Ethiopia

key figures

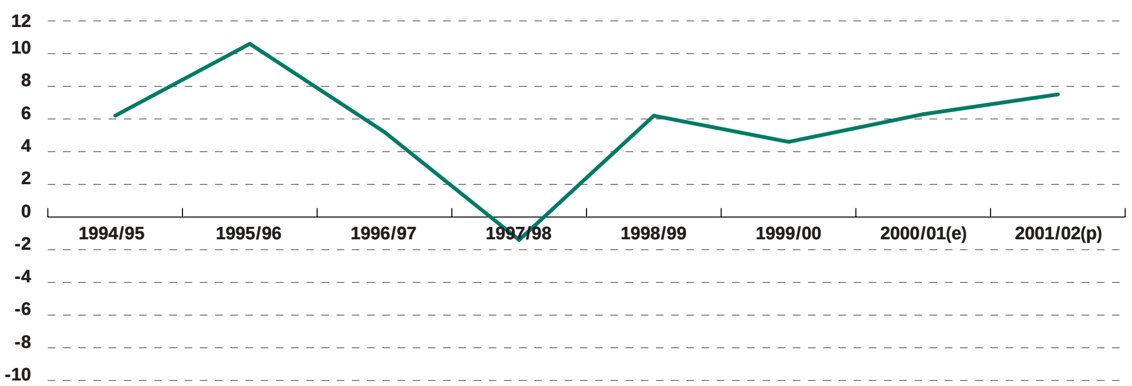
• Land area, thousands of km^2:	1 000
• Population, thousands (2000):	62 908
• GDP per capita, $ (2000):	100
• Life expectancy (1995-2000):	44.5
• Illiteracy rate (2001):	60.4

Ethiopia

ETHIOPIA'S RECENT GROWTH PERFORMANCE, which has been highly correlated with agricultural output, has been uneven. In 1999/2000, real GDP growth recorded 4.6 per cent from 6.2 per cent the previous year, reflecting the effects of the border war with Eritrea. The effects of the war were reflected in fiscal instability with widening budget deficits, and a deteriorating external position with increasing current account deficit. The external debt position is also unsustainable and Ethiopia is among eligible countries for assistance under enhanced HIPC. However, inflation remained low owing to the availability of large food aid supplies. Foreign exchange also remained stable with limited liberalisation. Ethiopia signed a peace agreement ending the war in December 2000. Since then, the government has shifted attention to developmental tasks. Donors have also started to release funds hitherto put on hold because of the war. The outlook on post-war growth is improvement with real GDP growth estimated at 6.2 per cent in 2000/01 and projected at 7.6 in 2001/02. Ethiopia continues to pursue reforms to enhance its competitiveness and attract investment. However, progress has been slow in its privatisation and financial reforms. In addition to ending the war with Eritrea, Ethiopia has improved relations with its neighbours. Ethiopia remains one of the poorest countries in the world, with the poverty situation reflected in declining health and education indicators.

Ethiopia signed a peace agreement ending the war with Eritrea in December 2000

Figure 1 - Real GDP Growth[a]



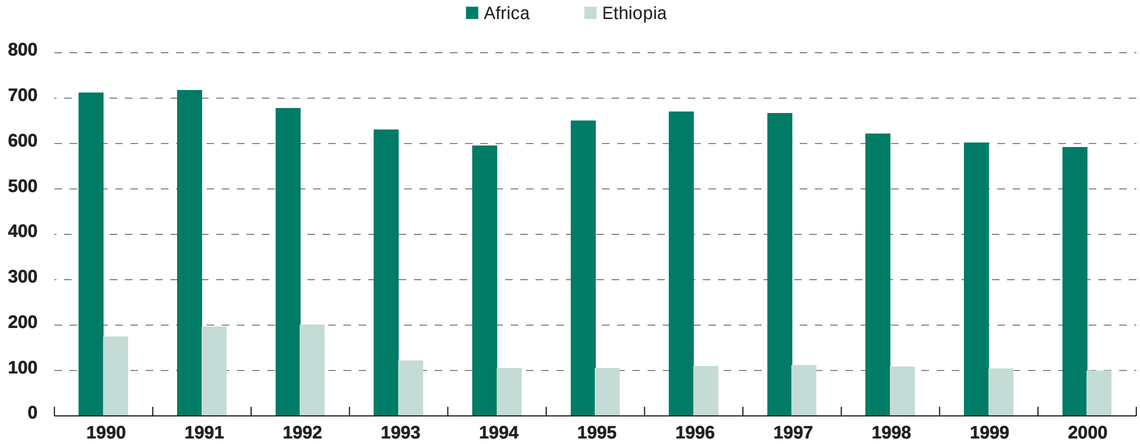
a. The percentage scale is different from the other countries since GDP growth exceeded the level of 10 per cent.
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Recent Economic Developments

