Ethiopia

2011

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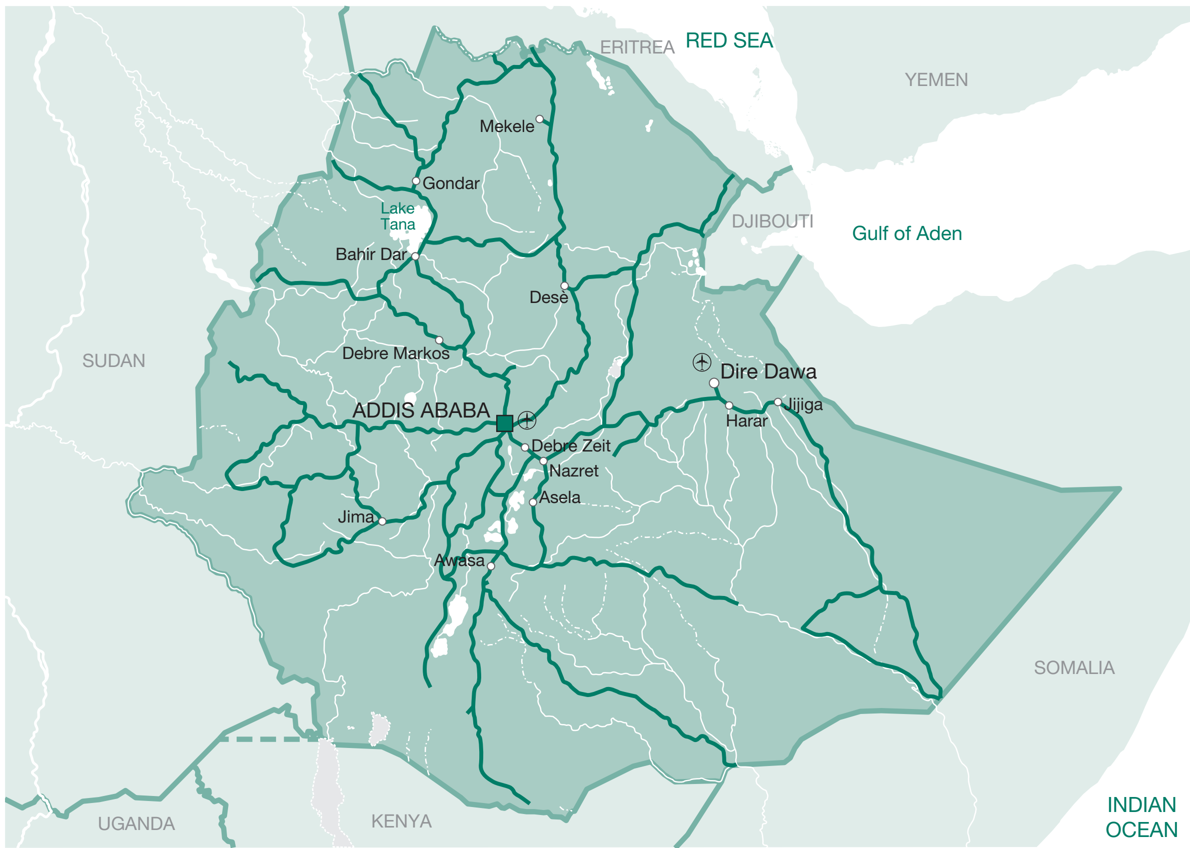
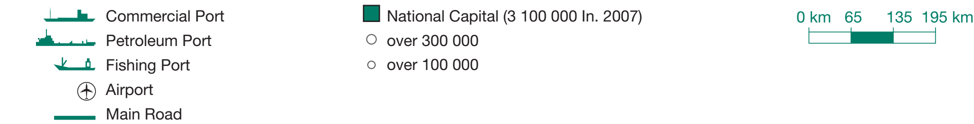




This map is for illustrative purposes and is without prejudice to the status of or sovereignty over any territory covered by this map.

Ethiopia

Overview

In 2010, Ethiopia continued to register the fast growth as it has for the last five years. Gross domestic product (GDP) growth in 2010 (2009/10) remained strong at 8.8%. Growth is driven by the service sector (14.5%), followed by the industrial (10.2%) and agricultural (6%) sectors. Except for a rebound in fishing, the rest of the agricultural sub-sectors remained fundamentally unchanged from their levels in 2009. The service sector's leading role is due to hotels and restaurants, financial intermediation, public services and real estate. The country continues to struggle with the macroeconomic challenges of high inflation and very low international reserves. The government's five-year Growth and Transformation Plan was launched in 2010/11. If it is successful, the prospects for 2011 and 2012 are likely to be as positive as in 2010. The plan calls for the agriculture sector to become the major source of economic growth. Industrial growth will also be given particular attention. The government intends to promote industrialisation through increased exports and import substitution. The economy is projected to grow at an average annual rate of 10% in 2011. The agriculture sector is expected to grow by 8.1% while industry and services are expected to show an average annual growth of 20 and 11% respectively during the planned five-year period of the government.

In 2010, although growth remained strong, macroeconomic management was problematic because of the rising level of inflation and a sharp depreciation of the national currency. The government managed to contain inflation through a combination of monetary instruments, i.e. the contraction of credit and money supply growth. The government devalued the national currency by 20% in 2010 with the aim of boosting exports and raising the level of external reserves. The government intends to use monetary policy to keep inflation below 10% starting in 2011 and through the duration of its five-year plan.

