



# **Responsible Land Governance: Towards an Evidence Based Approach**

**ANNUAL WORLD BANK CONFERENCE ON LAND AND POVERTY**  
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## **Growing Demand, Shrinking Supply of Industrial Lands in Addis Ababa, Ethiopia: Underlying Causes and Possible Solutions**

**[Draft]**

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# Responsible Land Governance: Towards an Evidence Based Approach

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## **Abstract**

While Addis Ababa is rapidly urbanizing, productive job creation remains to be a key challenge. The root cause of this has been the lack of structural transformation towards industries with higher potential for growth and job creation. In response, the government of Ethiopia through its Growth and Transformation Plan (GTP2) targets the industry and manufacturing sectors to enhance structural transformation and create more productive jobs in Ethiopia's cities. However, in the process of industrial promotion, shortage of industrial land has emerged as a key bottleneck. Currently, it is estimated that about 6000 investors are in the waiting list requesting land for investment in Addis Ababa. This has created distortions in the land and rental market and consequent price hike; and this threatens the job and economic growth potential of the city by discouraging businesses from entering or expanding in the city. Since Addis Ababa is one of the least industrialized cities in Africa, industrial land exhaustion mayn't be the major explanation. We argue that given the city's developable land size, there is significant scope to improve the supply of industrial land by solving some of the inefficiencies and market failures with the current arrangement of land allocation and management.

## **Key Words:**

Addis Ababa, corruption, governance, land, urbanization



## ***1. Introduction***

Land is a key resource and encompasses a variety of functions. In socio-economic terms, land can be viewed as a scarce space for locating economic production activities, infrastructure and dwellings, as productive soil that provides organic and inorganic materials for agriculture, and it provides aesthetic value and amenity services. It also acts as a store of value and assets and as a source of prestige and an organizing principle for socio-economic relationships (FAO 1995).

In present day Ethiopia, land is a public property. Article 40 (3) of the Ethiopian constitution states that “the right to ownership of rural and urban land, as well as of all natural resources, is exclusively vested in the State and in the peoples of Ethiopia. Land is a common property of the Nations, Nationalities and Peoples of Ethiopia and shall not be subject to sale or to other means of exchange” (FDRE 1995). It has been administered by the government since the 1975 radical land reform. The reform usually dubbed as “land to the tiller” brought to an end the exploitative type of relationship that existed between tenants and landlords. Tenants became own operators with use rights, but with no rights to sell, mortgage or exchange of land. The EPRDF-led government that overthrew the Military government (Derg) in 1991 has inherited the land policy of its predecessor.

The focus of this report is urban land in general and industrial land in particular. The role of land in urban development is three-fold (Ding and Lichtenberg, 2011). First, land is heavily used to support public finance. Land revenues constitute a large part of local revenues. The second role of land is land-based financing of urban expansion. Financing infrastructure through land leasing and bank loans securitized on land and property valuation accounts for a large percentage of infrastructure financing. This includes land financing directly (public land leasing) and indirectly (land used as collateral). The third role of land in development is associated with land based developments and reforms. Given the skyrocketed land prices, land is used to attract investments by providing free or subsidized land access. On the contrary, if unchecked, land is also open to speculation and bubble, where unproductive and non-value adding activities could take place.



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With this background let's come back to the problem of land in the Addis Ababa city. Compared to the level of urbanization in East Africa and other SSA countries, Ethiopia is still one of the least urbanized countries in the world at only 19%. However, it is also one of the most rapidly urbanizing countries in Africa (see [Table 1](#)).

