

AFRICA RISK CONSULTING
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Summary

The executive committee of the opposition Unity for Democracy and Justice (UDJ) party resigns ahead of a planned merger with the All Ethiopia Unity Party (AEUP). The World Bank calls on Ethiopia to devalue the birr, claiming it is 31% overvalued. The mines ministry signs an oil exploration agreement with Russia-based GBP Global Resources, a subsidiary of the Gazprombank Group. Muslim protests resume following Friday prayers at the Grand Anwar Mosque near the Merkato area in Addis Ababa.

1.1 Opposition Unity for Democracy and Justice party faces fractures

Ethiopia's opposition politics are increasingly fractious after one third of the **Andinet (Unity for Democracy and Justice, UDJ)** party's executive committee resigned.¹ The UDJ is the only opposition party to hold a seat in parliament and – alongside the **Semayami (Blue Party)** – was at the forefront of anti-government protests in 2013. The five members of the executive committee who resigned are deputy presidents **Tekle Bekele** and **Belay Fikadu**; head of political affairs, **Solomon Seyoum**; head of party affairs, **Daniel Tefera**; and head of economic affairs, **Dawit Asrade**. The resignations leave UDJ chairman **Gizachew Shiferaw** politically isolated after he took control of the party in January 2014 (See *ARC Ethiopia January 2014 Briefing*), succeeding former Ethiopian president **Negasso Gidada** (1995 – present). Daniel questioned the leadership of Gizachew, saying that the dissenting members of the executive committee did not “*believe that his leadership will lead the struggle forward*”.²

The UDJ claims that the resignations will not jeopardise the planned merger with the **All Ethiopia Unity Party (AEUP)**. The **National Electoral Board of Ethiopia (NEBE)** has yet to approve the proposed merger. The AEUP and the UDJ are members of the opposition **Forum for Democratic Dialogue in Ethiopia (FDDE)**, commonly known by its Amharic name of **Medrek**. The alliance

¹ The Reporter, 16 Aug 2014.

² The Reporter, 16 Aug 2014.

between the UDJ and the AEUP suggests that Ethiopia's opposition parties are looking beyond Medrek as they prepare for the May 2015 general elections. Medrek's constituent parties have competing ethnic, economic and political interests, and it resembles more of a democracy movement than a coherent political party. The "disparate"³ Medrek parties have little to unite them other than being the common enemy of the **Ethiopian People's Democratic Revolutionary Front (EPRDF)**. This is not necessarily enough to hold the forum together, and the grouping is likely to splinter in the short term. Medrek's failure to rally the enthusiasm which the **Coalition for Unity and Democracy (CUD)** captured in the 2005 elections and its inability to hold the government to account for the flawed 2010 election, have diminished its stature in the public mind.

Despite the opposition's lack of capacity to pose a meaningful electoral challenge to the EPRDF next year, the government is continuing its crackdown on opposition figures. In July, a court charged the detained journalists and **Zone 9** bloggers including political writer **Tesfalem Waldyes** (See *ARC Ethiopia May 2014 Briefing*) with offences under the Anti-Terrorism Proclamation.⁴

*"There is no real need for the EPRDF to worry about losing the election. What it does show is that the EPRDF will do its damndest to remain in power. There has never been a peaceful transfer of power in Ethiopia and the EPRDF continues to tighten its grip on the political and democratic space. Each time they do, the risk of Ethiopia's next political change being violent increases. The highest risk period will be between 2020 and 2030."*⁵

1.2 World Bank calls for currency devaluation

The **World Bank** on 22 July called on Ethiopia to devalue the birr in order to obtain a more accurate real exchange rate valuation and increase export revenue.⁶ The World Bank admitted that the impact of devaluing the currency is uncertain, and the Ethiopian government has typically proved reluctant to follow the international agency's policy prescriptions. According to a senior Ethiopian economist critical of the government's economic policies:

"The likelihood that the government will follow the World Bank's advice is 50-50. The probability of their doing so has declined since the original announcement. EPRDF officials are increasingly conscious that the gain from the 2010 devaluation measure (see below) was minimal at best. For devaluation to be effective, there would need to be wider reform of the economy – for instance,

³ Source, journalist, Addis Ababa

⁴ Committee to Protect Journalists, 21 Jul 2014.

