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Federal Democratic Republic of Ethiopia
OFFICE OF THE PRIME MINISTER

A Homegrown Reform Agenda: Unlocking Ethiopia’s Economic Potential

August 2019

Outline

- Rationale
- Our success story
- Drivers of the economic success
- Gaps and headwinds against the economic progress
- An economic reform agenda for job creation and sustainable growth
- Expected impact of the reform
- Resource requirements and next steps

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Rationale for an economic reform agenda

- *Time to leverage the achievements of the past decade for high quality growth*
  - *Ethiopia has made significant strides in infrastructure and human capital over the past decade*
  - *Need to leverage these platforms for private sector development*
  - *With a goal to generate high quality jobs, sustain economic growth, and create fiscal space for further public investments on infrastructure, human capital, and institutional building*
- *Need to overcome emerging challenges and create new opportunities— sustaining the success of the past decade requires*
  - *Correcting emerging macroeconomic imbalances*
  - *Easing structural bottlenecks*
  - *Creating new opportunities and sources of growth*
- *Need to upgrade our policy and institutional frameworks to take our success to the next level*
  - *Our macroeconomic policy framework needs to be upgraded to enable the development of a modern and stable financial system*
  - *Our institutions need to be efficient and transparent to support the modern economy that we are aspiring to build*

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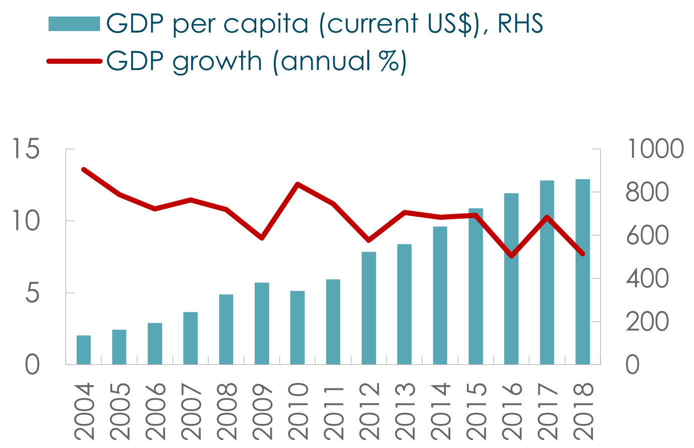
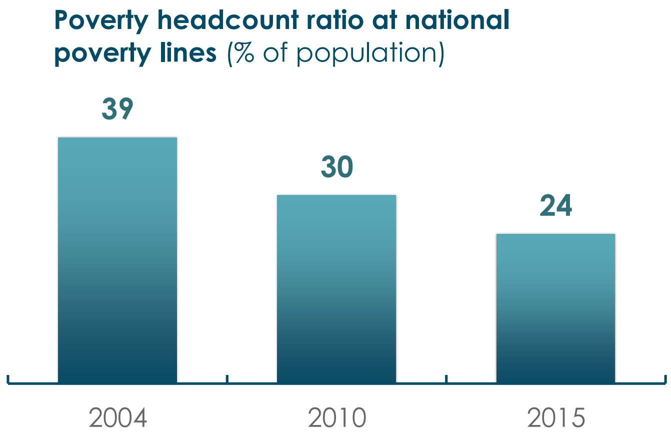
Rapid economic growth and a significant poverty reduction…

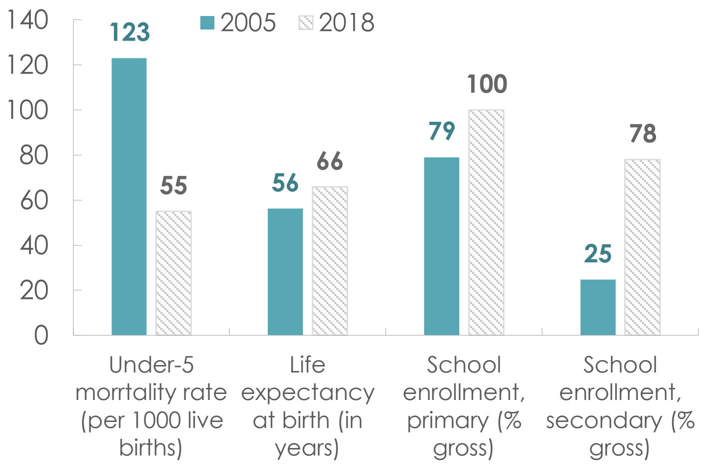


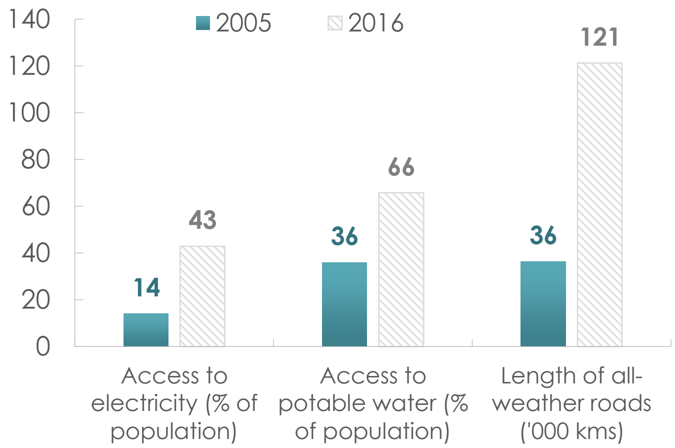


Double digit growth and over six-fold increase per capita during 2004-18 led to…

… a 15 percentage points decline in the rate of poverty.

… along with improvements in human capital and expansion of basic services.





Notable progress in health outcomes and access to education…

…accompanied improvements access to electricity, potable water, and roads.