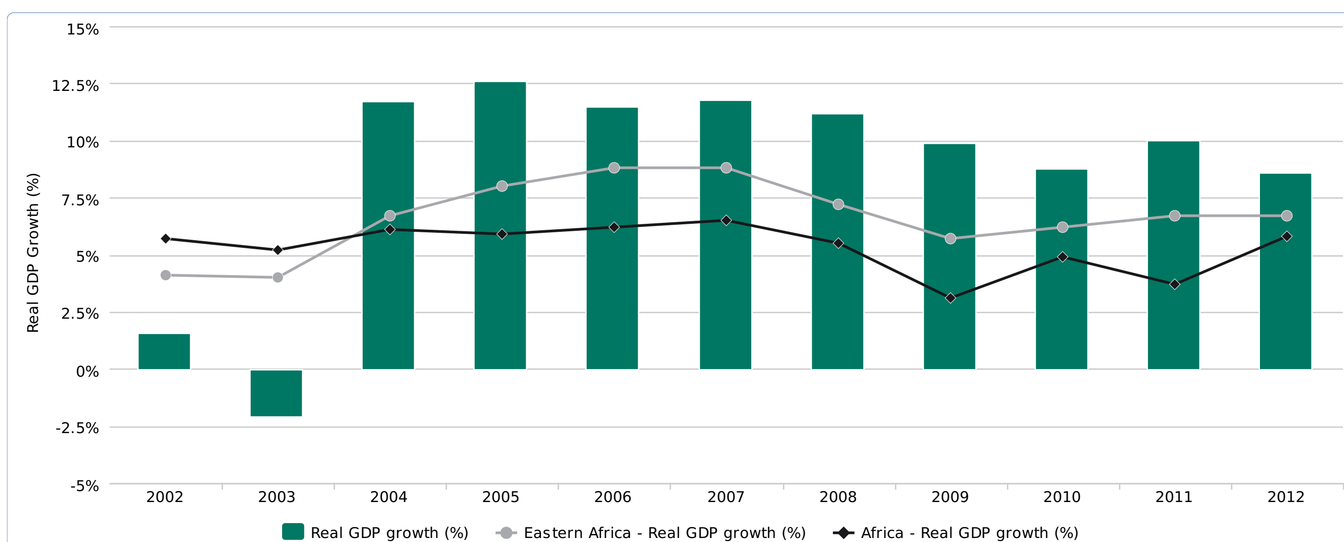
Following a drop in merchandise exports in 2009 due mainly to the global economic crisis hitting demand for key traditional export commodities, exports began to bounce back slowly in 2010. Imports remained strong in 2010 at 27.2% of GDP. The government projects this figure will grow to between 30 and 35% of GDP per annum by 2015. The result is a large trade and balance-of-payment deficit. The current account balance is expected to worsen from about minus 6.4% of GDP in 2010/11 to minus 11.9% in 2011/12.

The private sector is confronted with a number of challenges including: *i)* a poor business environment; *ii)* a poorly performing judicial system that fails to address property rights and weak corporate governance; *iii)* a relatively undeveloped financial system; and *iv)* a challenging macroeconomic environment. The government has attempted to address some of these issues by passing a competition law, setting up a public-private partnership forum and attempting to control inflation in 2010. However, the large devaluation in 2010 and the introduction of price controls on 18 goods designated as "basic" at the beginning of 2011 have led to confusion in the market.

The election held in May 2010 was generally peaceful. The ruling EPRDF claimed to win all but two seats in parliament – thus controlling 99% of the Parliament. Many in the opposition have complained about the lack of political space and intimidation of their supporters by the government. Political tensions in the region remain high because of insecurity in Somalia and the uncertainty associated with the future relations of North and South Sudan following the secession of South Sudan, with which Ethiopia enjoys friendly relations so far. The Ethiopian-Eritrea border dispute remained unresolved in 2010.

Despite limited success in institutionalising democratic governance, the Ethiopian government demonstrated impressive achievements in social and human development as government spending on education, health, agriculture and roads grew at an exemplary rate. In 2010/11, Ethiopia has made significant progress towards achieving the Millennium Development Goals (MDGs). In 2004/05, 38.7% of Ethiopians (about 30 million people) were poor. The figure has gone down to about 32.3% in 2009/10 and is expected to fall further to 31.0% in 2010/11. The decline in rural poverty since 1995/96 is substantial. Ethiopia is also on the right track in relation to education. Given the trend in the 1990s and the recent performance, conservative estimates show that this particular goal is achievable by 2015. However, this success may have come at the expense of quality in education. Ethiopia also appears to be on track to achieve gender parity in primary school enrolment by 2015. The country is also on track with regard to the health related MDGs such as maternal and child mortality, as well as HIV-AIDS and malaria prevention and treatment.

Figure 1: Real GDP growth (E)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later projections.

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Table 1: Macroeconomic indicators

	2009	2010	2011	2012
Real GDP growth	9.9	8.8	10	8.6
CPI inflation	36	11.2	17.6	14.3
Budget balance % GDP	-0.9	-2.3	-3.5	-4.1
Current account % GDP	-5	-6.6	-6.4	-11.9

Source: National authorities' data; estimates (e) and projections (p) based on authors' calculations.
Fiscal year July (n-1)/ June (n)

Figures for 2010 are estimates; for 2011 and later are projections.

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Recent Economic Developments and Prospects

Table 2: GDP by sector (in percentage)

	2005	2009
Agriculture, forestry, fishing & hunting	-	-
Agriculture, livestock, fishery, forestry and logging	47.4	43.2
of which agriculture	-	-
of which food crops	-	-
Mining and quarrying	0.4	0.4
Mining, manufacturing and utilities	-	-
of which oil	-	-
Manufacturing	5.2	4.9
of which hydrocarbon	-	-
Electricity, gas and water	-	-
Electricity, water and sewerage	2.2	2
Construction	5.8	5.8
Wholesale and retail trade, hotels and restaurants	14.1	17.3
of which hotels and restaurants	2.3	3.4
Transport, storage and communication	-	-
Transport and storage, information and communication	6.1	5.6
Finance, real estate and business services	-	-
Financial intermediation, real estate services, business and other service activities	8.8	10.6
General government services	-	-
Public administration & defence; social security, education, health & social work	8	8.6
Public administration, education, health	-	-
Public administration, education, health & other social & personal services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Public administration, education, health & social work, community, social services	-	-
Other community, social & personal service activities	2	1.8
Other services	-	-
Gross domestic product at basic prices / factor cost	100	100

Source: Data from local authorities.

Figures for 2010 are estimates; for 2011 and later are projections.

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Growth remains strong as in the previous five years. GDP grew by 8.8% in 2010 compared with the growth

attained in 2009, which was 9.9%. This is projected to reach 10% in 2011. Growth is mainly driven by the service sector (14.5%), followed by the industrial (10.2%) and agricultural (6%) sectors. Within the agricultural sector, the fishing sub-sector rebounded in 2010 while the other sectors remained fundamentally unchanged. The service sector's leading role was primarily driven by high growth in hotels and restaurants, financial intermediation, public services and real estate.

In terms of the structure of GDP, last year's dominant role of the service and the agricultural sector largely remained unchanged. Thus, in 2009 the most dominant sector of the economy in terms of its share remained the service sector at about 43.9% of GDP. This is followed by the agricultural sector with a 43.2% share in GDP. The industrial sector's share remained largely unchanged from last year with its share of GDP at about 13.0%. The manufacturing sector, within the industrial sector, also remained feeble in 2009, at 4.9% of GDP (Table 2).

