Development Finance and Debt Sustainability in Ethiopia: Lesson to Sub-Saharan African Countries

By Teshome A[1].(PhD), Assistant Professor, Friday, May 08, 2015

1. Introduction

Development is multi dimensional processes that required large amount of financial resources. Economic theories have shown that financial resources are more important than natural resources in the process of economic development (Teklu Kassu, D.K Mishra and Melesse Asefaw, 2014).The amount and the sources of development finance play major roles in realizing sustainable economic development in developing countries. . There are two broad categories of sources of development finance which know as internal and external sources of development finance. The former sources of finance mainly relied on the domestic resource such as tax, non-tax, domestic loan. The latter sources of finance is related to financial resources that came from external sources which include loans and aid from bilateral, multilateral institutions and international capital market. There are various argument in support or against of both types of sources of finances to realize sustainable economic development. But since 2002, the Monteria consensus most of the governments and scholars focus on the importance of the internal/domestic sources of development financing method because it is more effective and efficient to attain stable economic growth and structural transformation.

In the last ten years, the Government of Ethiopia (GoE) has been realizing an average of 10 percent economic growth with fast social and economic development. The double digits economic growth accompanied with higher government spending and borrowing. Few consider the higher government borrowing may lead to high indebtedness therefore the beast option is to cut economic growth. For instances Robert Looney(2015) said that by IMF calculations, to stay within safe limits of domestic credit and external debt, Ethiopia will have to scale down its growth targets to more achievable levels. In the same way Seid Hassan, Minga Negash, Tesfaye T. Lemma and Abu Girma Moges (2014) in their recent article entitled "Is Ethiopia's Sovereign Debt Sustainable?" conclude that Ethiopia debt is unsustainable. In his February 8, 2015 article Prof. Al Miriam claim that Ethiopia is facing high debt odious[2]. According to Hibamo Tagesse(2015) also, increased growth digits might mean much to our image, but when exposed to net indebtedness calculations, they are unable to draw us from the least developed economies backlist. In contrast to the above argument G. Ramakrishna (2015) said that higher government borrowing/debt not significantly affects economic growth of Ethiopia therefore Ethiopia should continue with high public borrowing.

Most of these studies have failed to observe and compare in detail the sources and trend of development finance with the public debt sustainability in the country. The absence of logical

[1] Author 's e-mail address:a.teshom@gmail.com

[2] Money borrowed by one country from another country and then misappropriated by national rulers. A nation's debt becomes odious debt when government leaders use borrowed funds in ways that don't benefit or even oppress citizens.

and scientific study in this area misled our big professors/scholars to make wrong generalization about Ethiopia development finance, economic growth and debt sustainability. This brief article will try to address this knowledge gap describing the trends and structure of development finance and debt sustainability in Ethiopia.

The study is consisting of six sections including introduction. The second section explains the relationship between sources of development finance and debt sustainability. The third section discusses the trends and structure development finances in Ethiopia. The fourth section focuses on debt sustainability in the Ethiopia. This section explains total and external public debt sustainability during 2000 to 2014. The fifth section identifies lessons to be learned for Sub Saharan African countries. The last section is summery.

2. Sources of Development Finance and Debt Sustainability in SSA Countries

The fast and sustainable economic development can be realized with sufficient availability of finance[3] resource in a given economy. There are different forms of categorizing the sources of development finance; internal and external, public and private, tax and not tax sources of development finance and etc. The sources of development finance affect the level and the composition of national public spending which has implication for debt sustainability. Many scholars argue that those countries which relayed more on external sources may face the risk of debt stress. Developing countries with low domestic mobilization capacity relay more on external loans and grant. Especially at the time of declining development aid or grant, most of the law income country use external borrowing to finance their economic development.

According to Taylor (1998) the domestic sources have their limits for the process of economic development. First, it's difficult to finance "the take-off" via only domestic sources since they are extremely limited at this stage (or nearly absent in the case of the poorest countries). Second, the relatively low income per capita poses certain limits on the voluntary private savings. Third, there is some empirical evidence for the long historical periods that the absence of the access to the global capital markets has adverse effect on the economic development of the SSA countries in the periphery of the world economy.

