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The situation along the Eritrean border remains tense, as Ethiopian government officials privately discuss war. The House of Representatives approves the government's 274.3 billion birr (\$13 billion) 2016/2017 budget. The budget contains provisions for meeting the government's increasing debt obligations. Ethiopian Electric Power agrees to pay \$6.5m to settle charges with the United States (US) Securities and Exchange Commission (SEC) after it violated US securities laws. Kenya and Ethiopia aim to finalise an agreement before the end of the year for the construction of a crude oil pipeline from Lamu to Addis Ababa.

Eritrean border situation remains tense

The situation along the **Ethiopian/ Eritrean** border remains tense following the June clashes in the **Tsorona Central Front (Tigray Regional State)**. There is concern that the situation could rapidly escalate. The fighting on 12 and 13 June involved exchanges of heavy artillery fire, with both sides blaming the other for the incident (*see ARC Briefing Ethiopia June 2016*).

"At the moment, there is an uneasy calm on the border area between Ethiopia and Eritrea. With strong words flying from both sides and a strong build-up of military forces in the troubled border area after the recent incident at the Tsorona war front, there is a strong fear that the two countries could end up fighting a full blown war once again."¹

Ethiopian officials, especially those from the influential **Tigray People's Liberation Front (TPLF)**, continue to blame the Eritrean government for backing opposition groups including **Ginbot 7**.² There is a widely held belief within Ethiopian government circles that Eritrean-backed groups are planning attacks in **Tigray, Amhara and Southern Nations, Nationalities, and Peoples' Regional States**.³ Ethiopian officials on 15 July claimed that Eritrean-backed gunmen killed 11 security officers in **Gondar** (Amhara Region).⁴ State media reported a **National Intelligence and Security Service and Federal Police Anti-Terrorism Joint Task Force** statement that said 16 others were injured in the incident.⁵ The statement warned the Eritrean government to refrain from its "evil actions".⁶

Ethiopian officials are also confident in private that Ethiopia has the military power to remove Eritrean president **Isaias Afewerki** (1993-present).⁷ While the **Eritrean Defence Forces (EDF)** are larger than the **Ethiopian National Defence Force (ENDF)**, the EDF rely on conscripts unlike the ENDF, which is a volunteer force.

¹ Source, journalist, Addis Ababa

² Source, journalist, Addis Ababa

³ Source, journalist, Addis Ababa

⁴ EBCTV, 16 Jul 2016.

⁵ EBCTV, 16 Jul 2016.

⁶ EBCTV, 16 Jul 2016.

⁷ Source, journalist, Addis Ababa

“Some in the government are heard saying these days that Ethiopia is now ready and able to take not only proportionate, but more than proportionate measures if Eritrea continues to provoke Ethiopia.”⁸

Eritrean claims about the number of casualties has also angered Ethiopian officials. The Eritrean government continues to repeat that

“TPLF (Ethiopian) troops were compelled to retreat to locations beyond from where they initially unleashed the attack. In this reckless attack whose ultimate aim is difficult to comprehend, more than 200 TPLF troops have been killed and more than 300 wounded. These are conservative estimates.”⁹

Following the clash, Eritrean officials have stepped up pressure on the **Ethiopia-Eritrea Border Commission** to implement its previous ruling that awarded the contested border town of **Badme** to Eritrea (see *ARC Briefing Ethiopia June 2016*).¹⁰ Ethiopia has objected to the ruling in the past, calling for a roundtable negotiation to demarcate the border, but Eritrea has rejected further talks.

*“The Commission’s decision was binding so Eritrea seemed to have a case to call for the ruling to be put in place, but Ethiopian officials are keen to downplay it every time **Asmara** makes the call. I am aware that Eritrean opposition forces that are based in Ethiopia (and supported by **Addis Ababa**) are willing to engage in discussions to demarcate the border.”¹¹*

The willingness of Eritrean opposition groups, including the **Eritrean National Council for Democratic Change (ENCDC)**, to negotiate the status of Badme is encouraging the Ethiopian government to extend financial and political backing to them.¹² This will further increase tension with the Eritrean government.