As regards prospects for 2011 and 2012, it is likely that this excellent growth will continue based on the government's recent forecasts. In 2010 the government launched a new five-year plan – the Growth and Transformation Plan 2010/11-2014/15. This plan, beginning in fiscal year 2010/11, envisions the agricultural sector to be the major source of economic growth. Industrial growth is also a particular focus and the government plans to promote the sector using both export-oriented and import-substituting industrialisation policy. The industrial sector is thus expected to grow at a faster rate than other sectors. In agriculture, the plan calls for a shift to high-value crops, a focus on high-potential areas, the commercialisation of smallholder farming, and the development of large-scale, commercial agriculture. Expanding infrastructure, such as roads, and power and water supply, is also expected to support the realisation of this strategy. In the base case scenario, Ethiopia's economy is projected to grow at an average annual rate of 11.2% from 2011 to 2015. In this scenario, agriculture on average will be growing at 8.1% per annum. Industry and services are expected to show an average annual growth of 20% and 11%, respectively. In the best case scenario the government envisages 15% growth in GDP with agriculture also growing at 15%, nearly doubling the base case scenario of 8.1%, while the other sectors' growth reaches the base case level.

Except for the last three years when inflation and foreign exchange became major problems, the macroeconomic performance has been very good. But the growth projections for the agricultural sector are based on unprecedented expectations given the traditional dependence on rain-fed agriculture. The sustainability of this growth is also questionable when one takes into account a low level of domestic resource mobilisation and the shortage of foreign exchange.

There is a need to focus on bringing about major structural change in the economy to ensure the sustainability of economic growth. The country has experienced significant growth in the last five years. However, when judged in the context of the structural problems confronted in the period under analysis, its sustainability is an issue. Growth is accompanied by a marked absence of structural transformation. Moreover, the sources of GDP growth were an intensive use of resources, especially labour and land, and the outcome still depended on good weather. Productivity growth played little part. This should not come as a surprise, however, given an economy that is operating with backward technology, rain-dependent agriculture, and vulnerable to external shocks. Economic growth, especially in urban areas, is also accompanied by rising inequality with detrimental impact on poverty reduction. Thus, if the country manages to attain even the base case scenario envisaged in the new five-year plan for the years 2011 and 2012, it would be a great achievement.

Domestic demand is still dominated by consumption. Compared to 2009, consumption marginally increased in 2010, by 7.8%. Private consumption is the main contributor to this growth in consumption. Gross capital formation has also increased by 11.5% in 2010 and is projected to grow by 13.3% in 2011. Both public and private capital formation contributed to this trend but the public sector's contribution was nearly double that of the private sector. In the external sector, imports have shown an increase of 5.7% in 2010 and are projected to decline by 3.4% in 2011. Exports grew by 1.3% in 2010 and are expected to increase further, by 14.8%, in 2011. The negative trade balance remained substantial in 2010, though projected to improve in 2011. Exports and investment are projected to grow to over 30% of GDP during the 2011-15 five-year plan but these figures seem ambitious – the current GDP level of exports and investment do not warrant such expectations. A more realistic level of export growth, combined with the plan's projected growth of imports (to over 45% of GDP), are likely to strain the balance of payments in the years 2011 and 2012. (Table 3).

Table 3: Demand composition

	Percentage of GDP (current price)		Percentage changes, volume			Contribution to real GDP growth		
	2002	2009	2010	2011	2012	2010	2011	2012
Gross capital formation	24.1	22.4	11.5	13.3	8.6	3.4	4	2.7
Public	14	17.5	13	15	9	3	3.6	2.3
Private	10.1	4.9	6	7	7	0.4	0.4	0.4
Consumption	89.9	95.8	7.8	1.9	8.3	8	1.9	7.9
Public	14.8	8.2	-0.4	15.1	6.8	-0.1	1.6	0.7
Private	75	87.5	8.8	0.3	8.5	8.1	0.3	7.1
External sector	-14	-18.2	-	-	-	-2.6	4.1	-2
Exports	12.6	10.5	1.3	14.8	1	0.2	2.4	0.2
Imports	-26.6	-28.6	5.7	-3.4	5	-2.8	1.7	-2.1
Real GDP growth rate	-	-	-	-	-	8.8	10	8.6

Source: Data from local authorities; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

Fiscal Policy

In keeping with the macro stabilisation policy to contain inflation in 2008 and 2009, the government's fiscal policy in 2010 focused on financing expenditure by raising government revenue in general and tax revenue in particular. Thus, tax revenue increased from 8.6% of GDP in 2008/09 to 8.8% in 2009/10. Despite this effort, government revenue actually declined marginally in 2009/10 to 15.8% of GDP from 16.3% in 2008/09. This decline is attributed to the decline in grants in 2009/10 to 3.6% of GDP, down from 4.3% registered in 2008/09.

In 2009/10, total government expenditure increased to 18.1% of GDP, up from 17.2% in 2008/09. Both current and capital expenditure moderately increased in 2009/10 compared with 2008/09. An interesting and encouraging aspect of public expenditure in Ethiopia is the importance attached to pro-poor spending (*i.e.* expenditure on education, health, agriculture and roads). This spending category was about 7% of GDP in 2009 and increased to 12.5% of GDP in 2010. It is also expected to increase to about 15% of GDP in 2011 and 2012.

The combined evolution of public expenditure and revenue shows that the government will continue to incur a budget deficit of about 2.3% of GDP well up from 0.9% of GDP in 2009. This figure actually would have hit 6% of GDP in 2010 had it not been for grants. The government budget, this year as last, depends to a considerable degree on external finance.

The government plans to adopt a sustainable fiscal posture in 2011 and 2012, one that calls for strengthening domestic revenue, financing major investment projects with its own fund, and mobilising external aid without creating macroeconomic instability. It has also a plan to boost revenue through the implementation of the ongoing tax reform programme, enhancing tax administration and collection as well as promoting compliance. The Growth and Transformation five-year plan is supposed to equip tax collection institutions with adequate enforcement power.

Table 4: Public finances (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Total revenue and grants	19.3	17.1	16	16.3	15.8	15.9	15.6
Tax revenue	11.9	10.1	9.6	8.6	8.8	9.2	9.5
Oil revenue	-	-	-	-	-	-	-
Grants	3.6	4.4	4	4.3	3.6	3.4	2.8
Other revenues	-	-	-	-	-	-	-
Total expenditure and net lending (a)	25.1	20.7	18.9	17.2	18.1	19.4	19.7
Current expenditure	15.9	9.4	9.1	7.9	8.2	8.2	8.2
Excluding interest	14.3	8.7	8.6	7.5	7.7	7.7	7.7
Wages and salaries	5.7	5.4	5.3	4.7	4.5	4.1	3.8
Goods and services	6.2	2.6	2.7	2.2	2.5	2.9	3.1
Interest	1.5	0.7	0.5	0.4	0.5	0.5	0.4
Capital expenditure	9.2	10.7	9.7	9.1	9.9	11.2	11.6
Primary balance	-4.3	-2.9	-2.5	-0.5	-1.8	-3	-3.7
Overall balance	-5.8	-3.6	-2.9	-0.9	-2.3	-3.5	-4.1

a. Only major items are reported.
Source: Data from local authorities; estimates (e) and projections (p) based on authors' calculations.
Fiscal year July (n-1)/June (n)

Figures for 2010 are estimates; for 2011 and later are projections.