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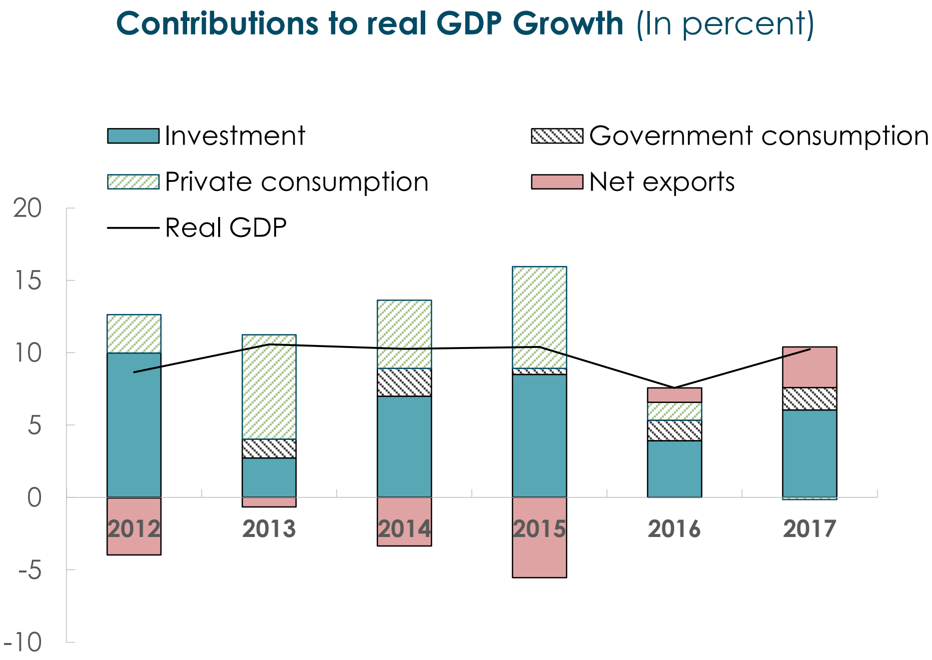
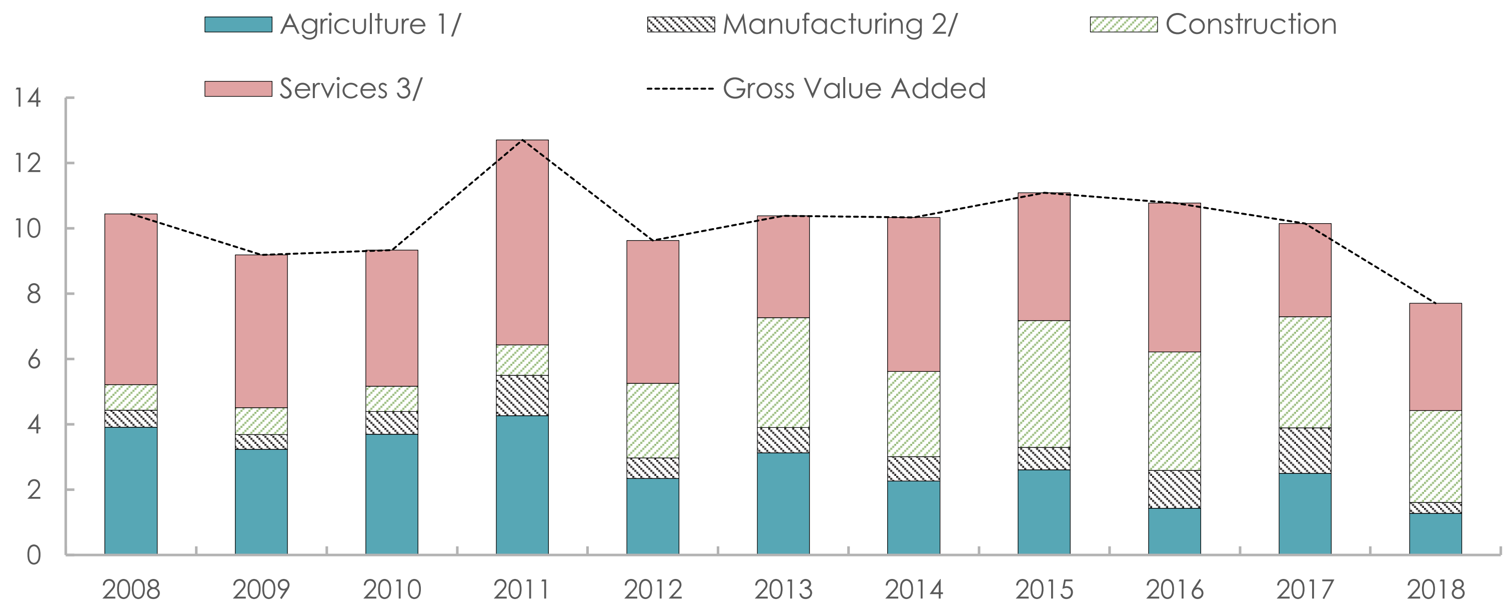
Growth has been driven primarily by public investment…



While the National Accounts data show that aggregate investment was the driver of growth, evidences from fiscal and financial accounts depict that the public sector has been on the driver's seat of the investment boom.

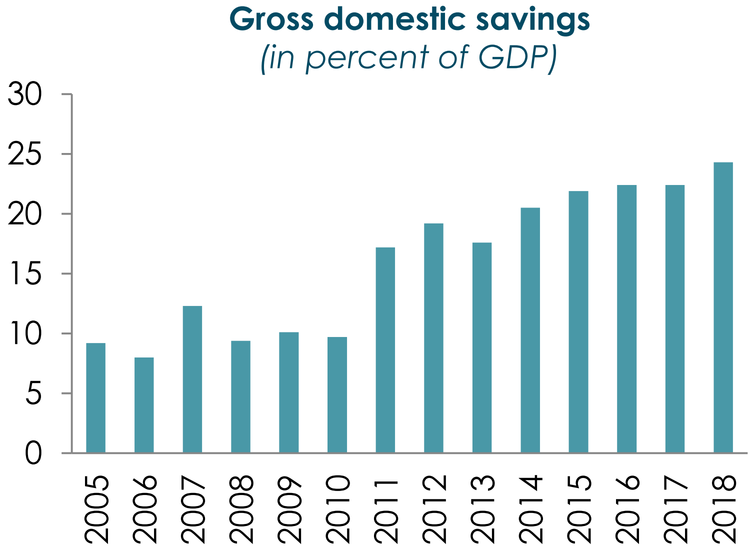
… which stimulated construction and service sectors.

Contributions to Real Gross Value Added Growth (In percent)

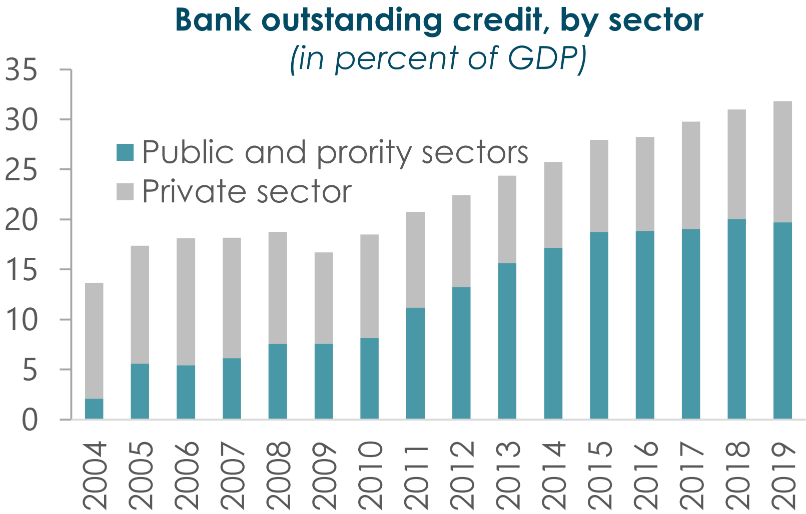


Note: 1/Includes agriculture, fishery, hunting, and forestry; 2/Includes manufacturing, mining, and quarrying; 3/Includes all service-related activities.

