. To realize this, geopolitical neutrality must be translated into commercial dependability through predictable regulation, sustained macro stabilization, and credible access to foreign exchange. Fragmentation increasingly favors regional and sector-specific value chains. Ethiopia should therefore deepen AfCFTA integration, strengthen logistics corridors, and target friend-shored manufacturing, agribusiness, renewables, and applied industrial technologies. On the financing side, fragmentation rewards countries with strong institutions and risk-management capacity. Ethiopia should prioritize long-term, patient capital DFI-anchored, blended, and equity-like financing - over volatile flows, with clear learning spillovers.

2.10.5 Strengthening Partnerships to Mobilize Capital, Investment and Trade

First, Ethiopia should prioritize local platform building to anchor capital, investment, and trade partnerships. Structured public–private–MDB collaboration platforms can link government, domestic finance, and multilateral development banks, turning institutions such as the Development Bank of Ethiopia into credible co-origination partners. MDB resources can then crowd in private banks, pension funds, and insurers through risk-sharing guarantees and blended finance. Strengthening project-preparation facilities within sector ministries and regions is essential to translate policy priorities into bankable, MDB-aligned pipelines. At this stage, financing should focus on export-oriented manufacturing, agro-processing, logistics, and energy, tied to measurable performance on jobs, exports, and FX generation. Over time, platform-based mobilization deepens domestic capital-market participation, improves investment discipline, and sustainably reduces reliance on sovereign borrowing. Second, Ethiopia should embed these platforms within regional integration. Implementing AfCFTA as a development compact moves the agenda beyond tariffs toward regional value chains in textiles, leather, agro-processing, and services, supported by trade finance, standards harmonization, and logistics investment. Coordinated financing by MDBs—especially the AfDB and World Bank—can support transport corridors, digital customs, and power interconnections that lower trade costs and anchor private investment across borders. Third, global capital mobilization should be MDB-anchored and credibility-led. By aligning macroeconomic reform, development policy operations, guarantees, and political-risk insurance, Ethiopia can crowd in long-term capital for climate, digital, and industrial transformation. Knowledge partnerships on technology transfer and skills should complement finance. Strategically aligning bilateral partners around

these MDB-anchored platforms positions Ethiopia as a reliable hub for investment, trade, and innovation. Sequencing global engagement last ensures reforms and regional credibility are in place before scaling exposure, reducing execution risk and volatility, and allowing Ethiopia to negotiate from a position of strength with global investors, DFIs, and strategic partners while safeguarding fiscal, external, and institutional sustainability over the medium term and improving development outcomes nationally.

2.10.6 Other Relevant Issues to Crowding in Global Private Capital in Ethiopia

Several often-overlooked structural constraints continue to limit private capital and trade-finance mobilization in Ethiopia, with clear differences in binding intensity. First, restoring FX credibility and curbing capital flight are paramount. Trade mis-invoicing, weak enforcement, and expectations of policy reversibility drain domestic savings, reduce FX availability, and sustain parallel-market premiums, undermining investor confidence. Second, insecure land tenure, unclear compensation frameworks, and restrictions on collateralization elevate risks for agribusiness, industry, and infrastructure, directly constraining long-term investment. Third, shallow trade-finance markets and limited correspondent-banking relationships force exporters to rely on costly, short-tenor instruments, eroding competitiveness and scale. Fourth, large domestic institutional investors-pension funds, savings and credit cooperative organizations (SACCOs,) and insurers-remain under-mobilized due to fragmented regulation, conservative mandates, weak corporate disclosure, and a thin pipeline of bankable projects. Underdeveloped capital markets and limited investor protection further restrict long-term financing options. Sequencing reforms along this hierarchy is essential to unlock private capital at scale sustainably.