The Ethiopian economy has started showing signs of recovery since the end of the border conflict with Eritrea in June 2000. From the severe drought in 1997 that led to negative growth of real GDP of -1.4 per cent in 1997/98, the economy rebounded strongly on a catch-up, to record real GDP growth of 6.2 per cent in 1998/99. Real GDP growth fell to 4.2 per cent in 1999/2000 owing to the negative impacts of the border war with Eritrea. The outlook on growth is a strong rebound with real GDP growth estimated at 6.2 per cent in 2000/01 and also projected at 7.6 per cent in 2001/02 as the government shifts attention from the war effort to developmental tasks.

Ethiopia's recent growth performance has been highly correlated with agricultural output growth.

Figure 2 - GDP Per Capita in Ethiopia and in Africa (current $)



Source: Authors' estimates based on IMF data.

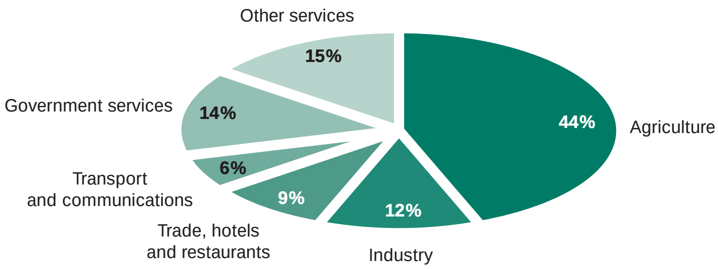
Agriculture is the mainstay of the economy, and in 1999/2000 accounted for about 44 per cent of GDP, 90 per cent of export earnings, 85 per cent of total employment and 70 per cent of raw materials requirements of agro-based industries. In 1999/2000, the agriculture sector grew by just 1.9 per cent as the sector began a slow recovery from the recent drought and the effects of the war. There was improved crop production, especially in grains such as cereals and pulses, which in the *meher* (main) harvest recorded about 50 per cent increase to about 12 million tons. However, coffee, the main cash crop, did not fare well as output fell by about 15 per cent between 1998/1999 and 1999/2000 to 360 000 tons owing to poor growing conditions. Total coffee production is, however, impossible to quantify accurately in Ethiopia given the fact that about 50 per cent of output is consumed locally. Livestock also improved in 1999/2000 with the improvement in weather conditions. Livestock holdings in 1999/2000 were estimated to have recovered to about 50 per cent of normal levels following the near dissipation of herds with the recent drought. The industrial sector accounted for about 12 per cent of GDP and achieved a growth rate of 4.8 per cent in 1999/2000. The growth was derived from manufacturing of agro-based industries as domestic availability of raw materials improved with the slight increase in agricultural output. The mining sub-sector remained largely unexploited thus contributing less than 0.5 per cent of GDP. The services sector accounted for about 44 per cent of GDP in 1999/2000 and continued its impressive growth performance, recording 7.4 per cent growth in 1999/2000. The largest part of the services sector in Ethiopia is distributive trade.

