In 2012/13, Ethiopia's economy grew by 9.7%, which made Ethiopia one of Africa's top performing economies.

Through co-ordinated, prudent fiscal and monetary policies, the Government of Ethiopia (GoE) has brought down inflation to single digits.

Trade and industrial policies are not yet attuned to global value chains; such policies should address all obstacles and opportunities linked to each level of the global market.

Overview

In the 2012/13 fiscal year, Ethiopia’s economy grew by 9.7%, the tenth year in a row of robust growth. In 2012, Ethiopia was the twelfth fastest growing economy in the world. Average annual real GDP growth rate for the last decade was 10.9%. Agriculture, which accounts for 42.7% of GDP, grew by 7.1%, while industry, accounting for 12.3% of GDP, rose by 18.5% and services, with 45% of GDP, increased by 9.9% in 2012/13. This momentum is expected to continue in 2013/14 and 2014/15, albeit at a slower pace because of constraints on private-sector growth.

In an effort to combat inflation, the government pursued a tight monetary policy stance using base money as the nominal anchor to control monetary expansion. This measure, in the context of a slowdown in global commodity prices, resulted in annual consumer price inflation of 7.9% in November 2013, compared to 39.2% and 15.6% in November 2011 and 2012, respectively. The government’s determination to reduce inflation was further reflected in the pursuance of prudent fiscal policy focused on strengthening domestic resource mobilisation and reducing domestic borrowing. The strong fiscal stance, particularly measures to improve tax administration and enforcement, contained the fiscal deficit at 2% of GDP in 2012/13 compared to 1.2% of GDP in 2011/12.

Between 2011/12, merchandise exports totalled USD 3.1 billion, posting a 2.3% decline from the previous fiscal year and decreasing from 7.4% to an estimated 6.5% as a share of GDP. The value of imports, mainly from Europe and Asia, increased from about USD 11.1 billion in 2011 to USD 11.5 billion in 2012/13. With imports rising faster than exports, the trade deficit deteriorated to USD 8.4 billion in 2012/13, from USD 7.9 billion in the previous year. However, the overall balance of payments deficit in 2012/13 decreased significantly, down by 88% compared to the previous year, mainly due to a good performance in other accounts (surplus in the non-factor services trade, huge private transfers and the surplus in the capital account).

Though the stock of external debt as a ratio of GDP increased from 21.6% in 2011/12 to 24.3% at the close of 2012/13, the country remains at low risk of external debt distress. Rebuilding gross official foreign reserves has, however, resurfaced as a challenge because foreign exchange reserves fell to less than two months’ of import coverage.
Ethiopia’s strong economic performance continued for the tenth consecutive year, with real GDP growth estimated at 9.7% in 2012/13. As in the preceding years, this growth continued to be broad-based, with all sectors contributing; the service sector accounted for 46.1% of the growth, followed by agriculture (32.1%) and industry (21.8%). The service sector was estimated to have grown by 9.9% during 2012/13, mainly driven by expansion in wholesale and retail trade (34.4%), transport and communications (17.1%), hotels and tourism (15.4%), and other community services. The continued construction boom, together with expansion in mining and manufacturing, helped the industrial sector to grow by 18.5% during 2012/13. There are positive prospects for 2013/14 and 2014/15 for enhanced growth in the industrial sector, given government attention to the sector, particularly to small and medium manufacturing, to increase value added and job creation.

Although its share of GDP has been declining steadily over the past decade, agriculture continues to be the backbone of the Ethiopian economy, contributing 42.7% to GDP, about 80% of employment and 70% of export earnings in 2012/13. Agricultural value added showed robust growth of 7.1% in 2012/13 as grain production hit a record level of 25.1 million tons. This came as a result of favourable weather conditions, increased access to extension services for smallholder farmers, and expansion in cultivated land. Total crop cultivated land expanded by 0.3 million hectares, in line with the government’s target to increase agricultural value added. Yield per hectare increased from 1.6 tons in 2010/11 to 1.8 tons in 2012/13.
Vulnerability to environmental and climatic shocks, especially given that food production is rain-fed, remains one of the critical challenges for Ethiopia’s agriculture. Despite improvements in yields, productivity is still very low, partly owing to limited use of chemical fertilisers and improved farming practices.

The agricultural sector is faced with a number of problems limiting its potential. First, marketing institutions and infrastructures are weak, leading to high transaction costs notwithstanding the role of the Ethiopian Commodity Exchange in disseminating price information to farmers. Secondly, the rising price of agricultural inputs such as chemical fertiliser remains a challenge for the adoption of improved technologies. Thirdly, soil erosion in the densely populated highlands due to over-cultivation, over-grazing, and limited land conservation practices, continued to constrain agricultural output growth. Recently, Ethiopia has witnessed a decline in per capita land holding because of high population growth. About 2.7 million people are expected to be dependent on emergency food aid and another 7 million people are estimated to be chronically food insecure in 2013/14 in the pastoral, agro pastoral and some drought prone areas.