The investment program that fuelled growth was financed through mobilization of domestic savings and prioritization of credits…



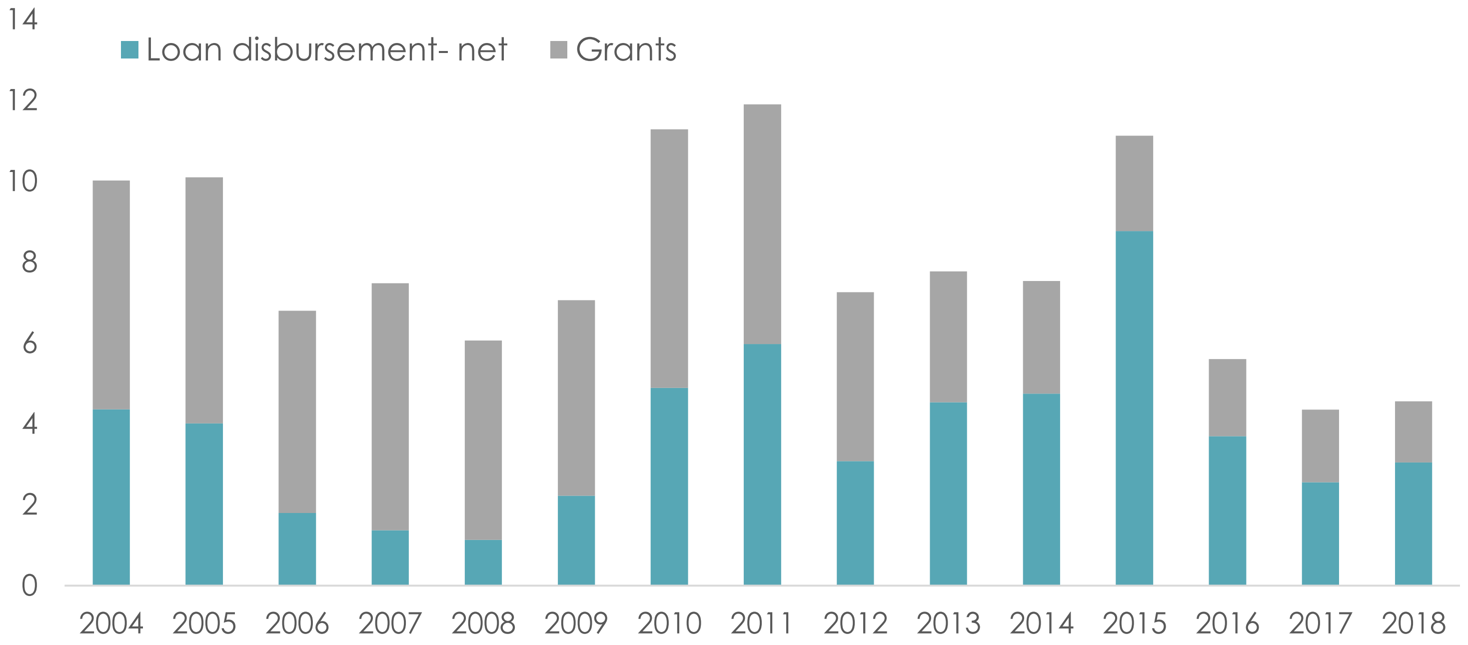
Domestic savings was increased by about 15 ppts of GDP to about 24 percent in 2018…



…and this was directed to finance primarily public and priority sectors.

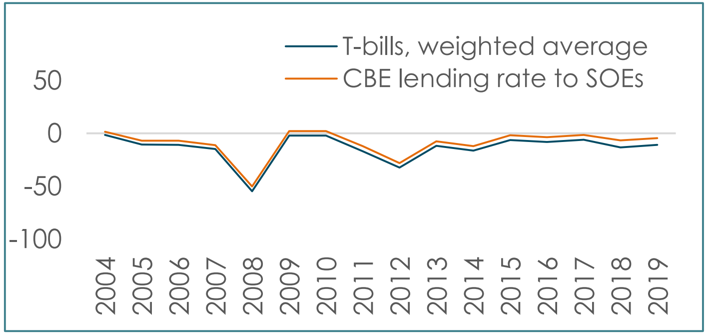
…along with significant mobilization of external resources…

External borrowing and grants *(In percent of GDP)*



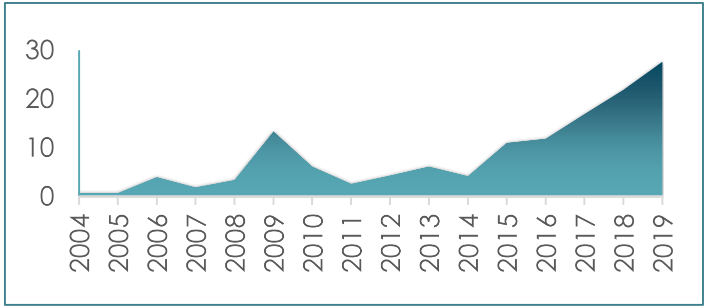
...and by keeping the cost of financing low.

Real interest rates (annual, in %)

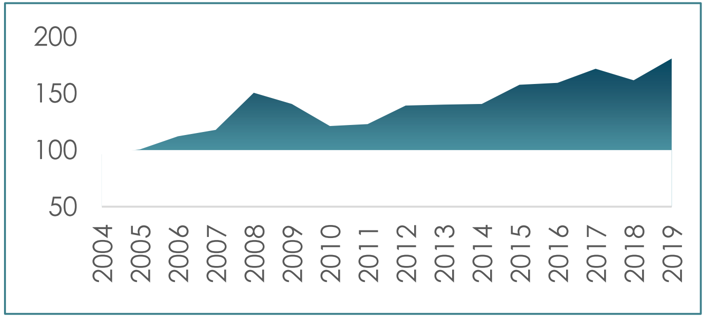


While negative real interest rates kept the cost of domestic financing low, overvalued exchange rate facilitated cheap imports for public sector projects.