Table 1 - Demand Composition (percentage of GDP)

	1994/95	1997/98	1998/99	1999/00	2000/01(e)	2001/02(p)
Gross capital formation	**16.4**	**18.2**	**18.9**	**16.0**	**20.5**	**22.1**
Public	7.5	7.6	7.4	6.5	8.6	9.5
Private	9.0	10.6	11.4	9.5	11.8	12.5
Total consumption	**92.0**	**93.7**	**96.4**	**100.8**	**104.4**	**102.7**
Public	11.8	14.3	19.3	20.0	14.8	15.8
Private	80.2	79.4	77.2	80.8	89.6	86.9
External demand	**-8.5**	**-11.9**	**-15.3**	**-16.8**	**-24.8**	**-24.8**
Exports	13.6	15.8	15.3	16.7	13.6	12.0
Imports	-22.1	-27.7	-30.6	-33.5	-38.4	-36.7

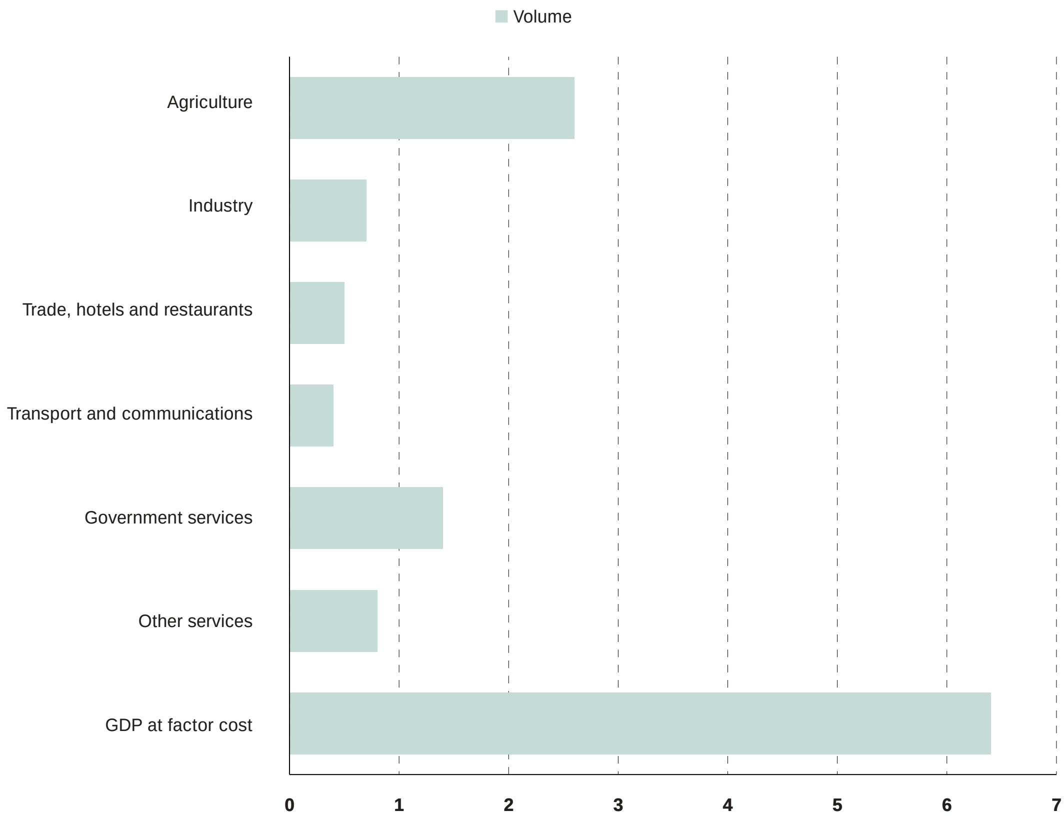
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Figure 3 - GDP by Sector in 1999/2000



Source: Authors' estimates based on IMF and domestic authorities' data.

Figure 4 - Sectoral Contribution to GDP Growth, 1999/2000



Source: Authors' estimates based on IMF and domestic authorities' data.

However, growth in services in 1999/2000 was due mainly to the transport and communications sub-sectors. The rehabilitation and reconstruction of railways and roads (especially feeder and link roads) boosted the transport sub-sector. In the telecommunications sub-sector, the number of telephones increased to 150 000 in 2000 compared with 120 000 in 1998.

The growth performance has been powered by substantial growth in consumption, especially of the private sector. However, in 1998/99 and 1999/2000, public consumption increased sharply owing to the war effort. The rise in total consumption was accompanied by a decline in domestic investment, which reached its recent lowest level in 1999/2000, and a deterioration of the external sector. The demand structure is expected to changein 2000/01 and 2001/02, as investment (public and private) rises, supported by increasing imports.