In spite of these challenges, the potential for growth in agriculture is enormous. Agricultural productivity is one of the lowest in sub-Saharan Africa. This indicates that there are untapped opportunities to increase production and productivity by promoting modern farming practices. Scaling up the practices of model farmers to the others by promoting the use of modern technologies, supporting the commercialisation of agriculture and the production of high value crops, encouraging micro-irrigation schemes, and improving marketing institutions and infrastructures are some of the key policy tools that the government is pursuing to enhance agricultural production and productivity. The government’s vision, as presented in its Growth and Transformation Plan (GTP), is to transform the economy by developing the agricultural sector and by raising the share of industry through expanded investment. The strategy for achieving this is to change the structure of current production (which is mostly subsistence) to commercially oriented small-scale production, including for exports. Such a strategy must address a number of issues including “connectivity”, security of tenure, inefficient input and output market structure, access to credit, improved extension services and promoting irrigation. One of the approaches could be moving towards small-holding commercial farming by addressing the property right issues, small-size holding and plot fragmentation. There is a need to move to farm-plot consolidation and farm-size enlargement through co-operation and co-operatives. A parallel move is also important towards non-agricultural secondary activities by addressing essential support facilities.

<table>
<thead>
<tr>
<th>Table 2. GDP by sector (percentage)</th>
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<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>2008</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>Agriculture, hunting, forestry, fishing</td>
</tr>
<tr>
<td>of which fishing</td>
</tr>
<tr>
<td>Mining</td>
</tr>
<tr>
<td>of which oil</td>
</tr>
<tr>
<td>Manufacturing</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
</tr>
<tr>
<td>Construction</td>
</tr>
<tr>
<td>Wholesale and retail trade, hotels and restaurants</td>
</tr>
<tr>
<td>of which hotels and restaurants</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
</tr>
<tr>
<td>Finance, real estate and business services</td>
</tr>
<tr>
<td>Public administration, education, health and social work, community, social and personal services</td>
</tr>
<tr>
<td>Other services</td>
</tr>
<tr>
<td><strong>Gross domestic product at basic prices / factor cost</strong></td>
</tr>
</tbody>
</table>

Source: Data from domestic authorities.
The service sector has been gaining much importance in GDP. Its share has increased from 38% to 45.2% within 10 years. The highest increase was observed in the wholesale and retail trade, and hotels and restaurants. In terms of employment also the sector is gaining more prominence. According to an employment-unemployment survey by the Central Statistical Agency (CSA) (2012) about half of people employed in urban areas are absorbed by service sectors. In addition, the informal sector, which is mainly concerned with services, makes up 31.7% of urban employment.3

In the medium term, growth may be decelerating. This is largely owing to the limited opportunities for the private sector to leverage large public investment, which is constrained by limited credit from the banking system, to further growth. As of 2012/13, only 21% of total credit from the banking system went to the private sector.

Macroeconomic policy

Fiscal policy

In 2012/13, the government continued to pursue prudent fiscal policy better co-ordinated with monetary policy to combat inflation, while maintaining the momentum of spending in physical and social infrastructure. Fiscal policy has focused on strengthening domestic-resource mobilisation (particularly tax collection) and reducing recourse to central bank lending while, at the same time, increasing pro-poor spending including investment in physical infrastructure. Domestic revenue collection has been improving in the past several years owing to vigorous tax-reform measures, improved tax administration and trade-facilitation efforts. During 2012/13, tax revenue increased by 24.8% and as a ratio of GDP, it increased by 0.1 percentage point from 11.6% in 2011/12 to 11.7%. Improved domestic revenue collection enabled the government to finance 81% of its expenditure from domestic sources.

Total government expenditure, as a ratio of GDP, decreased from 16.8% of GDP in 2011/12 to 16.1% in 2012/13. The share of pro-poor spending in total expenditure has been rising steadily reaching 70% in 2012/13 from 67% in 2010/11. Aggregate expenditure is expected to increase in 2013/14 and 2014/15, with capital spending growing faster than recurrent expenditure to support the implementation of the GTP targets and achieving the MDGs, as well as targets made towards making the country a middle-income economy by 2025.

Strong fiscal stance, particularly measures taken towards improving tax administration and enforcement, improved the overall fiscal position. The fiscal deficit remains within an acceptable threshold albeit widened from 1.2% of GDP in 2011/12 to 2% of GDP in 2012/13.

Table 3. Public finances (percentage of GDP)

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013(e)</th>
<th>2014(p)</th>
<th>2015(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue and grants</td>
<td>19.1</td>
<td>17.5</td>
<td>16.9</td>
<td>15.7</td>
<td>15.3</td>
<td>14.9</td>
<td>14.9</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>11.8</td>
<td>11.4</td>
<td>11.7</td>
<td>11.6</td>
<td>11.7</td>
<td>11.3</td>
<td>11.4</td>
</tr>
<tr>
<td>Grants</td>
<td>4.3</td>
<td>3.3</td>
<td>3.3</td>
<td>1.7</td>
<td>1.3</td>
<td>1.3</td>
<td>1.2</td>
</tr>
<tr>
<td>Total expenditure and net lending (a)</td>
<td>23.7</td>
<td>19.1</td>
<td>18.6</td>
<td>16.8</td>
<td>16.1</td>
<td>15.3</td>
<td>15.2</td>
</tr>
<tr>
<td>Current expenditure</td>
<td>12.7</td>
<td>8.6</td>
<td>8.0</td>
<td>7.0</td>
<td>6.6</td>
<td>6.5</td>
<td>6.5</td>
</tr>
<tr>
<td>Excluding interest</td>
<td>11.8</td>
<td>8.2</td>
<td>7.6</td>
<td>6.7</td>
<td>6.2</td>
<td>5.9</td>
<td>5.8</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>5.8</td>
<td>3.9</td>
<td>3.8</td>
<td>3.7</td>
<td>3.4</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>Interest</td>
<td>1.0</td>
<td>0.4</td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>10.8</td>
<td>10.6</td>
<td>10.5</td>
<td>9.9</td>
<td>9.5</td>
<td>8.9</td>
<td>8.6</td>
</tr>
<tr>
<td>Primary balance</td>
<td>-3.6</td>
<td>-1.3</td>
<td>-1.2</td>
<td>-0.9</td>
<td>-0.4</td>
<td>0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Overall balance</td>
<td>-4.6</td>
<td>-1.7</td>
<td>-1.6</td>
<td>-1.2</td>
<td>-1.2</td>
<td>-1.4</td>
<td>-0.4</td>
</tr>
</tbody>
</table>