[Insert table 1]

Over the last 30 years, Ethiopia's annual urban population and urbanization growth rate has been one of the highest in the world (UN 2009). And this growth trend is likely to continue; for instance, the UN estimates that Ethiopia's urban population will triple between 2010 and 2040, growing at an average rate of 3.5 percent per year. Furthermore, its expected urbanization growth rate is above 3.76% for the coming 15 years (2010-2025). In SSA in general and Ethiopia in particular, growth of urban population has been driven by rural-urban migration of individuals seeking for better jobs and other livelihood opportunities in urban areas (Anderson, 2001; APHRC, 2002). In Ethiopia, around 12.2 million (or 16.6% of the total population) were in-migrants during the 2007 census. Addis Ababa, due to its geographic location, combined with its political and socio-economic importance have made it a melting pot to hundreds of thousands of people coming from all corners of the country in search of employment opportunities and other services.

Consequently, job creation remains a top priority for the Addis Ababa City administration. Despite significant progress in unemployment reduction (i.e., the city's unemployment rate has decreased from 33% in 2003 to 21% in 2015) (CSA 2015), unemployment rate of 21 percent is still high. And given that urban Ethiopia especially Addis Ababa is facing what is known as the youth bulge, employment creation remains to be a critical challenge. And at the root cause of this is the lack of structural transformation from low value added and non-tradable activities to other sectors and industries with higher potential for growth and job creation. Urbanization processes that are not accompanied by structural transformation tend to have limited capacity to expand and create productive jobs for the urban youth. Urbanization must happen through massive structural transformation. In response, due to its superior intersectoral linkages and its ability to create productive employment opportunities, the government of Ethiopia through its Growth and



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Transformation Plan (GTP2) targets the industry and manufacturing sectors to enhance structural transformation and create more productive jobs in Ethiopia's cities. However, as Ethiopia promotes industrialization through entry of new and expansion of existing firms, its cities especially Addis Ababa, face a critical shortage of industrial lands. Currently, it is estimated that about 6000 investors are in the waiting list that have placed their request for land for investment from the Addis Ababa city<sup>1</sup>. This has created distortions in the land and rental market and consequent speculative land rush and price hikes; and this threatens the job and economic growth potential of the city by discouraging businesses from entering or expanding in the city. It is critical to understand the nature of the land administration and governance bottlenecks that are causing inefficiencies in the land and rental markets in Addis Ababa in order to come up with relevant solutions.

## ***2. Rationales, Research Questions and Approach***

A recent study by Berihu et al (2016) indicates that despite the priority and importance accorded to the industrial sector and efforts to improve the investment environment, quite a few domestic investors go beyond the licensing stage to start production. The study showed many domestic potential investors are either stuck or discouraged by the constraints and market failures they face along the investment process. At the top of the list of binding constraints is shortage of land. A number of other studies have been undertaken in the last few years on constraints to existing firms, including the Ethiopian Public Private Consultative Forum (EPPCF) National Business Agenda Report (2014); the World Bank's Doing Business (World Bank 2014) and Enterprise Survey (World Bank/IFC 2012) reports; the World Economic Forum's Global Competitiveness Report 2013-2014; and the various relevant studies undertaken by the Private Sector Development Hub. Most of these studies indicate that lack of access to land is a major constraint. For example, see **Figure 1** below summarizing some of the most severe barriers mentioned by firms and the issue land comes at the second place.

[Insert figure 1]

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<sup>1</sup> Based on information obtained from interviews with Addis Ababa Investment Agency authorities.



The issues of industrial land affect investors in at least two ways: during entry and expansion phases. Previous studies on similar issues relied on existing survey data sources which do not contain stuck/discouraged investors in their sample. For example, most World Bank Enterprise surveys and the Ethiopian Central Statistical Agency's surveys of large and medium scale manufacturing firms relied on data from operational firms, which could not definitively answer how the land problem affects the pre-operation phase. The fact that many investors were not able to move beyond the licensing stage to start operation is largely attributed to industrial land problems. However, most of these studies do not go beyond just identifying land as a major constraint. One has to go further and critically examine why Addis Ababa faces severe shortage of land at this stage. Given that Addis Ababa is at its early stage of industrialization, the hypothesis that land shortages are caused by land exhaustion seems to be premature. So, the key question for us is that given that Addis Ababa is at its early stage of industrialization and urbanization what are the real causes of (industrial) land shortages? Why do land shortages occur at this stage?

