The Bedrocks of Ethiopia's socio-economic stride

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Lately, everyone's talking point is Ethiopia's socio-economic stride.

As the news coverage from Bloomberg Business revealed:

> The buzz at the World Economic Forum on Africa, an annual summit of the continent's rich and powerful, is all about Ethiopia, where the economy is flourishing and the government is embracing select foreign capital.
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> Executives from General Electric Co., Dow Chemical Co., Standard Bank Group Ltd. and MasterCard Inc. attending the June 3-5 gathering in Cape Town all singled out the East African nation as a market with strong potential.

Indeed, Ethiopia has become the preferred destination of international investors. With an estimated nominal GDP of around $50 billion in 2014, it has grown rapidly over the last decade averaging 10.8% in real terms.

Over the last decade, the government has made significant progress in developing the country, as can be seen by the country's accomplishments in scaled-up investments in roads, railroads, agricultural infrastructure such as sugar factories, and other projects as well as in reducing child mortality, almost reaching universal primary education, and combating HIV, malaria and tuberculosis.

In 2011, Ethiopia had the world's third-highest public investment rate, behind only Turkmenistan (unrated) and Equatorial Guinea (unrated) – but the sixth lowest private investment rate, according to the World Bank.

Even though, Ethiopia's economy size seems relatively small, it should be underlined that the GDP data probably underestimates the size of the economy and overestimates the growth rate because the data is based on surveys and certain areas of the country are hard to reach due to a lack of infrastructure and insufficient resources.

Investors know that, therefore, they are coming en masse to take part in the booming Ethiopian economy. As a result, Ethiopia has become Africa's eighth-largest recipient of foreign direct investment last year. Less than two years, Ethiopia was on the 14th position. Since then, the number of projects in Ethiopia doubled.

Ethiopia's decade long double-digit growth and all-encompassing advance is an outcome of a committed leadership and prudent policy directions.

As Dow's president for sub-Saharan Africa Ross McLean attested: "Ethiopia has got a government that is managing economic development in a very deliberate, cautious manner."

Indeed, the deliberate and cautious developmental leadership was translated into economic strength, institutional strength and fiscal strength that made the development stride sustainable.

The foremost important and often cited strong feature of Ethiopia's state is its prudent fiscal management.

Fiscal strength is an important feature indicates the overall health of government finances, including the assessment of relative debt burdens and debt affordability as well as the structure of government debt. Fiscal strength is adjusted for the debt trend, the share of foreign currency debt in government debt, other public sector debt and for cases in which public sector financial assets or sovereign wealth funds are present.

Ethiopia's fiscal position is characterized low and stable deficits as researchers repeatedly had shown. These are achieved through prudent spending control in the face of fluctuating grant financing, and increased efforts to mobilize domestic revenues as nominal expenditure has grown.

Ethiopia's federal government budget execution has been tight over the last decade, with current spending closely monitored to ensure that it grows below the pace of revenues. The national fiscal policy supports the development objectives of the GTP through heavy investment in key sectors of the economy.

Roughly, 60% of government expenditures are directed towards public investment projects; about two-thirds of the budget consistently targets the pro-poor sectors of education, health, agriculture, water supply and sanitation and roads. As a result, poverty has fallen sharply since 2000 and Ethiopia is one of only four SSA countries on track to achieve the majority of the Millennium Development Goals.

The second key aspect of the developmental direction is the increasing achievements in revenue collection.

Tax revenues have been increasing steadily—from 11.9% of GDP in 2005 to 12.7% of GDP in 2014—on the back of stronger growth and improved tax administration. However, there are much more improvements needed, as Ethiopia's revenue share is still around just 14% of GDP well below the regional average of 23%.

However, nontax revenue has remained weak, in part because state-owned enterprises have been left to reinvest their profits instead of remitting them to the central government.

The third important advantage of Ethiopia is its Strong and reliable development partnerships.

Donors have demonstrated a high commitment to Ethiopia over the past decade. At their peak in 2011, donor inflows reached $900 million, representing around 19% of government revenues and accounting for 25% of development expenditures.

Donor funding has declined in recent years and has sometimes been subject to a degree of unpredictability, however Ethiopia remains by far the biggest recipient of aid in Africa in nominal terms.