Note: a. Only major items are reported. Fiscal year July (n-1)/ June n.
Source: Data from domestic authorities; estimates (e) and projections (p) based on authors’ calculations.
With better fiscal and monetary policy co-ordination, the government continued limiting its recourse to central bank borrowing for deficit financing during 2012/13 and, rather, used alternative liquidity-management mechanisms, such as cash budgeting and the issuance of treasury bills that obviate use of central-bank borrowing. An IMF Staff Report in October 2012 projected Ethiopia’s fiscal deficit to remain within the sustainable threshold up to 2017/18.

Ethiopia’s fiscal policy framework is flexible enough to accommodate revenue and external financing shocks by restraining expenditure when financing shortfalls arise while protecting pro-poor expenditures. Sound fiscal policies, combined with rapid expansion in public investments, especially in infrastructure and the provision of basic services, are expected to continue.

**Monetary policy**

Maintaining macroeconomic stability, particularly combating inflation, has remained the foremost policy challenge of monetary policy during 2012/13. The high inflation, which was largely contained in 2009/10, re-emerged during 2011 and 2012, mainly caused by monetary expansion and commodity price shocks. The unanticipated foreign currency build-up in the previous year in the absence of adequate sterilisation tools had expanded liquidity that, in turn, put pressure on inflation.

The monetary authorities took strong measures to limit money growth through the use of base money as the operating target. To support a tight monetary policy stance, recourse to the central bank to finance the fiscal deficit was avoided and a cash budget mechanism was introduced. Further, the treasury bills market was re-activated to assist in the mopping up of excess liquidity in the banking system. On top of this, the National Bank of Ethiopia used its foreign asset holdings aggressively to sterilise monetary growth. These measures reduced the growth of base money from 39.7 % in 2010/11 to -4.4 in 2011/12. The impact of these efforts has been seen in the reduction of the inflation rate during the year and: annual inflation fell to 7.4 % in June 2013 and 7.9 % in November 2013, in contrast to 39.2% in November 2011 and 15.6% in November 2012. There is a need to be vigilant as inflation may re-emerge due to loosened monetary policy. Reserve money grew by 13.4% in 2012/13 against a target of 12.2%. Moreover, the government has started borrowing from the central bank and the reserve requirement was reduced from 10% to 5% in March 2013.

Although the government’s monetary policy allows for flexibility in interest-rate determination (subject to the regulation of a minimum deposit rate of 5%), there is, in practice, rigidity in interest rates, which leads to negative real interest rates in an inflationary environment. Negative real interest rates have limited the effectiveness of monetary policy in demand management and discouraged savings. Currently, commercial banks are facing liquidity constraints partly because of negative real interest rates.

**Economic co-operation, regional integration and trade**

During 2012/13, the value of merchandise exports totalled USD 3.1 billion, posting a 2.5% decline from the previous fiscal year. As a share of GDP, exports shrunk from 7.5% in 2011/12 to 6.6% in 2012/13. Coffee continued to be the leading export item accounting for 24.2% of the total export receipts followed by gold (18.8%), oil seeds (14.3%), chat (qat) (8.8%) and pulses (7.6%). The leading six export items accounted for close to 80% of export earnings. Gold has become the second most important export item in the past two years reaching a record high of USD 602 million in 2011/12, and USD 579 million in 2012/13. Secondary sector exports, especially manufacturing, are still very low, albeit increasing. In recent years, there has been rapid growth in non-traditional exports, with the share of non-coffee exports rising from 40% in 1997 to 75.8% in 2012/13.

The value of imports marginally increased to USD 11.5 billion in 2012/13 from USD 11.1 billion in the previous year, posting an annual increase of 3.7%. The trade balance further deteriorated in absolute terms to USD 8.4 billion (20.3% of GDP) in 2012/13, from USD 7.9 billion (18.6% of GDP) in
the previous year. However, the overall balance of payments has improved; the deficit in 2012/13 was only USD 114 million, compared to USD 972 million in 2011/12, as a result of the surplus in the non-factor services trade, huge private transfers and the surplus in the capital account. Trade in non-factor services registered USD 459 million net receipts in 2012/13, which was more than a five-fold increase over the preceding year. Remittances inflows reached USD 2.5 billion equal to an increase of 19.8% increase. Capital account flows improved by 52%, to reach USD 3.2 billion (USD 2.0 billion in long-term capital (loan) and USD 1.2 billion in FDI. Official transfers were USD 1.5 billion.