⁵ Source, senior Western diplomat, Addis Ababa

⁶ World Bank Third Ethiopia Economic Update, 22 Jul 2014.

moving away from the export of non-manufactured goods to manufactured goods – and the authorities are unwilling to do this.”⁷

A finance ministry official said that the government would consider devaluation but only once it had determined the wider impact on the economy, notably Ethiopia’s debt balance. World Bank lead economist in Ethiopia **Lars Moller** forecast that a 10% reduction in the currency’s value would lead to a 5% increase in stalled export earnings (see below) and a 2% increase in growth on the back of increased exports.⁸ The **National Bank of Ethiopia (NBE)** has operated a carefully managed floating exchange rate regime since 1992. Ethiopia last devalued the birr in September 2010, when it fell by 16.7% against the **United States (US)** dollar. Former prime minister **Meles Zenawi** (1995 – 2012) announced in February 2011 that the government would not instigate a significant depreciation for five years, instead continuing a policy of steady incremental depreciation.

The World Bank estimates that since the 2010 devaluation the currency has appreciated in real terms by more than 50% resulting in a currency overvalued by 31%.⁹ Annual exports from Ethiopia have remained steady at approximately \$3 billion since 2012, mainly because of falling international commodity prices. The value of exports increased to \$2.6 billion in the first ten months of 2013- 2014, an increase of almost \$5m over revenue earned through the entirety of 2012 – 2013. However, Ethiopia’s major export commodity, coffee, declined 8.7% in amount exported and 15% in revenue generated during the first ten months of the year.¹⁰ Ethiopia expects to earn \$1 billion a year by 2023 from exporting electricity. The World Bank report noted that Ethiopia’s export and manufacturing sectors remain relatively small, with half as many exporting firms as **Kenya**. An overvalued exchange rate will reduce Ethiopia’s competitiveness with regard to the price of basic export commodities. The World Bank recommended additional measures to boost exports including expanding processing and packaging to add value, constructing additional industrial zones, increasing access to credit for small and medium sized enterprises, and reducing trade logistics bottlenecks and improving regulatory quality checks to reduce business costs and time.

A senior Ethiopian economist agrees with the scale of this overvaluation, but is sceptical whether the devaluation will have the intended impact on stimulating exports.¹¹ The economist’s main concern is that the 2010 depreciation had little impact on Ethiopia’s high inflation rates and low interest rates:¹²

⁷ Source, senior Ethiopian economist

⁸ World Bank Third Ethiopia Economic Update, 22 Jul 2014.

⁹ World Bank Third Ethiopia Economic Update, 22 Jul 2014.

¹⁰ Addis Fortune, 27 Jul 2014.

¹¹ Source, senior Ethiopian economist

¹² Source, senior Ethiopian economist

“The government has been quietly but effectively devaluing the birr. Why would they announce a devaluation measure that would raise popular expectations about the cost of goods, when they could continue their policy of quiet devaluation? Under normal circumstance having relatively high inflation rates and low interest rates should not be sustainable but this has been the case for the past decade. The reason is that the economy is not exposed to the international financial markets. It remains a largely agrarian economy with minimal financial depth. Had there been financial deepening and linkages to the global financial markets, the two would not have coexisted this long but with the government channeling all available credit to state-owned enterprises and not the private sector, it may continue until the day of reckoning arrives.”¹³

Any significant depreciation of the currency would contribute to inflation and affect the import cost of capital and consumer goods. Economists warn that there would need to be additional policy measures such as a tightening of monetary policy to mitigate this. There are concerns that inflation could increase after the finance ministry announced increases in civil service pay of between 22 – 46%.¹⁴ Increased government spending in the run up to the 2015 elections will also increase inflationary pressures. The **International Monetary Fund (IMF)** estimates that inflation decreased from 24.1% in 2012 to 8.0% in 2013.¹⁵ The IMF forecasts that inflation will average 7.7% between 2014 and 2019. There is unlikely to be a major change in government monetary policy:

