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Homegrown Economic Reforms in Ethiopia (HGER): A Review of Progress and Prospects

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Homegrown Economic Reforms in Ethiopia (HGER)

HGER Review Report

Berihu Assefa Gebrehiwot
July 2022

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Executive Summary

- Ethiopia has experienced rapid economic growth over the past decade and a half, leading to impressive poverty reductions and improvements in social indicators. However, the country's state-driven economic growth has also created macroeconomic imbalances and vulnerabilities, suggesting that the public investment-driven economic growth model has its own limitations.
- In addition to macroeconomic imbalances, the country has experienced multiple shocks, most notably political instability, the pandemic, and most recently a full-blown war that has drastically slowed economic growth. For example, in its World Economic Outlook published in October, the IMF found that the Ethiopian economy was on track to grow just 2% in 2021; and due to the conflict in the country, which is characterized by unusually high levels of uncertainty and volatility, Ethiopia has not been included in the IMF's 2022-2026 growth projections.
- In 2019, the HGER reform plan was launched to address the macroeconomic, structural, and sectoral challenges facing the Ethiopian economy. In the short to medium term, the reform measures combined aim to help Ethiopia address its chronic macroeconomic and business environment challenges; and create a private sector-driven economy with greater competition, productivity, and new sectors.
- In terms of scope of implementation, while some of the reform measures are incremental-efficiency-enhancing (or quick wins), others are more drastic in nature. Our review finds that while reforms of the former type have been largely implemented, reforms of the latter type have not made good progress. HGER reforms that focus on opening up the economy have not been implemented. For example, while quick-win reforms such as reducing (or phasing out) direct (central bank) financing of government spending have been achieved, HGER's more profound reforms that are aimed to sustainably address the foreign exchange shortages and overvaluation by moving to a more flexible exchange rate regime has not materialized. As a result, the country's foreign exchange shortage remains chronic and persistent. Real depreciation is unlikely to be achieved without transitioning to a more flexible exchange rate regime. Ethiopia continues to strictly

manage its foreign exchange regime through its central bank authorities. The lack of a flexible (or market clearing) forex exchange regime negatively impacts the country's external competitiveness, leading to stagnant and less diversified exports (total export not more than US\$3 billion and more than 80% from a few agricultural exports).

- On the other hand, the HGER's reform on state-owned enterprises (SOEs) has a two-pronged approach: strengthening corporate governance and privatization. The establishment of SOE supervisory agency and prudent requirements on their debt levels and cost-recovery tariffs (in the case of energy, for example) helped in strengthening SOEs' corporate governance. The second component and less successful has been the privatization of SOEs in the telecom, energy, sugar, logistics, and aviation sectors. The sole privatization process that has shown some progress was the partial privatization of the state-owned Ethio-Telecom. The auction process to sell 40% of the state-owned Ethio-Telecom Company was launched, but suddenly the government recently (in March 2022) announced its postponement. Hence, most SOEs including Ethio-Telecom, the Ethiopian Shipping Lines and Logistics Services Company (logistics sector), the Ethiopian Electric Utility Company (power sector), the Ethiopian Sugar Corporation (sugar sector), the Ethiopian Airlines (aviation sector), and many other SOEs remain in the hands of the government.
- The HGER plan is not limited to privatization, but also envisaged market liberalization in the state-controlled sectors of logistics, power, finance, and telecom. However, market liberalization has taken place only in the telecom sector. In May 2021, a foreign telecom operator was licensed to operate along with the state-owned Ethio-Telecom Company in the Ethiopian telecom market. This marked the end of Ethiopia's public monopoly in the telecom market. Similar market liberalizations have not taken place in the other much-anticipated sectors of logistics, finance, power, and Aviation.
- While crosscutting challenges such as the COVID-19 pandemic and the conflict have affected the implementation of the HGER plan across most reforms, our review also finds that coordination issues, technical capacity, opposition voices, and the government's legacy of retaining control of key sectors have impacted the implementation of the HGER plan in one way or another.

1. Why reforms? A background

Ethiopia embarked on a strong growth course in 2003/2004. In the period prior to that (i.e., 1991-2002) the economy showed little growth as it was an economy that had just transitioned from a command economy (1974-1991) and prolonged civil war. In 2003/04, the Ethiopian government drafted and began implementing its first Industrial Development Strategy (IDS) (FDRE, 2002). Ethiopia's IDS came at an opportune time as an industrial policy was gaining increasing traction among policymakers and academics around the world¹. Ethiopia's industrial policy emphasized the implementation of strong pro-poor policies, including investments in infrastructure, social services (like education and health), agricultural programs and investments in state-owned enterprises in selected sectors (like sugar, finance, energy, etc.) and introduced investment support programs to encourage the private sector to invest in productive sectors such as manufacturing and agriculture. These state-driven development programs have resulted in remarkable economic growth and improvements in living standards. For example, as shown in Table 1, Ethiopia's growth rate averaged 10.3 percent between 2003/2004 and 2017/2018.