Ethiopia is a member of the Common Market for Eastern and Southern Africa (COMESA) and the Intergovernmental Authority on Development (IGAD), and has signed all regional integration protocols, with the exception of the COMESA Free Trade Area Protocol. For COMESA member countries, Ethiopia provides only a 10% preferential discount. Ethiopia is negotiating to join the WTO and submitted initial tariff offers on commodities and services. It also continues to negotiate an Economic Partnership Agreement (EPA) with the EU, but is not yet a signatory of the Interim EPA.

Ethiopia has streamlined its tariff structure. The minimum tariff rate on imports is zero, while the maximum is 35%, with a weighted average tariff of 10.4%. The number of tariff bands was reduced from over 30 to 5 as part of the trade reforms. There are no minimum export prices, quantitative export restrictions or quotas; nor are export-financing or export-performance requirements applied. There are no quantitative import restrictions or import quotas. However, the strict foreign exchange control regimes administered by the National Bank of Ethiopia deter imports. Customs administration and administrative entry barriers appear to be the major non-tariff barriers (NTB) affecting Ethiopia’s trade with COMESA member states. Ethiopia’s trading across borders, diversification and trade freedom indices are among the lowest in sub-Saharan Africa (SSA). The World Bank’s Ease of Doing Business Survey has identified trading across borders as an aspect of Ethiopia’s business climate environment where performance is relatively weak. Globally, Ethiopia stands at 166th in the ranking of 189 economies in this regard.

### Table 4. Current account (percentage of GDP)

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013(e)</th>
<th>2014(p)</th>
<th>2015(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade balance</td>
<td>-22.9</td>
<td>-21.3</td>
<td>-17.6</td>
<td>-18.6</td>
<td>-20.3</td>
<td>-20.1</td>
<td>-20.6</td>
</tr>
<tr>
<td>Exports of goods (f.o.b.)</td>
<td>7.0</td>
<td>6.8</td>
<td>8.8</td>
<td>7.4</td>
<td>6.1</td>
<td>5.6</td>
<td>5.8</td>
</tr>
<tr>
<td>Imports of goods (f.o.b.)</td>
<td>29.8</td>
<td>28.1</td>
<td>26.3</td>
<td>25.9</td>
<td>26.4</td>
<td>25.7</td>
<td>26.4</td>
</tr>
<tr>
<td>Services</td>
<td>2.0</td>
<td>1.6</td>
<td>2.2</td>
<td>0.2</td>
<td>0.2</td>
<td>2.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Factor income</td>
<td>-0.3</td>
<td>-0.2</td>
<td>-0.2</td>
<td>-0.2</td>
<td>-0.2</td>
<td>-0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td>Current transfers</td>
<td>14.5</td>
<td>15.7</td>
<td>14.7</td>
<td>11.8</td>
<td>10.0</td>
<td>8.6</td>
<td>7.5</td>
</tr>
<tr>
<td><strong>Current account balance</strong></td>
<td><strong>-6.6</strong></td>
<td><strong>-4.2</strong></td>
<td><strong>-0.9</strong></td>
<td><strong>-6.5</strong></td>
<td><strong>-5.4</strong></td>
<td><strong>-9.4</strong></td>
<td><strong>-10.9</strong></td>
</tr>
</tbody>
</table>

Source: Data from the Central Bank and domestic authorities; estimates (e) and projections (p) based on authors’ calculations.

**Debt policy**

Since the debt relief granted under the Multilateral Debt Relief and Heavily Indebted Poor Countries initiatives (MDRI and HIPC) in 2006, Ethiopia’s external debt stock has grown by more than four-fold, as a result of the surge in public enterprises’ external borrowings from non-Paris-club and commercial banks. In 2012/13 the external debt stock rose to USD 11.1 billion from the previous year’s level of USD 8.9 billion. The share of commercial banks in the outstanding external debt rose to 28% in 2012/13 from under 10% in 2007/08. On the other hand, the share of Paris-club donors shrank to 3.6% in 2012/13 from 4.6% in 2011/12. This may continue in light of the ambitious GTP investment agenda, which may pose risks to Ethiopia’s debt rating and hence requires vigilance in debt management to mitigate the risk of debt distress. Any non-concessional borrowing should be consistent with maintaining a low risk of debt distress.
The latest debt sustainability analyses show that Ethiopia would remain at a low risk of external debt stress, despite the growth in external borrowing. Ethiopia will also remain at low risk of debt stress in 2013/14 and in 2014/15. The debt burden indicators are, however, on the rise.

Figure 2. Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)

![Graph showing stock of total external debt and debt service](image)

Source: IMF (WEO & Article IV).

**Economic and political governance**

**Private sector**

Reforms to business registration and investment licensing procedures, as well as changes to regulatory institutions, have simplified rules, improved the quality of business support and considerably reduced the cost of doing business. The time required to clear customs for export and securing a business license has been cut to 15 days from 44 days in 2004. The cost of starting a business, in per capita income terms, has been cut by about 95%, compared to its level in 2004. The amount of paid-in capital required has also been dramatically cut. Ethiopia continues to fare relatively well in “paying taxes”, dealing with construction permits, opening businesses, and enforcing contracts. According to the World Bank report *Doing Business 2014*, Ethiopia ranks 109th in paying tax, 55th in dealing with construction permits and 44th in enforcing contracts.