Monetary Policy

Although growth remained strong in 2010, macroeconomic management had its fair share of problems, namely rising inflation and a sharply depreciating national currency. Monetary policy in 2009 and 2010 focused on fighting inflation. Exchange rate management, despite its negative impact on inflation, was also an important monetary policy in 2010 as it addressed the shortage of foreign exchange.

In 2010, the government managed to contain rising inflation through a combination of monetary instruments, the principal one being contraction of credit and money supply growth. The culprits behind inflation in Ethiopia in the last three years are expansion in the money supply, rising prices of imported goods, a significant markup by traders and producers, and higher inflation expectations. The National Bank of Ethiopia (NBE) sought to keep monetary growth below 20% in 2008/09 and under 17% in 2009/10. The growth in broad money supply has been driven by domestic credit both to private and public enterprises. Growth in net lending to government contracted from 12.8% in 2007/08 to 0% in 2008/09 as well as 2010. A cap on credit placed on private banks in 2010 limited the expansion of credit to the private sector. This monetary policy kept inflation to about 11% in 2010 but inflation has since risen to over 17% (February 2011).

Another monetary policy development in 2010 relates to exchange rate policy. The exchange rate in Ethiopia is characterised by managed floating with strong government control. The year 2010 witnessed a continuous depreciation of the local currency against major currencies. The strain on the country's foreign exchange reserves was such that they remained below the equivalent of two months of imports in 2010. There has also been a nonstop depreciation of the currency in the parallel (black) market, aggravated by the government's devaluation of nearly 20% in September 2010. The official exchange rate has declined from ETB 13.60 (Ethiopian birr) per USD to ETB 16.50 per USD in 2010. Currency depreciation combined with oligopolistic pricing by most distributors/traders in Ethiopia forced the government to establish price controls in January 2011 on 18 major commodities identified as "basic".

The government's plan for 2010-15 includes a monetary policy target for the next five years of below 10% inflation. Money supply is expected to grow at a level consistent with real GDP growth targets, annual inflation targets, and at the economy's monetisation rate. However, containing inflation to a single digit is a huge challenge for monetary policy. The projected high GDP growth and investments required to achieve it will have an impact on foreign exchange demand and could lead to a further depreciation of the national currency.

External Position

Ethiopia experienced a marginal decline of 1.2% in the nominal value of merchandise exports in 2008/09 after hitting annual growth of 25.5% from 2003/04 to 2007/08. Exports as a percentage of GDP were 4.5% in 2008/09 and remained fairly unchanged in 2009/10 (about 4.6% of GDP). The drop in merchandise exports in 2009 was due mainly to the global economic crisis hurting demand for key traditional export commodities; however, demand bounced back in 2010 for some of Ethiopia's key commodity exports such as coffee. Two of the major exports (coffee and oil seeds) saw a small decline in volume in 2010 compared with their 2009 level. The decline in the volume of coffee exports, however, was compensated by a rise in the international price of coffee in 2010. On the other hand, the international price of oilseeds declined in 2010. Among the other two key exports (khat and pulses), pulses had exhibited a rise both in volume and price while khat has only increased in volume, with minor drop in its price. The combined effect left the level of exports in 2010 fairly unchanged compared to its level in 2009. Foreign exchange earnings in 2010 are helped by the positive change in service balance. This improvement reflects the excellent performance of Ethiopian Airlines. The year also saw a large level of current transfer (about 14.6% of GDP), up from 13.3% in 2009.

Imports remained strong in 2010 at about 27.2% of GDP, compared with 24.0% of GDP in 2009. According to the government's new five-year plan, this figure is projected to grow over five years starting from a projected 30.5% in 2011 to an estimated 35.0% of GDP in the years to follow. According to the National Bank of Ethiopia, imports of consumer goods, raw materials, capital goods and fuel remained important in 2010, as in 2009. Despite the global economic crisis in 2009, Ethiopia's net service exports expanded at a remarkably high rate of 145% in 2008/09, as compared with its 31% contraction in 2007/08. The figure for 2009 was 1.3% and increased a little further in 2010 to 1.6% of GDP. Net service exports are projected to increase to about 2.1% in 2010/11. The government's projection is a little lower, about 1.5% of GDP in 2011 and again in 2012.

Europe remains the largest export market for Ethiopia though its share declined from 47.6% in 2006/07 to 42% in 2007/08 and further to 41.7% in 2009. Ethiopian exports to Asia, by contrast, went from 30.2% in 2007 to 35.2% in 2008, and to 35.6% in 2009. China, Saudi Arabia and United Arab Emirates have become increasingly important partners in 2009 and 2010. Among European importers of Ethiopian goods, Germany, Italy and the Netherlands, in order of importance, were the most important trading partners in 2010. About 65% of Ethiopia's imports came from Asia, followed by Europe at 24.8%.

The growing divergence between imports and exports is a striking feature of Ethiopia's external sector. Growth in exports is not keeping pace with imports. The result is a large trade and balance-of-payment deficit. The current account balance deteriorated from -5.0% of GDP in 2008/09 to -6.6% in 2009/10. This is expected to worsen to about 12% in 2010/11, based on the government's five-year Growth and Transformation Plan.

This five-year plan projects the export of goods to grow at a faster rate in response to measures to promote exports. The plan calls for exports to grow by 36.6% in 2010/11 and average 28.4% annually in the remaining period. Exports of non-factor services are expected to increase by 31.1% in 2010/11 and average 22.9% per year. Imports of goods, on the other hand, will continue to boom. By the end of the plan period, the bill for imports is expected to reach 34.8% of GDP. The government's own projections point to an external trade deficit of 21.1% of GDP in 2009/10 though it may decline to 17.8% by 2014/15. The plan clearly runs the risk of an unsustainable external balance that could lead to macroeconomic instability.

Ethiopia's external debt declined to a historic low in 2006/07. Ethiopia received debt relief to the tune of 21% of GDP in 2006/07 mainly because of the World Bank's 100% cancellation of the country's debt to the International Development Association. Total external debt fell sharply from 85.4% of GDP in 2002/03 to 11.7% in 2006/07 before steadily rising to reach 14.8% in 2008/09 and hitting 19.2% in 2010. This trend is expected to remain intact in 2011 and 2012. Similarly, the external debt service ratio declined from 7.3% in 2002/03 to 1.2% in 2007/08. However, it has risen to 3% in 2008/09 and remained at the same rate of 3% in 2010. One aspect of Ethiopian debt worth watching is the rapid rise in debt owed to non-traditional partners such as China.