The lower capacity of domestic resource mobilization or/and traditional methods of domestic resource mobilization enforcing many African countries to look for conditional external loans and grant. The higher external borrowing with absence of loan management strategies in SSA countries had increased debt burdens. In 2000, the external loan to GDP ratio of Sub Saharan African was 63 percent as compared to the 26 percents of South Asian countries (World Bank, 2015). Most of the SSA countries development finance was covered by conditional loans and aid. Such higher reliance on external source development finance has increased indebtedness risk of SSA countries. This situation has enforced many international organizations to provide debt cancelation and relief to improve debt sustainability in highly indebted countries.

The dramatic reversal of trade and financial flows during the global economic crisis, together with the general uncertainty and volatility of aid flows, has heightened the need to think about

[3] This study believes that there are a number of non financial resources used in achieving fast and sustainable economic development. But the main focus of the study is on the financial resource that use for economic development.

sustainable sources of development finance. The priority to domestic resource mobilization has received more attention to the sustainable development of low income countries. Enhanced domestic resource mobilization increases the ability of Governments to achieve long-term development objectives (UNECA, 2014).

Starting Monterrey Consensus in 2002, there has been increasing emphasis on domestic[4] resource mobilization to finance sustainable development. SSA countries domestic revenue has increased from USD 141 in 2002 to 520 in 2011. The increase in domestic revenue mobilization in SSA countries was due to various factors that include improvement in the potential benefits of taxation for state building; independence from foreign aid; the fiscal effects of trade liberalization; the financial and debt crisis in the "West"; and the acute financial needs of developing countries. According to OECD (20114) private financial flows – investment and remittances – are increasingly contributing to Africa's domestic development finance landscape.

The increasing share of domestic resources could allow SSA countries to distance themselves from the volatility of Official Development Assistance (ODA) and can increase their policy space strengthening accountability and achieve greater country ownership of their own development strategies. The higher domestic sources of development finances reduce the debt instability of developing countries. For most countries, Domestic Resources Mobilization (DRM) is the largest resource available to fund SSA national development plans. A country's ability to mobilize domestic resources and spend them effectively—at the national, sub-national and municipal levels—lies at the crux of financing for development (WB/IMF, 2015).

This does not mean that developing country does not need the external financial resources. According to Seid Hassan, Minga Negash, Tesfaye T. Lemma and Abu Girma Moges (2014) the access to external capital markets may potentially encourage the government to reduce its dependence on domestic borrowing and pave the way for domestic enterprises to access international capital markets. The risks of external sources of development finances can be mitigated by prioritizing stable and long-term sources of development finance from sovereign wealth funds, private companies, and development finance institution.

3. Trends and Structure of Development Finance in Ethiopia

Ethiopia experienced different trends and structure of development finance. During 1974-1991, the military government was relied more on domestic sources development finance that affected seriously the private sector credit provision which leads to crowding out effect in the country. Beginning early 1990s, the current government has undertaken various reform measures that changed the trends and structure of development finance. In this sub section the study was analyzed the trends and structure of development finance in Ethiopia.

[4] Awareness of the importance of domestic resources is not a new development: back in 2001, the framework document of the New Partnership for Africa's Development (NEPAD) emphasized the need for Africa to strengthen domestic resource mobilization, and this was reaffirmed at the global level in 2002 by the Monterrey Consensus on Financing for Development, which made improved domestic resource mobilization the first of its six leading actions and stressed the importance of establishing the necessary internal conditions for mobilizing domestic savings to sustain adequate levels of productive investment(UNECA,2014).

3.1 Trends of Development Finance in Ethiopia

Trends of development finance indicate the change in the level development finance in the country during the study period. Between 1991 and 2000 the level of development finance growth rate in the country was very law. During this period the total government spending was increased from Birr 4.2 Billion in 1991 to Birr 15.7 Billion in 2000(CSA, 2012). It was changing annually into around Birr 1.2 Billion. This law level of government spending was due to the minimal government intervention that gave more priority to the inefficient market outcome than to provide social and infrastructural development. Such approach has prevented higher and continuous economic growth between 1991 and 2000.