2.11 Conclusion and Policy Recommendations

Ethiopia's development financing challenge is fundamentally about credibility, coordination, and execution rather than the scarcity of instruments. Debt distress, FX shortages, shallow markets, and fragmented institutions have constrained scale, while global fragmentation raises the penalty for policy uncertainty. Yet Ethiopia is underpinned by strong fundamentals: robust growth potential, a large domestic market, sustained reforms under HGER 2.0, AfCFTA integration, resilient remittance inflows, and substantial natural resource endowments. Mobilizing finance at scale therefore requires stitching reforms into a coherent platform where macroeconomic stability, revenue mobilization, public financial management, blended finance, PPPs, and capital markets reinforce each other. Multilateral development banks (MDBs) can anchor this transition, but success ultimately depends on domestic institutions delivering predictable rules, bankable projects, and credible enforcement. If sequencing is disciplined and governance gaps are closed, Ethiopia can convert fragmentation from a constraint into leverage, crowding in long-term private and institutional capital to finance structural transformation, resilience, and inclusive growth nationally.

Policy priorities should focus on five mutually reinforcing actions. First, complete debt restructuring and entrench macro stability to lower country risk and anchor investor expectations. Second, broaden domestic revenue through base expanding tax reforms, stronger compliance, and efficiency gains, complemented by PFM reforms that close leakages and improve value for money. Third, scale MDB- anchored blended finance and PPP platforms, shifting from isolated transactions to programmatic pipelines with standardized risk allocation and credible FX frameworks. Fourth, deepen financial markets by operationalizing the securities exchange, mobilizing pension and diaspora capital, and expanding long -term, local-currency instruments. Fifth, leverage AfCFTA, climate finance, and natural resource capital to diversify exports and crowd in private investment. Across all areas, regulatory predictability, project preparation capacity, land security, and enforcement are decisive. Sequenced reforms, transparency, and delivery discipline will determine whether Ethiopia mobilizes financing at scale or remains constrained despite ambitious frameworks.

3 STRENGTHENING AND CONSOLIDATING ETHIOPIA'S FINANCIAL SYSTEMS AND AGENCY IN THE CHANGING WORLD

KEY MESSAGES

- Ethiopia's financial system remains shallow, bank-dominated, and state-led, with limited capital markets, weak monetary transmission, and constrained global and regional integration, restricting its ability to mobilize long-term finance.
- Key challenges include fiscal dominance, foreign exchange scarcity, shallow pension and insurance markets, weak credit infrastructure, and limited hedging instruments. Despite progress through FX liberalization, payments modernization, bank recapitalization, and capital market development, vulnerabilities persist due to inflation, debt distress, and institutional capacity constraints.
- Strengthening the system requires sequenced reforms focused on macro-financial stabilization, credible monetary policy, FX liberalization, and capital market deepening. Expanding risk-sharing mechanisms, mobilizing long-term savings, improving legal and credit systems, and enhancing payments interoperability and regional integration are essential.

3.1 Introduction

This chapter examines the need to strengthen and modernize the RMC financial architecture and agency in a weakening global environment marked by tightening financial conditions. It assesses the decline in global development financing and the rising risks for RMCs, including the contemporary state of financial system with volatile capital flows, the structural vulnerabilities within domestic financial systems as well as financial system integration. The objective is to highlight reforms needed to create a more resilient and integrated financial architecture that can effectively mobilize capital and support long-term development goals.

3.2 Strengthening Ethiopia's Financial System: Addressing Bottlenecks and Expanding Impact

3.2.1 Current State of Financial System in Ethiopia

Ethiopia's financial system remains bank-dominated, state-led, and shallow, reflecting a gradualist reform path shaped by macroeconomic fragility. Public banks, especially the Commercial Bank of Ethiopia, dominate assets, credit allocation, and government financing, crowding out private intermediaries. Capital markets are nascent,

with no operational equity or corporate bond market, constraining long-term financing, risk-bearing capacity, and risk-sharing. The National Bank of Ethiopia has historically reinforced this structure through interest rate controls, directed lending, and FX rationing. Recent market-based reforms bank recapitalization, steps towards FX liberalization, and preparatory work on securities markets, signal progress, but sequencing remains critical amid inflation, debt distress, and weak monetary transmission.