There is also concern amongst Ethiopian officials about the increased presence of **Saudi Arabia** and **Gulf** forces in Eritrean ports as part of the military intervention in **Yemen**. In 2015, Ethiopia warned that it would fight Asmara and its ‘collaborators’ (referring to the Saudis and the Gulf states) if their presence threatens to destabilise Ethiopia:

“Isaias has now become a frequent visitor to these countries and this is clearly alarming the officials here. This could also prompt them to remove the regime in Asmara.”¹³

House of representatives approves budget

The **House of Representatives** on 5 July approved the government’s 274.3 billion birr (\$13 billion) budget.¹⁴ The 2016/2017 budget is in line with the second **Growth and Transformation Plan (GTP 2)** and marks a continuation of Ethiopia’s state-led economic model. The EPRDF’s dominance of the House of Representatives made passage of the budget a formality and it received unanimous backing. The budget is 13.6% larger than the current budget as the government looks to stimulate growth through infrastructure spending.¹⁵ The government allocated 46.39 billion birr (\$2.17 billion) to the rehabilitation and extension of the road network.¹⁶ The budget allocates 105.7 billion birr (\$4.82 billion) to capital expenditure and 68.8 billion birr (\$3.14 billion) recurrent.¹⁷ The remainder of the budget takes the form of 87.87 billion birr (\$4.09 billion) budget subsidies for the regional states, and 12 billion birr (\$547m) for projects to meet the **United Nations (UN)** sustainable development goals

⁸ Source, journalist, Addis Ababa

⁹ www.shabait.com

¹⁰ Source, journalist, Addis Ababa

¹¹ Source, journalist, Addis Ababa

¹² Source, journalist, Addis Ababa

¹³ Source, journalist, Addis Ababa

¹⁴ www.ena.gov.et

¹⁵ www.ena.gov.et

¹⁶ www.ena.gov.et

¹⁷ www.ena.gov.et

(SDG).¹⁸ In total, 63.5% of the budget is allocated to the federal government, and 36.4% to regional states.¹⁹

According to the budget, the government will raise 198.2 billion birr (\$9.04 billion) from tax and customs, 247 billion birr (\$11.3 billion) from international concessional and non-concessional lenders, and 35.5 billion birr (\$1.6 billion) from local sources.²⁰

Hailemariam in his budget speech acknowledged the economic impact of the 2015 droughts when the government diverted \$800m to secure food aid (see *ARC Briefing Ethiopia December 2015*).²¹ Hailemariam said the agriculture sector had grown only 3% in the past year, compared to 7% growth in the services sector. Hailemariam revised downwards the government's growth estimate for 2016 from 11% to 8.5%.²² This is, however, still higher than international financial institution projections. The **International Monetary Fund (IMF)** in April forecast growth of 4.5% in 2016 compared to 10.2% in 2015.²³ The GTP forecasts growth of 11%. The government in the budget forecasts 8% inflation in 2016.²⁴ This compares to IMF estimates of 10.6% for 2016, and 10.1% in 2015.²⁵ The droughts have increased inflationary pressures as low yields have reduced the food supply and increased prices.

Hailemariam committed to diversifying Ethiopian exports to decrease its dependence on the agriculture sector as it looks to increase exports by 30% in the new fiscal year.²⁶ Increased exports will depend upon effective infrastructure investment to improve logistics channels. The government will focus on manufacturing, agro-processing and mining to increase exports.²⁷

The budget contains details of the government's increasing debt obligations. The budget allocates 13.9 billion birr (\$638m) to meeting credit and interest obligations in the financial year beginning 8 July.²⁸ This is 2 billion birr (\$91.2m) more than the amount the government allocated in 2015/2016, and almost double the 8.2 billion birr (\$374m) in 2014/2015.²⁹ Only 30% of the repayment will cover principal debt, and the rest will go towards settling interest. Approximately 56% of the amount allocated for debt settlement will go to international creditors.³⁰ The finance ministry in March published a state debt statistical bulletin stating that government debt had reached \$36.36 billion, 54.6% of gross domestic product (GDP).³¹ According to the bulletin, external debt stands at \$19.96 billion, with the government owing \$10.48 billion and state-owned enterprises the remainder.³² The government has guaranteed external debt in the form of both loans and credits for the state-owned **Ethiopian Electric Power** (formerly known as **Ethiopian Electric Power Corp**), **Ethiopian Electric Utility**, **Ethiopian Sugar Corp**, **Ethiopian Railways Corp**, and **Ethiopian Shipping Lines**.³³