Table 1: Trends of Development Finance in Ethiopia between 2000 and 2014 (in Billion Birr)

S.N	Year	Development Finance	Change in Annual Development Finance	Annual growth rate
1	2000	15.7	-	-
2	2001	14.9	-0.8	-5
3	2005	24.5	4.3	21
4	2006	29.4	4.9	20
5	2010	72.5	14.8	25.6
6	2011	93.6	21.1	29.1
7	2012	124.4	30.8	32.9
8	2014	178.6	24.2	15.7

Source: National Bank of Ethiopia, 2014

In 2005 the total level of government spending has reached Birr 24.5 Billion with the average annual growth rate of 11.2 percent between 2000 and 2005: Annually the additional level of government spending was increased to Birr 1.8 Billion. In 2014, the total government spending reaches its highest level that is Birr 178 Billion. Between 2010 and 2014, the annual government spending was growing by 15 percent with yearly additional government spending of Birr 24.2 Billion.

The level of development finance in the countries has shown increasing at increasing rates for the last ten years due to the implementation of developmental state development paradigm. According this development paradigm the maximal government intervention is the most important measure to achieve fast and sustainable economic transformation in the country. Despite various critics about higher government spending from the western international organizations, the governments of Ethiopia has relied on its own fundamental principles of government intervention in high social return investment. Actually the bold government policy measure has been producing continuous economic growth and social transformation in the country.

The higher government spending and pro-poor resource allocation has decreased the absolute poverty from 44 percent in 2000 to 26 percent in 2014.. With strong performance metrics and monitoring, public expenditures can have increasing impact and create higher quality sustainable results (WB/IMF, 2015). The government spending in social development enabled the country to achieve the higher human development during the last two decades. Ethiopia is one of the 10 countries globally that has attained the largest gains in its HDI[5] (Human Development Index) over the last several years.

3.2 Structure of Development Finance in Ethiopia

The structure of development finance presents the composition of the development finance in the countries since 2000. Commonly there are four major sources of development finance: domestic, external loan, external grant and domestic borrowing. The domestic finance includes tax and non tax revenue mobilized from internal/domestic sources. External grant includes any forms of aid/grant obtained from external sources. The external loan indicates the government borrowing/loan from external sources: Multilateral, bilateral and international capital market loan.

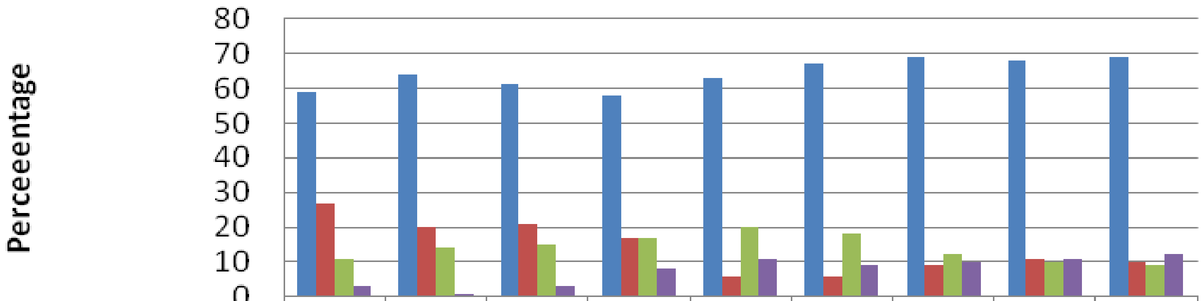
In 2000 the domestic source of development finance was taken 59 percent of the total development finance. In the same year the external grant and external loan were taken 27 and 11 percent respectively. The remaining 3 percent development finance was covered in domestics borrowing. In this year around 38 percent of the development finance was obtained from external sources in the forms of external loans and grant. In 2011, the domestic revenue was taken 63 percent of the total development finance which has changed into 4 percent increments as compared to 59 percent in 2000. The external grant in this year was increased to 18 percent as comparing to 11 percent before ten years. Despite the increased donor sponsor social development and basic service protection programs, the share of external loan in the country have shown declining trends from 27 percent in 2000 to 6 percent in 2011.

In 2014, the domestic revenue and domestic loans was taken 69 percent and 12 percent of the sources of development finance in the country respectively. In this year, the country has managed to mobilize 81 percent of its development finance from domestic sources. In 2014, the external loan and grant were taken 10 and 9 percent respectively. The increase in domestic resources mobilization capacity due to higher tax revenue, increase gross domestics saving[6], improved remittance from abroad has significantly reduced the external sources of development finances. The gross domestic saving in Ethiopia has increased from Birr 8.8 billion in 2000 to 235 Billion in 2013. In addition to this, the domestic revenue in the country has increased from Birr 9 billion in 2000 to Birr 123 Billion in 2014

[5] Ethiopia human Development Index (HDI) has improved from 0.217 in 1992 to 0.435 in 2013(UNDP, 1995 and 2015 Report).