Parallel-official exchange rate spread
(in % of official exchange rate)



Real exchange rate appreciation



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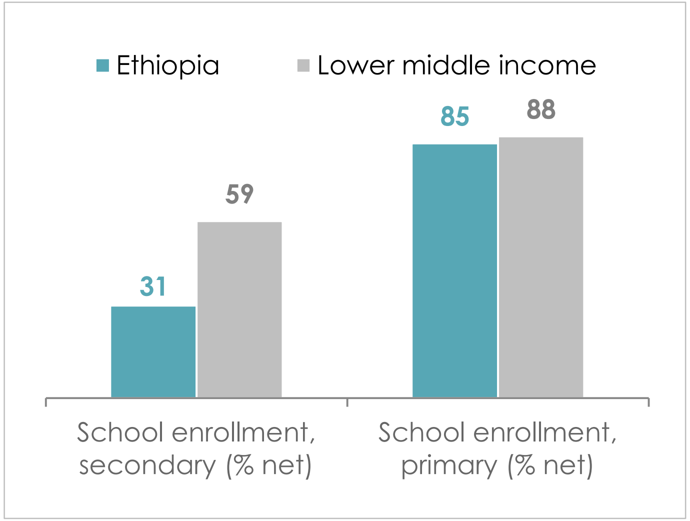
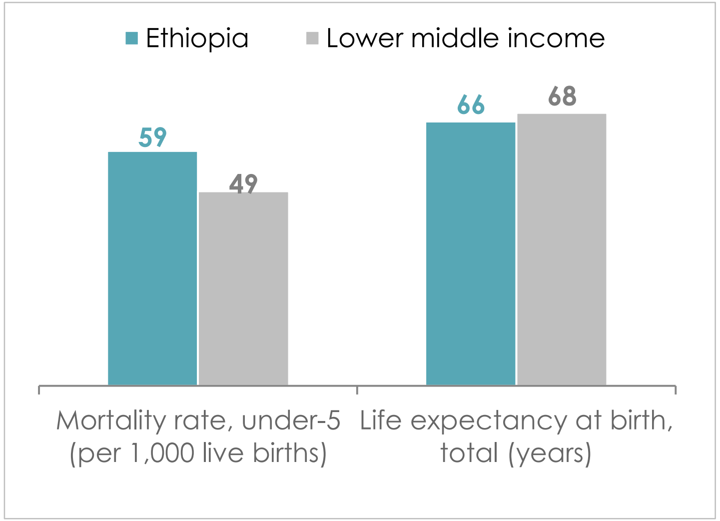
While closing the education and health gap with lower middle income economies…

Access to education, 2015

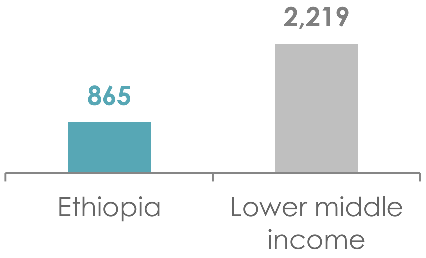


Health outcomes, 2017



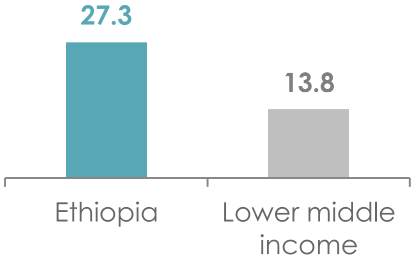
... we have a long way to go to reach today's lower middle income level benchmarks in other development indicators.

GDP per capita (current US$), 2018



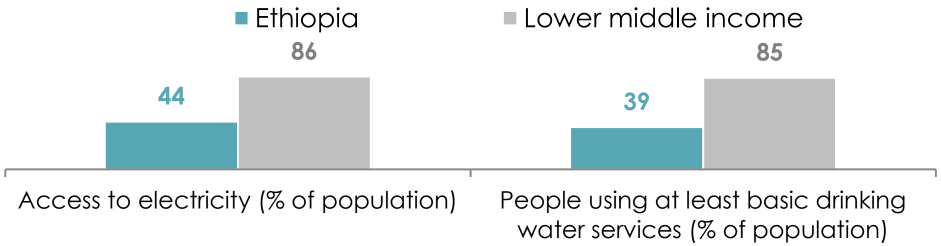
Need to triple per capita GDP to reach today's lower middle income level

Poverty headcount ratio at $1.90 a day, 2015



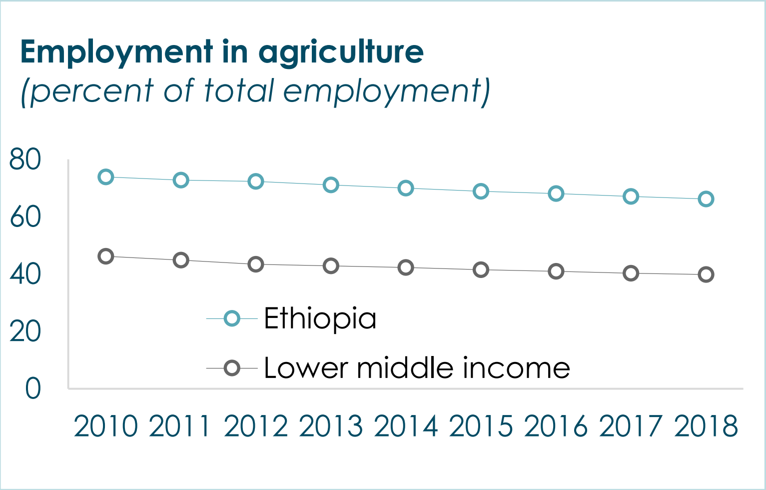
Need to cut poverty in half to achieve today's lower middle income level

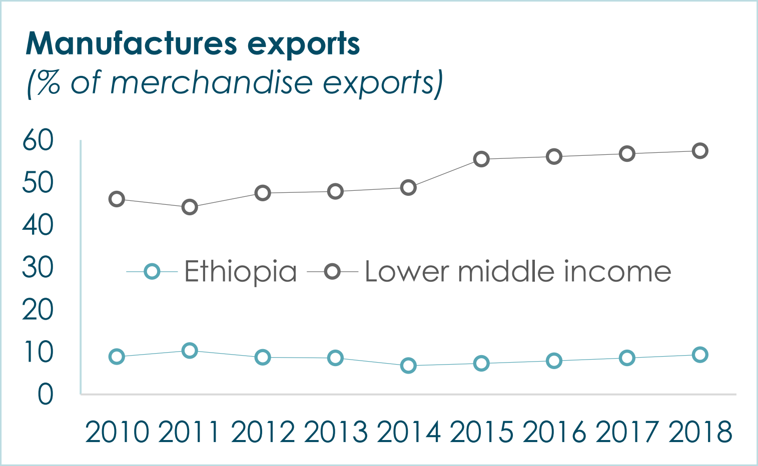
Access to electricity (2017) and basic drinking water (2015) services



Need to provide electricity and water for additional 40-45 million to reach current coverage rate of lower middle income countries.

