monthly updates on the ETHIOPIAN ECONOMY

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1. The crisis in Tigray and its economic impacts and implications

The political crises that had been brewing between the Federal Government of Ethiopia and the leadership of the Tigray National Regional State turned into an active armed conflict on November 04, 2020. The build up to the launch of the military offensive included, among others, a series of economic measures by the Federal Government including its decision to withhold transfer of budget subsidies to the regional state. During the course of the military offensive, measures such as the suspension of bank accounts opened in the Tigray region and closure of bank branches located in the region by the Central Bank of Ethiopia also clearly had serious impacts on the regional economy and the economic life of people living in the regional state.

The crisis is expected to have negative impacts on the regional as well as the national economy of Ethiopia both in the short and long terms. A full accounting of the economic impacts is not possible at this stage due to lack of credible and sufficient information on the ground. The overall impact of the conflict also depends on how quickly and sustainably the crisis is resolved and the situation on the ground is normalized. Nevertheless, based on available information and previous experiences in both international, national and regional conflict contexts, it is possible to highlight some of the potential direct and indirect impacts and implications of the conflict not only on the regional but also the national economy.

The first most obvious negative economic consequence of the conflict is its impact on the livelihoods, incomes, jobs, property, business activities and economic welfare of the general population in the regional state. For instance, the conflict could not come at any worse time for the rural populations in the region given it is one of the areas which had been battling with the devastations inflicted by the recent desert locus invasion and it flared up during the harvesting season. The UN estimates that some two million are now in need of assistance in and around Tigray and some one million have been displaced by the fighting.[1] The internally and externally displaced populations of the region are also likely to suffer losses of their properties including livestock, stored grains, unharvested produce, production tools, household utensils, etc. The second direct and immediate economic impact relates to the destruction and damages to economic infrastructure and facilities across the regional state. Rebuilding and rehabilitating these will require time and substantial amounts of resources.

There are also several channels through which the conflict will affect the national economy. For instance, any armed conflict in the country would force the national government to prioritize and increase expenditures related to the military and security apparatus at the expense of sectors such as infrastructure investments. During the costly Ethio-Eritrean war (1998-2000) for example, the size of the national army was expanded from 60,000 to 350,000 and defense expenditure skyrocketed (increasing US$95m in 1997/98 to US$777 million in 1999/2000) as the result of which military expenditure became about 50 percent of the country's total recurrent expenditure.[2] ▶

[1] https://news.un.org/en/story/2020/12/1079112
[2] https://news.bbc.co.uk/2/hi/africa/1476618.stm

In addition to the shift in budgetary priorities, one cannot underestimate the developmental impact of the shift in policy and institutional attention of the various levels of government and its partners towards managing the crisis. For instance, the fight against the COVID-19 pandemic or the implementation of the 10 years Perspective National Development Plan has taken the back seat ever since the attention of policy makers in the country shifted to Tigray. The discussions among development partners are at the moment mainly focused on the humanitarian response in Tigray.

Likely additional macroeconomic consequences include increased budget deficits, increased balance of payments problems, increased pressure on hard currency reserves, increased pressure on exchange rate of the currency, increased pressure on price levels (inflation) in the economy and so on. Any sense of increased insecurity, instability and uncertainties also negatively affects appetite for long-term investment by both local and foreign investors. Thus, inflows of foreign direct investment, which have already been significantly affected by the COVID-19 pandemic, will likely see a further decline over the short- to medium-term.

Another key area of impact will be on investor confidence, as a conflict state Ethiopia may struggle to attract new FDI flows as investors look for more stable investment destinations. While it is too early to calculate, the conflict is an immense reputational risk and the reputational damage to Ethiopia as an investment destination is likely to have a measurable impact.

In summary, the overall economic costs of the conflict and its impact on economic growth and sustainable development in the country will be substantial. A comprehensive and more accurate assessment will be needed as soon as the situation on the ground allows. Such an assessment would also provide indications about estimated costs of reconstruction works in the region.

2. Delays in the accession process to WTO membership

Ethiopia begun the accession process to the World Trade Organization (WTO) close to two decades ago where it formally applied for membership to WTO in January 2003. The accession negotiations were, however, halted in 2012 largely due to the country's reluctance to liberalize and privatize what it used to consider 'strategic' sectors such as banking, finance and telecommunications.