The World Bank *Doing Business* ranking shows deterioration in investor protection, registration of property, access to finance and competitiveness. Ethiopia’s overall ranking is 125 out of 189 economies, down from 124 the previous year. It scored 3.3 out of 10 on the investor protection index, and ranked 113rd for ease of registering property. On the World Economic Forum’s Global Competitiveness index, Ethiopia ranked 121st out of 144 countries.

Among SSA countries covered by the World Bank’s “Investing across Sectors” indicators, Ethiopia has above average restrictions on foreign equity ownership. It imposes restrictions on foreign equity ownership in many sectors, in particular the service industries. The list of prohibited sectors includes telecommunications, financial services, media, retail trade and transport.
Financial sector

The Ethiopian financial sector consists mainly of banks (3 public and 16 private), insurance companies (one public and 15 private) and 31 micro-finance institutions. The banking system accounts for about 80% of total assets of the financial sector, and is dominated by state-owned banks, mainly the Commercial Bank of Ethiopia (CBE). Currently, public banks account for 51.1% of bank branches (1,724), 54.6% of total capital, 68.4% of total deposits and 63.5% of outstanding bank loans, although their dominance is declining with the entry of more private banks, as well as expansion of the existing ones. The recent directive requiring private commercial banks to invest 27% of their gross loan disbursements in National Bank of Ethiopia bonds is likely to further make the playing field between private and public banks more uneven. However, the recent directive requiring private commercial banks to invest 27% of their loan disbursements in 5-year National Bank of Ethiopia (NBE) bonds at an annual interest rate of 3%, while the minimum deposit rate is 5%, would put private banks in uneven ground to compete with the public banks.

The financial sector is considered shallow because it is characterised by limited range of services, limited foreign participation in the banking sector and the non-existence of capital markets. According to the Global Competitiveness Report 2013/2014, Ethiopia is ranked 126th out of 148 countries in financial market development, lower than the average of “factor driven economies”.

Banking coverage stands at about 50,200 people per commercial bank branch, concentrated mainly in urban areas, making Ethiopia one of the most under-banked countries in sub-Saharan Africa. By June 2013, the private credit to GDP ratio was around 15.9% compared to the average of 30% for sub-Saharan Africa. Lending is mainly collateral-based, to the detriment of the vast majority of small entrepreneurs. Credit to the private sector, which is already low, will be held back as banks allocate funds towards NBE bills, following the new directives. Private banks’ lending interest rates could also rise to compensate for the loss, unless the banks fully absorb the costs of the new policy. In the World Bank report Doing Business 2014, Ethiopia ranks 109th in getting credit out of 189 countries, slightly worse than last year (105th).

On the money market, the government offers 28-day, three-month and six-month maturity treasury bills. It prohibits the interest rate from exceeding the bank deposit rate. With the yields on these T-bills set below 3%, this market remains unattractive to the private sector and, thus, over 95% of T-bills are held by the state-owned CBE and public enterprises.

The policy, regulatory and institutional frameworks for micro-finance institutions is well established. There are 31 micro-finance institutions helping about 3 million people, with 14.7 billion birr (ETB) in assets and ETB 10.3 billion in outstanding loans, mobilising ETB 6.0 billion in the form of voluntary and compulsory savings by the end of December 2012. Demand for micro-credit, however, far outstrips supply.

The government has made some efforts to improve the settlement system. Recently, the NBE launched a technology platform for Real Time Gross Settlements for large value payments and a centralised Automated Clearing House. A modern Credit Bureau has been setup and the Credit Information Centre has been fully automated and upgraded. The commercial banks have rolled out core banking solutions (CBS) across branches. The banks have already started seeing the benefits of the system, including real-time transfer of funds among all branches (on-line local transfer services); increased utilisation of ATMs by the customers of all online branches; and efficiency of service delivery and ease of access of banking services for online branches.

Public sector management, institutions and reform

The year 2013 saw significant progress in the reforms to Public Financial Management (PFM) systems, which commenced in 2002, notably through the implementation of Phase III of the Promoting Basic Services Program. Notable progress has been made in the preparation of guidelines, action plans, performance reports for programme budgeting, finalisation and
dissemination of the directive to form audit committees in 400 Woredas, revision of the treasury manual, dissemination of manuals on performance audit to all federal bodies and regions, IBEX connectivity in five regions, and rolling out of IBEX to Woredas in emerging regions. The 2010 Public Expenditure and Fiduciary Assessment (PEFA) indicated that nine out of the 28 indicators had improved while none had worsened. Ethiopia’s budget is policy-based (poverty oriented), credible, comprehensive, and implemented as planned with a 5% deviation.

To improve the effectiveness and efficiency of public sector service delivery, the government has implemented business process re-engineering and a business score card. In addition, efforts to embed accountability and integrity are underway within the framework of the government’s Good Governance Package. However, there is some way to go before results orientation of the civil service becomes embedded. A key impediment to the government’s capacity is the high turnover of qualified staff due to low wages. The situation is particularly critical at regional and Woreda levels. In principle, promotions and hiring are based on merit. However, political interference in the civil service system undermines meritocracy. Nevertheless, levels of control and ethics in the public sector are high.