In view of this, our approach followed multi-layered information gathering mechanisms to really understand the issue of land as a key business entry barrier and key market failure.

- a) Qualitative firm level data - we think that qualitative firm level research among the firms who received an investment license but are stuck/discouraged by the long process of securing land access is likely to be very useful in finding out how land administration and governance problems affect the land allocation process.
- b) Key informant interview – we interviewed key government and private institutions and stakeholders including the Addis Ababa City Government Investment Office, the Ethiopian Investment Commission, Addis Ababa Bureau of Land Administration and Management, World Bank staff, and other relevant government agencies to verify the information mentioned by firms on the land administration and governance obstacles.
- c) Document and institutional review - we also reviewed relevant regulations, policies and strategies related to urban land and the current institutional arrangement under which city's land administration is operating.



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In order to identify and select firms for sampling, we worked with the Addis Ababa Investment Agency and the Ethiopian Investment Commission who allowed us access to the database of investors licensed and other relevant documents on land issues. Some of the key questions we addressed include:

- We want to understand if the current legal, institutional and policy framework for land tends to favor speculators rather than serious investors? And we also want to investigate if there are perverse incentive systems that guide the city to maximize revenue from land sales at the expense of maximizing the development impact of land?
- Within the current land administration and governance system, what are the key sources of inefficiencies and failures? What are the consequences of inefficient land governance system or in other words, what are the potential contributions of improved land governance?
- Besides, we will discuss additional mechanisms to improve transparency and accountability, thus, build credibility in the process of land allocation and markets.

### ***3. Challenges Associated with Industrial Land Acquisition: Results and Discussions***

Ethiopia's urban land market is divided into two: primary and secondary markets. While transactions in the primary land market are between the state and private land users, those land transactions in the secondary market are between private land users. While the state assumes a sole supplier of land in the primary market, it assumes a regulatory role in the secondary market.

In the primary market, the Addis Ababa city government as a sole supplier of land allocates land use rights to private users through two routes: leasehold and allotment systems. Below we discuss how these land allocation systems work and their characteristics and associated problems.

#### *i) Lease-hold (auction) system and its problems*

The lease-hold system is supposed to reflect market value of land. However, the government as a sole supplier artificially limits the supply of auctionable land to capture the increased value of land as demand for land increases following rapid urbanization. Land auctions take place at fixed



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time intervals (like every six months) and anyone can take part. But the amount of land supplied at every auction tends to be tightly controlled. The limited supply (or unsatisfied demand) is well illustrated by land auctions in cities, where the number of bidders at land auctions has been 12 to 24 times higher than the number of plots for residential land and 3 to 7 times higher than available plots for commercial land (Ozlu et al., 2015). In 2011, more than one-quarter of companies in Ethiopia reported that access to land represents a major or severe constraint to doing business. Likewise, a recent qualitative study by Berihu et al (2016) shows that land is a key binding constraint for investors to get stuck or discouraged in the investment process in Addis Ababa.

The tightly controlled supply of urban land has contributed to record high prices of land. For instance, Addis Ababa has seen one of the world's highest lease prices, as demonstrated by USD 15,250 per square meter bid in December 2014 around Merkato. Monopoly power in land supply, unbalanced revenue and expenditure commitments provide strong incentives for the city administration to generate and maximize revenue from land sales. This might have led to unsustainable and wasteful land resources allocation. In other words, land sales is an easy way out to raise revenues to meet the city's financial demand to provide municipal services, including water, sanitation, local roads, and solid waste management.

However, the right thing to do would have been to maximize the development impact of land rather than to maximize revenue to meet short-term financial needs. In addition to more traditional responsibilities of managing municipal services, the city administration is responsible for economic development and job creation. And so, attracting investors in the productive sectors would have a multiplier effect – i.e., increasing tax revenue, generating productive jobs, etc. As a result, prudent allocation of land not only avoids wasteful land resources (or increases the supply of land) but it also improves the development impact of land.