The current Ethiopian administration, since it came to power in 2018 committed itself to resume and expedite the accession process as part of its efforts to create a secure and predictable market access to exports. It sees the WTO accession process as an anchor for its Homegrown Economic Reform Plan and has set the goal of achieving WTO membership by end-2021.[3] Accordingly, Ethiopia's accession negotiation process officially resumed on 30 January 2020 with its 4th Working Party meeting. By end of November 2020, however, the Ministry of Trade and Industry announced that Ethiopia's WTO accession was at risk of delay due to COVID-19, which has halted discussions and further talks.[4]

Since WTO accession is an integral element to the current Ethiopian administration's economic reform agenda[5] and one of its short-term reform priorities[6], the expected delay in the negotiation process can be considered as a serious challenge to successful and timely implementation of the economic reform agenda. At the same time, the expected delay in the completion of the WTO accession process is not expected to have substantial negative impact on the economic prospects and fortunes of average Ethiopians. This is because, essentially, the most important benefit that WTO membership is purported to bring to Ethiopia is providing access to a rules-based and predictable global market for its products and services.

This, however, is not a significant benefit for the Ethiopian economy at its current state of development as access to foreign markets is not a major challenge for its exports of goods and services, which are predominantly primary commodities. The more important and immediate challenges with respect to the external sector of the Ethiopian economy include low-productivity, inefficient and costly export logistics and transportation, insignificant value addition in exported products and so on. In other words, Ethiopia can hope to reap significant benefits from becoming a member of the WTO only as and when its economy is able to transform structurally and can produce and export products and services that have higher value-added but has challenges in regard to access to foreign markets.

[3] https://www.wto.org/english/thewto_e/acc_e/nl_e/2020_01_acc_newsletter_e.pdf
[4] https://www.thereporterethiopia.com/article/ethiopias-wto-accession-risk-delay-due-covid-19
[5] https://www.thereporterethiopia.com/article/ethiopias-wto-accession-risk-delay-due-covid-19
[6] https://www.wto.org/english/news_e/news20_e/acc_eth_31jan20_e.pdf

3. Progress in telecom sector liberalization process

For close to three decades, the previous Ethiopian administration considered the telecommunications sector as one of the strategic sectors that should remain largely under state control closed from investment by foreign companies. This was despite the intense pressure from international financial institutions and development partners. In fact, the privatization and liberalization of the sector was one of the thorny issues, which led to the extended delay of the process of Ethiopia's accession to the WTO (discussed above). The sector is also one of the priority areas for reform and liberalization by the administration of Prime Minister Abiy Ahmed where, for example, the Home-Grown Economic Reform plan includes expediting the telecom reform as one of the priorities aimed at building an inclusive digital economy.

The initial reform plan for the sector included proposals to partially privatize the current state monopoly – Ethio Telecom – and liberalize the sector by licensing two multinational operators. After a long preparatory process, which included preparation and setting up of the necessary institutional and regulatory environment and infrastructure, on 27 November2020, the Ethiopian Government launched the highly anticipated and long-awaited request for proposals (RfP) to license two international telecom operators. This is seen by observers as a major development in the liberalization of Ethiopia's telecom market and the two new licenses are planned to be issued by March or April 2021. The Government has also announced that it has decided not to let any additional operators enter the telecommunications sector for at least 10 years and the two new joining companies will receive a 15-year operator license, enabling them to provide combined services for mobile, internet and fixed-line.

The liberalization of the telecom sector entails potential benefits and poses some risks to the Ethiopian economy and to its prospects both in the long and short terms. In terms of benefits, the obvious one is the expected short-term, one-time income to the public sector in the form of hard currency that will be coming into the country when the two winning multinational companies pay for their operating licenses. The anticipated mid- to long-term economic benefit include access to improved (and more efficient) telecommunications services (and hopefully at lesser costs) for the large and growing customer base in the country. Availability of improved and more efficient telecom and ICT services (which are expected as a result of a more competitive sector) could improve the operating environment for businesses and make the country more attractive for foreign direct investments. Additionally, expansion and modernization of the sector due to entry of two new operators in the economy is hoped not only to directly create and expand employment and business opportunities. It is also hoped to generate significant additional public revenue (e.g. in the form of profit taxes).

