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Businesses in Oromia Regional State strike over income tax reforms. The government deploys soldiers but appears wary of triggering further unrest. State-owned Ethiopian Industrial Park Corp (EIPC) announces plans to complete a pharmaceutical industrial park in Kilento in the first quarter of 2018. However, there is reportedly concern amongst senior government officials about level of foreign debt accrued through the industrial park strategy. Fitch Ratings Inc affirms Ethiopia's long-term foreign and local currency Issuer Default Ratings (IDRs) at 'B' with a stable outlook.

Businesses strike over tax reform

Businesses in **Oromia Regional State** began an open-ended general strike on 17 July in a dispute over the imposition of a revised tax law.¹ The dispute may trigger a resumption in anti-government protests in the region after months of relative stability. Retail businesses in urban areas including **Ambo, Woliso** and **Ginchi** closed, and transport services between the cities and **Addis Ababa** were disrupted.² The strike subsequently spread to Addis Ababa, and the **Amhara** and **Southern Nations, Nationalities and Peoples' (SNNP) Regional States**. Business owners are striking despite the state of emergency in place since the anti-government protests in 2016.

"The discontent is now so severe that many have defied the state of emergency and are closing their businesses, an act punishable by the emergency law."³

The trigger for the strike was the revised **Income Tax Proclamation**, which came into force at the start of the financial year on 7 July.⁴ 'Category C' small and medium enterprises, such as roadside vendors, which have an annual turnover of less than 100,000 birr (\$4,300) face a significant tax increase.⁵

"Government officials have said that businesses in Oromia have been under-taxed for years. The government on its part said it's merely trying to expand its tax base and make businesses pay taxes when they were not paying anything in the past."⁶

According to the new law, businesses are taxed between 10 and 30% of their net profits.⁷ However, local media have reproduced letters from the **Ethiopian Revenues and Customs Authority (ERCA)** appearing to demand annual taxes of up to 50,000 birr (\$2,150).⁸ Business owners have complained that ERCA and finance ministry officers have overestimated their turnover by as much as tenfold, in terms of the new system which allows ERCA officers to estimate sales figures.⁹

¹ ESAT, 19 Jul 2017.

² Addis Standard, 17 Jul 2017.

³ Source, journalist, Addis Ababa

⁴ Addis Standard, 17 Jul 2017.

⁵ ESAT, 19 Jul 2017.

⁶ Source, journalist, Addis Ababa

⁷ Source, journalist, Addis Ababa

⁸ Addis Standard, 17 Jul 2017.

⁹ ESAT, 19 Jul 2017.

“My total daily revenue is something around 1,000 birr (\$50) but they estimated it to be three times more. How can I pay the tax according to this estimate? They are trying to get rid of us out of business.”¹⁰

There are reports in the local media of some business owners in Addis Ababa and **Bahir Dar** relinquishing their business licences rather than comply with the new tax.¹¹

The protests have generally been peaceful, however protesters reportedly set fire to state vehicles in Ambo, which was the location of the most violent anti-government protests in 2016.¹² The government responded by deploying **Ethiopian National Defense Force (ENDF)** soldiers in the city and other areas in the Oromia.¹³ However, the government appears wary of responding in a heavy-handed way and antagonising the protesters further. According to eyewitnesses,

*“Security forces were watching from afar and doing nothing even when two buses owned by **Selam Bus Plc** were burned down recently in the Oromia region.”¹⁴*

Nevertheless, the protests have involved anti-government sentiments. **Ethiopians** have uploaded pictures of dilapidated public infrastructure to social media to challenge the ruling **Ethiopian People’s Revolutionary Democratic Front’s (EPRDF)** use of their taxes.

The regional Oromia government has been conciliatory, opening discussions with affected business owners.¹⁵ Oromia regional president **Lemma Megersa** has committed state-level tax authorities to examining the implementation of the new tax.¹⁶ However, the national government has defended the tax and blamed business owners for either failing to understand the new rates or engaging in tax evasion.¹⁷ **Birhanu Tadesse**, coordinator of the tax policy directorate at the finance ministry, said,

“This is disgraceful and shows how their tax understanding is small.”¹⁸

The ERCA faces a number of internal challenges including a lack of capacity at branch level, tax fraud, a reliance on bank statements to determine income, and limited use of cash register machines.¹⁹ Collection efficiency varies markedly across cities and municipalities. Tax coverage is also a problem with a failure to revise and update fixed charges and fees, and is subject to political pressure.²⁰ Payment procedures are slow and inconvenient, while enforcement mechanisms for defaulters are limited.²¹

The national state of emergency is due to end on 10 August. It is unclear if the EPRDF will lift the state of emergency amid the ongoing strike due to concern it might stir up insecurity.