Table 1. Ethiopia's Economic Growth Performance Trajectory

Year	Average Real GDP Growth Rate (%)
1975/1976 – 1991/1992	1.7
1992/1993 – 2001/2002	5.5
2002/2003	-2.1
2003/2004 – 2017/18	10.3
2018/2019-2020/2021*	5.7

Sources: PDC, MoF, NBE, IMF; *GDP growth for 2021 is forecasted at 2%

Ethiopia's strong growth and investments in social services (such as education and health) has resulted in per capita income quadrupling, the poverty rate almost halving (see Table 2) and most of the health MDG targets being achieved (e.g., 67% reduction in under-five mortality and 71% decline in maternal mortality ratio) (Assefa, Van Damme, Williams, & Hill, 2017; Berihu, 2022; PDC, 2019).

Table 2. Ethiopia's per capita income and poverty Levels

Ethiopian Year	Per capita income (USD)	Poverty headcount (%)
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¹ See, for example, Rodrik 2004, and Hausmann and Rodrik 2006 for discussions on the revival of industrial policies in developing countries.

1996/1997		46
2004/2005	250	39
2009/2010		30
2018/2019	985	22

Source: PDC, MoF

Although rapid growth over the past decade and a half has resulted in impressive poverty reductions and improvements in social indicators, macroeconomic imbalances and vulnerabilities have begun to emerge, suggesting that the public investment-driven economic growth model has its own limitations (FDRE, 2019). The macroeconomic imbalances that the country is facing include a shortage of foreign exchanges, high inflation, high external debt and an underdeveloped financial sector (hence limited private sector access to finance). Furthermore, the economy faces structural bottlenecks and sector-specific market failures (FDRE, 2019). To address these challenges, the government announced in September 2019 a 3-year Homegrown Economic Reform Program, comprising three components: (i) macroeconomic reforms, (ii) structural reforms, and (iii) sectoral reforms. The reforms aim to address the above-mentioned macroeconomic imbalances and structural and sectoral bottlenecks to boost exports and foreign direct investment. Much of the reform promises to implement an ambitious privatization program for key sectors that are solely controlled by the government, such as telecom, energy, aviation, finance and logistics, and a move towards greater exchange rate flexibility. Complementary reforms to consolidate public sector deficit and mobilize domestic resources are also priorities of HGER to create the fiscal space and sustainable financing of infrastructure and social services.

The HGER document only lays out broad reform directions for the macro-financial, structural, and sectoral reforms. The implementation of the HGER plan is the responsibility of the implementing government agencies, who prepare detailed 3-year and annual HGER implementation plans for their sectors. It has been around two years since the HGER reform agenda was launched. Against this background, this report aims to provide a brief analysis of the HGER implementation progress made towards achieving the HGER targets. In doing so, we also identify gaps and constraints that may have been encountered, and as well as lessons learned.

2. Current contexts since 2018/2019

The Ethiopian economy has faced multifaceted challenges in recent years, especially since 2018. Real GDP growth rates have decelerated to an average of 5.3% between 2018/2019 and 2020/2021 (see Table 1), reflecting a significant slowdown in economic activities. Two important events that have occurred since 2018 explain much of the observed economic slowdown: COVID-19 and conflict. Ethiopia has experienced severe internal unrest and upheavals in recent years, culminating in a full-blown war in 2020. This is in addition to the impacts of the COVID-19 pandemic. Manufacturing, services such as tourism and trade and the export sector have been hit the hardest by both the conflict and the pandemic. Productions were destroyed and interrupted in many places, and firms could not repay their debts. This in turn has led to a significant increase in non-performing loans (NPLs), particularly at the Development Bank of Ethiopia (DBE). For example, the latest NPLs of the two major public banks, Commercial Bank of Ethiopia (CBE) and Development Bank of Ethiopia (DBE), add up to about 21.2 billion birr, of which 55.5% are manufacturing NPL. DBE accounts for the largest share (around 92%) of all NPLs in manufacturing. This suggests that DBE borrowers (mainly manufacturers) are facing mounting financial difficulties that could lead to massive closures and job losses.

The country also suffers from chronic macroeconomic imbalances such as foreign exchange shortage, high inflation, and other unfavorable business conditions related to power interruptions, logistics, taxes, and public service inefficiencies. The foreign exchange shortage problem is acute, as businesses find it difficult to obtain the foreign exchange needed to import inputs, parts, and components, and are forced to operate below capacity (between 40 to 60 percent depending on the sector in most priority sectors). The root cause of the foreign exchange problem is a weak external (export) sector (Gebreyesus, M.; Demile, A., 2017; Kiflu & Berihu, 2019). Other sources of foreign exchange, such as remittances, foreign direct investment (FDI), and official development assistance (ODA), which are crucial to fill some of the funding gaps, have also been affected by both the conflict and the pandemic. Overall, the IMF noted in its World Economic Outlook released in October that the Ethiopian economy was on track to grow just 2% in 2021. In addition, the IMF has not included growth projections for 2022-2026 for Ethiopia due

to the conflict in the country characterized by an unusually high level of uncertainty and volatility.