Table 5: Current account (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Trade balance	-16	-20.1	-19.9	-19.5	-22.5	-23.9	-27.5
Exports of goods (f.o.b.)	5.8	6.1	5.4	4.5	4.6	6.6	5.7
Imports of goods (f.o.b.)	21.8	26.2	25.3	24	27.2	30.5	33.2
Services	2	0.8	0.5	1.3	1.6	2.1	3.1
Factor income	-0.5	0.1	0.1	-0.1	-0.3	-0.3	-0.6
Current transfers	10.1	14.8	13.8	13.3	14.6	15.8	13.1
Current account balance	-4.5	-4.5	-5.6	-5	-6.6	-6.4	-11.9

Source: Data from local authorities; estimates (e) and projections (p) based on authors' calculations.
Fiscal year July (n-1)/June (n)

Figures for 2010 are estimates; for 2011 and later are projections.

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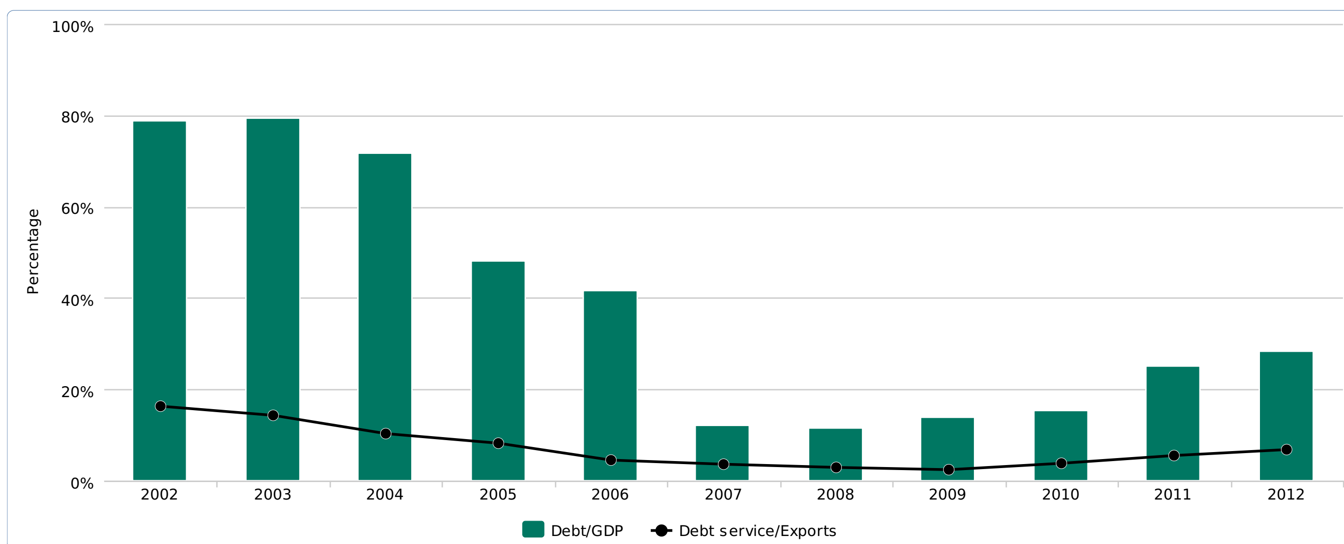
Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Structural Issues

Private Sector Development

Ethiopia's private sector is predominantly small scale, informal and service-oriented. The public sector dominates most economic activities, except for smallholder agriculture in rural Ethiopia. Private investment as a percentage of GDP not only remains low but has actually declined since 2003/04. The country performed poorly in a number of the World Bank's global *Ease of Doing Business* indicators, its ranking in 2010 and in 2011 being 103rd and 104th respectively. There were gains in the following indicators: *i)* Trading Across Borders: Ethiopia made trading easier by addressing internal bureaucratic inefficiencies; *ii)* Starting a Business: reforms at the company registry and the streamlining of procedures have made it easier to start a business in 2011; *iii)* Registering Property: the government has simplified property transfers by decentralising administrative tasks and merging procedures performed by the land registry and municipalities; *iv)* Court delays have been reduced through a combination of better case management and internal training, as well as an expanded role for enforcement judges. Hence doing business in Ethiopia in 2011 has become slightly easier in certain areas. Despite these improvements, the overall results – 103rd out of 183 in 2010 and 104th in 2011 – are not that encouraging.

The financial sector in Ethiopia has been too weak to support the private sector. Stringent collateral requirements for access to credit from banks is usually the major impediment. The banking system performs poorly when it comes to using modern banking technology and innovative financial instruments. It is also characterised by weak customer service. The situation is complicated by weak regulatory capacity that could make the banking sector potentially vulnerable to financial crisis. The existing data reveal that the dominant position is held by the Commercial Bank of Ethiopia (CBE). The data also show the fast growth of private banks, both in the mobilisation of deposit and disbursement of credit. The financial sector is still closed to foreign-owned banks so the sector performs in a sheltered and globally non-competitive environment. A number of studies underscore the need to bring about fundamental change in its performance and operation. There is a need to cautiously deepen the reform in financial sector and come up with new financial innovations such as venture capital, capital market and investment banking. There is also a need to mobilise resources for use in the private sector. This may include the introduction of policies designed to attract international remittances and discourage their use for non-productive activities as well as limiting government credit to a legally stipulated level. The latter is important, not only to avoid the crowding out of the private sector but also to ensure macro and financial sector stability. Finally, ensuring access to credit to targeted private sector operators based on performance, productivity and government close monitoring could be important. In this regard, it is impressive to note the government's policy of supporting micro enterprises through various channels with the aim of employment creation and skills formation. This approach could be extended to the other private sector operators.

Despite the limited size of the private sector and its many problems, the Ethiopian government policy is clear about the importance that it attaches to its development. The government's commitment to develop the private sector is unequivocally outlined in two important plans named the SDPRP (Sustainable Development and Poverty Reduction Programme) for 2002-05 and the PASDEP (Plan for Accelerated and Sustained Development to End Poverty) for 2006-10, as well as the New Growth and Transformation Plan (for the years 2010/11-2014/15). The government envisions the private sector as an engine of growth for development. However, in order to succeed, this strategy needs to be supported by concrete steps. Such actions may be related to market-supporting institutions, financial sector reform, and sectoral growth strategy and strengthening economic governance. Under the right circumstances, the private sector could be the major economic agent that helps realise this government strategy. This does not mean, however, the public sector is unimportant. The latter is important but needs to complement, not replace, the private sector.