The auction system is not only characterized by prohibitively expensive prices due to tightly controlled land supply to maximize land revenues, but it also has the effect of inviting speculators and rent-seekers rather than serious investors. The auction system tended to produce



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a perverse incentive system and invites land speculators rather than serious investors. According to the firms we interviewed the list of auction winners tend to be the same group of people over time. These are people who make a lot of money from land use right sales without adding value, by exploiting the loopholes of the auction system and the extremely weak controlling mechanisms of the city government. The government's extremely weak land use control mechanisms have bred frequent practice of enterprises and individuals diverting the use of land to other purposes (for example, a common practice is using an industrial land for commercial or warehouse purposes to reap short-term benefits and rents). Hence, while the bid system has been developed as a market-based solution, it is plagued by the problems discussed above.

## *ii) Allotment*

A much cheaper alternative to acquire land is through public means – i.e., public allotment. Allotment refers to land allocation without tender and most of the eligible activities under this category are public services. The only private economic activity given privilege under the allotment scheme is the manufacturing sector. So, the city government provides land to eligible industrial investors at very subsidized rates. Since this is the best alternative to acquire land, almost everyone opts for this option. However, the city administration has quite limited capacity to satisfy demand. As demand far exceeds supply, land requests tend to accumulate in the city and the process of screening takes time and becomes tedious. For example, during our interviews with investors we found out that there is a backlog of up to 6000 potential investors in Addis Ababa who have placed their request for land and awaiting decision by the city administration.

The process of acquiring land through allotment is quite slow for at least three reasons

- (i) Servicing land takes time and requires financial capacity – the city government has to first service the land before it allocates to eligible investors. Servicing land includes access to basic services such as power, utilities, roads, transport links, and paying compensation, etc. The city administration has only limited capital budget that it can allocate for this purpose. Furthermore, provision of the basic services and infrastructure takes time.



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- (ii) The land administration and management apparatus is far from modernization and professionalism. It lacks modern land administration and management institutions such as cadastral systems, land use control mechanisms, and enforceable land market regulations. The result is very slow land allocation process plagued by rampant corruption and inefficient practices.
- (iii) The city government lacks bureaucratic efficiency due to the weak capacity of the civil servants to run efficient land allocation system. Since demand for land exceeds supply of land, the city government needs to screen and prioritize out of the many land applicants. However, this process requires professional manpower, which the city lacks seriously. The government sector seems to be trapped in low-skill equilibrium largely due to the low salaries and incentives. There is also a governance aspect to this problem. The final decision and approval regarding land allocations through allotment rests in the hands of the Mayor and Cabinet of the City Government. This leaves local government units (Sub-cities in the case of Addis Ababa) with limited authority and capacity to manage land allocation and urbanization under their territory. The fact that there is a backlog of 6000 firms waiting for land shows that the centralized decision system is not working. The downside of group vetting and centralized decision tends to be inefficient in terms of providing timely decisions.

## ***4. Summary of the Key Challenges and Suggested Solutions***

### ***4.1. Summary of Key Challenges***

We found that access to land is the most crippling constraint for investment in Addis Ababa. Many of the investors who are either stuck or got discouraged and cancelled their investment have attributed the problem largely to the lack of land access. This is consistent with previous Doing Business and Enterprise Survey studies by the World Bank and Global Competitiveness Report by the World Economic Forum.

Job creation remains a top priority for the Addis Ababa City administration. The city's unemployment rate has decreased from 33% in 2003 to 21% in 2015 (CSA 2015). However,



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unemployment rate of 21 percent is still high and given that urban Ethiopia especially Addis Ababa is facing what is known as the youth bulge, employment creation remains to be a critical challenge. Due to its superior intersectoral linkages and its ability to create productive employment opportunities, the promotion of manufacturing, especially private domestic investment remains a priority in the Addis Ababa city in particular and the country in general.