The impacts of the conflict and the pandemic are not yet fully felt and could continue in the years to come. Consequently, a further slowdown in economic activities is to be expected and the targets set in the 10-year Perspective and the HGER Plan are likely to be missed by a wide margin. Which reform areas have been implemented, delayed, or postponed are discussed in detail in subsequent sections.

3. The HGER reform, its goals and implementation approaches

The HGER plan sets out to address the reform areas in three pillars: macro-financial reforms, with a focus on macro issues such as foreign exchange, debt, inflation, fiscal and monetary issues; structural reforms, with a focus on creating a conducive business environment for the private sector; and sectoral reforms, with a focus on addressing sector-specific market failures to increase productivity and unlock new sources of growth. Each of these reform areas is discussed below.

3.1. Macro-financial reforms

(i) Public sector financing reforms

When it comes to financing the public sector, the reform aims to find a good balance between continued investment in infrastructure, social services and human capital and maintaining a sustainable financing model. In other words, the country wants to move to an investment financing model that ensures debt sustainability, avoids inflationary pressures, and does not crowd out private investment. Key reform measures under this include maintaining a low government budget deficit, increasing the efficiency of public investment, improving the governance of SOEs, and expanding concessional external sources of finance.

(ii) Foreign exchange reforms

The foreign exchange problem in Ethiopia is chronic and therefore small fixes will not bring a lasting solution. The reform needs to be bold to allow for a gradual transition to a market-driven exchange rate regime and remove controls over current account transactions. Once a market-driven exchange rate regime is in place, the NBE can ensure exchange rate stability by buying

and selling foreign exchange rather than through fiat. The HGER plan also includes reform measures to correct the prevailing overvaluation of the birr, mobilize foreign exchange from cheaper sources and build reserves, boost exports, tourism and foreign direct investment, and improve the functionality of the interbank market.

(iii) Monetary policy reforms

The HGER plan and several other studies recognize that controlled interest rates in particular and financial repression, in general, have restricted private sector access to credit² and contributed to the prevailing macroeconomic imbalances. To this end, the reform measures introduced along this line focus on the gradual phasing out of these financial repression policies. More specifically, the main areas of reform include the elimination of central bank credit provision to the government in the form of direct advances, containing inflation to single digits, the introduction of market-based monetary policy instruments (e.g., operationalizing a competitive T-bill market), transitioning to an interest rate-based monetary policy and the capacity building of the National Bank of Ethiopia.

(iv) Financial sector reforms

The financial sector is one of the most regulated sectors in Ethiopia. The sector remains closed to external (foreign) banks and financial institutions. Ethiopia revised its investment law in 2020 but the financial sector remains out of reach to foreign investors even under the revised investment law³. Small allocative efficiency problems in the country's financial sector could be addressed by eliminating the various financial repression policies but the development of the financial sector can only be largely driven through innovations and internal and external competitions. Secondary markets do not yet exist in Ethiopia, further limiting access to finance for investors and entrepreneurs⁴. The reforms proposed in the HGER plan to address these constraints include developing interbank money markets, establishing a stock market, opening the sector to external competition and promoting financial inclusion through the introduction of mobile technology.

² World Bank & International Finance Corporation (2019). Creating Markets in Ethiopia: Sustaining Progress Towards Industrialization.

³ Ethiopia investment proclamation NO. 1180/2020

⁴

3.2. Structural reforms

While the macro-financial reform measures are necessary to address the macroeconomic imbalances, restore confidence and lay a solid foundation for continued economic growth, bringing the private sector to be a key player (in an economy dominated by the state) would require the creation of a conducive business environment. This is where the role of structural reforms comes in. Various surveys, such as the World Bank's Doing Business and Enterprise Surveys and the World Economic Forum's Global Competitiveness Report (GCR) indicate that, in addition to foreign exchange shortages and limited access to finance, cumbersome procedures, corruption, barriers to international trade, poor logistics, and limited access to reliable electricity are often cited as the key structural bottlenecks to doing business in Ethiopia. For example, the poor and inefficient logistics and transportation services significantly constrain the country's economic competitiveness and export growth (Geiger & Moller, 2013). According to the World Bank's Doing Business, Ethiopia's transit time for export is about 42 days, which is much longer than even landlocked comparator countries such as Rwanda and Uganda. The time it takes to export for Ethiopia is about twice as long as for China, Vietnam, and Kenya. Ethiopia ranks low in the overall Doing Business ranking (159th), in starting a business (176th) and in cross-border trade (166th) out of 190 countries in 2019. To address this, the HGER reform prioritizes improving the country's business environment (doing business ranking) by introducing efficiency-enhancing reforms in public service and introducing competition in the enabling sectors of energy, logistics and communications.