Corruption in the public sector is claimed not to be pervasive. There is a culture of intolerance to corruption. Anti-corruption campaigns have been intensified and a good number of government officials have been prosecuted through the legal system. However, according to the 2013 Index of Economic Freedom, Ethiopia ranked 118th out of 183 on freedom from corruption. According to Transparency International, Ethiopia ranked 111th in 2013 on its index of perceptions of corruption, compared to 113rd in 2012. Recent trends in the International Transparency Corruption Index, thus, suggest that this could be a potential problem. A recent corruption study under the Federal Ethics & Anti-Corruption Commission (FEACC), entitled “Perception of the Level of Corruption by Foreign Investors in Ethiopia”, indicates prevalence of petty corruption in various government institutions, while playing down the impact of grand corruption. The power, tax, investment and transport sectors are identified as having the highest corruption levels.

Ethiopia’s regulatory system is generally considered fair. Secured interests in property are protected and enforced. Investment, business, and other licenses can be obtained from the Ethiopian Investment Agency in a matter of hours. Proposed national laws are generally circulated for public comments prior to enactment. Disputes may be settled by means agreeable to both parties. Property and contractual rights are recognised and there are commercial and bankruptcy laws. Although efforts are underway to strengthen its capacity, Ethiopia’s judicial system is overburdened, poorly staffed, and inexperienced in commercial matters. There is significant government influence and intervention into legal proceedings, particularly those related to government entities or officials. The pervasive presence of state- and party-owned businesses distorts the perception of private owners of property rights and erodes policy credibility. In 2013, Ethiopia scored 30.0 out of a total score of 100 and was ranked 97th out of 183 countries on the property rights scale of the Heritage Foundation, as well as 79th out of 144 countries in the 2012/13 Global Competitiveness Report.

The state is able to protect the lives and property of most citizens from crime and violence most of the time. According to the Global Competitiveness Report of 2013/14, crime and theft is the least problematic factor for doing business; Ethiopia ranked 36th and 38th out of 148 in business costs of crime and violence and organised crime.

Natural resource management and environment

Ethiopia’s ecological system is very fragile and vulnerable to climate change, in part due to stress on natural resources. The key challenges include soil degradation, deforestation and loss of biodiversity, besides weak environmental management and enforcement capacity.
Ethiopia has launched and disseminated to all stakeholders a Climate Resilient Green Economy (CRGE) facility operations manual and a Sectorial Reduction Mechanism (SRM). The SRM is a comprehensive system for reducing vulnerability and emissions. It is part of Ethiopia’s CRGE initiative to reduce emissions and vulnerability in order to build a climate-resilient green economy with zero-net carbon emissions by 2025 by providing up-front support and ex-post payment for the preparation and implementation of reduction interventions.

Interventions made during the last decade have brought results and the forest cover has started to grow. The total forest cover tripled from 3% in 2000 to 9% in 2013, as a result of large-scale reforestation campaigns.

Lately, as part of the effort to realise the government’s Climate Resilient Green Economy strategy, the former Environment Protection Authority has been upgraded to Ministry of Environmental Protection and Forestry. The new ministry is responsible, among other undertakings, for spearheading the reforestation, and other wide-ranging tasks.

Political context

Ethiopia’s political situation has evolved since the political crisis following the 2005 elections. The third national elections under a multi-party political system that were held in May 2010 were generally peaceful and the ruling Ethiopian Peoples’ Revolutionary Democratic Front (EPRDF) emerged with all but two seats in the Federal House of Parliament. However, for the political opposition, the perceived narrowing of the democratic and political space remains a concern. Ethiopia has passed through a smooth political transition with the election of a new Prime Minister, Hailemariam Desalegn, and the re-election of the chair and deputy chair of the ruling Party, EPRDF, and its constituents in the recent convention, the first without the presence of the late Meles Zenawi. Premier Hailemariam consolidated power and successfully reshuffled key ministerial posts. The next elections are due in 2015.

Its location in a volatile neighbourhood poses significant spill-over risks to Ethiopia’s security situation and political stability. The border conflict with Eritrea remains unresolved, although outright conflict remains improbable. Furthermore, fragility in Somalia poses immediate security challenges. Ethiopia is also playing a key role in the negotiations between Sudan and South Sudan and in the South Sudan internal conflict under the auspices of the African Union’s High-Level Panel. Religious extremism and issues related to the Renaissance Dam on the Nile River, especially with Egypt, remain a concern.

The Arab Spring events demonstrate how quickly stability can change, and how much that stability depends on meaningful progress in economic opportunity, democracy and social accountability. These latter two areas have generally been lacking throughout Ethiopia’s history, and reflect an underlying brittleness of the political system.

Social context and human development

Building human resources

Ethiopia has achieved significant gains in poverty reduction and all aspects of human development. It is among the countries in sub-Saharan Africa making the fastest progress towards the MDGs. The government’s commitment to poverty-focused spending has led to substantial progress in improving access to basic services and significant gains in social indicators. Overall, Ethiopia is on track to meet 6 MDGs (1, 2, 3, 4, 6, and 8) and likely to meet the other 2 MDGs (5 and 7). The progress so far recorded is attributed to strong commitment by the government and its development partners to the MDGs and to the overarching national development plans – the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) and GTP.
Impressive results in health-service expansion have been achieved. According to the recent Demographic and Health Survey (DHS), contraceptive prevalence increased to 29% in 2011/12 from 15% in 2005 and the coverage of antenatal visits reached 34% from a baseline of 28%. The rate of deaths among children under five declined from 123 per 1 000 live births in 2005 to 88 in 2010. Infant mortality dropped from 77 to 59 during the same period. There is a clear focus on poverty-related health issues, such as communicable diseases, and health problems that affect mothers and children. There has likewise been progress on water and sanitation services. By 2013, the proportion of the rural population with access to potable water rose to 66.5% from 46% in 2006. The government aims to reach universal access to water supply in 2015.