Reforms should proceed in clear order. First, restore macroeconomic and monetary credibility through durable disinflation, foreign-exchange stability, and improved transmission, enabling banks to expand balance sheets sustainably. Second, deepen financial intermediation by easing repression, strengthening supervision, improving credit information, and mobilizing domestic savings toward long-term uses. Third, build capital-market foundations corporate disclosure, investor protection, custody and settlement systems, and public–private co-financing vehicles before advancing more complex risk-bearing instruments. At a later stage, green bonds, diaspora bonds, carbon markets, and remittance-linked products can be scaled, as these instruments require market depth, governance capacity, and macroeconomic confidence.

Financial inclusion and digital finance should also follow a sequence. Transaction-based inclusion has expanded rapidly through mobile money, agent banking, and fintechs, reducing payments costs for households and firms. The next step is converting access into risk-bearing services- such as credit, insurance, and pensions through interoperability, data governance, cybersecurity, and prudent regulation. Without deeper markets, first-loss mechanisms, and effective supervision, digital finance risks entrenching transactional access without delivering productivity gains, resilience, or export competitiveness. This sequencing clarifies roles for public banks, private intermediaries, and regulators, aligns incentives with stability, and supports a gradual shift from bank-led credit to a market-based, risk-sharing financial system.

3.2.2 Expanding Ethiopia's Financial Sector Reach and Impact

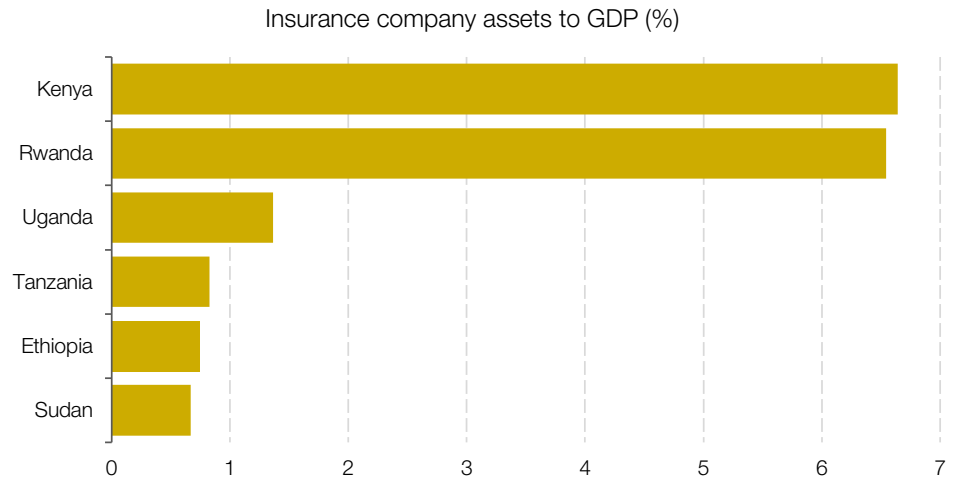
Ethiopia can expand access to long-term capital by shifting from narrow, transaction-based inclusion to productive, risk-bearing finance, as shown in Figure 20, indicating low insurance coverage. While digital payments and basic accounts have grown, access to credit, insurance, and long-term savings remains limited by collateral constraints, weak credit information, and macro instability. Reforms should be sequenced to improve readability and effectiveness.

First, there's the need to expand digital interoperable payments, digital ID, and credit registries to lower entry costs for households, MSMEs, women, and youth. Inclusion should be delivered through layered institutions, with MFIs, SACCOs, and agent networks originating clients and commercial banks providing scale. Second, banks should be crowded into underserved segments using expanded risk-sharing tools, including partial credit guarantees, portfolio insurance, and first-loss tranches.