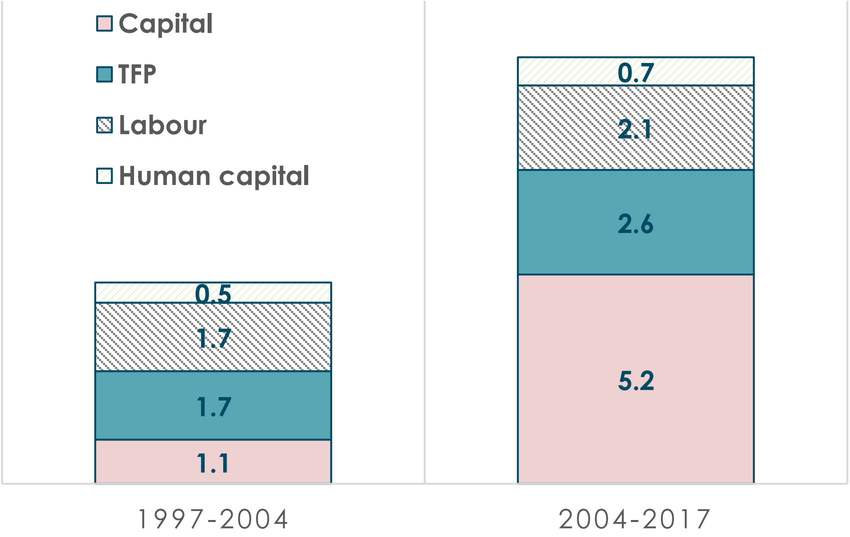
At the same time, the economic progress has not been entirely successful in inspiring structural transformation…





… reflecting the fact that income growth was achieved primarily through capital accumulation and less through productivity growth.

Contributions of Factors of Production Growth *(in %)*



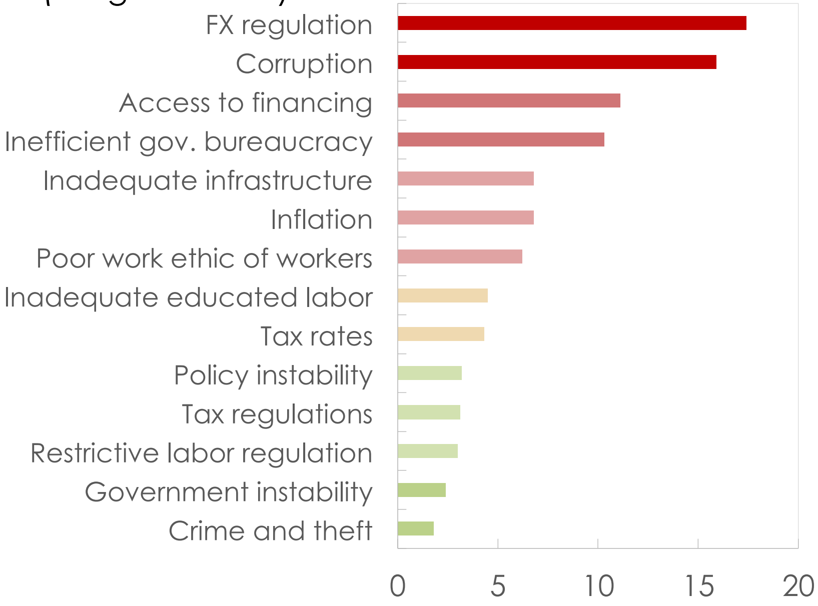
Source: estimated based on data from Penn World Tables 9.1.

While capital contributed half of the growth during 2005-17, the contribution of productivity (TFP) was not overwhelming…

- In particular taking into account the potential increase in inefficiency associated with large capital accumulation

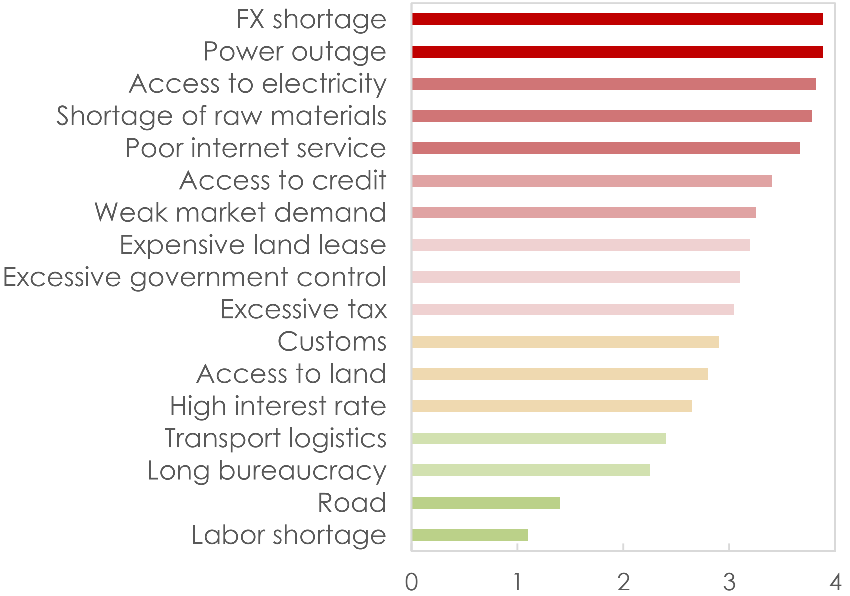
Productivity growth is constrained by structural and institutional bottlenecks ...

Constraints to doing business
(weighted rank)



Source: World Economic Forum, Global Competitiveness Report, 2018.

Constraints in the manufacturing sector, ranked by firms
(0-4; not a constraint to a major constraint)



Source: UNDP, Growing Manufacturing Industry in Ethiopia, 2017.

FX shortages, access to and reliability of electricity, corruption and government inefficiency, poor internet service, and access to finance are cited as the most problematic factors to doing business.

... and constraints specific to key productive sectors.

Agriculture

Insufficient yield growth due to inefficient provision of inputs and services, difficulty with respect land lease rights, limited investment on R&D and irrigation, marketing and logistic related problems, and lack of agriculture-specific financial services.