This mainly reflects Ethiopia's critical geopolitical role in the Horn of Africa, a region characterized by political instability. The large aid inflows also result from the notable impact of donor funds on key social indicators such as access to education, health, and water.

Another crucial aspect of the successful developmental paradigm is its pro-poor development spending and infrastructure effort.

The government's budgetary allocation for the poor is the highest in Africa – pro-poor development spending has averaged 13% of GDP over the last decade, which is considerably above its regional peers. Pro-poor spending has been a key government priority and one of the main elements of the GTP that will enable the country achieve the Millennium Development Goals (MDGs).

This strategy has paid off, evidenced by the remarkable improvement in the core poverty indicators, with the share of people living on less than $1.25 a day halving to 30% of the population by 2011 since the mid-1990s. Over the same period, child mortality has decreased by a significant 60%.

A very high share of capital spending drives Ethiopia's expenditure growth (see exhibit 17). According to the recent budget, around 46% will go to current outlays, while a comparatively large 54% will go to capital spending.

Another important feature of Ethiopia's growth paradigm is its low debt-servicing burden.

Ethiopia's debt service is still low compared to peers, reflecting the low level of debt and a favorable debt structure. Interest payments make up only 0.4% of GDP, as almost 70% of the government's external debt consists of concessional loans. The government's external debt profile has, however, been shifting in recent years towards a larger share of non-concessional loans. The increase in non-concessional borrowing in 2014 was mainly due to the central government's inaugural Eurobond issue as well as increased borrowing by public enterprises from private creditors.

The low debt-servicing burden is not only due to lower interest rates but also low debt burden. That is another aspect of Ethiopia's developmental state.

Ethiopia's debt burden is low compared to its peers, standing at around 26% of GDP in 2014, which is slightly up from 23% of GDP in 2013.

From 2001, Ethiopia benefitted from debt relief under the Heavily Indebted Poor Countries (HIPC) initiative and Multilateral Debt Relief Initiative (MDRI). In fact, from 2001-2014, Ethiopia received debt relief in the amount of $6.5 billion, allowing the government to drastically reduce its external debt burden from 120% of GDP in 1998 to just 11% of GDP in 2008.

The total stock of public sector debt fell to a low of 21% of GDP in 2012, but it has been rising since, on account of increased borrowing for large capital projects (in line with government's growth strategy outlined in the GTP). This trend may continue as these large scale projects are being constructed as they require substantial new borrowing.

One of the key questions relating to the strength of public sector finances are the operations of public sector enterprises. The main state-owned enterprises are Ethiopian Airlines, CBE, Ethiopia Telecoms, EEP (the energy company), and the railway corporation constructing the rail line to Djibouti.

Public enterprises are a key part of the government's growth strategy and are undertaking the development of the country's power and infrastructure improvement, as well as building factories and housing through large-scale investments.

The high focus given to electricity expansion and power generation projects is one of the major strengths of the Ethiopian developmental state.

Indeed, the government has long recognized that increasing the population's access to electricity is a key to development of the industrial sector which is crucial for transforming Ethiopia to middle income status.

A number of major infrastructure projects currently underway aim to address these issues, particularly with respect to the electricity deficit. The large-scale investment in the electricity sector is expected to pay off through increased foreign exchange earnings from electricity exports to neighbouring countries and by boosting domestic productivity as access to electricity improves.

Power generation projects under construction will increase the power supply, strengthen the power export program and help boost foreign exchange earnings. The plan is to invest proceeds from electricity exports in off-grid local generation capacity in order to provide electricity to more sparsely populated regions.

As one report described it:

> Energy is a highly strategic sector for Ethiopia given its significant generation potential—estimated at 1,400 gigawatts (GW), the second largest in Sub Saharan Africa after Democratic Republic of Congo—and taking into account the energy deficit present in the East African region.
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> If harnessed, the sector has the potential to generate much needed hard currency for Ethiopia. As such, Ethiopia has ambitious plans to capitalize on this potential by establishing itself as a power hub for the East Africa region.

Two of the most important projects in this regard are the Grand Ethiopian Renaissance Dam and Corbetti Geothermal Plant is the country’s first independent power project.