The budget comes amid increased scrutiny of its borrowing strategy. On 8 June, Ethiopian Electric Power agreed to pay \$6.5m to settle **United States (US) Securities and Exchange Commission (SEC)** charges that it violated US securities laws.³⁴ The charges relate to its failure to register bonds

¹⁸ www.ena.gov.et

¹⁹ www.theafricareport.com

²⁰ www.imf.org

²¹ www.theafricareport.com

²² www.theafricareport.com

²³ www.imf.org

²⁴ www.imf.org

²⁵ www.imf.org

²⁶ www.imf.org

²⁷ www.imf.org

²⁸ www.CapitalEthiopia.com

²⁹ www.CapitalEthiopia.com

³⁰ www.CapitalEthiopia.com

³¹ www.mofed.gov.et

³² www.mofed.gov.et

³³ www.capitalethiopia.com

³⁴ www.sec.gov

sold to the Ethiopian diaspora in the US between 2011 and 2014 to finance the **Grand Ethiopian Renaissance Dam (GERD)** after commercial banks refused to back the dam.³⁵ To assuage concerns about fiscal discipline, Hailemariam said his government would introduce internal and external auditing systems to monitor budget implementation.³⁶

Kenya and Ethiopia begin pipeline studies

Kenya and Ethiopia are aiming to finalise an agreement before the end of the year for the construction of an oil pipeline from **Lamu** to Addis Ababa.³⁷ The agreement will boost the development of the proposed \$24 billion **Lamu Port- Southern Sudan -Ethiopia Transport (LAPSSET)** corridor which had appeared to stall. Hailemariam and Kenyan president **Uhuru Kenyatta** (2013-present) signed the agreement in **Nairobi** on 23 June.³⁸ The Kenyan petroleum ministry will oversee the start of construction of the \$2.73 billion pipeline with completion expected in 2021.³⁹ While local media initially reported that Kenya and Ethiopia had signed a full agreement, Ethiopia's petroleum minister **Tolosa Shagi** clarified that the two governments have committed to technical and commercial feasibility studies.⁴⁰ Hailemariam and **Djibouti** president **Ismail Omar Guelleh** (1999- present) in September 2015 signed a \$1.55 billion petroleum pipeline deal involving developers US-based **Black Rhino Group LLC** and **South Africa**-based **Mining Oil and Gas Services (MOGS)** (see *ARC Briefing Ethiopia October 2015*).⁴¹ Black Rhino Group has finished its feasibility study on the 550 km pipeline, which the Ethiopian government has agreed to in principle.⁴²

Kenyatta and Hailemariam also agreed to form a **Joint Railway Commission**, to expedite the implementation of the trade and investment special status agreement, and to discuss flexible business visas for Kenyan investors in Ethiopia.⁴³ Neither country has fully implemented a Special Status Agreement (SSA) signed in November 2012, which has curtailed bilateral investment. Failure to implement the SSA has further held back trade as it includes provisions to simplify transit procedures, avoid double taxation and establish a joint private investment council.⁴⁴

Implications

While Ethiopian government officials are talking in private about war, it remains unlikely. Eritrea's increased commercial and diplomatic engagement with regional and international governments increase the opportunity costs of conflict.

The budget is a continuation of the state-led economic model that has resulted in more than a decade of growth. Continued state-led investment in infrastructure, manufacturing and agriculture will continue to drive real economic growth. However, the government must cautiously manage its increased debt obligations or face pressure to divert funds from these key economic sectors to meeting debt obligations.

The pipeline, if completed, will reduce fuel transportation and logistics costs, significant bottlenecks to conducting business in Ethiopia. Close political, security, infrastructure and economic ties between Ethiopia and Kenya will contribute to a more stable and prosperous **Horn of Africa**. Should Ethiopia liberalise its key banking and telecommunications sectors, Kenyan companies are in an advantageous position to benefit.

³⁵ www.sec.gov

³⁶ Walta Information Center, 6 Jul 2016.

³⁷ Daily Nation, 23 Jun 2016.

³⁸ Daily Nation, 23 Jun 2016.

³⁹ Daily Nation, 23 Jun 2016.

⁴⁰ The Reporter, 9 Jul 2016.

⁴¹ Mail and Guardian, 30 Sept 2015.

⁴² The Reporter, 9 Jul 2016.

⁴³ East African, 27 Jun 2016.

⁴⁴ Kenyan foreign ministry, 2014

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