

## AFRICA RISK CONSULTING

### Country briefing – Ethiopia

February 2013

## Summary

*IMF says that Ethiopia's foreign reserves have increased and can now cover more than two months' worth of imports. Divisions arise between National Bank of Ethiopia and industry minister, Mekonnen Manyazewal about extent of foreign reserves problem. Government uses Charities and Societies Proclamation legislation to further crack down on NGOs. Ethiopia provides guarantee for \$505m loan extended to Djibouti by the China Export Import Bank to facilitate development of efficient railway system between Ethiopia and Djibouti. Government introduces Export Trade Duty Free Incentive to encourage exports.*

### **Foreign exchange reserves improve and debate reveals rare divisions in ruling party**

The government has depleted Ethiopia's foreign exchange reserves in attempts to sterilise liquidity rather than build up reserves, to the chagrin of the **International Monetary Fund (IMF)**. In February **Jan Mikkelsen**, IMF representative to Ethiopia, said that Ethiopia's foreign reserves had improved to cover more than two months of imports<sup>1</sup>. Ethiopia's lack of foreign currency has created problems for the business community and debate over foreign exchange now reveals divisions in the ruling **Ethiopian People's Revolutionary Democratic Front (EPRDF)**. Foreign currency shortages encourage trading on the parallel market and hinder the ability of businesses to obtain letters of credit on time. The government has responded by easing regulations in the export sector (see below) while reserves of the **National Bank of Ethiopia** have risen in US dollar terms since the start of the fiscal year<sup>2</sup>.

The foreign exchange debate has given some insight into the complexity of politics and divisions within the EPRDF. On the one hand, **Teklewold Atnafu**, governor of the National Bank, argues there is no shortage, blaming speculative foreign exchange requests for distorting estimations of the market's requirement of US dollars. On the other side, industry minister **Mekonnen Manyazewal**

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<sup>1</sup> Capital, 18 February 2013

<sup>2</sup> Capital, 18 February 2013

shares the concerns of the business sector<sup>3</sup>. Prime Minister **Hailemariam Desalegn** appears to side with the governor; in his most recent address to parliament, he criticised the effect of continued speculative foreign exchange requests. Hailemariam's cabinet shuffle in November 2012 demonstrates his need to balance ethnic power blocs in the EPRDF<sup>4</sup>. He also needs to mediate between factions divided by their approach to economic development and balance the state-led approach with a growing private sector.

Whoever comes out on top between Atnafu and Manyazewal may guide Ethiopia's monetary policy in the short term but the future is less certain. In October 2012 the IMF reiterated its position that the government must scale back public spending and intervention in the market so as not to crowd out the private sector, even if this undermines Ethiopia's growth in the short term<sup>5</sup>. If foreign reserves are insufficient to protect Ethiopia against a deterioration in the country's terms of trade, it will increase the likelihood of a return to IMF borrowing and therefore acceptance of IMF policy prescriptions. While Mikkelsen admitted that speculation was a concern, he said the market was failing to meet currency requirements.

### **Government's uneasy relationship with NGOs and media continues**

In February, the Ethiopian government banned three civil society organisations for "illegal religious activities" under the 2009 **Charities and Societies Proclamation** legislation. In the same month, the **Cassation Bench** of the **Federal Supreme Court** heard a petition by the **Human Rights Council** to admit an appeal against the freezing of its bank accounts under the same legislation. The EPRDF has traditionally had a strained relationship with NGOs who accuse it of using the 2009 Proclamation to crack down on those providing an alternative narrative to its state-led approach to development or raising concerns about alleged human rights abuses in the **Ogaden, Gambella** region and elsewhere. February's events suggest that tension between the government and NGOs will continue.

The **Committee to Protect Journalists (CPJ)** on 3 February appealed to the government to release journalist and magazine editor **Solomon Kebede** who they say is suffering ill health in prison. Ethiopian security forces arrested the Muslim journalist on 17 January, accusing him of incitement to commit terrorist acts. They have held him without charge since his arrest. He is due to face trial at the end of February, although this might be postponed. Kebede was managing editor of the now-defunct **Ye Muslimoch Guday** (Muslim Affairs) which the authorities forced to close after the journal reported the continuing Muslim protests in **Addis Ababa** and other cities. The protests target

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<sup>3</sup> Addis Fortune, 17 February 2013

<sup>4</sup> Source: Western diplomat, Addis Ababa.