To engage the private sector in its new five-year plan, the government will need to determine the right strategy to steer the sector in the desired direction. This is not difficult from a policy perspective because the government, as we noted above, has clearly articulated its position in major policy documents. What is still missing is the political will and a detailed action plan elaborated by the joint private-public partnership (PPP) forum. In 2010, the government established such a forum and it is hoped that the PPP will address the major and multifaceted problems of the private sector.

There are a number of outstanding issues that are important for private sector development. Among them are reforms of the legal institutions such as competition legislation and the legislation related to collaterals; an improvement in the business climate (including the government-business partnership); good governance and building institutions that are able to facilitate private sector development; access to land and finance; improvement in tax administration; and maintaining a stable macroeconomic environment.

In 2010/11, the government has attempted to address some these issues. It has established the public-private

partnership forum. It has issued a competition law and began implementing it. It has also attempted to provide a stable macroeconomic environment despite the uncertainty surrounding exchange rate stability and inflation witnessed at the beginning of 2011. It has also created new challenges and uncertainty for the private sector following the introduction of price controls on 18 major commodities. It is imperative to work on these challenges to bring about meaningful change in the development of the private sector.

Other Recent Developments

There are other structural and institutional issues that emerged in 2010 and are likely to influence the trajectory of growth and development in Ethiopia in 2011 and 2012. Despite an average double-digit growth in the last five years, and projections for more of the same in the coming five years, beginning in 2011, the poor in Ethiopia are still extremely vulnerable to external shocks that could include further conflict, climate change (failed rain or drought), the world price of exports and imports (such as coffee and fuel) as well as, at the micro level, the death or sickness of the head of household. This shows that sustaining growth and reducing poverty in Ethiopia is an enormous challenge that requires major structural transformation.

Sustainability at the macro level could be attained by the structural transformation of the economy. This could be done in the medium term by tackling the dependence on rain-feed agriculture through an expansion of small and large scale irrigation. Structural transformation could also be addressed by raising the competitiveness of the industrial and export sector through the provision of physical infrastructure and human capital formation. Without such transformation economic growth and poverty reduction will remain vulnerable to external shocks in 2011 and 2012.

Sustainable growth also depends on the external balance (exports versus imports) and prudent macroeconomic management. Although the government's macro management was constrained by problems in the last four years owing to its ambitious investment, it seems now to be on track in 2010. Yet capacity building in macroeconomic management (including debt management) is essential to ensure macroeconomic stability through prudent fiscal and monetary policy as a pre-requisite for growth. Although this could be a medium-term strategy, scaling up external financing (to at least four months of imports) and limiting higher import growth are short-term policy challenges that the government needs to address in 2011 and 2012.

The challenge of vulnerability also has a micro dimension. Poverty studies in the country show that the poor who could manage to escape poverty are extremely vulnerable and run the risk of slipping back into poverty. The level of poverty would have dropped by nearly half had it not been for the vulnerability of households to various shocks. The chances of slipping back into poverty both in rural and urban areas in the wake of shocks such as drought or the death of the head of household are considerable. The persistence of poverty is often related to the absence of structural transformation. In other words, there is weak technical progress in agriculture; a lack of strong institutions; restricted access to markets; and a lack of asset accumulation in the country (see UNDP, 2010[1]).

The second structural issue relates to the rising level of inequality in urban areas and the implication of this for poverty reduction in 2010 and beyond. Inequality, measured by the Gini Coefficient, shows a moderate rise at the national level while rising sharply in urban areas. Despite income growth in urban areas, this has not translated into poverty reduction because the rise in inequality in urban areas has wiped out the poverty-reducing gains. In short, the growth attained in the last decade has also generated a more unequal distribution of income, especially in urban areas. The positive impact of growth on poverty would have been much larger had it not been for this rise in inequality. Therefore, there is legitimate concern about the implications of worsening income inequality and its relation to poverty in Ethiopia. Inequality in Ethiopia is related to the geographic location of households, those in urban areas being the main victims. It is also related to size of landholding in rural areas, household assets as well as access to markets. Addressing these challenges of inequality is as important as that of the drive for growth.

The government's five-year Growth and Transformation Plan for the period 2010/11-2014/15 seeks to sustain rapid and broad-based economic growth path that could eventually realise the MDGs and end poverty. The government has set the following objectives to be achieved during the plan period: maintain at least an average real GDP growth rate of 11%; improve the quality of education and health services enough to achieve the MDGs in the social sectors; and ensure sustainable growth by realising the above objectives within a stable macroeconomic framework. The government promises, moreover, to establish favourable conditions for sustainable state building through the creation of a stable democratic and development-oriented state.

By the end the of this planning period, the government expects to achieve a number of ambitious targets such as the doubling of agricultural output, a per capita GDP of about USD 700 (up from the current level of USD 400); 2 000 km of new railway line, 8 000 megawatts (MW) of additional power generation (up from the current level of 2000 MW); a mobile phone density of 8.5 per 100 (up from the current level of 1.5); a road network of 136 000 km (up from the current level of 45 000 km) – to name but few. This is quite an ambitious

programme. If it is to become reality, it must take into careful account the available resources, current planning and implementation capacity, and challenges to macroeconomic stability.

Emerging Economic Partnerships

The last decade has seen growth in new partnerships between Ethiopia and emerging economies of China, India and Turkey. The partnership with China is the most significant one as shown by the level of trade and investment, which includes the financing and construction of infrastructure such as roads, power and communications. India and Turkey are far behind in this new and emerging set of partnerships. Given its significance, Ethiopia's partnership with China will be explored in detail in the rest of this section.

China's emergence over the last decade as one of the key net importers of commodities from Africa and its growing investment in Africa means that global commodity markets and foreign direct investment (FDI) are the main channels through which the impact of China's ascendancy has been (and will be) felt on the African continent. China is currently the leading export destination for Ethiopia, overtaking Germany. It is also the leading source of imports for Ethiopia, having overtaken Saudi Arabia (NBE, 2008/09). Total trade (both imports and exports) between the two grew from USD 100.12 million in 2002 (of which Chinese exports to Ethiopia took up USD 96.43 million with Ethiopia's exports to China being USD 3.69 million) to over USD 700 million (Ethiopia's exports growing to over USD 120 million) in 2006 and over USD 1 billion in 2009/10.

In the last five years the boom in Ethiopian-Chinese economic relations has been felt in areas like road construction, the supply of manufactured goods from China, telecommunications development, the installation of big electric power stations by Chinese companies and investments in the manufacturing sector.