3.3. Sectoral Reforms

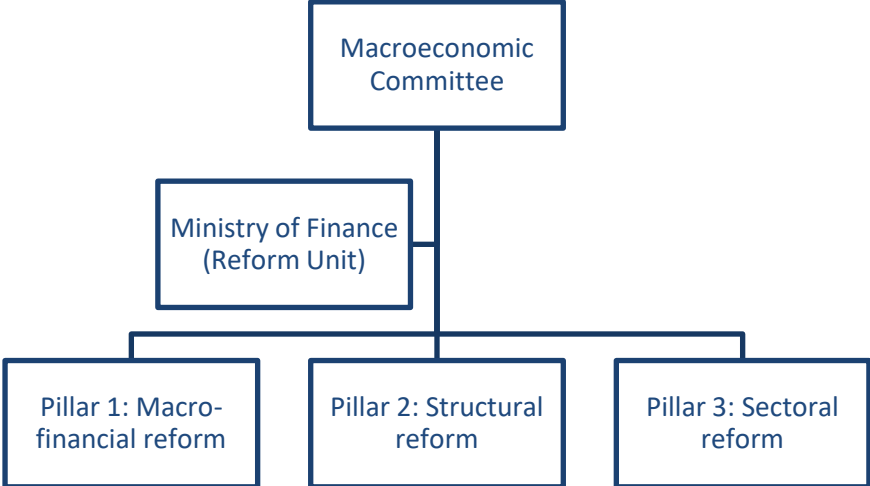
The sectoral reforms aim to address sector-specific market failures to exploit opportunities in existing and new sectors with growth potential, including agriculture, mining, manufacturing, tourism and the digital economy, by improving access to inputs, finance, and market systems, and skills and technology.

4. HGER implementation and coordination approach

The HGER plan, prepared centrally by the Macroeconomic Committee (under the Prime Minister), went through several stakeholder consultations to ensure quality and ownership. The HGER plan provides only broad and main areas of reform to be implemented in three years. It is the sectoral (or implementing) agencies that are tasked with concretizing it through the

preparation of detailed three-year and annual plans and mobilizing resources and capacity for its effective implementation. Coordination, overseeing and alignment across sectors are ensured by the Macroeconomic Committee and the Ministry of Finance, which acts as the secretariat of the HGER reform (see figure 1). The HGER plan has been warmly welcomed and supported by several international development partners. The IMF officially approved the Ethiopian government’s request for a nearly US\$ 3 billion loan under its Extended Credit Facility and Extended Fund Facility in support of the Homegrown Economic Reform Plan. The AFD also financially supported the implementation of the HGER, part of which was used by the MoF to fund research programs on HGER through the Policy Studies Institute. Other international organizations provided technical support by seconding key staff to key institutions involved in the implementation of the HGER, such as the NBE and the MoF.

Figure 1: HGER implementation coordination



Source: FDRE HGER, 2019

5. Methodology

The preparation of this report is largely based on a review of the HGER main document, sectoral HGER plans, progress reports from government sources, interviews with implementing government agencies, and a review of sources from some international partners who have supported the HGER reform plan. More specifically, the report relies on

(a) Desk research

This includes an extensive review of the HGER main document, sectoral HGER plans, implementation reports and other secondary sources on the HGER.

(b) Administrative data and progress reports

The implementation of the HGER reform plan started in September 2019. A little over two years have passed since then. Implementing government agencies are expected to have a system to track the status of reform implementation and to generate data for research. In practice, however, this is not the case. The quality of the data varies from agency to agency. But for the most part, most data are fragmented, incomplete, or old. However, we have attempted to access and use all data that could be accessed. While data on macro-financial reforms come from the National Bank of Ethiopia (NBE) and the Ministry of Finance (MoF), information on structural and sectoral reforms is collected from sectoral agencies such as the Ethiopian Investment Commission (EIC), Ethio-telecom, Ministry of Water and Energy, Maritime Authority and other sector ministries.

(c) Interview

As the data collected was not complete or sufficient, we attempted to supplement it with key informant interviews with implementing agencies (in May 2021).

6. HGER: A Review of Implementation Progress

6.1. Macro-financial

The macro-financial reform pillar targets five key areas - public sector finance, foreign exchange, monetary policy, and the financial sector. The implementing agencies for the macro-financial reforms are the Ministry of Finance and the National Bank of Ethiopia.