“I think it was wrong timing to introduce the new tax law at this moment. This is a major recipe for protests. They could have done it when things calm down in the future. I don’t know what they were thinking.”²²

The strike and protests highlight the failure of the government to address the systematic grievances behind the anti-government protests in 2015 and 2016. Security has improved under the state of emergency, seemingly ending any EPRDF appetite for political and economic reforms. This will only further bottle up tensions. If the EPDRF does not allow genuine political competition during local

¹⁰ Source, coffee shop owner, Ethiopia

¹¹ Addis Fortune, 20 Jul 2017.

¹² Addis Standard, 17 Jul 2017.

¹³ Addis Fortune, 20 Jul 2017.

¹⁴ Source, journalist, Addis Ababa

¹⁵ Reuters, 19 Jul 2017.

¹⁶ Addis Standard, 17 Jul 2017.

¹⁷ ESAT, 19 Jul 2017.

¹⁸ Addis Fortune, 19 Jul 2017.

¹⁹ Addis Fortune, 26 Oct 2014.

²⁰ Ethiopian Civil Service University, 2014.

²¹ Ethiopian Civil Service University, 2014.

²² Source, analyst, Ethiopia.

elections in May 2018 and the 2020 general election, it will further encourage the opposition to seek change outside formal political channels.

Government announces plan to complete pharmaceutical park in early 2018

The state-owned **Ethiopian Industrial Park Corp (EIPC)** confirmed on 14 July that it plans to complete work on a pharmaceutical industrial park in **Kilento** (Addis Ababa) in the first quarter 2018.²³ Despite concerns about international debt levels, manufacturing parks remain central to government plans to increase sources of hard currency. **China-based China Tiesiju Civil Engineering Group Co Ltd**, a subsidiary of state-owned holding company **China Railway Engineering Corp**, is constructing the pharmaceutical park, which will include a waste treatment plant.²⁴ The state **Pharmaceutical Fund and Supply Agency (PFSA)** has said that the park will reduce government spending on medical imports.²⁵ The PFSA currently has an annual budget to distribute 600m birr (\$25.7m) worth of medicine and medical equipment.²⁶ However, the rapid expansion of health centres across Ethiopia has resulted in the PFSA receiving 22 billion birr (\$945m) in requests.²⁷

The local pharmaceuticals manufacturing sector is currently extremely limited with regard to production capacity, technology acquisition, and investment.²⁸ The majority of local manufacturers are not compliant with good manufacturing practice, and the **World Health Organization (WHO)** has not prequalified a single locally manufactured product.²⁹ There are a number of reasons for the under-development of the local pharmaceuticals sector including lack of foreign and domestic investment, poor information management and communication between health institutions, and ineffective strategic planning.³⁰ The government developed the **National Strategy and Plan of Action for Pharmaceutical Manufacturing Development in Ethiopia (2015–2025)** to address shortcomings in the sector.³¹ The national strategy aims to facilitate the progression of existing manufacturers along the value chain, and attract new foreign direct investment (FDI) from international research and development pharmaceutical companies.³² The PFSA is working to improve its tendering process to increase investor interest.³³ The PFSA also sees an opportunity for Ethiopia to become a regional pharmaceutical hub due to relatively limited supply of medicines in **East Africa**, an ambition that **Kenya** shares.³⁴

The announcement of the pharmaceuticals park, however, comes amid uncertainty about the wisdom of the government's industrial park strategy. The government views industrial parks as a key source of foreign exchange and an opportunity for the employment of thousands of low-skilled workers.³⁵ The government wants manufacturing to account for 20% of gross domestic product (GDP) and 50% of exports by 2025.³⁶ The government expects manufacturing parks to create two million direct and 4.4 million indirect jobs.³⁷ The leading advocate for the strategy within the ruling EPRDF is former Addis Ababa mayor **Arkebe Equbay**, an adviser to the prime minister, **Hailemariam Desalegn**

²³ Ethiopian Herald, 14 Jul 2017.

²⁴ Ethiopian Herald, 14 Jul 2017.

²⁵ Ethiopian Herald, 14 Jul 2017.

²⁶ Ethiopian Herald, 14 Jul 2017.

²⁷ Ethiopian Herald, 14 Jul 2017.

²⁸ National strategy and plan of action for pharmaceutical manufacturing development in Ethiopia (2015–2025)

²⁹ National strategy and plan of action for pharmaceutical manufacturing development in Ethiopia (2015–2025)

³⁰ National strategy and plan of action for pharmaceutical manufacturing development in Ethiopia (2015–2025)

³¹ National strategy and plan of action for pharmaceutical manufacturing development in Ethiopia (2015–2025)

³² National strategy and plan of action for pharmaceutical manufacturing development in Ethiopia (2015–2025)

³³ Ethiopian Herald, 14 Jul 2017.

³⁴ Source, private sector healthcare executive, UK

³⁵ Source, journalist, Addis Ababa

³⁶ Source, journalist, Addis Ababa

³⁷ Xinhua, 15 Jul 2017.