However, even if the manufacturing receives top priority, in practice it faces several challenges. Using qualitative firm level research among the firms who received an investment license but are stuck or discouraged, we found out that land is the top binding constraint for business. We identified that the land problems in the city emanate from land administration and governance bottlenecks (corruption, inefficient and non-transparent decision making processes); problems in the leasehold system (for example, its inability to differentiate between speculators and genuine investors); the city's focus on revenue maximization rather than maximizing the development impact of land, which leads to wasteful land resources allocation; implementation problems related to timely transfer of the land to the lessee once decision is made, problems related to price volatility and uncertainty in the secondary land market.

The land allocations systems – both auction and allotment – have their own problems. The problem with land allocation through *allotment* is that it takes very long time, from 3 to 7 years. In Addis Ababa, the allotment land allocation decision is made by the city Cabinet based on proposal by the land development and management bureau. However, the Cabinet meets rarely due to continuous meetings and other commitments and decisions are often late. The purpose of centralized decision making was to reduce the mismanagement and corruption in land allocation. But it does not seem to serve its purpose of controlling corrupt practices.

On the other hand, the *auction system* suffers from monopoly pricing and corruption. The city government, who is the sole supplier of land, tightly controls the supply of land to capture the increased value of land. The limited land supply coupled with discretionary power of the government officials to restrict, tighten or widen access to land creates a large rent; thus, attract more speculators into the bid. The bid system does not differentiate speculators from serious



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investors; in fact it tends to favor the former. Consequently, the bid process is largely dominated by speculators, which tend to increasingly bid with high prices that are unaffordable by the serious investors. Then the speculators retain the land for some time and resell the use right of the land at even higher prices, and get high profit margins without adding any value. This has proven to be discouraging to the genuine investors and the productive sectors.

The bid allocation system is also marred by implementation problems - i.e. transferring the land to the lessee once decision is made. According to the World Bank study land allocation in Ethiopia (especially in Addis Ababa) is plagued with corruption<sup>2</sup>. The most corrupt activity in the land sector occurs at the implementation stage suggesting that the level of corruption is influenced by the way policy and legislation are formulated and enforced. The study identified serious gaps in the enforcement that include reliance on inconsistent, unpublished and easily changed and manipulated directives, lack of real system to record rights and restrictions, ignorance of the master plan particularly green areas and roads in favor of private use. One has to knock so many doors to get things done as many agencies are involved in the process. Coordination between different agencies is weak. The civil service is incapable, less paid and less motivated.

Another dimension of the land transfer problem is that illegal conversion is rampant. Due to weak monitoring and controlling mechanisms, there is a frequent practice of altering the use of land from industrial (or priority sectors such as manufacturing) to commercial purposes such as stores and shops. Since the land allocated to the industrial sector is under negotiated price (which is usually much lower than market prices), it is illegal under the law to convert it to other purposes. However, in light of the high land prices, individuals and enterprises that have obtained land use rights often sublease or convert land for other than the original purpose for profit. This is due to weak enforcement capacity of the government and the lack of modern land registry system.

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<sup>2</sup> World Bank/IFC (2012). Enterprise Survey Reports



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In the absence of publicly-provided land (either through allotment or auction), the third option for investors is to use their own land or buy/lease from private sources in the secondary land market. The private lease transfer price (and rental of premise) is very expensive consuming large part of their investment and also sometimes uncertain due to changes in the prices of private holdings. Many of the investors stated that no investor needs to start business in a rental land unless and other wise he/she has more money to do that. According to the respondents, leasing from private providers also creates a big uncertainty because the landlords frequently increase rental price or force the tenants to leave the premises giving several reasons. There is also uncertainty about the legality of the lease/rent. Price setting is up to the land lord. Landlords often force the tenants to pay down payment for extended period of time, which reduces the working capital available for the investors. There appears no efficient contractual arrangement that binds both the supplier and customer. More importantly, the private rental is not an option for many manufacturing activities that require large tracts of land.