Primary school enrolment rates increased from 68% in 2004/05 to 85.7% in 2012/13. The completion rate of grade eight students increased from 48% in 2009/10 to 52.8% in 2012/13, not yet high enough to achieve the education goal. Literacy rates have risen since 2004 from 38% to 47%. There is a parallel drive to expand vocational training and tertiary education, to provide students with skills needed by the economy.

The challenges posed by HIV/AIDS have continued to be addressed through instituting HIV/AIDS policies, strategies and programmes. A National Task Force on HIV/AIDS was established, which designed medium-term prevention and control programmes focusing on information, education and communication (IEC), condom promotion, surveillance, patient care and HIV screening laboratories at different health service delivery posts. Ethiopia has achieved tremendous results at the country level to scale up effective coverage and services, and with its commitment to universal access to HIV prevention, treatment, care and support. As the result, HIV/AIDS prevalence among the adult population dropped to 1.5%, against the MDG target of 2.5%. There has been progress in controlling malaria & tuberculosis. By 2010, all residents of malaria-prone areas had an insecticide-treated net against anopheles mosquitoes, from only 2% in 2005. In 2010, 90% of children aged under-five slept under insecticide-treated bed nets, compared to 5% in 2003. The death rate from malaria declined by 55% and hospital admissions by 54%. There is now an 84% success rate in treating tuberculosis.

Human development indicators remain low, however, compared to other developing countries. Ethiopia ranked 174 out of 187 countries in the 2012 United Nations Human Development Index. The poverty head count is high at 29.6% in 2010/11. Maternal mortality remains high at 470 per 100 000 live births with skilled attendants at only 10% of births. The quality of basic service delivery remains low and regional disparities persist.

**Poverty reduction, social protection and labour**

With the consistent implementation of the poverty-reduction initiatives, pro-poor spending continues to rise (70% in 2012/13). As a result, poverty in Ethiopia has declined at an annual average of 2.32 % since 1995. The proportion of people living below the poverty line fell from 45.5% in 1995/96 to 29.6% in 2010/11 and is estimated to have further declined to 27.8% in 2012. The target in GTP is to reduce poverty to 22.2% by 2015. The decline in poverty is attributable to the recent implementation of welfare programmes such as the Productive Safety Net Program (PSNP), as well as urban food distribution and subsidies. The PSNP reaches close to seven million chronically food-insecure individuals and has a strong focus on addressing the poverty of female-headed households and encouraging women's participation in public-works activities. The national Gini coefficient however remains almost constant at 0.298 in 2010/11 vs. 0.3 in 2004/05, while the urban Gini coefficient has increased to 0.37 in 2010/11 from 0.34 in 1995/96.

Labour-market regulations are broadly appropriate and enforced for an increasing number of workers. Active labour-market programmes (linking micro and small-scale enterprises with public works like paving and urban housing construction) are improving in quality and coverage, although weaknesses remain. The government had created more than 1.1 million jobs in the past fiscal year, through its support to micro and small-scale enterprises. The data from Ministry of
Urban Development & Construction shows that about 193,241 small-scale job opportunities were created during the construction of condominium houses. The government has ratified the various ILO Labor conventions, including ILO Convention 182 on the Worst Forms of Child Labor. However, enforcement of these conventions, especially the child labour convention is rather weak.

**Gender equality**

The government has actively mainstreamed gender as a cross-cutting issue through joint planning between sectorial line ministries and the Ministry of Women, Children and Youth Affairs. Such strategies have led to reduced gender disparities, especially in education. Ethiopia recorded about 40% improvement in its gender parity index in primary school enrolment from 1991 to 2013, and is near complete gender parity at the primary school level. At the secondary level, gender parity fast-tracked from 0.67 in 2007 to 0.82.

In the health sphere, maternal mortality in Ethiopia fell sharply from 510 deaths per 100,000 live births in 2005 to 350, due in part to a concerted effort to make family planning services more widely available. According to the recent Demographic and Health Survey (2010), the percentage of married women using a modern method of contraceptives more than doubled from 13.7% in 2005 to 27.3%. Access to health care for women remains low, however, as only 10% of Ethiopian women give birth with a skilled health professional in attendance.

Other indicators of gender equality in Ethiopia are promising. The percentage of seats in the national parliament held by women was 27.8% in 2013, a dramatic improvement from 7.7% in 2005. Adolescent birth rates, an indication of the rights of young women, fell from 109.1 births per 1,000 women aged 15-19 in 2002 to 79 in 2013. The government has reviewed all discriminatory laws; genital mutilation and other forms of violence against women are punishable crimes.

There are still areas where the government must make a concerted effort to improve the status of women. The participation rate of women in business and in decision making is low. The literacy level of women is markedly lower than that of men (63% for men and 47% for women).