In the power sector, Chinese engagement has been growing at a significant rate in the last decade. The Chinese companies are currently involved in nearly in all power generation projects (except some handled by the Italian firm Salini) irrespective of the financier of the project. The value of the power generation in which the Chinese companies are currently involved is estimated at about USD 1.7 billion. Their involvement in power transmission projects is estimated at USD 350.23 million. Chinese firms are also dominant in the construction of major projects in Ethiopian telecommunications and road sectors. One of the biggest Chinese telecom companies, ZTE, has offered Ethiopian telecom credit (vendor financing) to the tune of USD 1.5 billion, conditional on ZTE doing the job of expanding and improving the Ethiopian telecom infrastructure without bidding. This credit is as big as the total current worth of the Ethiopian telecom monopoly. Chinese firms also dominate both rural and urban road construction. Currently there are about ten Chinese firms engaged in the construction of roads throughout the country, representing about 60% of the total. Four of the firms dominate the field with nearly 70% of the Chinese engagement in the sector.

The success of Chinese firms in this areas is explained by the political ties that the Chinese government created with the government of Ethiopia, their competitive bidding, the self-financing options (sometimes referred to as "vendor financing") that the firms give to the Ethiopian government owing to the support they get from the Chinese government. Furthermore, the relatively lower level of skilled Ethiopian personnel (in terms of negotiation, technical and managerial skill) who deal with Chinese negotiators as well as the weak institutional capability of the Ethiopian experts in various ministries who are dealing with Chinese firms must have helped Chinese firms gain access to these various projects.

Chinese direct investment in Ethiopia, which has been growing since 2000, takes two forms: joint venture and wholly Chinese-owned investment. According to data obtained from the Ethiopian Investment Agency, there are 812 Chinese firms in Ethiopia, of which 191 are at the operational stage while the remaining 621 are in what the investment authority calls "under implementation stage" (which basically means the investor has got licence and began setting up the firms). The majority of Chinese firms are concentrated in the manufacturing sector (over 60%), which is different from what happened in other African countries where the Chinese FDI is pretty much resource seeking. In terms of significance, however, this Chinese FDI represents only 3.6% of total FDI in Ethiopia. A final point worth noting in the context of Chinese direct investment in Ethiopia is the planned Chinese industrial zone in Ethiopia. A Chinese investment group, Jiangsu Qiyuan, has begun construction of an industrial zone, the Eastern Industrial Zone (EIZ), 37 km south of the capital, Addis Ababa. Eighty investment projects will be constructed at a cost of about USD 500 million in the first phase. Over 20 Chinese companies have already expressed interest in investing in the industrial zone. The projects include textiles and garments, shoe, leather and leather products, food, electrical materials and steel. When the construction of this private industrial zone is complete in the next five years it will create jobs for more than 20 000 local people. This will take the issue of Chinese direct investment in Ethiopia to a whole new dimension.

Chinese and other emerging partners (such as India and Turkey) offer challenges as well as opportunities to Ethiopia. Ethiopian firms exporting labour-intensive manufactures face competition in third markets with Chinese exports and local producers of labour-intensive manufactures could be crowded out from the local market. This competition is severe in textile and footwear manufacturing in particular. Traditional suppliers and contractors in road construction, electric power and telecommunications, which are invariably firms from

industrialised countries, also lose out. On the other hand, consumers and commercial traders who bring manufactured goods from China for sale in Ethiopia are benefiting from this new partnership, as are entrepreneurs engaged in establishing small-scale factories and service centres buying machinery and equipment from China. The country as a whole is also benefiting from the acquisition of infrastructure and access to the Chinese market.

The lesson from Ethiopia's new partnership with emerging economies is the importance of designing optimal investment, trade and industrial policies that can lead to a win-win situation for both Ethiopia and its new partners. Studies recently conducted on the Chinese-Ethiopian economic relationship suggest that Ethiopia lacks a coherent strategy based on a rigorous examination of the facts. It is high time to come up with such a strategy. There are both positive and negative impacts that may emanate from this emerging partnership. In order for both countries to benefit from it, Ethiopia will have to come up with an appropriate policy response and incentive schemes. The transfer of managerial skills as well as technology, which is of utmost importance to Ethiopian firms, has been extremely limited. One vehicle to achieve this transfer is the joint-venture between Chinese and Ethiopian firms. This calls for appropriate incentive schemes by the government to encourage such joint ventures. The benefit from new partnerships with emerging economies depends on overcoming the gap in skill and expertise between Ethiopia and China (and other new partners) in negotiation and managing investment. This gap is evident in Ethiopia. It works against the interests of Ethiopia in the short run and of both countries in the long run. In order to tackle this challenge, Ethiopia must, in the long run, upgrade the skills of its workforce, as well as its bureaucrats and experts. In the short run, however, it may need to use qualified consultants (say from its diaspora or the private sector) with adequate knowledge to deal with negotiators from emerging economies. In summary, there is a need to come up with an appropriate, broad and comprehensive engagement strategy with emerging partners such as China that is based on rigorous study. The strategy needs to treat emerging partners such as China as a complement, not a replacement, of traditional trade and investment partners such as the OECD countries. The year 2011 is not expected to see any major partnership either with regional countries or traditional partners in the European Union (EU).

Political Context

Political tensions were expected to rise during the national elections held in May 2010 (both federal and regional). However, the election was conducted peacefully and the ruling EPRDF claims to won have all but two seats in parliament – thus controlling 99% of parliament. Many in the opposition have complained about the lack of political space and government intimidation. Although development partners largely remained silent about the election and its result, the EU election observers noted that the election was not conducted in a free and fair environment and hence was below international standard.

The government's strong grip on power, which reflects its actions against the opposition, foreign non-governmental organisations (NGOs) and media, remained pretty strong in 2010 as in 2009. In 2009, the head of opposition party—the Unity for Democracy and Justice (UDJ)—was arrested, amnesty was cancelled, and five opponents of the government were sentenced to death and 33 to life-long sentences. An Ethiopian weekly often critical of the government’s policies, *Addis Neger*, was forced to close down. Human Rights Watch issued warnings of a progressive hardening of the stance towards political opponents. In 2010, one of the leading opposition figures noted in the *AEO 2010* report (Ms Bertukan Midekesa) was released from prison and granted amnesty. But for now, there seems to be no regrouping of the opposition. Ethiopia seems set to remain effectively a one-party state for the next five years, since none of the opposition parties has managed to get a seat in parliament.