Third, long-term capital should be expanded by repositioning the Development Bank of Ethiopia and Multilateral Development Banks (MDBs) as market creators rather than dominant lenders. The Development Bank of Ethiopia should evolve into a wholesale, catalytic institution, channeling concessional resources through co-financing, guarantees, and refinancing lines while strengthening governance and appraisal. MDBs can amplify impact through local-currency lending, political risk insurance, and blended finance that attract private capital into infrastructure, manufacturing, agribusiness, and climate projects. Only at a later stage should green bonds, diaspora bonds, carbon markets, remittance-linked finance, and public–private investment funds be scaled. These instruments require market depth, governance capacity, and macro stability to function credibly. Sequenced reforms that integrate inclusion, development finance, and capital-market deepening can mobilize long-term savings, crowd in private investment, and support transformation without recreating

debt distress. Careful sequencing sustains confidence, manages risk, and ensures public–private finance complements competitive markets rather than substituting for them over the medium term sustainably.

Figure 20 : Insurance Market Landscape in Ethiopia (Assets% to GDP)



Source: AfDB ECST Data

3.2.3 Other Relevant Issues in Ethiopia's Financial System

Beyond banks and digital finance, Ethiopia's financial system faces several underexamined constraints, notably shallow pensions and insurance markets that limit long-term savings mobilization; weak insolvency and collateral enforcement frameworks that increase lending risks; fragmented public credit programs that distort incentives; limited availability of financial statistics that undermines effective supervision; and persistent fiscal dominance that crowds out private sector credit and financial innovation.

3.3. Consolidating Ethiopia's Financial System to an Integrated Architecture

3.3.1 Ethiopia's Financial System Integration

Ethiopia's regional financial integration has advanced institutionally but remains limited in practical depth and balance. The country has aligned with continental and regional initiatives such as the Pan-African Payment and Settlement System (PAPSS) under AfCFTA and COMESA's Digital Retail Payments Platform, which enable cross-border settlements in local currencies and significantly reduce transaction costs relative to dollar-based correspondent banking. These AfCFTA-aligned systems are strategically important for lowering trade costs, supporting MSMEs, and easing pressure on scarce foreign exchange (FX) reserves. However, Ethiopia's participation is functionally constrained by tight FX controls, administrative approval requirements for outbound payments, and restrictions on the use of foreign exchange for current-account transactions, even if capital-account controls are not the binding margin. As a result, most cross-border activity remains inward-focused, dominated by remittances and donor or MDB flows, while firms face persistent frictions in paying for imports, services, logistics, and regional value-chain inputs. Payment infrastructure has thus moved faster than policy openness, creating a gap between formal integration commitments and actual business usability.

Beyond payments, Ethiopia's deeper regional financial integration remains shallow relative to economic size. Cross-border banking presence is minimal, access to regional trade-finance facilities is limited, and firms lack affordable instruments to hedge currency and commodity risks. Even with tariff reductions,

trade costs remain high because of settlement delays, convertibility risk, and limited regional guarantees continue to raise financing costs. Capital-market integration should therefore be treated as a later-stage objective, contingent on progress in payments usability, trade finance availability, and FX credibility. Ethiopia's cautious, stability-anchored financial regime is understandable given macro fragility, but without carefully sequenced liberalization supported by supervision, guarantees, and safeguards regional financial integration will remain largely symbolic rather than commercially transformative. This sequencing preserves stability while gradually expanding firms' ability to trade, invest, and integrate across regional markets competitively and sustainably.

3.3.2 Policy Pathways to Consolidate Ethiopia's Financial System

Ethiopia can consolidate and integrate its national financial system with regional markets by sequencing domestic reforms ahead of outward liberalization. Foreign exchange reforms, market-based rates, decentralized approvals, forward contracts, and relaxed FX account rules have reduced distortions that historically blocked cross-border participation. These changes create the foundation for leveraging AfCFTA-aligned payment systems, including PAPSS and COMESA platforms, which enable local-currency settlements and lower transaction costs. However, payment connectivity alone is insufficient. Integration must be anchored in stronger domestic supervision, reduced fiscal dominance over banks, credible monetary policy transmission, and improved credit infrastructure. Without these, regional platforms risk serving mainly remittances and official flows rather than supporting trade finance, services exports, and private investment. Consolidation therefore requires aligning financial-sector reforms with trade, logistics, and services liberalization, ensuring that domestic institutions can intermediate risk, mobilize savings, and support local firms.