Macroeconomic Policy

Fiscal and Monetary Policies

The effects of the border conflict have dominated Ethiopia's recent fiscal developments. Ethiopia had made major strides in fiscal management before the outbreak of war. However, all the gains vanished with the war as the primary deficit on the government's budget rose sharply from 2.6 per cent of GDP in 1997/98 to 6.8 per cent of GDP in 1998/99 and further to 9.4 per cent of GDP in 1999/2000. The overall budget deficit widened accordingly. The main factor behind the sharp deterioration was the rise in defence spending from about 4.9 per cent of GDP in 1997/98 to 13.3 per cent of GDP in 1998/99. The government's finances are expected to improve with the cessation of the war, as defence expenditures come down and the government turns its attention to revenue enhancing measures. Since the end of the war, the government has begun to address some of the fundamental problems that underlie the fiscal system: the limited revenue base, low revenue/GDP ratio and declining capital expenditure. Reforms that have been initiated in income tax include new legislation on presumptive taxation and a 5 per cent withholding tax on imports that became effective in February 2001. Also, a new income tax code and legislation regarding standard assessment is to be effective in 2002. Regarding indirect taxation, the government publicly announced in November 2000 that a VAT is to become effective in 2003; meantime, in January 2001 the government eliminated the 10 per cent import surcharge on imports and increased the top sales tax rate to 15 per cent. Tax administration has been strengthened with legislation passed in March 2001 to introduce a Taxpayer Identification Number (TIN). The primary deficit is estimated to narrow to 3.3 per cent of GDP in 2000/01 but to widen again to 6 per cent of GDP in 2001/02.

Table 2 - Public Finances[a] (percentage of GDP)

	1994/95	1997/98	1998/99	1999/00	2000/01(e)	2001/02(p)
Total revenue and grants[b]	**20.8**	**20.7**	**21.3**	**21.8**	**23.9**	**23.1**
Taxes	11.5	11.6	11.4	12.6	13.5	13.3
Grants	3.3	2.8	3.6	3.3	5.5	4.7
Total expenditure and net lending[b]	**24.8**	**25.2**	**30.0**	**33.5**		
Current expenditure	15.5	15.8	20.9	26.8		
Excluding interest	*12.9*	*13.9*	*18.9*	*24.5*	*18.3*	*19.3*
Wages and salaries	5.6	5.9	8.3(e)	9.9(e)	8.6	7.8
Interest on public debt	2.6	1.9	2.0	2.3		
Capital expenditure	9.3	9.2	9.1	6.7	8.9	9.8
Primary balance	**-1.4**	**-2.6**	**-6.8**	**-9.4**	**-3.3**	**-6.0**
Overall balance	**-4.0**	**-4.5**	**-8.7**	**-11.7**		

a. Fiscal year begins 1 July.
b. Only major items are reported.
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Since the end of the war the government has started to sterilise the excess liquidity in the economy and is taking steps to modernise monetary management. The growth of broad money fell from 14 per cent in 1999/2000 to 11.3 per cent in 2000/01, mainly because of a reduction in Net Domestic Assets (NDA) from 22.1 per cent of total money supply in 1999/2000 to 4.6 per cent in 2000/01. The NDA fell as a result of a fall in net claims on government from 27.9 per cent of NDA in 1999/2000 to -0.9 per cent in 2000/01, as the government was reimbursing the banking system. The average annual rate of inflation had risen to 5.3 per cent in 1999/2000.

Ethiopia's inflation rate has been relatively low because upward pressure on food prices has been dampened by the availability of large food aid supplies. The rate of inflation is expected to remain in single-digit figures. The annual average rate is estimated at 3.7 per cent in 2000/01 and projected at 4.2 per cent in 2001/02, slightly above historical levels as economic growth picks up. Interest rates have also been on a downward trend since the end of the war. The benchmark rate on the 91-day Treasury bill fell from its high level of 4.4 per cent in 1998/99 to 3.1 per cent in 1999/2000.

The Ethiopian government aims at a flexible foreign exchange market. The exchange rate premium between the official and the parallel market rates has decreased to less than 3 per cent in 2000/01. In 2000 the birr dropped by 8 per cent in nominal terms to follow a similar depreciation in 1999.

