

monthly
updates
on the

ETHIOPIAN ECONOMY

JANUARY
2021



UNITED
NATIONS
ETHIOPIA



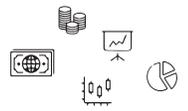


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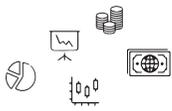
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1. The two decades-old industry development policy under revision

At the turn of the year, the Ministry of Trade and Industry announced that it has been leading the process of revising the industrial development policy of the nation that was issued close to two decades ago.¹ The Ministry also disclosed that the work begun in March 2020 and is expected to be finalized by the end of the fiscal year (July 2021). In addition to producing a revised policy document, the exercise is expected to produce a five-year industry development strategy, incentive packages, and an operational guideline for implementation. Objectives of the revised policy are reported to include promotion of import substitution, shifting local investors to manufacturing and creating a conducive environment for foreign investors joining the sector.

When announcing the work on revising the industry development policy, the Minister of Trade and Industry was quoted as saying, “The manufacturing sector is unequalled in the efficient use of land, labor and capital. We need to shift from an agricultural to a manufacturing-led economy.” This is one of the clear signs that the Ethiopian government - which for decades had emphasized the leading role of agriculture and has only over the past few years started to emphasize the manufacturing sector – is recognizing industrialization as the main path towards economic development in the country. This is an encouraging shift since, with a few minor exceptions, all successfully developed countries achieved economic development and high living standards through industrialization to the extent that the terms ‘industrialized nations’ and ‘developed nations’ are used interchangeably.

Moreover, as noted in the Economic Briefs for December 2020, the newly released 10 Years’ Perspective Development Plan (2020-2030) underlines the importance of the manufacturing sector due to its potential for generating large number of decent and productive jobs; its strong linkages with many other sectors; and for its potential to be center of productivity growth, innovation and technological upgrading of the overall economy. The Plan also has linked many of the chronic challenges of the Ethiopian economy such as continuing hard currency shortages, low performance of the export sector and high urban unemployment with lack of meaningful structural transformation² and goes on to see it as a sustainable path to address these chronic challenges.

Thus, the industry development policy, strategy and implementation guidelines that are expected out of the policy revision process are hoped to concretize, flesh out and operationalize this strategic shift in the policy thinking of the government. In addition, as opposed to the current state of affairs where there seems to be no coherent, coordinated, dynamic, synergistic and wholistic approach meant to achieve structural transformation and industrialization in the country, the policy revision process is hoped to create a coherent, multisectoral and comprehensive package of policy, legal, regulatory and institutional framework to guide, shape, incentivize and direct a process of rapid but sustainable industrialization in the country.

¹ <https://addisfortune.news/ministry-revamps-two-decade-old-industrial-policy/>

² In simple terms, structural transformation means sustained and significant shift away from low-tech agriculture and unskilled services towards higher tech manufacturing and skill-intensive economic activities.





2. Establishment of the first stock exchange in Ethiopia underway

Towards the end of December 2020, the Council of Ministers of Ethiopia approved the much awaited draft law prepared by the National Bank of Ethiopia that allows Ethiopia to set up a stock and sent the bill to the House of Peoples Representatives of Ethiopia (lower house of parliament) to be approved.³ The bill, which has been developed as part of the Homegrown Economic Reform Plan launched in 2019, was tabled to the House in mid-January 2021 and indicates that the stock exchange is to be established as a share company through a partnership of the public and private sectors, including foreign investors.⁴ In case, however, there is lack of interest among private sector stakeholders to own shares of the envisaged company, the Government plans to form it as a state enterprise. While there are stock exchanges in more than 30 countries in Africa, this is the first time that Ethiopia is about to establish one.

According to a press statement from the Office of the Prime Minister on the occasion⁵, the Government believes that establishing the stock exchange is important for economic development of the country and prosperity since it is expected to enable companies to raise funds by selling shares, stocks and bills to finance promising investment projects. In addition, the Government believes that the stock exchange would also serve citizens as an alternative saving mechanism facilitating investments in stocks; and increase in the investments coming from domestic saving through this channel are thought to reduce Ethiopia's dependence on foreign direct investment. The statement also argues that

capital markets play critical role in stabilizing the macro-economy by fixing balance of payment of the country.

While the establishment of such a stock exchange in the country is a promising development in terms of promoting growth and dynamism in the private sector, expectations regarding the potential impacts and outcomes of the exchange need to be managed and potential concerns have to be taken into account from the outset. For instance, the Government is of the opinion that the Ethiopian economy is, "at a stage where a vibrant private sector is starting to emerge, we have companies that are ready to be listed in the stock exchange"⁶. However, in many African countries that have established such stock markets, one of the biggest challenges has been that the markets are too thin with limited number of companies listed in the market and most of the markets tend to lack financial liquidity. In addition, in most of the African stock markets, trading occurs in only a few stocks, and these stocks typically represent a considerable portion of the total market capitalization.⁷

Moreover, the Government's expectation that the stock market could help fix chronic balance of payments challenges might be unrealistic. In fact, if large foreign finance comes into the economy in the form of purchases of stocks, bonds and shares of companies through the stock market, added balance of payment risks would be introduced into economy unless there are strict and proactive capital account



³ <https://furtherafrica.com/2020/12/23/ethiopia-approves-law-to-introduce-capital-market/>

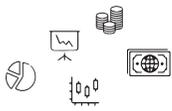
⁴ <https://addisfortune.news/stock-exchange-to-be-operational-through-ppp/>

⁵ <https://furtherafrica.com/2020/12/23/ethiopia-approves-law-to-introduce-capital-market/>

⁶ <https://ethiopianmonitor.com/2020/12/22/council-of-ministers-passes-bill-to-create-ethiopias-first-stock-exchange/>