Manufacturing

The manufacturing sector remains underdeveloped despite recent efforts to stimulate the sector due to inefficient incentive structure, limited backward and forward linkages, and insufficient incentives for production of import competing activities.

Mining

Ethiopia's vast and diverse mineral resources, with the potential to generate the much needed FX, remain untapped due to a variety of constraints including institutional and technical barriers against large-scale miners, absence of a legal framework to manage the miners' relationship with local communities, and informality and pricing issues related to gold mining.

Tourism

While maintain historical and cultural assets for centuries, sufficient efforts have not yet been made to leverage these assets for economic growth. Challenges include limited accessibility and attractiveness, insufficient marketing and branding, and weak supporting institutions.

ICT penetration, which is crucial for productivity growth, is also limited by various constraints, including:

Hard infrastructure	*Limited access to reliable electricity, limited access to affordable and reliable high-speed internet, and high cost of IT equipment*
Enabling system	*Lack of digital national ID and poor digital payments system*
Applications	*Underdeveloped e-commerce systems*
Finance	*Limited access to finance for entrepreneurs and start-ups*
People	*Limited digital literacy and future-oriented advanced skills*
Police and Regulation	*Public sector monopoly in telecom and energy, restrictive regulation for new start-ups, and traditional Industrial Policy may be ill-suited to innovation*

At the same time, the economy is facing headwinds from growing macroeconomic imbalances.

- While achieving the intended objectives of building human capital and infrastructure and reducing poverty,
- … efforts to finance public investment programs through,
    - rapid accumulation of debt, and
    - directing domestic financial resources to public and priority sectors,
- … coupled with poor project execution have brought to the fore macroeconomic imbalances, including:

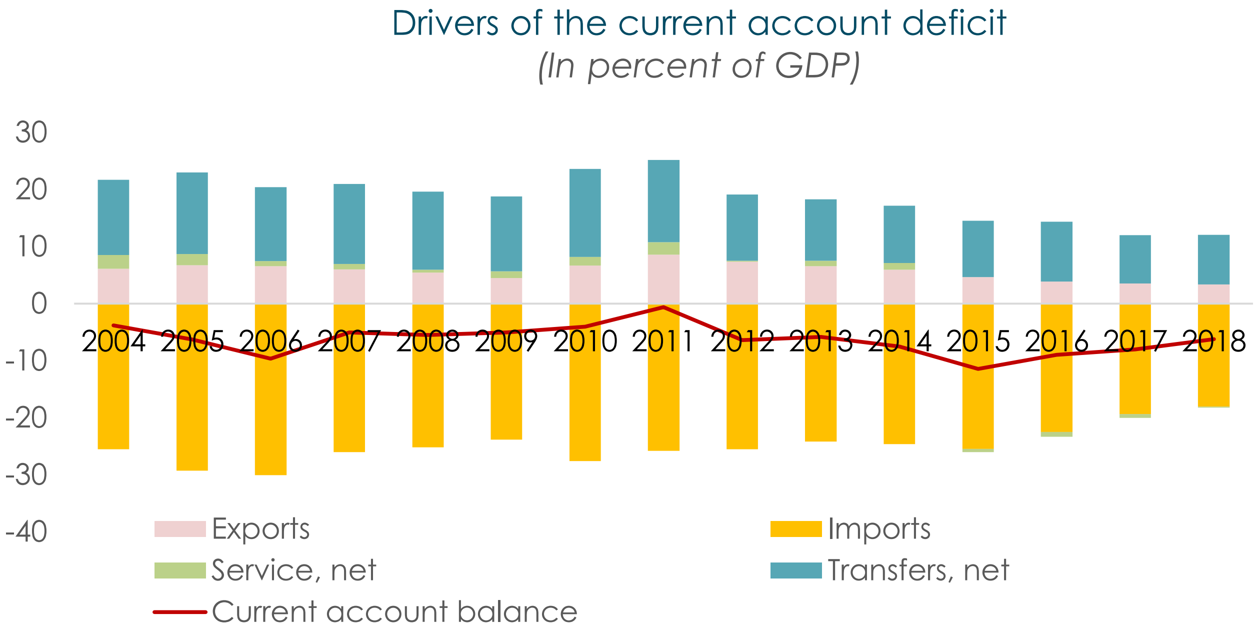
Foreign exchange imbalances

External debt burden

Limited private sector access to finance

High inflation

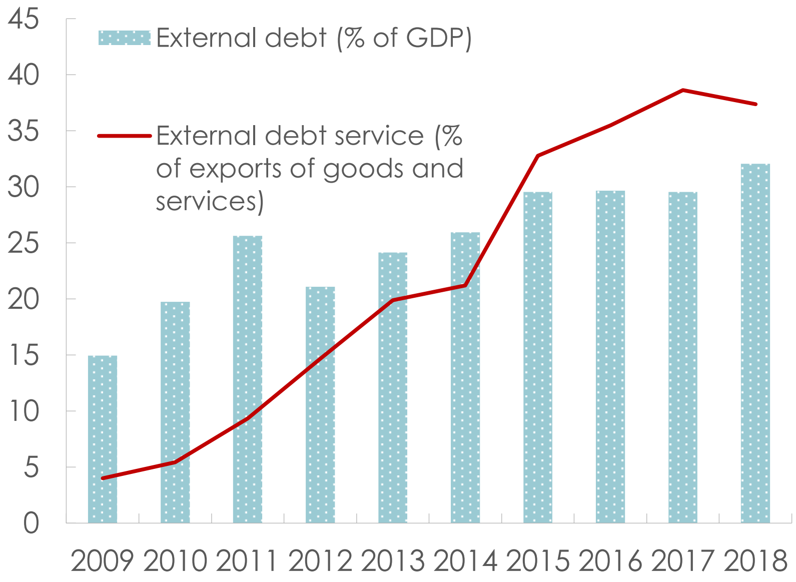
High demand for imports and poor export performance resulted in large CA deficits and significant FX shortages



As a result of persistent current account deficit, FX shortage has become one the main binding constraints to business.

Rapid increases in external debt in the context of poor project execution and export performance led to high risk of debt distress.