[6] The country overpasses the GTP gross saving GDP ratio plan set by GTP I. Currently the national gross domestics saving GDP ratio is around 23 percent above the 20 percent set by GTP I.

Figure 1: Percentage share of sources of development finance between 2000 and 2015



	2000	2001	2002	2005	2010	2011	2012	2013	2014
Domestic Rev.	59	64	61	58	63	67	69	68	69
External Loan	27	20	21	17	6	6	9	11	10
External Grant	11	14	15	17	20	18	12	10	9
Domestic Loan	3	1	3	8	11	9	10	11	12

Source: Ethiopia Budget Proclamations between 2000 and 2014

The uninformed writer Robert Looney (2015) said in his recent article revenue shortfalls has already forced the government to finance some of its more ambitious projects through international loans from China, India, and the World Bank. Robert Looney argument completely contradicts with the reality prevailed in the country. The domestic revenue in Ethiopia increased from an increase in the tax and non tax revenue. The government decision to borrow from international markets was not due to decline in domestic revenue rather due to high desire to undertake both social and infrastructure development in the country. Today postponing economic development[7] in the name of fiscal discipline is not the characteristics of Ethiopia government or developmental state.

4. Public Debt Sustainability in Ethiopia

Debt refers to the legal obligation to the government to pay the money borrowed with the principal as per the terms of agreement. In other words debt indicates the accumulated annual fiscal deficit in the country in the given period. That means the higher fiscal deficit lead to the higher public debt stock in the economy. The purpose of this sub section is to observe the debt sustainability in the Ethiopia in terms of total public and external debt. The total public debt includes domestic and external debt. Public external debt represents government debt from external sources.

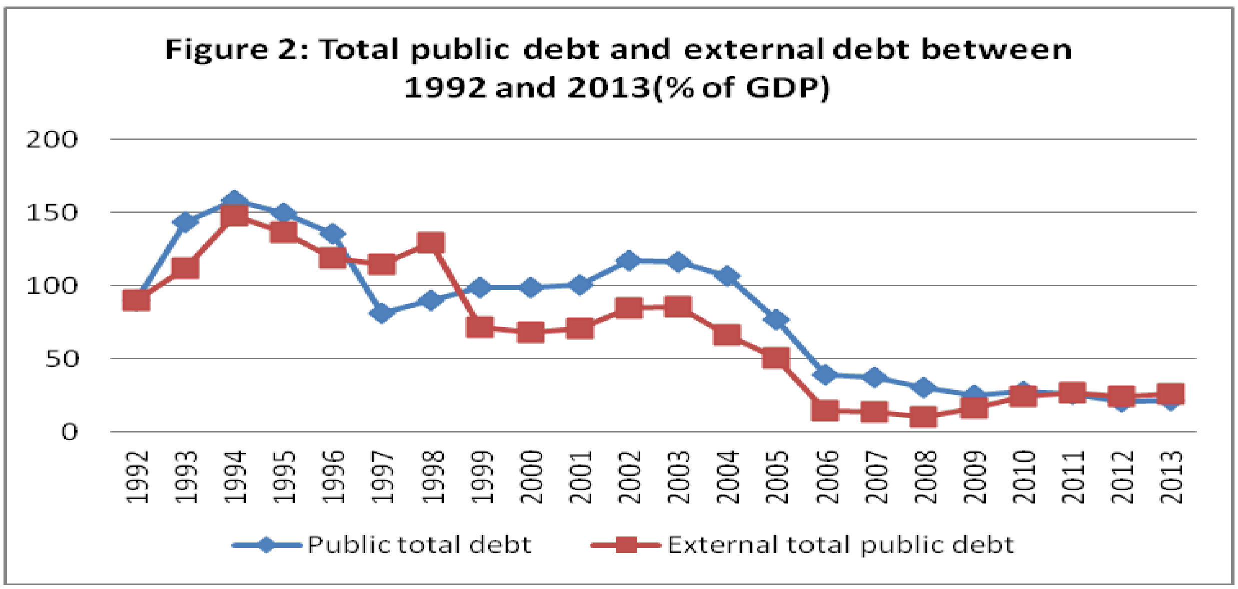
According to IMF (2014), the total amount of public debt in Ethiopia was increased from Birr 26 Billion in 1992 to Birr 227 billion in 2014. According to World Bank (2012), the external debt before the failure of the military government was USD 8.6 billion in 1990. In 2013 the external debt in Ethiopia was USD 12.5 Billion. The country total and external debt during this period