The other aspect of land administration and governance problems relate to the lack of modern land administration and management apparatus to support efficient and inclusive land development and allocation. Modern land management and governance systems such as land registry and cadastral systems, improved land transfer mechanisms (land titling, etc) and land use control mechanisms are not in place. The city government has started some initiatives to implement the cadaster system but it is not functional yet. But more importantly, the city should work on reforming its civil service as land management requires high professionalism and institutional capacity.

Besides to the lack of modern land management and governance systems, there are no strong and functional complaint hearing mechanisms; and no strong protection to whistleblowers (people who expose corruption, inefficiency and other malpractices) to increase transparency and accountability of authorities and processes.

With respect of land use problems, the major problem is the city's perverse incentives to focus on revenue maximization rather than development impact maximization. The increasing gap between



demand and supply creates artificially high land price, which the city government considers an easy capture to cover its increasing expenditure commitments. This kind of land allocation usually tends to be wasteful as the state develops fiscal dependence on land sales.

#### **4.2. *Suggested solutions***

Below we present our suggested solutions.

*i) Do not Maximize Revenue from Land sales, instead Maximize Development Impact of Land*

One of the major solutions to improve the supply of land is to improve land use and land control. It may be tempting to raise revenue from land sales to satisfy mounting expenditure commitments but this may potentially lead to wasteful land allocation. The city's more sustainable development outcomes are job creation and economic development (and hence better tax revenues). Therefore, the city administration should not try to maximize the lease revenue by tightening the land supply but it should maximize the development impact of land. Maximizing the development impact of land constitutes a) efficient and sustainable allocation of land, and b) controlling mechanisms to prevent land conversion to unintended and wasteful uses. The city should tightly control if an allocated land is diverted to other than the original purpose or misused. Not all investors are serious investors. There is a frequent practice of investors altering the use of land from industrial to commercial and other speculative purposes. Hence, modern land use control mechanisms need to be put in place. Therefore, prudent allocation of land not only increases the supply of land but it also improves the development impact of land.

*ii) Strictly enforce and implement city master plan*

The manufacturing sector is not the only sector whose demand for land remains unmet. In fact, the largest demand is from non-manufacturing activities. The land supply to these activities is limited as well. The city can increase the supply for all economic activities in two more ways. We argue that better urban planning and reconstruction can significantly increase the land supply. A large part of the inner city of Addis Ababa is still underdeveloped and occupied by slum residential places. The city should, thus, develop the inner part of the city by providing quality infrastructure and also re-claiming land from the slum areas by building condominiums



affordable by the average resident. While doing this it should adhere to the city master plan, which designates places to different uses. Full authority should be given for designated institutions overseeing the master plan and its enforcement. Authorities that violate this rule should be corrected and held accountable.

*iii) Address land administration and governance issues*

Another major task for the city administration should be to improve the land administration and governance institutions. The regulations need to be made simple and clear. The government should improve transparency by providing sufficient information on time. Institutions involved in the investment process should be streamlined and specifically the city needs to implement a real one-stop-service for investors. Although effort has been in place to strengthen individual property rights and develop basic legal and institutional frameworks, the city administration has to deepen the regulatory and institutional framework for land and modernize the land administration and management apparatus to support efficient and inclusive land development and allocation. This would include the implementation of modern land registry and cadastral systems, improved land transfer mechanisms (land titling, etc) and land use control mechanisms.

The city should quickly apply the communications technology to digitalize its land bank and management. This will enhance transparency and reduce discretionary power. Further, creating a comprehensive inventory and audit system of land would help identify excess land that could be reclassified and released for development. But more importantly, the city should work on reforming its civil service in terms of professionalism, integrity and service. The civil service needs to be trimmed and efficient; and the city needs to enhance ethics of service to the public (e.g., establish codes of conduct) and adequately compensate public servants in order to attract, retain and motivate qualified people.