At the policy level, Ethiopia should pursue functional integration before full capital-account openness. Priorities include interoperability between domestic real-time gross settlement (RTGS) and automated clearing house (ACH) systems and regional platforms, expansion of regional trade-finance and guarantee schemes with Afreximbank and TDB, and gradual cross-border banking through correspondent relationships, syndicated lending, and representative offices. The national AfCFTA implementation strategy rightly links financial, digital, and services reforms, but success depends on calibrating the National Bank of Ethiopia (NBE) regulations to regional norms on payments, data, and settlement while preserving macroprudential safeguards. Regional integration should be used as a discipline device for domestic reform: FX liberalization, hedging markets, investment banking, and capital-market institutions can be piloted through AfCFTA priority sectors and regional corridors. If Ethiopia leverages regional payment and guarantee systems to crowd in private finance while insulating banks from fiscal pressures, it can transition from defensive participation to hub-oriented regional intermediation, aligning financial integration with growth, resilience, and structural transformation. Such sequencing strengthens credibility, reduces volatility, and embeds Ethiopia credibly in regional financial markets.

3.3.3 Other Relevant Issues in Consolidating Ethiopia's Financial System

Beyond the reforms outlined above, Ethiopia's financial consolidation is also constrained by less-discussed structural weaknesses that undermine intermediation. Weak collateral registries and slow judicial enforcement raise credit risk and skew lending toward immovable assets, limiting access to finance for SMEs. Fragmented public credit programs distort pricing and crowd out private lenders, while gaps in financial statistics and credit reporting weaken supervision and market discipline. Cybersecurity and operational risks are rising faster than regulatory capacity, threatening

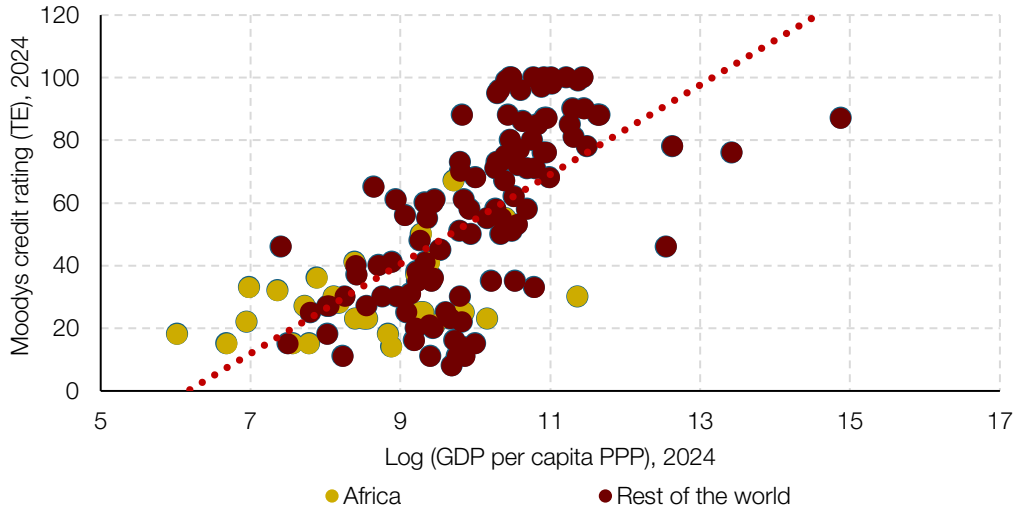
confidence in digital finance. At the same time, shallow pension and insurance markets limit long-term savings, and continued fiscal dominance through state-linked borrowing and guarantees weakens monetary transmission and bank balance sheets. Skills shortages in risk management, insolvency practice, and capital-market operations further slow reform implementation. Addressing these "soft infrastructure" constraints, specifically legal enforcement, data quality, governance, cybersecurity, and institutional capacity is essential for achieving durable financial deepening and stability.