[7] Impressive achievements were also made in social development, especially in the expansion of health and education services (UNDP, 2015).

has shown unstable trends. The total debt reached its higher amount of Birr 74 Billion in 1996 and reached its lower level in 1997(Birr 46 Billion). The level of total debt stock does not indicate the debt sustainability of a given country. Based on IMF and WB, the common or usual method of debt sustainability measurement is the total debt to GDP ratio and/or external debt to GDP ratio. This study uses both indicators to see debt sustainability in Ethiopia.

In 1995 the share of total government debt to GDP ratio increased and has reached to 150 percent. This was due to high government borrowing from external sources to implement the post war social and economic reform program which is known as Structural Adjustment Program (SAP). In 2000, the total debt to GDP ratio was declined to 77 percent. The recent data revealed that the current total public debt to GDP ratio of Ethiopia was only 23 percent in 2014. The country surprisingly managed to reduce its debt to GDP ratio to the lower level that indicates the debt sustainability of the country with rapid growing government spending and borrowing.

In the same way the level of total external debt to GDP was reached 150 percent in 1994. As you can see from Figure 2 below, the level of total external debt to GDP ratio has dramatically decreased to 26 percent of the national income. Such a decline in the share of the external debt to GDP ratio has improved the country debt stress/risk from high before ten years to law in 2014. According to the recent joint WB/IMF (2015) World Debt Report, Ethiopia was categorized under law debt stress.



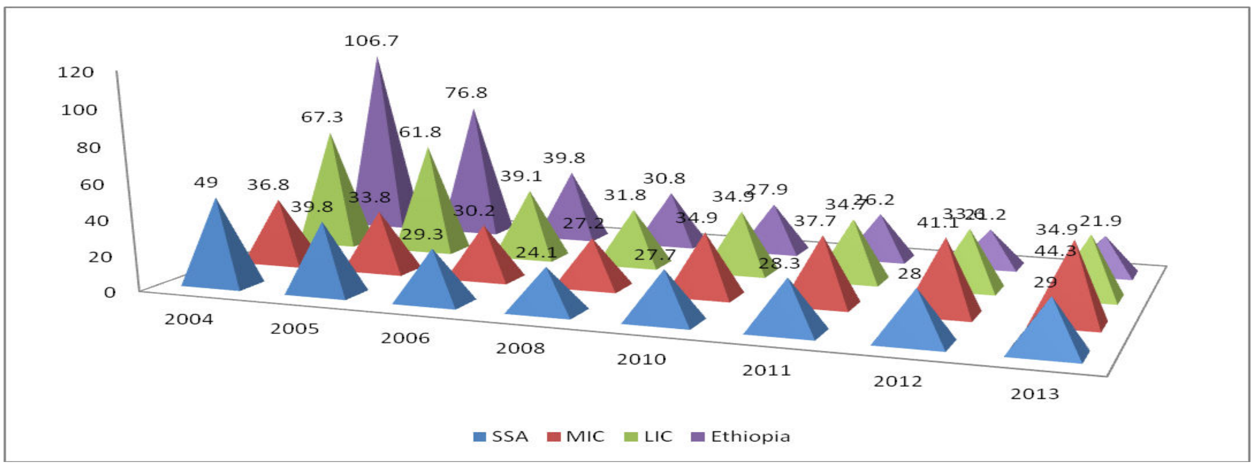
Source: WB and IMF, 2014

In order to see these recent debt sustainability performances of Ethiopia, it is better to make a comparative analysis with selected SSA (Sub Saharan African) countries, Middle Income Countries (MIC) and Law Income Countries (LIC) in terms of total public debt to GDP ratio. In 2004, the average public debt to GDP ratio to SSA was 49 percent. This level of public debt was declined to 24.1 percent in 2008. After 2008 the total public debt started to increased and reached 29 percent in 2013.