Moreover, the city government should introduce additional mechanisms to improve transparency and accountability such as a strong complaint hearing and redressing mechanisms. There should also be a mechanism to protect whistleblowers (people who expose corruption, inefficiency and other malpractices) to increase transparency and accountability of authorities and processes.



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## *iv) Improve efficiency of the secondary market*

Another area, which needs the attention of the government, is how to improve the regulatory environment of the land and work premises market. Private leasing of land (use right transfer) or working premise in Addis Ababa is extremely expensive and unregulated. A large part of the costs of many businesses working on rental premises is the rent they pay to landlord. While this creates a large and unreasonable rent for the landlord, the cost ultimately transferred to the final consumers exasperates the high living cost in Addis Ababa, which in turn pushes up labour cost. Ultimately, the high land and working premises cost means lower profitability and competitiveness of businesses. Investors who lease from private sources are also subjected to a lot of uncertainties emanating from frequent rent increase and evictions. These are found to cause business closures and discouraging new investment. The city should, therefore, regulate the private lease for land and premises in a way that facilitates smooth and predictable transactions.

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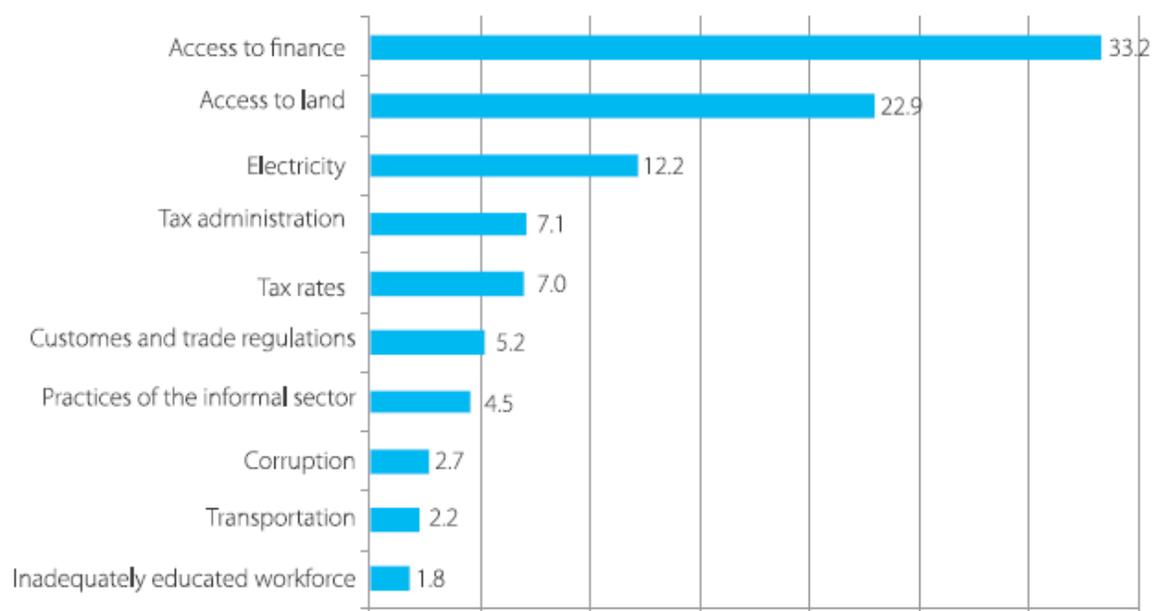


**Table 1:** Level of urbanization in some SSA countries, in 2000 and 2015

	Level of urbanization (in %)	
	2000	2015
Ethiopia	15	19
Uganda	12	16
Kenya	20	26
Rwanda	15	29
Sudan	32	34
Angola	32	44
Nigeria	35	48
Zimbabwe	34	32
Mali	28	40
Sub-Saharan Africa	31	38

Source: World Bank, World Development Indicators, 2000 & 2015.

**Figure 1:** Top 10 business environment constraints in Ethiopia (2011/12)



Source: World Bank / IFC Enterprise Survey 2012