External Position

Ethiopia has endeavoured to liberalise its external trade by progressively lowering its maximum import tariffs from 230 per cent to the current 40 per cent, thereby also lowering the average tariffs from 21.5 per cent to 19.5 per cent. The government also committed itself to define by July 2001 a time-bound plan for reducing the number and level of import duty rates so that the unweighted average tariff would decline from the current 19.5 per cent to 17.5 per cent by January 2003. Also, export taxes, export subsidies and import levies have been eliminated. However, the external payments situation remained precarious owing to poor export performance and high imports in 1998/99 and 1999/2000. In 1998/99 high imports to finance the war effort combined with poor export performance led to a sharp widening of the trade deficit. Current transfers also fell because of the war. In effect, the current account deficit increased to about 10.4 per cent of GDP in 1998/99. In 1999/2000, coffee exports fell by about 30 per cent and an improvement in non-coffee exports by 13 per cent was not sufficient to improve the trade account. The current account deficit remained around 10.5 per cent of GDP as the trade deficit widened. The outlook on the external position is a continuing deterioration in the trade deficit as export levels fall and imports rise with the renewed growth. The trade deficit is estimated to rise to 23.7 per cent of GDP in 2000/01 and stabilise around that level in 2001/02.

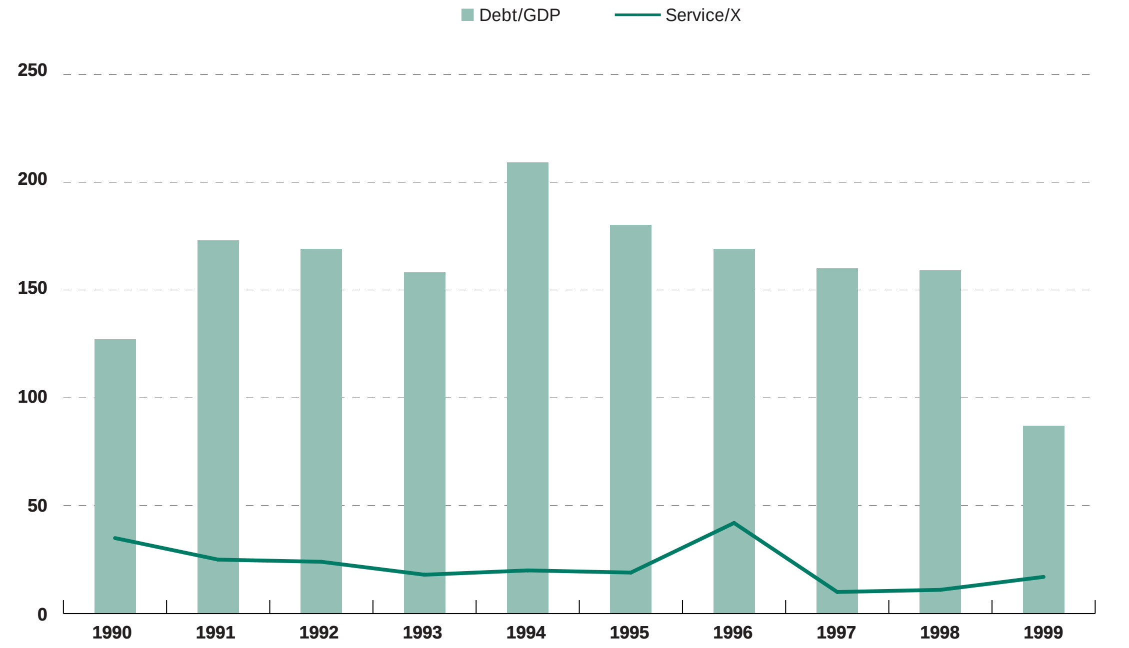
Table 3 - Current Account (percentage of GDP)

	1994/95	1997/98	1998/99	1999/00	2000/01(e)	2001/02(p)
Trade balance	-10.4	-11.5	-16.7	-19.8	-23.7	-23.2
Exports of goods (f.o.b)	7.9	9.2	7.5	7.8	6.7	5.9
Imports of goods (f.o.b)	-18.3	-20.7	-24.2	-27.5	-30.4	-29.0
Services	2.1	2.2	1.7	2.9		
Factor income	-1.0	-1.1	-0.8	-1.1		
Current transfers	10.8	6.2	5.3	7.5		
Current account balance	**1.5**	**-4.3**	**-10.4**	**-10.5**		