During the last ten years the total debt to GDP ratio of SSA countries has shown a declined trend by 69 percent between 2004 and 2013. The total government debt to GDP ratio to middle income countries was reduced from 36.8 percent in 2004 to 27 percent in 2008. Starting 2009, the total public debt to GDP ratio of middle income countries has shown an increasing trend. In 2013, the total government debt to GDP ratio of middle income countries has reached to 44.2 percent. That mean the debt to GDP ratio has increased to around 20 percent and 60 percent as compared to 2004 and 2008 respectively. The same patterns of debt to GDP ratio was observed in law income countries.

In 2004, the total public debt[8] to GDP ratio of Ethiopia was around 106.7 percent which is more than average Sub-Saharan, middle income and law income countries. At this time Ethiopia was considered as highly indebted countries. The country total public debt to GDP ratio was declined to 25.4 percent in 2009 and 21.9 percent in 2013. Just within nine years the Ethiopia has managed to reduce the debt to GDP ratio by 387 percent. Today Ethiopia debt to GDP ratio is lower than SSA, MIC and LIC. This indicates the debt sustainability of the country with broad base social and economic development[9] during the last decade.

Figure 3: The total government debt in Middle income, law income and Ethiopia in selected years (% of GDP)



Source: OECD, 2014

The study also applied comparative analysis for external debt sustainability by selecting two neighbors' countries: Kenya and Uganda, two economically successful African countries: South Africa and Botswana and average SSA countries. In 2000, the average SSA total external debt to GDP ratio was 54.4 percent which was declined to 23 percent in 2013. Ethiopia external public debt to GDP ratio was 67.3 percent in 2000. In the same year the public external debt to GDP ratio of Uganda, South Africa and Botswana were 57.7 percent, 27.8 percent and 42.0 percent

[8] In 1975, Ehtiopia government debt stood at about US$ 343.7 million, equivalent to 14% of the GDP, and US$ 9.1 billion (214% of GDP) in 1991. As at June 30, 1999 this figure had increased to an equivalent of US$ 10.2 billion which is …percent of GDP(Melese Gizaw,2005)

[9] Between 1991 and 2015 the national road net work increased from 18,081KM to 105,000KM in 2015. The additional road net work has increased at increasing rate during this period. Between 1991 and 2005, the annual additional road network was only 604KM. But between 2005 and 2015, the annual additional road network was 7,845KM. This indicates the country achieved debt sustainability not by the cost of national development.

respectively. The higher external public debt to GDP ratio of Ethiopia was declined by higher rates as compared to the SSA and selected countries in this study. In 2013, Ethiopia total public external debt to GDP ratio was declined to 18 percent which is lower than average SSA countries. You can see in the Table 2 below, Kenya and Uganda external public debt to GDP ratio in 2013 were 30.5 and 26.7 percent respectively which is higher than Ethiopia. Between 2000 and 2013 Ethiopia has achieved higher declining rate of external debt to GDP ratio as compared to Uganda, Botswana, South Africa, Kenya and SSA countries

Table 2: The public external debt in selected countries between 2000 and 2013(% of GDP)

year	Ethiopia	SSA	Uganda	South Africa	Kenya	Botswana
2000	67.3	54.4	57.7	27.8	41	42.7
2006	41.8	25.6	40.5	21.8	27.3	12.5
2007	12.1	23.8	10.8	26.3	23.2	10.2
2008	11.5	21.4	16.1	26.6	23.5	9.9
2009	14.7	23.9	21.5	27.6	25.3	26.1
2010	20.5	22.2	23.6	28	26.7	21.3
2011	23.4	22	24.6	28	30.2	21.8
2012	18.4	22.5	24.4	36	29.4	23.2
2013	18.3	23.2	26.7	36.9	30.5	22.6

Source: Arica Statistical Book, 2014

Such decline in external debt to GDP ratio was realized in Ethiopia with higher and stable economic growth. According to World Debt Report (2015), the annual growth rate of debt in Ethiopia between 2000 and 2013 was only 9.8 percent when the country gross national income increased by 37 percent. In the same years the annual growth rate of debt and gross national economic growth of South Africa was 34 percent and 11 percent respectively. Even in Botswana, the fast rising African country, the external debt growth rate (33 percent) was much higher than their national economic growth rate (13 percent). Unlike Ethiopia, Botswana and South Africa failed to generate enough gross national income that can pay their external debt. Ethiopia fast economic growth as compared to its total debt has reduced debt to GDP ratio. Based on staff's macroeconomic projections and authorities' external borrowing plans, Ethiopia maintains a low risk of external debt distress (IMF, 2012). The effective debt disbursement and use for intended purpose enabled the country to achieve both debt sustainability and social development.