(2012- present).³⁸ Hailemariam inaugurated the first phases of the \$190m **China Civil Engineering Construction Corp (CCECC)** and **China Communications Construction Co-**constructed **Kombolcha** and **Mekelle Industrial Parks** in June. However, at the time, no company was already operating in either park. Investors are reportedly concerned about the lack of supporting logistics in both parks suggesting they may have expanded too quickly.³⁹ There is speculation that government officials around Hailemariam, most notably chief economic adviser **Mekonnen Manyazewal**, are concerned about the level of foreign debt accrued during the development of industrial parks.⁴⁰ The majority of debt obligations are to China, with significant debt maturing in 2018.⁴¹ The current budget allocates \$1.2 billion, 8% of the total budget, to debt servicing, more than double the amount budgeted in 2016/2017.⁴²

There is, however, no indication that the EIPC is revising its strategy. EIPC chairman Arkebe confirmed on 14 July that the government plans to increase the number of operational industrial parks from seven to 15 by the second quarter of 2018.⁴³ The under-construction **Dire Dawa** and **Adama Industrial Parks**, as well as the planned **Ayisha Industrial Park**, lie on the route of the Ethiopia-Djibouti railway line, which will reduce transportation time for manufactured exports. Industry state minister **Bogale Feleke Temesgen** and **Ethiopian Textile Industry Development Institute** director general **Sileshi Lemma Bekele** also led a business delegation to **India** in July to encourage India-based textile companies to base themselves in Ethiopian manufacturing parks.⁴⁴ Ethiopia's low labour costs and cheap electricity mean it remains an attractive investment destination for the manufacturing sector. The average monthly wage for a factory worker is approximately \$50, compared to \$70-\$90 in **Bangladesh**, \$140- \$160 in **Kenya**, \$150-\$170 in **Vietnam** and \$400-\$500 in **China**.⁴⁵

*"The Bangladeshi textile industry is absolutely terrified of Ethiopia and the competition it poses."*⁴⁶

Despite concerns about debt, the government is unlikely to abandon its manufacturing strategy. Ethiopia remains attractive to manufacturers due to its rapidly growing population, subsidised power, stable government that has prioritised manufacturing to substitute imports due to low foreign currency reserves, development debt in local currency and a dollar-pegged currency.

Fitch affirms 'B' ratings

Ratings agency **Fitch Rating Inc** affirmed Ethiopia's long-term foreign and local currency Issuer Default Ratings (IDRs) at 'B' with a stable outlook on 21 July.⁴⁷ Fitch's positive ratings could encourage a return to international bond markets despite reported concern within government about debt levels (see above). Fitch's rating is constrained by low development indicators, significant external imbalances and rapidly increasing state-owned enterprise (SOEs) debt.⁴⁸ However, mostly concessional government debt and "robust" economic growth offset these weaknesses.⁴⁹ With regard to human and economic indicators, Fitch noted that Ethiopia's purchasing power parity gross national income is only \$1,500, compared to the 'B' median of \$7,720.⁵⁰ Fitch warned that the 2016 anti-government protests were the result of long-standing challenges caused by low governance

³⁸ Source, journalist, Addis Ababa

³⁹ Addis Fortune, 16 Jul 2017.

⁴⁰ Addis Fortune, 16 Jul 2017.

⁴¹ Addis Fortune, 16 Jul 2017.

⁴² Addis Fortune, 16 Jul 2017.

⁴³ Xinhua, 15 Jul 2017.

⁴⁴ www.knnindia.co.in

⁴⁵ www.asia.nikkei.com

⁴⁶ Source, private sector executive, East Africa

⁴⁷ www.fitchratings.com

⁴⁸ www.fitchratings.com

⁴⁹ www.fitchratings.com

⁵⁰ www.fitchratings.com

indicators.⁵¹ According to Fitch, average GDP growth between 2012 and 2016 was 9.5%, compared to the 'B' median of 3.9%.⁵² Growth was 10% in the 2016/2017 financial year, and Fitch projects it will average 8% over the next three years due to continued public investment in infrastructure and a gradual increase in manufacturing (see above).⁵³ According to Fitch, government finances are sound. Government debt is 27% of GDP, less than half the 'B' median of 56.4%.⁵⁴ However, government debt rises to 57.9% of GDP when the liabilities of SOEs are factored in.⁵⁵ Fitch expects government debt to stabilise over the next three years due to sustained GDP growth and low debt service costs.⁵⁶ Fitch also expects that government expenditure will moderate, as the government is not considering additional major infrastructure until current projects are completed.

Fitch's overview is indicative of Ethiopia's positive economic outlook. Continued growth will in turn attract continued investment. Even if the manufacturing sector does not deliver the projected returns as quickly as the government hopes, donor payments and remittances will remain high, easing pressure on the government's balance of payments.

⁵¹ www.fitchratings.com

⁵² www.fitchratings.com

⁵³ www.fitchratings.com

⁵⁴ www.fitchratings.com

⁵⁵ www.fitchratings.com

⁵⁶ www.fitchratings.com