3.4 Towards Financial Agency and Sovereignty

3.4.1 Imperatives of Ethiopia's Financial Agency

Rethinking Ethiopia's financial architecture means shifting from administrative allocation to a rules-based system that prices risk and mobilizes long-term capital. Reform should proceed in stages while ensuring inclusive growth marked by significant growth in GDP per Capita. As shown in Figure 21, Africa lags other regions in GDP per Capita growth yet sovereign creditworthiness, borrowing costs, access to international capital markets, and economic fundamentals for financial agency are highly correlated with GDP per Capita. In the financial system, first, mandates must be clarified and functional regulations adopted across banking, capital markets, fintech, and fiscal agencies, anchored by a legally backed Financial Stability Council for systemic risk and crisis management. Second, credible price signals must be locked in by implementing the market-based foreign-exchange framework and negotiated bank rates under FXD/01/2024, deepening the transition to interest-rate-based monetary policy and preventing renewed central bank financing of government. Third, micro-prudential foundations need strengthening through enforceable governance standards, large-exposure limits, forward-looking provisioning, improved supervisory data, and stress testing. Fourth, domestic-currency capital formation should be built by operationalizing the securities exchange, broadening the investor base especially pensions and insurance and repositioning public and development banks toward catalytic, transparent development finance supported by recapitalization and restructuring. Finally, Ethiopia should integrate regionally without premature capital-account opening by connecting to REPSS and PAPSS with strong AML/CFT, cybersecurity, and data standards. Cross-border payments lower trade costs, preserve stability, and strengthen investor confidence.

Figure 21 : GDP per Capita to Correlation to Credit Risk Ratings



Source: Staff calculations using data from World Bank International Debt Statistics 2025.

3.4.2 Institutional Structure for a Resurgent and Impactful Financial Sector in Ethiopia

Creating a new financial architecture in Ethiopia requires sequenced institutional reforms to address fragmented oversight, state dominance, and weak credibility while managing political risks. The priority is restoring credibility. Mandates across the National Bank of Ethiopia, capital market authorities, fintech regulators, and fiscal institutions should be clarified and coordinated through an anchored Stability Council responsible for oversight and crisis management. In parallel, central bank independence must be protected by binding limits on monetary financing, liquidity operations, and governance safeguards that lock in market-based interest rates and foreign-exchange pricing. Once credibility anchors strengthen, supervision should evolve from compliance-driven rules toward risk-based, forward-looking approaches supported by regulatory data, stress testing, and early-warning systems. Public banks and development finance institutions should then be restructured to play catalytic roles, providing guarantees and finance while crowding in private capital. Capital market, payment, and regional integration should deepen later to support inclusion and resilience. While stabilization, IMF support, FX reform, and AfCFTA commitments create momentum, progress remains vulnerable to debt restructuring risks, FX shortages, and inflation pressures, underscoring the need for disciplined sequencing.

3.4.3 Other relevant Issues in Ethiopia Regarding Financial Agency and Sovereignty

Ethiopia's financial reform debate insufficiently addresses financial agency and sovereignty alongside ongoing liberalization. While exchange rate, monetary, and capital market reforms dominate policy discourse, limited attention is paid to whether households, firms, and institutions can effectively access, use, and control financial services. Persistent informality, weak credit information, collateral enforcement gaps, and risk pricing constraints mean liberalization may deepen exclusion rather than agency. Financial sovereignty is also underexamined: greater reliance on market-based FX, cross border payment systems, and external financial rails raises exposure to volatile flows, correspondent banking risks, and data dependencies, yet governance safeguards remain thin. Discussion often frames sovereignty as sequencing rather than as institutional control over systemic risks. In addition, fiscal dominance, SOE balance sheet pressures, and the absence of a legally empowered financial stability council dilute state capacity to exercise coherent monetary and regulatory authority. Finally, fintech expansion improves access but raises sovereignty risks.