The Grand Ethiopian Renaissance Dam, about 750km southwest of Addis Ababa, is a hydroelectric power plant with a projected capacity of 6,000MW and 15,692GWh annual energy output. The project consists of a 1,780m long and 145m high main dam on the Blue Nile River and will be completed by 2017 at an estimated cost of $4.8 billion.

The project, which is about 43% complete, will be the largest dam in Africa and will substantially increase the country’s power supply and strengthen Ethiopia’s power export program. The project is on track to begin generating 700MW at end-2015.

The Corbetti Geothermal Plant is the country’s first independent power project. A 1,000MW geothermal power plant which will be developed by Reykjavik Geothermal in the Corbetti Caldera area of the Rift Valley for an estimated $4 billion.

The project will be developed in two 500MW stages and is expected to be one of the largest geothermal facilities in Africa, adding to the country’s power-generation capacity. The project development is supported by a number of international development organisations, including USAID, the German KfW and the African Union. The project’s first 500MW are scheduled to be online by 2018.

A number of additional hydro-electric, geothermal and wind projects will add to the country’s power generation capacity in the next few years and support the security of energy supplies. The Gibe III hydro project that is 90% complete is expected to start generating power in July 2015.

In addition, transmission projects like the Ethiopia-Kenya Power Systems Interconnection project will expand the transmission infrastructure between the two countries and create additional transmission capacity for exporting energy to the East Africa region.

The foreign exchange earnings potential of the sector will be Ethiopia's tremendous advantage in the coming years.

Today, total installed generation currently stands at 2200MW compared to 800MW in 2007—this will rise to 5200MW by mid-2016 once the Grand Renaissance comes online.

Ethiopia already exports 195MW of electricity to Sudan and Djibouti, and earned $40 million from these exports in 2014. Plans are underway to scale up these exports as well as increase the number of countries to which Ethiopia exports power, as generation capacity increases and transmission infrastructure is completed. Ethiopia has signed a power purchase agreement to export 400MW to Kenya starting in 2016, with this amount increasing to 2000MW by 2028.

The foreign exchange revenue potential from this deal is estimated by the African Development Bank at $0.6 billion (roughly 20% of total international reserves at end-2014) from 2016 onwards. Negotiations are ongoing to export 400MW to Tanzania via Kenya through an upgraded interconnector, as well as 400MW to Rwanda, 500MW to Burundi and 100MW to Yemen, the latter via Djibouti.

It is known that Ethiopia's foreign currency earnings depend on export trade. With the global economic slow-down in the past years, many expected Ethiopia's economy to suffer hard.

However, Ethiopia maintained strong growth despite depressed prices for major exports. That is another strong aspect of Ethiopia's developmental stride.

Preliminary estimates of real GDP growth in the fiscal year ending July 2014 (FY 2013/14) show the Ethiopian economy expanded by 10.3% over the previous year. In nominal terms, agriculture, industry and services accounted for 42.3%, 15.4% and 43.2% of total output, respectively.

In this past fiscal year, increased production somewhat offset the downward trend in agricultural prices in world markets.

Growth in services further strengthened in the past year, in particular wholesale and retail trade (14.9% real growth), hotels and restaurants (26.4% real growth), as well as financial intermediation (17.8% real growth). And, in terms of industry, construction grew rapidly at 36.4% in real terms, bolstered by public infrastructure spending. Although activity in the mining sector contracted by 3.4% over the previous year, gold exports still made up about 14% of total export earnings in FY 2013/14.

The government's five-year development plans support policy continuity and predictability. Judging from the experience of the previous plan – the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) – as well as the current one(GTP), fiscal results of the policies align relatively closely with targets.

Indeed, the critical aspect of any developmental endeavor is policy continuity and stability. Ethiopia's developmental direction repeatedly demonstrated that.

A wise investor would waste no time to take part in this booming economy and get a slice of it.

As the Nigerian investor and Africa's richest person, Aliko Dangote, who inaugurated East Africa's largest cement factory in Ethiopia this month demonstrated, the right time to invest in Ethiopia is today. However, investing tomorrow would not late.

As Prime Minister Hailemariam Desalegn recently said:

> "Ethiopia will leave no stone unturned to make this country a suitable destination for foreign investment".