<sup>5</sup> Article IV Consultation, 2012

perceived government manipulation of 2012 elections to the **Islamic Council**. Authorities responded by repressing Muslim publications and other media outlets reporting the protests, forcing at least three papers, including *Ye Muslimoch Guday*, to stop publishing. The protests, which have continued in a largely peaceful manner in the vicinity of mosques, have been a highly sensitive issue for the government which fears Islamist militant infiltration of Ethiopian Muslim organisations<sup>6</sup>. While al Qaeda/al Shabaab has undoubtedly been seeking to undermine the Ethiopian government by trying to recruit radicals, there is little evidence the majority of Sufi Muslims have any sympathy with Islamist militancy (as discussed in the January briefing).

### **Ethiopia Guarantees \$505m loan to Djibouti**

Ethiopia demonstrated its commitment to improving the effectiveness of its import and export industries as the finance and economic development ministry provided a guarantee for a \$505m loan to **Djibouti** by the **China Export Import Bank**. The bank had asked for the guarantee before approving Djibouti's loan request as part of the construction of a \$1.2 billion railway between the two countries to replace the decrepit **Ethio-Djibouti** track. The new standard gauge railway line will connect **Addis Ababa** and **Djibouti City** once completed by 2016. The loan is to cover the cost of the track in Djibouti which **China Civil Engineering Construction Corporation** is to build. The **Ethiopian Railway Corporation** had already reached agreement worth \$1.64 billion with the **Chinese Railways Engineering Corporation (CREC)** for the completion of its end of the track in October 2011. Ethiopia's funding also comes from the China Export Import Bank. CREC is undertaking the Light Railway Transit project in Addis Ababa. Ethiopia and Djibouti have formed a joint commission to oversee the coordination and development of the project. Under the **Growth and Transformation Plan**, the Ethiopian government aims to develop the 2,400 km railway network, with the majority to be completed by 2015. As part of its commitment to improving its import and export capability, the Ethiopian Shipping and Logistics Service Enterprise announced in February that it will expand **Modjo** dry port, increasing its capacity from 6,300 to 9,500 containers<sup>7</sup>.

### **Government implements Export Trade Duty Free Incentive Scheme**

In February the government's **Export Trade Duty Free Incentive** directive to improve export capabilities came into effect. The incentive scheme is aimed at boosting the manufacturing sector's level of exports in line with the **Growth and Transformation Plan**. Since its original date of November 2012 the government had twice postponed the directive that revised the scheme due to confusion about what it means in practice. The initiative includes new regulations regarding duty drawback for when an import fee has already been paid for a good which is then subsequently exported. This process will take 30 days rather than up to a year as previously. The new regulations

<sup>6</sup> Source: Western diplomat, Addis Ababa

<sup>7</sup> Walta Information, 13 February 2013

include Ethiopia's bonded export factory scheme, manufacturing warehouse scheme, input supply warehouse scheme and industrial zone scheme. Bonded warehouses will not have to pay import taxes and duties, provided the goods are then exported or involved in producing goods to be exported.

### **National Bank reduces reserve requirement**

In February, the National Bank reduced the reserve requirement of commercial banks to 5% from 10%<sup>8</sup>. This is the second time in the past two years that the bank has reduced the reserve requirement which peaked at 15% three years ago. In a separate measure, the bank introduced regulations that the portfolios of commercial banks must consist of 40% of short term loans due within one year. There will be a two year grace period before this change comes into force.

### **Implications**

While foreign exchange reserves have improved, this will not assuage the concerns of the IMF and others who hold that Ethiopia's statist approach to development is not sustainable in the long term. Any return to IMF borrowing will challenge this model with a range of policy prescriptions but for now the government will remain at the heart of Ethiopia's economic growth and intolerant of dissenting voices. The government remains committed to investment in infrastructure and export capabilities as demonstrated by its guarantee for the China Export Import Bank loan extended to Djibouti and the Export Trade Duty Free Incentive. A culture of close business-government links will continue to shape the business sector<sup>9</sup>.

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<sup>8</sup> Fortune, 21 February 2013

<sup>9</sup> Source: oil industry executive, London.