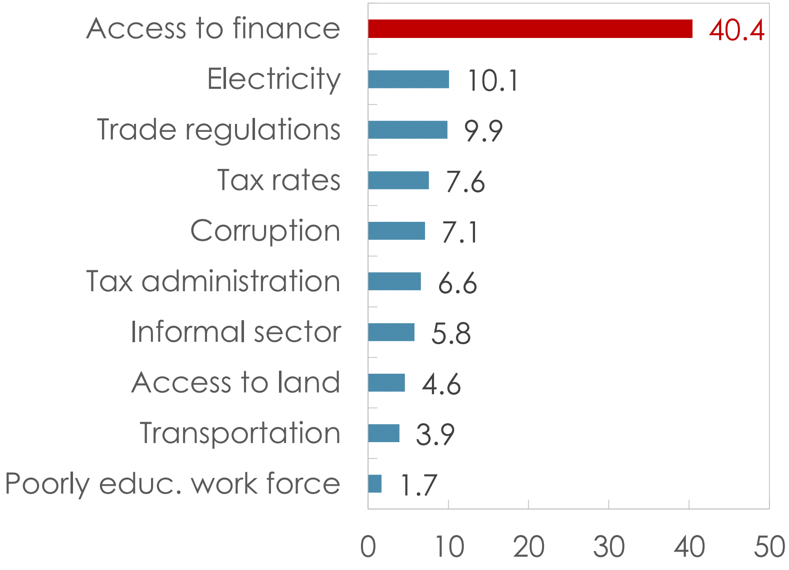
Public sector external debt



- While the stock of the external debt is not particularly high by international standards…
- Poor project execution along with disappointing export performance…
- Prompted the IMF and World Bank to rate Ethiopia's external debt burden as a high risk of distress
- Undermining the country's credit standing and borrowing ability.

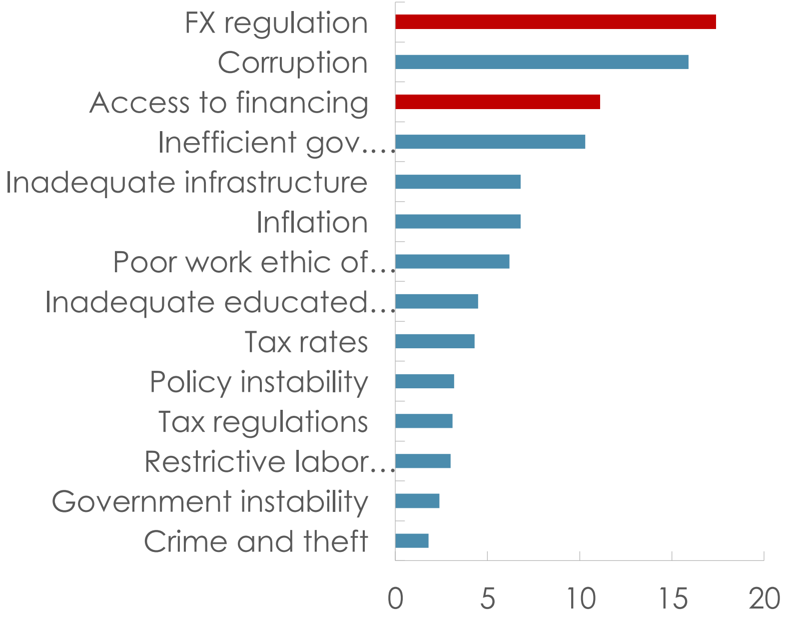
Expansionary fiscal policy appears to have crowded out private sector's access to finance…

Percent of firms identifying the following as the biggest obstacles to business



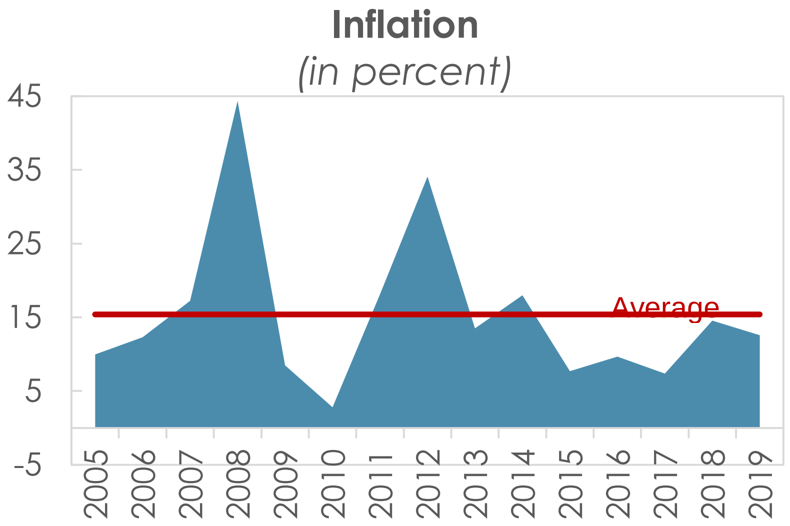
Source: The World Bank's Enterprise Survey (2015).

Most problematic to doing business



Source: Global Competitiveness Report (2018).

… and might have contributed to the high inflation.



Inflation averaged about 15½% a year during 2005-19, with wide ranging economic consequences such as:

- Dwindling purchasing power of consumers, in particular the poor and middle class
- Negative saving rates, there by discouraging financial saving
- Appreciating real exchange, there by eroding external competitiveness

At the same time, anticompetitive and hoarding practices are making it difficult to stabilize prices

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Our reform agenda aims to overcome the aforementioned challenges through comprehensive and well-synchronized set of measures

Macroeconomic reforms

- Correct FX imbalances
- Control inflation
- Improve access to finance
- Ensure debt sustainability

Structural reforms

- Ease business constraints

Sectoral reforms

- Address sector-specific institutional and market failures

Build confidence

Rebalance growth and enhance productivity

Jobs, inclusive growth, and poverty reduction

Macroeconomic reforms will aim at correcting imbalances and safeguarding macro-financial stability

A stable macro-financial system supports growth and job creation by:

- Enabling savers to invest their financial assets in the financial system with confidence;
- Providing investors the predictability and finance they needed to invest in job-creating projects; and
- Allowing consumers to utilize the financial system and smooth their consumption.

… and macro-financial stability requires:

- Strengthening public sector finances
- Correcting FX imbalances
- Controlling inflation
- Safeguarding financial stability
- Improving access to finance and developing capital markets

… macroeconomic reforms (cont'd)

1

Strengthen public sector finances through:

- Maintaining a prudent fiscal policy stance
- Improving domestic revenue mobilization
- Enhancing efficiency of public investment
- Implementing the privatization plan
- Finalizing ongoing public projects
- Enhancing operational efficiency, transparency, and governance of SOEs

Fiscal policy will focus on supporting high quality growth and ensuring debt sustainability through revenue mobilization and improving efficiency of public spending.