Box 4: Ethiopia- Examples Successful/Current Reforms to Strengthen Financial Architecture and Governance

Monetary policy and FX reform: Ethiopia has modernized its monetary policy under NBE's leadership, shifting from direct controls to market based instruments, improving liquidity management, and moving toward a more flexible exchange rate regime. These steps have narrowed FX distortions, improved price signals, boosted export competitiveness, and strengthened central bank credibility.

Capital market creation: The establishment of the Ethiopian Securities Exchange is a structural milestone, enabling organized trading of government securities with modern settlement and custody. It lays the groundwork for price discovery, market based domestic financing, and reduced reliance on bank credit.

Legal and regulatory upgrades: Revisions to the Commercial Code, Capital Market Proclamation, and e transaction laws have improved contract enforcement, disclosure,

corporate governance, and digital transactions, enhancing predictability and investor confidence.

Payments and digital finance: Payment system liberalization under the Digital Ethiopia agenda has opened the sector to non bank and foreign participation, accelerating mobile money and fintech adoption and expanding financial inclusion.

PFM and fiscal governance: IFMIS rollout, TSA expansion, and better budget transparency have strengthened fiscal financial coordination and reduced fiduciary risks, supporting macro financial stability.

Supervisory innovation: Regulatory sandboxes and proportionate licensing reflect a shift to risk based, forward looking supervision, balancing innovation with stability and reducing entry uncertainty.

Regional integration: Commitments under AfCFTA, COMESA, IGAD, and progress toward WTO accession are aligning rules with regional and global norms, supporting convergence, cross border investment, and institutional discipline.

3.5 Conclusion and Policy Recommendations

Conclusion

Ethiopia's financial system is moving toward a market-based architecture but remains constrained by bank dominance, foreign exchange scarcity, shallow markets, and vulnerability to external shocks. Reforms in monetary policy, exchange rates, digital finance, and capital markets are encouraging, yet transaction costs, cross border frictions, and debt distress persist. A coherent response requires macro financial stabilization through joint cash and liquidity forecasting, reduced FX risk concentration, deeper money markets, consolidated capital markets, mobilization of savings, and modernization of payments systems.

Policy Recommendations

Strengthening Ethiopia's financial architecture requires a sequenced reform agenda built around four mutually reinforcing pillars. The first is macro financial stabilization and foreign exchange risk management, requiring institutionalized coordination between the National Bank of Ethiopia and the Ministry of Finance on cash flow forecasting linking cash management, Treasury bill issuance, reserve management, and banking system liquidity. Integrating external debt service and reserves into medium term frameworks and improving disclosure and stress testing, especially for SOEs, would reduce FX risk concentration and ad hoc financing pressures.

The second pillar is capital market development and long-term savings mobilization. Reform should consolidate market activity around the Ethiopian Securities Exchange to ensure trading, settlement, custody, and price discovery before expanding into corporate, municipal, and thematic, including green, instruments. Pension and insurance governance reforms can help mobilize domestic savings, while development finance institutions should shift toward guarantees, co-financing, blended finance, and trade finance risk sharing to crowd in private capital. The third pillar focuses on payments, data, and regional connectivity, requiring interoperability, wider switch access, stronger cybersecurity, better data, and routing through COMESA, IGAD, and PAPSS. The fourth pillar is governance and partnerships, including system wide risk governance, tighter SOE fiscal risk controls using debt sustainability analysis, careful liberalization, and AfDB and MDB partnerships aligning policy lending, assistance, and guarantees with AfCFTA driven regional integration frameworks priorities.

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