Public sector financing reforms. One of the important reforms in public sector financing has been to phase out the provision of credit to the government by the NBE in the form of direct advances. The direct NBE financing of public expenditure contradicts the government's goal of price stability (which is an important macroeconomic goal in the HGER plan). Such a financing arrangement not only undermines the independence of the National Bank of Ethiopia but also creates inflationary pressures on the already high inflation rate in the country. Before the launch

of the HGER, T-bills were only sold to government entities, mainly pension funds and the Development Bank of Ethiopia (DBE). As a result, the yields on T-bills have been extremely low, remaining below 2 percent (Chauffour & Gobezie, 2019). In December 2019, as part of the HGER plan, the Ministry of Finance (MoF) introduced a market-based auction for treasury bills (T-bills), allowing private sector actors to bid. With the introduction of the competitive T-bills, MoF also converted the debt stock from direct advances to a 25-year bond with a 10-year grace period, and the previous stock of T-bills held by the DBE and the pension funds were converted into two-year maturity T-bills. As a result, T-bill yields have increased significantly since competitive auctions began, with the average yield reaching 7.1 percent in March 2020 and 8.1 percent in March 2021. While these are good steps towards transparent and market-based modes of public financing, the T-bill rates remain around the minimum deposit rate (which is 8%) and negative (considering the 20.6 percent headline inflation), and NBE direct advance has not shown a significant decline, suggesting that NBE direct financing is unlikely to be phased out at the end of the three-year reform period. In addition, a recent NBE directive requiring insurance companies to invest at least 40 percent of their assets in T-bills could negatively impact the dynamics of the T-bills auction market (Sanchez Martin, Mulugeta, Getachew, & Wieser, 2021). These challenges need to be addressed in order to anchor the achievements made.

In terms of easing debt distress, while the debt service suspension has yielded a small gain in reducing the debt ratio from 33.2% in 2018 and 29.8% in 2019 to 28.4% in 2020, improving the country's debt sustainability analysis risk rating, however, fundamentally pivots on successful debt treatment under the G20 common framework, significantly improving export earnings, and improving tax revenue mobilization. Overall, we can say that while Ethiopia's budget deficit remains below the 3% reference value set by the Maastricht fiscal rule⁵, it has increased to 2.8% in 2020 and 2.97% in 2021, compared to just before the launch of the HGER (which was 2.5%).

Forex shortages. The forex imbalance problem in Ethiopia has dimensions of exchange rate overvaluation and foreign exchange shortages. Addressing the forex exchange problem requires a comprehensive approach that includes increasing exchange rate flexibility, reducing inflation, strengthening competitiveness, and rebuilding international reserves. While Ethiopia's de facto

⁵ https://ec.europa.eu/info/sites/default/files/2019-09-10-assessment-of-eu-fiscal-rules_en.pdf

exchange rate regime is classified as a managed float by its central bank authorities, the IMF classifies it as crawl-like due to its fairly stable movement and the central bank authorities' intervention policies. There have been several devaluations to bring the birr exchange rate closer to the market rate, but as it is not allowed to adjust freely on its own, the overvaluation usually comes back quickly. The NBE's recent depreciation of the Birr against the USD to reduce the overvaluation of the birr and eliminate the gap between the official and parallel exchange rates has led to real effective exchange rate depreciation. However, the parallel market premium has proved to be persistent. Another crucial step in addressing the foreign exchange imbalance is improving the performance of the export sector. During the year and a half reform period, merchandize export earnings improved significantly (mainly due to increases in gold export). However, the services export declined due to the COVID pandemic. As a result, no significant gain has been achieved in terms of an overall increase in export earnings. The fact that export earnings remain quite low and the exchange rate regime remains unchanged has made addressing the forex imbalance a challenging task. Tackling the weak export sector and increasing the flexibility of the exchange rate regime are the elephants in the room that must be adequately addressed. The HGER's plan to introduce a flexible exchange rate regime has not been implemented. The exchange rate regime in the country remains strictly managed and the capital account is closed (effectively prohibiting the development of secondary markets for stocks and securities). However, there are some groundworks towards the establishment of capital markets – for example, a capital market proclamation was ratified in July 2021, and following that the Ethiopian Capital Market Authority was established in the same year. Overall, foreign exchange reforms have been limited in scope and have shied away from addressing critical issues such as foreign exchange flexibility, and as a result, a significant gap between demand and supply of foreign exchange remains wide, as evidenced by the difference between the official and parallel markets rates.

Financial sector development. The Ethiopian financial sector is highly underdeveloped and characterized by a high level of financial repression, is heavily regulated and remains closed to international actors (Chauffour & Gobezie, 2019; World Bank & International Finance Corporation, 2019). For example, the World Economic Forum's 2019 Global Competitiveness Report ranks Ethiopia 107th out of 140 countries in terms of financial market development; and