5. Development finance and debt sustainability: Lesson to SSA

Before ten years Ethiopia was facing the twin challenge: low domestic sources of development finance and high public debt burden. Currently the increase share of domestic sources of finance and declined debt to GDP ratio has open fiscal space for the government to undertake wide rage social and infrastructural development in the country. There are many lessons that SSA countries can learn from Ethiopia performances in development finance and debt sustainability. .

The first and the most important lesson was to use HIPC[10] (Highly Indebted Poor Countries) and Multilateral Debt Relief (MDR) initiative which was organized by the donors and multilateral organization. The country reached completion point[11] to qualify for HIPC and MDR incentive. In 1999 and 2006, Ethiopia was received USD 4.3 and 4.4 billion debt forgiveness or cancelation respectively. Such debt cancelation significantly reduces the national debt burden.

The second lesson is the government of Ethiopia[12] established debt management Director under MoFED[13](Ministry of Finance and Economic Development). This department was established to monitor the level of total and external debt in the country. This department is also responsible to makes available the debt information to the public at large in general and policy maker in particular.

The third lesson is the government of Ethiopia decided to reduce share of conditional loans or grant from Multilateral Organization which provide more policy space. The Government of Ethiopia also focused more on soft and untied borrowing. As a result government debt composition[14] has changed from official loans to private loans. Between 2003 and 2013, the share of private government debt increased from 3.6 percent to 23.9 percent. Such change in government debt has been reducing the conditional loan provision from multilateral organization like IMF and World Bank. In the same way the share of the bilateral external debt increases from 34 percent in 2003 to 42.3 in 2013. The higher share of bilateral external debt provides good opportunity for the government to bargain about the nature and duration loan repayment.

The forth lesson is the effective use of government debt to social and economic development. The government borrowing was used for pro-poor spending that improved the infrastructure and social development in the country. Today the pro-poor spending is taking 70 percent of the national budget which was less than 30 percent before 2000. The last but not the least lesson is the productive use of the public debt. The productive use of public debt has increased the debt servicing capacity of Ethiopia. According to Ethiopia Debt Management Directorate report, in 2003 the debt service amount was only USD 166 million. But today in 2013 the country managed to repay around USD 22 billion. The higher return from public debt in terms of economic and social development has enabled the nation to repay its debt on time as per the terms of agreement.

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[10] In 1996, the international aid community responded by launching the Heavily Indebted Poor Country (HIPC) Initiative, a debt relief program designed to reduce the external debt burdens of the most heavily indebted poor countries to sustainable levels.

[11] The completion point is the point at which a country has implemented the policy reforms required by IMF and World Bank supported programs in order to qualify for full debt relief under the HIPC Initiative and the MDRI

[12] There is good coordination and information sharing between the fiscal and monetary authorities and the debt managers.(World Bank,2013)

[13] MoFED prepares feasibility studies prior to on-lending funds and issuing loan guarantees, and the legal adviser is involved in all loan negotiations.(World Bank,2013)

[14] Ethiopia has moved from being a passive recipient of whatever terms creditors were prepared to offer, to an active participant, setting its own agenda based on its needs for financing poverty reduction and reaching the Millennium Development Goals.(Matthew Martin and Alison Johnson,2005)

6. Summery

The developing countries can achieve fast and sustainable development with proper selection of sources of development finance. Today respecting fiscal discipline by the cost of social and economic development has not been acceptable to any standard of Ethiopia. Ethiopia government priority is to realize social and economic development with stable macroeconomic situation. Ethiopia government applied pragmatic development finance and debt management strategies which transform the national economy with low debt burden. Policy maker in SSA countries should learn this lesson from Ethiopia and must identify the suitable and stable sources of domestic resources mobilization which can enable them to realize fast and sustainable economic development.

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