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Ethiopia's external debt stock was estimated at about $5.55 billion at end-1999. Multilateral debt constituted 51 per cent; official bilateral debt constituted 46 per cent, of which debt to Paris Club members was 30.3 per cent; while commercial debt made up the remaining 2 per cent. Significantly, the debt stock at end-1999 was nearly 50 per cent of the outstanding debt at end-1998. The sharp reduction was the result of about $4 billion debt write-off from Russia in late 1999. Ethiopia's current external debt remains unsustainable even after the application of traditional debt relief mechanisms. According to the updated preliminary document on the HIPC issued by the IMF and World Bank in February 2001, the NPV of debt-to-export ratio was 243 per cent in 1999 and would remain above 150 per cent until 2012; while debt service ratio, before debt relief, was estimated at 55.4 per cent in 1999. Ethiopia has benefited from traditional debt relief from the Paris Club three times, in December 1992 on enhanced Toronto terms with 50 per cent NPV reduction; in January 1997 on Naples terms (67 per cent NPV reduction), and in March 2001 on similar terms. As a result of the latest Paris Club concessions, Ethiopia's debt relief was estimated at $849 million. Ethiopia is listed among the eligible countries for assistance under the enhanced HIPC initiative, and is expected to reach the decision point under the programme at the end of 2001. The total estimated amount of HIPC assistance required to bring Ethiopia's ratio of the NPV of debt to exports to 150 per cent is estimated at $1 028 million in NPV terms, based on the projected NPV of debt outstanding on 7 July 2001.

Figure 5 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank (2001), *Global Development Finance.*

Structural Issues

Ethiopia has implemented a broad spectrum of reforms aimed at improving the functioning as well as liberalising the economy. Although Ethiopia started its privatisation programme in 1997, a large proportion of national productive assets still remains within the public sector. The pace of the privatisation exercise improved somewhat in 1999 when several large enterprises and state farms were brought to the point of sale, and preparations began for the privatisation of the Construction and Business Bank. At the same time the revision of the Investment Code increased private sector (including foreign) participation in infrastructure provision by opening up key areas formerly under state control, such as domestic civil aviation, power and telecommunications, to private investment. Also, in 1999 in an attempt to increase foreign direct investment in the economy, the government removed the minimum capital limit ($20 million) applying to foreign investment in joint ventures and the upper limit ($20 million) applying to sole ventures in engineering, metallurgical, pharmaceutical, chemical and fertiliser industries. Yet, the response to the privatisation programme has been weak with Ethiopia receiving no offers for most of the enterprises on offer. Of those for which offers had been received, including state farms, the cement factory, and the Kahub Gas Share Company, the offers had been considered inappropriate. In 2001, the government put the CBE under a management contract with a foreign institution. The slow response of the domestic private sector to the privatisation programme reflects the smallness of the sector. On the other hand, the apparent lack of foreign interest underscores the structural and infrastructural bottlenecks in the economy. Charges of corruption with the privatisation process have also hindered its progress further. However, in July and August 2001, some key figures in the process arrested on corruption charges, are now under investigation.

Ethiopia's financial sector remains weak and non-competitive, with a narrow scope of the financial services that are provided. The sector is dominated by state-owned institutions with the Commercial Bank of Ethiopia alone accounting for about 80 per cent of total deposits. However, private financial institutions are now permitted to operate. In this regard, six private domestic banks have already been established but foreign participation is still not permitted in the financial sector. However, on the basis of a study undertaken with joint technical assistance from the IMF and the World Bank, Ethiopia has reviewed its medium-term financial sector reform strategy to structure the financial sector and increase its competitiveness, with a view to promote growth.

Political and Social Context

Ethiopia is a functioning democracy. Broad participation in the political process is considered limited as some opposition groups charge the government with practising political marginalisation of sections of the population. However, within the context of its regionalisation policy, the Government of Ethiopia has broadened stakeholder participation of the development process by decentralising power to regions and lower-tier government (zones and woredas).