the World Bank's 2020 Doing Business report ranks Ethiopia 176th out of 190 economies in the Getting Credit indicator. There are 19 banks in the country but two state-owned banks dominate the financial sector. As a result, access to credit in Ethiopia remains severely restricted. Furthermore, international financial institutions are not allowed to lend money in local currency as the domestic market remains closed by policy. In some cases, international financial institutions may lend money in foreign currency to private sector operators who have the capacity to generate foreign currency. Private businesses that cannot generate foreign exchange do not have access to international sources of finance. The financial sector is one of the targets of the HGER reform. The HGER reforms related to financial development are led by the NBE. The first reform area in the financial sector concerns addressing vulnerabilities at public banks such as the Commercial Bank of Ethiopia and the Development Bank of Ethiopia. These two large public banks have had large NPLs (around 21.2 billion birr), affecting the health of the financial sector. To support this, a Liabilities & Assets Management Corporation (LAMC) was recently established to help with reducing (eliminating) the risk of SOE loans that are not being serviced in the financial sector by setting a ceiling to SOEs domestic borrowing and strengthening the oversight and management of SOEs. The LAMC also generate resources, including from the privatization proceeds, to rebuild the health of the two banks' balance sheet. As of this review report, the corporation is newly established and has not taken significant concrete steps yet. The other reform in the financial sector is the recent elimination of the 27 percent rule to enhance the greater availability of credit for private sector development and growth. However, more profound reforms such as the liberalization of the financial sector appear to have been postponed, as this report found no evidence of reform activities started towards financial sector liberalization.

Monetary reforms. With the objective of price stability, the HGER document planned to cap inflation at a single digit. However, inflation was much higher than the single-digit level envisaged in the HGER plan. For example, inflation was 13.8% (2018), 15.8% (2019) and 25.2% (2020). Food inflation is even slightly higher. In a country where a quarter of the population lives below the poverty line, persistent and rising double-digit inflation has serious consequences, as food spending makes up the bulk of the consumption basket of poorer households, particularly wage earners and retirees whose incomes rarely adjust with inflation. High inflation also raises

the real exchange rate, reducing the competitiveness of exports. Some evidence shows that Ethiopia's inflationary pressures are mainly driven by demand-side factors (such as monetary growth and public sector borrowing), structural factors (such as sluggish agricultural output growth), exchange rate depreciation, and built-in high inflation expectations (Ndikumana, Nkurunziza, Sanchez Martin, Mulugeta, & Getachew Kelbore, 2021).

6.2. Structural Reform

The structural reform of the HGER agenda aims to alleviate structural bottlenecks that limit the productivity and competitiveness of the private sector. Structural reforms have a crosscutting nature but the Ethiopian Investment Commission (EIC), the Ethiopian Maritime Affairs Authority (EMAA) and the Ministry of Water and Energy were the main implementing agencies for many of the structural reforms around the Doing Business Indicator. Let's start with the reforms undertaken by the EIC. To improve Ethiopia's Doing Business ranking, the EIC revised its investment proclamation in 2020. The new proclamation introduced new pro-business articles, including a switch from a positive to a negative listing⁶, the addition of private sector representatives to the Ethiopian Investment Board, and the recognition of intellectual property rights as investments. Also, in 2019, Ethiopia made improvements in starting a business by removing the need to obtain a certificate of competency for certain types of businesses and made the process of obtaining construction permits faster by reducing the time to obtain approval⁷. Ethiopia also made enforcing contracts relatively easier by establishing specialized benches to resolve commercial disputes.

With a view to simplifying cumbersome business processes and tax payment administration, some reforms have been implemented, including the introduction of an electronic single window system (a one-stop service system), the digitalization of some business processes (such as registration & licensing, construction & electricity permits, and e-filing & e-payment of taxes). These reforms help to contribute to less time and money spent on business processes. However, any reforms that are short of liberalizing the sector are unlikely to transform the logistics sector and bring a drastic change in Ethiopia's Doing Business ranking. Ethiopia's Doing Business

⁶ The new investment proclamation (No. 1180/2020) provides three categories of investments, areas reserved exclusively for joint investment with the government, areas reserved exclusively for domestic investors and areas reserved exclusively for joint investment with domestic investors. And the rest is open for everyone.

⁷ Ethiopia Doing Business 2020 Profile (World Bank 2020).

global ranking remained 159th out of 190 countries between 2018 and 2020. This is quite low compared to some comparable sub-Saharan countries, Rwanda ranked 38th (2020), Uganda 116th (2020), Ghana 118th (2020), and Kenya 56th (2020). The reforms that have been implemented in the area of doing business are of limited scope and therefore have not significantly improved the business environment in Ethiopia to encourage investment and private sector participation. Although the HGER plan aspires to liberalize the logistics sector, its full implementation as envisaged in the HGER plan has not yet started. What has typically happened in the telecom sector in terms of opening up to the private sector has not been leveraged in other sectors such as logistics, finance and energy. Since the introduction of a telecom proclamation in 2019, the liberalization process in the telecom sector has progressed well. At least one other operator has been licensed to operate in the Ethiopian telecom market alongside the state-owned Ethio-telecom. But the partial privatization of the state-owned Ethio-telecom was postponed. Opportunities arising from the telecom liberalization and the recently completed Digital Ethiopia 2025 strategy⁸ could be a great springboard for the logistics sector to take off.