⁷ <https://www.imf.org/external/np/seminars/eng/2008/afrfin/pdf/senbet.pdf>





controls aimed at smoothly managing inflow and outflow of 'hot money'. Otherwise, these inflows could easily create or exacerbate risks of financial crises.⁸

Another important challenge that can be foreseen in relation to the establishment of the stock market is the issue of effective governance and supervision. In the case of other African countries, supervision by regulatory authorities has been often found to be inadequate.⁹

In the case of Ethiopia, due to weak legal, regulatory and institutional frameworks, successful establishment and growth of share associations (equivalents of corporations in other countries) is very limited. Probably the only exception to this has been the banking and finance sector, which has not only been highly profitable over the past quarter century but also has attracted very large number of the ordinary citizens in buying and owning shares of these companies. The most likely reason for this exceptional development is the strict regulatory and supervisory role played by the central bank. This is because banks and finance institutions are not ordinary private businesses in the sense that they manage the financial savings of the public and their health is critical for the healthy operation of the rest of the economy.

Therefore, while the initiative to establish a stock market is a welcome development, the importance of putting in place strong, capable, effective and

transparent regulatory, supervisory and monitoring systems and institutions cannot be overstated. In addition, while presence of a vibrant stock market is one of the enablers of development of a productive private sector in an economy, the Government and its partners also need to work hard to address the other major challenges hampering the private sector from playing active and growing role in the development of the economy such as availability of reliable and sustainable energy, land, infrastructural services, etc.

⁸ The highly destructive economic crises that hit a number of East Asian economies and then spread to other emerging economies resulted from a financial crises which has its roots in this kind of 'hot money' that had flown into these economies suddenly reversed course and took flight out of the economies.

⁹ Ibid.





3. Imposition of limits on financial transactions by National Bank of Ethiopia

Over the course of 2020, the National Bank of Ethiopia (NBE) has been issuing a series of directives and circulars that are aimed at restricting and controlling financial transactions. In May 2020, it issued a circular that put cash withdrawal limits aimed at managing liquidity as well as controlling money circulation. In addition, the circular aims to was to mitigate “the risk of robbery, fraud, money laundering, tax evasion, illicit activities including smuggling, counterfeiting and other criminal activities which are illegal and immoral.”¹⁰

The circular put a Birr 100,000 Birr daily and a one million Birr monthly withdrawal limit on individuals and a 300,000 Birr daily and 2.5 million Birr monthly withdrawal limit on businesses. Around mid-July 2020, the Bank removed the limits for government institutions, refugee and disaster management agencies, defense and security bodies, charity organizations, diplomatic missions and credit cooperatives.¹¹ In mid-September 2020, following the currency changeover, it imposed a restriction on depositing money on behalf of another account, only allowing account-to-account transfers. In October 2020, the Bank altered the directive and decreased the daily withdrawal limit to Birr 50,000 for individuals and Birr 75,000 for businesses.¹²

NBE introduced what some experts termed as draconian restrictions on transactions in early January 2021 as it introduced a new rule that forces depositors to make a *maximum of five transactions per week*.¹³ The aim of the new rule seems to be to

paralyze illegal money transfer agents, weaken the parallel foreign exchange market and reduce illicit financial transfers. In particular, the idea behind the rule is to stop the informal foreign exchange market where those who intend to send money from abroad transfer the amount to transfer agents that are based abroad (instead of sending it to Ethiopia through the official remittance channels) and then the intended beneficiary of the remitted money in Ethiopia receives a Birr equivalent from representative/agents of the foreign based remittance agent. Thus, the main aim is to reduce illicit financial transfers and increase inflow of remittances from Ethiopians living abroad and Ethiopian Diaspora that come in through formal channels.

This draconian measure of the Central Bank, however, has had substantial side effects including creating lots of challenges for legitimate businesses to send and receive money through account-to-account transfers and posing difficulties for businesses and other institutions to even pay salaries to their employees.¹⁴ Thus, the rule has caused great concern and controversy for example among merchandise and wholesale businesses across the country. As a result, by end of January 2021, the Bank had to modify the rule somewhat and exempt deposit accounts of the government, state-owned enterprises, government universities, international organizations and embassies from the weekly transaction restriction.¹⁵ It also relaxed the rules such that limit would not apply to account holders in effecting utility payments, buying mobile

¹⁰ <https://nbebank.com/wp-content/uploads/pdf/directives/bankingbusiness/Cash-Withdrawal-Limit.pdf>

¹¹ <https://addisfortune.news/central-bank-relaxes-cash-withdrawal-limit/>

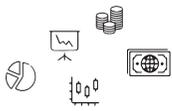
¹² <https://addisfortune.news/central-bank-shrinks-daily-cash-withdrawal-limit/>

¹³ <https://www.thereporterethiopia.com/article/remittance-induced-fear>

¹⁴ <https://www.ethiopianreporter.com/article/20990>

¹⁵ https://addisfortune.news/central-bank-imposes-further-transaction-limits/?utm_source=rss&utm_medium=rss&utm_campaign=central-bank-imposes-further-transaction-limits





top-ups and making salary payments. Transactions effected by financial institutions from their accounts were also exempted from the restriction. The latest circular also entitles commercial banks to conduct due diligence and exempt private businesses and non-government organizations from the restrictions. In this process of introducing a series of changes on the rules and regulations pertaining to limits to financial transactions, one thing seems to be very clear. While the goals and objectives of the Central Bank are laudable, the way the restrictions have been designed and imposed on the banks and users of the financial services has not been consultative and did not adequately take into account their concerns before the application of the restrictions. In addition, it appears that the Bank has not been doing a thorough analysis of the costs and adverse effects of the measures before imposing restrictions.