However, there is a mid- and long-term risk associated with entry of multinational telecom operators into Ethiopia. Given the fact that most of the revenues and incomes of these operators will be in Ethiopian Birr and the fact that the sector is considered to be highly profitable, eventual repatriation of after-tax profits of these companies (in hard currencies) is very likely to put significant pressure on the meager hard currency reserves of Ethiopia and a downward pressure on the exchange rate between Ethiopian Birr and major foreign currencies.

4. Alarming worker turnover rates in industrial parks

The industrial parks development initiative of the Ethiopian Government was launched in 2014/15 as a key pillar of the Government's drive to make Ethiopia a leading light industries manufacturing hub in Africa and be among the leading countries in the globe. According to the Industrial Parks Proclamation of Ethiopia (Proclamation 886/2015)[7] the objectives of establishing and managing industrial parks across the country include contributing towards the development of the country's technological and industrial infrastructure; encouraging private sector participation in manufacturing industries and related investments; enhancing the competitiveness of the country's economic development; and creating ample job opportunities, and achieving sustainable economic development.

To date, the Industry Parks Development Corporation (IPDC) has managed to develop and commission more than a dozen industrial parks across the country.[8] The parks currently (November 2020) employ about 68,400 people, according to the report released by the corporation in November 2020.[9] The report also indicates that the corporation was planning to create additional employment in the parks for 136,000 people during the fiscal year that started in July 2020 but only 10,864 new jobs were created in the industrial parks during the first quarter of the fiscal year. The major reason for this is the ongoing COVID-19 pandemic. The more peculiar challenge reported by the corporation is that about 11,169 employees from the industrial parks have left their jobs during the same quarter, which means that the number of workers who quitted their jobs was higher than the number of new jobs created. The high employee turnover in the industrial parks during the past quarter year is not an anomaly or something that can be explained by the current economic slow-down due to phenomena such as the COVID-19 pandemic. In fact, it has become an unfortunate feature of the industrial parks' initiative in the country. As far back as 2017/18, some reports indicated that staff turnover in the Hawassa Industrial Park – the most prominent such park in the country – hovered around 100 percent per year[10] meaning that a company operating in the park had to replace 100 percent of its employees in a year.

IPDC rightly mentions high cost of living in the towns where the parks are located, low level of salaries and lack of affordable housing as drivers for the high staff turnover in the parks. The issue of very low salaries and benefits is very serious given the fact that the workers in the parks are the lowest paid in the world with the workers typically earning somewhere between $35 and $50 per month (The next lowest are in Bangladesh and Myanmar with $95 per month, almost four times that of Ethiopia.)[11] In other words, most of the jobs currently offered in the industrial parks do not pay decent, living wages and therefore hardly put their beneficiaries above national and international poverty lines. In addition, such a very high level of worker turnover is costly to the businesses operating in the parks. ▶

[7] http://www.investethiopia.gov.et/images/pdf/Industrial%20Parks%20Proclamation%20No%20886_2015.pdf
[8] http://www.ipdc.gov.et/index.php/en/industrial-parks
[9] https://www.ethiopianreporter.com/article/20385
[10] https://www.france24.com/en/20200204-angry-workers-spurn-ethiopia-s-industrial-revolution
[11] https://www.theafricareport.com/12866/ethiopia-factory-workers-paid-less-than-subsistence-wage/

It is worth noting here that under Goal 8, the SDG agenda not only underlines the importance of promoting sustained, inclusive and sustainable economic growth and productive employment but **promotion of decent work** for all. Promotion of access to **decent employment opportunities** is also one of strategic focus areas of the recently signed UN Sustainable Development Cooperation Framework signed between the UNCT and the Ethiopian government. Therefore, both the Ethiopian government, the UN agencies and other development partners supporting the industrial parks' initiative should take the issues of ensuring that jobs created in the industrial parks are decent and providing living wages to the workers seriously.