Moreover, Ethiopia now appears to have improved relationships with its neighbours. In addition to the recent peace agreement that ended the war with Eritrea, relations with Sudan, which had deteriorated from 1995, have steadily improved. In March 2000, Ethiopia signed ten agreements with Sudan to improve cross-border security. Ethiopia also signed a security agreement with Yemen in October 1999, and has at the same time consolidated relations with Djibouti since the election of Ethiopian-born Ismail Omar Gelleh as Djibouti's new President in May 1999.

The extent of corruption in the country began to cause concern in 1996, as the country's Deputy Prime Minister was dismissed and detained, and finally given a jail term in February 2000. Several other public officials have been removed, though most have not been brought before the courts, leading to opposition charges that the dismissals had been political rather than ethical. Human rights have also emerged as a contentious issue, with several editors, owners and journalists often arrested on the basis of criticism or questioning of government policy. Ethiopia is believed to have detained more journalists than any other African country in recent times.

The incidence of poverty in Ethiopia is one of the highest in the world. According to the UNDP (2000) Human Development Report (based on 1998 data), Ethiopia ranked as 171st out of 174 countries in terms of Human Development Index (HDI) and 83rd out of 85 countries in terms of Human Poverty Index (HPI). About 55 per cent of the population is believed to live below the poverty line of one dollar a day; in some regions of the country, this incidence of poverty is as high as 70 per cent and close to 85 per cent in the worst cases. For most of the poor in Ethiopia, food security even in times of good weather is a source of anxiety as Ethiopia has a persistence of structural food insecurity that affects 2 to 3 million mostly poor people every year. This is frequently exacerbated by severe drought conditions. Other features of poverty in Ethiopia are the existence of many families headed by widows; a large proportion of orphans and street children; children suffering from malnutrition and beggars in urban areas. Recent estimates put women-headed households at about 35 per cent of urban households, while 48 per cent of children less than five years of age suffer from malnutrition. The government's traditional poverty reduction measures have been embodied in sectoral programmes, notably in health and education, and have been integrated into the national budget, subject to regular public expenditure reviews. Such programmes suffered from capacity constraints coupled with the conflict-related reallocation of resources of the last two years. To address the serious poverty problem, Ethiopia has prepared an Interim Poverty Reduction Strategy Paper (I-PRSP). The reform agenda outlined in the I-PRSP is being supported by the IMF PRGF, amounting to $112 million approved on March 2001, and the World Bank ERSC amounting to $150 million, approved in June 2001. The EU has also provided additional parallel financing.

Ethiopia's socio-economic indicators also reflect the widespread poverty and are in most cases worse for women, reflecting gender inequality. In the health sector, coverage is limited to about 46 per cent of the population. There are about four physicians per 100 000 people; access to safe water is limited to 24 per cent of the population, while access to sanitation is limited to 15 per cent of the population. These figures are well below the continental average. The figures also reflect the fact that only about 1.6 per cent of GNP is spent on the health sector in Ethiopia, compared with 2.5 per cent in sub-Saharan Africa. There are also the problems of inadequate facilities and equipment, those available are often in a state of disrepair, and there is a shortage of essential drugs. The HIV/AIDS pandemic has added a new dimension to the health problem with about 10.6 per cent of the adult population being HIV positive.

In the education sector, UNESCO estimates that the combined primary, secondary and tertiary gross enrolment ratio was 19 per cent for females and 34 per cent for males in 1999. On a positive note, there has been a significant improvement in primary school enrolment over the past four years. The recent review of the Education Sector Development Programme in February 2001 revealed that gross primary school enrolment improved to 51 per cent of the relevant school age in 2000 compared with 42.9 per cent in 1996; net primary school enrolment ratio for girls increased from 21.5 per cent in 1996 to 36.6 per cent in 1999, while for boys the increase was from 32.3 per cent to 51.2 per cent. Thus, despite the general improvement for both sexes, the gender gap worsened from 10.8 percentage points in 1996 to 14.6 percentage points in 1999. Also, both quantitative and qualitative limitations persist in the educational system including shortage of classrooms, teachers, essential textbooks and other learning materials, poor curriculum, and high repetition and drop out rates, especially among girls. In general only half of all pupils who enrol in primary schools successfully complete the full cycle.