6.3. Sectoral Reform

While the sectoral reforms focus on some sector-specific reforms that could enhance the productivity and value addition of the sectors (e.g., agriculture, manufacturing and mining) or unlock new sources of economic growth and job creation (e.g., tourism and digital economy). These reforms attempted to overcome several chronic supply-side constraints to production and productivity, export growth, and job creation. The following are the main sectoral reforms that have been implemented since the launch of the HGER.

Agriculture

The HGER recognizes that agriculture is a key sector, not only to provide food and exports but also that the growth of the industry is highly reliant on a dynamic, rapidly growing agricultural sector that is well integrated with the rest of the economy. The agricultural sector has experienced remarkable growth for more than a decade and a half; however, the sector still depicts some weaknesses that constrain it from fully contributing to the vision of the reform program. Below we highlight some important reforms that have been or are being implemented.

⁸ Digital Ethiopia 2025: A digital strategy for Ethiopia inclusive prosperity (FDRE 2020)

- Agricultural yield levels in Ethiopia remain well below the global average and even below the average in other developing countries. Several factors contribute to the relatively low level of agricultural productivity, but at the top of the list are extremely low levels of mechanization and improved technologies. The low and sub-optimal utilization of agricultural mechanization technologies and improved inputs is mainly attributed to limited technology options, underdeveloped input supply systems and weak advisory services. To ameliorate some of these constraints, the HGER reform introduced the removal of import duties and taxes on agricultural mechanization equipment. This has reduced the cost of importing agricultural mechanization equipment and increased affordability and access for farmers. The second area of reform to improve the limited utilization of improved agricultural inputs and technologies was to encourage private sector participation in the production and distribution of seeds, chemical fertilizers and other agricultural technologies and extension services. The agricultural input supply and distribution are monopolized by the state in Ethiopia. Although the HGER reform document aims to rationalize the role of government and recognizes that significant cost advantages and efficiency gains can be achieved by opening up the sector to private-sector competition, it has not yet been implemented. The public sector continues to dominate, crowding out private sector participation⁹. SOEs involved in these activities have preferential access to land, newly introduced seed varieties, credit guarantees, and foreign exchange.
- The other area of reform in the agricultural sector that has received much attention in recent years and has been included in the HGER reform plan is the intensification of wheat production. The country's demand for wheat has increased with population growth, urbanization, political upheavals (affecting farming areas), inflation, changing consumption patterns (driven by economic growth), and growing investment in food processing factories such as bakeries (Abate, Bernard, Brauw, & Minot, 2018). According to statistics from the Ministry of Agriculture, production has nearly tripled since 2005, and yet about 30% of wheat demand is being met by subsidized government imports. The reform aims to reverse this course by introducing a shift in government

⁹ World Bank Group, Country Private Sector Diagnostic: Creating Markets in Ethiopia – Sustaining Progress Towards Industrialization, 2019, <https://documents1.worldbank.org/curated/en/410541567678527988/pdf/Country-Private-Sector-Diagnostic-Creating-Markets-in-Ethiopia-Sustaining-Progress-Towards-Industrialization.pdf>

policy towards producers with the gradual reduction in subsidized import and distribution of wheat that has depressed domestic prices. To that end, the reform identifies specific areas in Ethiopia where wheat production can be optimized through land-consolidation systems and the use of modern farm equipment. It is currently being implemented and encouraging results have been registered, but until the self-sufficiency target is achieved (which is likely to be beyond the HGER implementation period) wheat import is likely to continue.

Manufacturing

Over the past 15 years, Ethiopia has invested in manufacturing sector development to accelerate its structural transformation. To achieve this, it has built industrial parks and promoted labor-intensive, export-oriented light manufacturing. This has produced some encouraging results in terms of attracting foreign direct investment, including brand manufacturers, into its labor-intensive textile and garment, leather and leather goods sectors. However, Ethiopia's manufacturing sector is still far from being an engine of economic transformation. In 2018/2019, manufacturing, which has been and still is the target of most government incentives and support, contributed about 6.8% to GDP, 24.3% to industrial output, and only 2.9% to employment.

Against this background, the Ministry of Industry has initiated some reforms as part of its HGER reform plan. The first reform concerns the revision of the country's industrial policy, which has been implemented since 2004. The existing industrial policy targets (through channeling sector-level incentives) a few labor-intensive and export-oriented industrial sectors, mainly textile and garment, leather and agro-processing. The sector-level policies and incentive packages have somehow resulted in an unbalanced growth between the upstream and downstream sectors in the country. For example, Ethiopia attracted more garment firms (more than 70 firms in the medium and large category) than textile firms (less than 10 firms). This imbalance is a characteristic feature of many of Ethiopia's priority sectors and remains the main constraint to creating strong supply linkages between large and small firms (Assefa & Gebreeyesus, 2020). The imbalance could be corrected by encouraging new investments in the upper stream sectors by introducing subsector incentive policies and structures. For example, the textile subsector is a skill- and capital-intensive relative to the garment subsector. Shifting from sector-level targeting to subsector-level targeting would allow Ethiopia to target the underdeveloped subsectors such as

yarn and fabric sub-sectors, which is one of the reasons behind the ongoing industrial policy revisions. Second, the industrial policy revision also seeks to broaden the set of subsectors by including adjacent subsectors (i.e., subsectors with a limited share in the country's export basket but with large global market opportunities) and complexity-enhancing subsectors (i.e., subsectors that are more sophisticated and typically higher value-added).