The foreign policy of Ethiopia is still dominated by tense relations with Eritrea, as the long-standing border dispute has not yet been settled despite several attempts at diplomatic solutions. The independent Eritrea-Ethiopia Boundary commission (EEBC) closed its operation in November 2007 and the UN Security Council decided to withdraw its peacekeeping force (UNMEE—UN Mission in Ethiopia and Eritrea) in July 2008. This raises the risk of conflict between the two countries, a risk still unresolved in 2010. Moreover, tensions in the region remain high as a result of the insecurity in Somalia. There is also a new development in Sudan, following the referendum on the independence of South Sudan. It is still unclear what the implications will be for Ethiopia.

The government’s Mass Media and Freedom of Information Proclamation Act in July 2008 was officially an update of the first-ever Ethiopian press law of 1992, which banned the censorship of private media and detention of journalists. It also granted journalists the right to set up an independent press council. However, members of opposition parties and many local and international media groups have expressed their deep concern and frustration over the new law as it allows state prosecutors to invoke national security as grounds for impounding materials prior to publication and distribution. The other threat to the freedom of expression under this new law is the government’s appropriation of the right to prosecute defamation cases against constitutionally mandated legislators, executives and members of the judiciary. It raises compensation for defamation caused by a mass media from ETB 1 000 to ETB 100 000. This development in 2009 has remained in 2010.

The government also passed a new proclamation for the registration and regulation of local NGOs and civil society organisations (CSOs) in January 2009. At the core of this new law is a provision stating that any CSO receiving over 10% of its funding from abroad is considered a foreign NGO and foreign NGOs are not allowed to engage in activities concerning democratic and human rights, conflict resolution or criminal justice. The 10% ceiling may restrict foreign funding and the scope of activities that have been undertaken by these CSOs and NGOs. It may also hurt human rights groups critical of the government. Implementation of this law commenced in 2010. Human rights activists have accused the Ethiopian government of tightening its grip on power through this new law. Many civil society organisations have also argued that this new law is restrictive in demarcating areas of operations for different types of CSO, especially for those who are working for human and political rights. Finally, after the 2010 election, a major cabinet reshuffle by the ruling EPRDF brought new faces to the upper ranks of power and veteran senior politicians were demoted to the lower ranks despite their holding high office in some cases for the last 20 years. The notable exception is the prime minister who holds the top political position for the third decade. This could very well become the trend in coming years with senior politicians in the party being replaced by new and younger members.

Social Context and Human Resource Development

The Poverty Reduction Strategy Programme (PRSP) continued in 2010/11 as an extension of the PASDEP, which covered the years 2005/06-2009/10, and contributing to the government's new Growth and Transformation five-year plan for the years 2010/11-2015/16. In 2010/11, Ethiopia made significant progress towards achieving the MDGs. In 2004/05, 38.7% of Ethiopians (about 30 million people) were poor. Poverty was slightly higher in rural areas (39.3%) than urban areas (35.1%). The figure has gone down to about 32.3% in 2009/10 and should decline further to about 31% in 2010/11.

Ethiopia is on right track as regards education (MDG 2). Given the trend in the 1990s and recent excellent progress, conservative estimates show that this goal is achievable. The gross primary enrolment rate rose from 91.30% in 2005/06 to 94.20% and 95.97% in 2008/09 and 2009/10, respectively. However, this success may have come at the expense of the quality of education. Ethiopia also appears to be on track to achieve gender parity in primary school enrolment by 2015. Though the gender gap is narrowing, there is still a gender disparity at the primary level. The gender disparity gets wider at higher levels of the educational system. The linear projections to gender parity in secondary and tertiary levels by the United Nations Development Programme (UNDP) (2010) indicate a possible divergence from the path to the goal in 2015.

Ethiopia has made important progress in reducing child mortality over the past decade, although child and infant mortality still remain high. The government envisioned a reduction in the number of deaths of children under the age of 5 from 123 to 85 per 1 000 live births and the infant mortality rate from 77 to 45 per 1 000 live births in 2010. Recent information from the UNDP shows that in 2009/10 the under-5 mortality rates and infant mortality rates decreased to 101 and 45 per 1 000 live births, respectively. Ethiopia is one of the countries with the highest maternal mortality ratio (MMR) in the world, which in 2005 was 871 per 100 000 live births. MMR in 1990 was 1 040 per 100 000 live births. The health sector development programme (HSDP III) had the target of reducing this to 600 per 100 000 live births by 2009/10. According to the draft report of the government's health sector programme, the maternal mortality rate is projected to fall to 267 per 100 000 by 2014/15. Using a proxy measure, for lack of a recent survey, the number for 2010 is believed to have been 600/100 000 MMR, according to the government (UNDP, 2010).

A trend analysis of HIV/AIDS prevalence rates shows that the urban epidemic appears to have levelled off at a high prevalence in the past years while the rural epidemic has not shown significant change. At the national level, the epidemic has been stable over the past several years. Adult HIV prevalence in 2009/10 was estimated to be 2.4%. With an estimated 1.1 million people living with HIV, its prevalence in Ethiopia is high, according to the UNDP (2010). In terms of progress towards the universal targets set in the Millennium AIDS campaign, data from UNAIDS show the country is on track for: antiretroviral treatment; support for people living with the virus; counselling and testing programmes to support orphans and vulnerable children. However, coverage of mother-to-child prevention services is lagging behind. Significant strides have been made in disseminating malaria knowledge and the provision and use of insecticide-treated nets over the past five years. According to the 2008 Federal Ministry of Health (MOH) report, cited by UNDP (2010), malaria was the leading cause of morbidity and mortality in the country in 2005/06. The assessment of the implementation of the last five year plan, PASDEP, indicates that the household level Insecticide Treated Net (ITN) coverage rate in malaria-prone areas increased from 3.5% in 2005 to 100% in 2009/10.

In general, the progress towards achieving the MDGs has been encouraging. The government has made enormous progress in the provision of social services such as education, health and infrastructure by investing in both physical and human capital formation and allocating a large share of its budget, to the tune of over 60%, to pro-poor spending. The share of total spending on poverty-targeted sectors (both recurrent and capital from all sources) increased from about 42.0% of total expenditure in 2002/03 to over 64.1% by the end of 2007/08. This has resulted in significant strides towards meeting the MDGs and in human development generally in 2010/11. Ethiopia is on track to achieve the MDGs related to goals 1, 2, 4 and 6 and likely to be on track for goals 3, 5 and 7. What is important in respect to some of the goals that seem within reach in quantitative terms, such as health and education, is improvement in quality. Without an improvement in the quality of education and health care, the money spent could be a waste of resources.

Notes

1. UNDP (2010), "Tracking MDGs in Ethiopia", background paper, United Nations Development Programme Ethiopia Country Office, Addis Ababa.