“The question is where the government will get the money to cover the pay rise which I estimate will cost the government an additional \$504m. Taxes? The tax base is limited, and small and medium businesses are folding already due to a lack of capital. Income tax? The EPRDF will not want to burden the business elite, especially in an election year. The only option will be increased government borrowing, in effect a continuation of its expansionary policy.”¹⁶

1.3 Mines ministry signs oil exploration agreement with Russian firm

The mines ministry announced on 19 July that it had signed an oil exploration agreement with **Russia-based GBP Global Resources**, a subsidiary of the **Gazprombank Group** which is part of state-owned **Gazprom**.¹⁷ The mines ministry is now overseeing a total of 15 petroleum production and sharing agreements with nine companies. The production sharing agreement is for the

¹³ Source, senior Ethiopian economist

¹⁴ ERTA, 3 Aug 2014.

¹⁵ World Economic Outlook, April 2014.

¹⁶ Source, senior Ethiopian economist

¹⁷ Energy monitor worldwide, 19 Jul 2014.

exploration and development of a 42,000 square kilometre concession in **Afar**. According to a GBP Global Resources statement, exploration will take up to seven years and the agreement includes a 25-year exploitation period in the event of successful exploration.¹⁸ If the concession does reach production stage, GBP Global Resources will hold 30% of the concession right and the Ethiopian state 70%. GBP Global Resources facilitates Gazprom's oil and gas projects in **Libya**, and was formerly **GPB Neftegaz Services**. The US and **European Union (EU)** both imposed sanctions on Gazprombank in July following Russia's support for secessionist militant groups in the **Ukraine**.

1.4 Muslim protests resume

Muslim protests have resumed in **Addis Ababa** after several months. The protests are about religious policy and are not indicative of political tensions increasing before the May 2015 elections. In the largest incident, hundreds of protesters fought with federal and Addis Ababa police near **Addis Merkato** following Friday prayers at the **Grand Anwar Mosque** on 18 July.¹⁹ Protests in Ethiopia's Muslim community have been fairly regular over the past few years but have quietened in recent months. The trigger for the reoccurrence is uncertain but the protesters called for the release of the leaders of previous demonstrations detained under Ethiopia's contentious anti-terrorism proclamation.²⁰ The ongoing tensions with the Muslim community are more about religion than politics. There are longstanding grievances within Ethiopia's Muslim community about alleged government interference in religious matters. In early 2013, there was a series of protests after Muslim leaders accused the government of manipulating elections to appoint *majlis* ('councillors') to the **Supreme Council of Islamic Affairs** as part of the **Al Ahabash** campaign to control Ethiopia's dominant brand of Islam.²¹ According to a leaked government report dated 2012, the Ahabash campaign aims to curb Islamic extremism.²² The protesters accused the security forces of a heavy-handed response to the demonstrations.

2 Implications

The EPRDF will remain the dominant political force in the 2015 election due to its control of the state apparatus down to village level. It is unlikely in the medium term that it will sufficiently open up the political space for a meaningful opposition to emerge, raising the long term risk of a tumultuous transfer of power.

¹⁸ Interfax, 19 Jul 2014.

¹⁹ The Reporter, 19 July 2014.

²⁰ The Reporter, 19 July 2014.

²¹ Source, journalist, Addis Ababa

²² Source, journalist, Addis Ababa



The NBE will maintain its policy of gradual depreciation with occasional sharper adjustments. Increased government spending on public sector wages and electioneering and the limited role of the domestic private sector will additionally increase the risk of inflation. Inflation will pose a significant challenge to Ethiopia's liquidity management which will continue to crowd out the private sector's access to credit. The 70% stake that the government will hold in any successful production agreement with GBP Global Resources shows its commitment to its state-led economic model.

Sporadic protests by Muslim groups have been occurring for approximately three years now. Ordinary Muslims continue to feel harassed by government attempts to crack down on their community leaders rather than addressing their religious and political grievances. Localised protests will continue.