… macroeconomic reforms (cont'd)

2

Correct FX imbalances through:

- Mobilizing FX through privatization and concessional borrowing
- Implementing a comprehensive remittance strategy
- Improving the incentive structure for diaspora savings by facilitating creation of longer-term saving instruments and allowing banks to pay competitive interest rates
- Promoting exports, tourism, and FDI through macroeconomic and structural reforms
- Easing controls on FX sales to private sector importers
- Improving the FX management and functioning of the interbank market based on further study

… macroeconomic reforms (cont'd)

3 ***Controlling inflation through:***

- Containing the growth of reserve money, including by gradually reducing direct advances to the budget
- Introducing effective monetary policy and liquidity management instruments
- Strengthening the NBE's analytical capacity
- Improving the efficiency of the supply chain and domestic commodity markets

4 ***Safeguarding financial stability through:***

- Modernizing the operations of CBE and DBE to the level of industry best practices
- Upgrading NBE's financial regulatory framework to international standards
- Enforcing the regulatory rules uniformly across banks

… macroeconomic reforms (cont'd)

5

Improving financial access through developing capital and financial markets. In particular, reform measures will include:

- Developing a competitive and well-functioning T-bills market
- Upgrading the financial market infrastructure through gradually phasing out the NBE bill and facilitating the development of inter-bank money markets
- Establishing secondary bond markets and a stock exchange market in collaboration with the private sector and with TA from development partners
- Supporting the development of mobile banking to promote financial inclusion

Macroeconomic reforms will be complemented with structural reforms to create an enabling environment for investment...

- *Streamlining bureaucratic and regulatory procedures*
- *Improving governance at public institutions*
- *Improving power reliability and access through*
  - ✓ *Modernizing corporate governance and improving operational efficiency at EEU and EEP*
  - ✓ *Restoring cost recovery through tariff reforms*
- *Implementing the telecom sector reform*
- *Creating a secure and predictable market access to exports, including by expediting WTO accession and strengthening regional trade integration*
- *Undertake logistic reform to enhance logistics efficiency and invest in logistics infrastructure*
- *Improving the efficiency of domestic markets for goods and services, such as by removing barriers to entry, enforcing the competition Law, and improving the efficiency of the commodity market supply chain.*

…along with sectoral reforms, focusing on key sectors where Ethiopia has great potential:

Agriculture

- Enhance productivity of small-holder farmers and pastoralists through provision of modern inputs and services;
- Develop a legal framework that will allow farmers to lease land use rights and become shareholders in large commercial farms;
- Modernize livestock production through improving veterinary infrastructure, research and innovation, and establishing linkages with other industries;
- Establish effective linkage between agriculture producers and commodity markets as well as the commercial value chain;
- Encourage private sector investment in agricultural R&D and exploring PPPs to expand medium and large-scale irrigation infrastructure;
- Develop a legal framework for agriculture-specific financial services such as micro-lending, crop insurance, and forward contracts.

… sectoral policies (cont'd)

Manufacturing

- Revisit and overhaul the incentive structure of our industrial policy;
- Prioritize the development of manufacturing sectors with strong local content such as agro-processing and leather products;
- Strengthen the backward linkage of emerging manufacturing value chains through encouraging domestic production of primary and intermediate industrial inputs;
- Promote import competing industries, leveraging on large domestic market size;
- Develop industrial relations framework to achieve fair pay and minimize disruptions.

… sectoral policies (cont'd)

Mining

- Formalize and support artisanal and small-scale mining;
- Review gold pricing to reduce incentives for contraband trade;
- Address political and legal issues with local communities and incentivizing miners to engage and invest in local communities;
- Address technical and institutional barriers against large-scale mining projects;
- Develop policies and institutional capacities to create a sustainable and inclusive mining sector with strengthened geological information and diversified product base with industrial input focus.

… sectoral policies (cont'd)

Tourism

- Improve the attractiveness of and access to historical, cultural, and natural tourist sites;
- Promote tourist sites through marketing, branding, and packaging based on customer segmentation;
- Modernizing the standards for tourism and relate service provides ;
- Develop new tourist sites;
- Strengthen the linkage to the agriculture sectors by promoting use of local produces at hotels and restaurants.

Finally, exploring new source of productivity and job growth.

ICT and creative industries

Efforts will be geared towards exploring new sources of productivity and job growth, levering on the rapidly growing educated young labour force. In this regard, the reform agenda will focus on:

- *Building inclusive digital economy through:*
    - *Expediting the telecom reform agenda and ongoing work on National ID system;*
    - *Sandbox regulatory approaches to support technology start-ups and incumbents;*
    - *Scaling up ongoing government ICT initiatives such as e-governance, WoredaNet, the rural connectivity program, and rural public internet access centres;*
    - *Promoting e-commerce and digitization of the financial and logistic sectors;*
    - *Developing ICT parks and fostering the development of the ICT ecosystem;*
    - *Investing on ICT literacy and advanced vocational and tertiary education.*
- *Creating an enabling environment for creative industries*

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Macroeconomic outlook

- The rapid growth will be sustained through:
  - ✓ Stepped-up efforts to finalize ongoing public investment projects
  - ✓ Increased private sector investment facilitated by the reform agenda
- The sources of growth will be rebalanced and diversified
- The strong recovery in imports will widen the current account deficit in the near term,
  - ✓ However, this will reverse in the medium term as exports pickup, reflecting the impacts of the reform agenda
- Prudent monetary policy will help control inflation
- Public sector reforms will ensure debt sustainability, while continuing to support growth.

Overall developmental goals for the next 10 years

- Sustain a rapid economic growth
- Build a resilient and diversified middle income-level economy achieved through;
  - ✓ Raising agricultural productivity and incomes of small-scale farmers
  - ✓ Diversification, technological upgrading, and innovation
  - ✓ Inclusive and sustainable industrialization
  - ✓ Inclusive digital economy
- Eradicate extreme poverty and hunger, and reduce the proportion of people living in poverty by half
- Provide universal access to
  - ✓ Affordable health care
  - ✓ Quality secondary education to relevant school-age children
  - ✓ Safe drinking water
  - ✓ Affordable and reliable energy and transportation services
- Build an emerging market economy-level modern policy and institutional framework
- Build an efficient, resilient, and well-functioning financial market system that provides affordable access to finance to investors and consumers

Outline

Resource requirements and next steps

Resource requirements

In addition to mobilization of **domestic savings** and **privatization proceeds**, implementation of the homegrown economic reforms will require **significant external financing.**

Financing options

The additional external financing is expected to be mobilized from **multilateral and bilateral development partners** in the form of **concessional** and/or **de-risked** financing.

Next steps

- Communication to the public
- Roadshow to the international community
- Strengthen reform committees
- Implementation

End

THANK YOU!