**Thematic analysis: Global value chains and industrialisation in Africa**

Ethiopia’s participation in global value chains (GVCs) and its relative share in total value-added created by trade in GVCs are minimal both in forward and backward linkages. Ethiopia, along with many African countries, is still in the initial stages of gaining access to GVCs beyond natural-resource exports, highlighting the need for new strategies to enable better access to value chains. Even those engaged in GVCs are not yet getting the full benefit. A representative producer co-operative in Ethiopia gets only about 7% of the retail price of specialty coffee and this share would decline to about 4% for non-member (private) coffee exporters. The selling price of cut flowers from Ethiopia is about USD 0.183 per stem while the retail price in the European market, where the bulk of Ethiopian cut flowers are destined, is about USD 9.09. This makes the share of the Ethiopian exporters in the vicinity of about 2%. Notwithstanding the extremely small share of the retail value that accrues to the cut-flower exporters, the sector has shown respectable growth, mainly due to favourable government support to the sector, along with a conductive climate. The Ethiopian flower industry represents an extraordinarily fast and successful diversification into a non-traditional export product. The floriculture industry began to emerge in the early 2000s and, within a decade, Ethiopia became the 5th largest non-EU exporter to the EU cut-flower market and the 2nd largest flower exporter from Africa (after Kenya). One of the largest shoe exporters in China – Huajian – set up a factory in Ethiopia in 2011, as part of a plan to invest USD 2 billion over 10 years in developing manufacturing clusters focused on shoemaking for export. The company has the potential to create 100,000 jobs over this period and will integrate local input manufacturers into global supply chains.
Ethiopia has many natural resources that can provide valuable inputs for light manufacturing industries serving both domestic and export markets. Among its abundant resources are cattle, which can be processed into leather and its products; forests, which can be managed for the furniture industry; cotton, which can support the garments industry; and agricultural land and lakes, which can provide inputs for agro-processing industries. Ethiopia has abundant low-cost labour which gives it a comparative advantage in less-skilled, labour-intensive sectors such as light manufacturing. The Ethiopian livestock value chain can become a thriving industry that can produce packaged meats destined for Middle Eastern, European and East African markets, or fashion gloves and shoes that sell in volume on the high streets and boutiques of Europe. To reach this level of development, operators and investors along the value chain might consider how to improve the quality and value of meat exports by establishing a standardised grading system for meat and live animals; encouraging more supply into the abattoirs to increase capacity utilisation, thereby lowering costs; improving cost competitiveness and providing more raw material for leather producers; and introducing proper and improved feeding, fattening, animal health care and other services while encouraging foreign and domestic investment at all points along the value chain.

Ethiopia has identified the leather and leather products value chain as one of the promising industries in the country. The leather value chain's potential is to become a leading supplier of leather and leather-based products to fashion houses in Europe and Asia.

Important issues facing the agro-processing industry as it strives to strengthen its capabilities in the face of increasingly fierce global competition include lack of sufficient supply of raw materials to meet demand, lack of a price incentive that reflects premiums for superior quality; limited foreign and domestic investment in the value chain and lack of access to operating capital; lack of specialisation necessary for accessing key niche markets in Europe and Asia; low worker productivity and weak backward and forward linkages. By addressing several shortcomings, including increasing the supply of animals into the abattoirs, improved collection and introducing quality standards, the promise of accessing the globe's leading buyers of leather can be realised. Friendly macroeconomic policies and domestic administrative reforms would, properly sequenced, enable Ethiopia to use its abundant factor of production – cheap labour – to drive its development on a basis less vulnerable to the risks inherent in rain-based agricultural production, including participation in the processing trade. The government can follow the course pioneered by a succession of Asian nations by taking the initiative to accelerate the realisation of latent comparative advantage in segments of light manufacturing in which specific, feasible, sharply focused, low-cost policy interventions can deliver a quick boost to output, productivity, and perhaps exports, opening the door to expanded entry and growth. The value chain requires efficient services as well as the possibility to move people, capital and technology across countries. Policy should thus address obstacles at all points of the value chain, especially on the trade logistics. As mentioned earlier, Ethiopia's performance in trading across borders is relatively weak. Globally, Ethiopia stands at 166th in the ranking of 189 economies. Policies and strategies are not yet tuned towards the forward and backward linkages of the Global Value Chains.

The GoE, under its GTP, launched a strategy openly to lay the foundation for a rapid structural transformation in the economy to benefit from the GVC. The vision is building an economy which has a modern technology and an industrial sector that plays a leading role in the economy. The significance of expanding the industrial sector lies in its capacity to help transform other sectors, particularly agriculture. Efforts are currently marshalled through a holistic, comprehensive industrial development policy and incentive packages. Textiles and garment, leather and leather products and agro-processing have got due attention. FDI in these sectors, especially in the industrial parks, is flowing in. Several multinationals are vying to be part of the new government-developed industrial zones that are being established in Addis Ababa, and in other areas around the country. Some 20 foreign companies are setting up in the Bole Lemi industrial zone on the outskirts of Addis Ababa, the first of its kind constructed by the government. The Eastern
Industry Zone, developed and owned by a Chinese firm some four years ago, paved the way for the government to realise potential in the area. The export sector and foreign direct investors have received a lot of encouragement through tax and non-tax incentives. More precisely, in its Agricultural Sector Policy and Investment Framework, the government has planned to address the bottlenecks, through increased rural commercialisation, increased private-sector participation and natural-resource management. The industry policy advocates export-oriented industrialisation that could be taken as support towards increased participation in the global value chain. In addition, the ongoing negotiation for accession the WTO is another commitment by the government that would indicate the country's prospects for increased participation in the global value chain.

**Notes**

1. Ethiopia's fiscal year runs from 8 July to 7 July of the next year.