The Ministry of Industry has also initiated the revision and harmonization of the country's investment and export incentive packages. This revision addresses the lack of internal consistency between some industrial incentive packages. For example, investment incentives to attract FDI is found to have adverse effects on local linkage formation. A strong illustration of this is the duty exemption for the import of foreign inputs. The purpose of this incentive is to attract FDI. However, this runs counter to local supplier development, since the low import taxes and duty-drawback incentives put local suppliers at a cost disadvantage compared to imports due to the value-added tax that is levied on their local products. The revision/harmonization of the industrial incentive packages also addresses the problem that incentives are given across the board without strong consideration of performance. The revision seeks to ensure that industrial incentives are performance-based, with clear indicators and clauses for monitoring.

Digital economy

Despite its great potential (with expanding STEM universities in the country, a growing population of ICT graduates and specialized ICT parks), the digital economy in Ethiopia remains highly underdeveloped (Tekleselassie, 2021). Its underdevelopment was particularly exposed by its lack of innovation and response to the COVID pandemic. The underdevelopment of the sector is related to the lack of a dynamic telecom market, which has been absent in Ethiopia. Until 2021, Ethiopia's monopolistic control over the telecom sector limited network expansion and the scope for digital innovation. Consequently, the sector has remained largely untapped with mobile subscriptions just below the sub-Saharan African average (20% versus 28%) and fixed broadband subscriptions at an exceptionally low 0.05 per 100 people (GSMA, 2021). In May 2021, the Ethiopian government awarded a telecoms license to a consortium led by Kenya's Safaricom. This marked the end of Ethiopia's public monopoly in the telecom market and charts a new phase and basis for the development of the country's telecom market and digital economy. To capitalize on these opportunities, the HGER plan began implementing Ethiopia's digital

strategy ‘Digital Ethiopia 2025’ and a newly ratified e-Transactions Proclamation. The implementation of these reform measures, together with the great opportunities created by the liberalization of the telecom market, would lay the foundation for the development of digital services and innovation.

Energy

Despite improvements, the power sector is characterized by low access, quality (reliability), poor financial performance and weak institutional & regulatory frameworks (FDRE, 2019). HGER reform measures for the energy sector include both quick efficiency-enhancing measures (such as the restoration of cost recovery through tariff revisions) and drastic reforms (such as liberalization of the power sector). One of the most important efficiency-enhancing reform measures was the adjustment of electricity prices to a cost-recovery level. The average tariffs have long been below cost recovery, which has impacted the performance of Ethiopia’s state-owned Ethiopian Electric Utility. On the other hand, the HGER’s drastic reform of liberalizing the power market in Ethiopia has not progressed. As in finance and logistics, the government continues to play an outsized role in the energy sector.

7. Conclusions

In the short to medium term, all reform measures combined would help Ethiopia to alleviate its chronic macroeconomic and business environment challenges; realize its untapped markets, and create a private sector-driven economy with greater competition, productivity, and new sectors. In terms of outcomes, while some reform measures have an immediate impact, some reform measures would have an impact in the medium term. In terms of the scope of implementation, some of the reform measures are incremental-efficiency-enhancing (or quick wins) and others are drastic in nature. Our review noted that while reforms of the former type have been implemented effectively, reforms of the latter type have not progressed well.

The macro-financial reforms on public sector financing (e.g., the phasing out of direct finance and the transition to a market-based T-bills auction) and debt sustainability (e.g., introducing stronger oversight of state-owned enterprises as most debt vulnerabilities arise from large borrowing by SOEs) brought improvements in the country’s budget deficit and debt levels.

Limited government access to NBE advances has prompted the government to expand its use of market instruments in the T-bills auction market to meet its domestic public financing needs. On the other hand, the HGER's promise to durably address the foreign exchange shortage by reducing real overvaluation and moving to a more flexible exchange rate regime has not been realized and as a result, the country's foreign exchange shortages remain chronic and persistent. Real depreciation is unlikely to be achieved without transitioning to a more flexible exchange rate regime. Ethiopia continues to strictly manage its foreign exchange regime through its central bank authorities. The lack of a flexible (or market clearing) forex exchange regime impacts the country's external competitiveness, leading to stagnant and less diversified exports (total export not more than US\$3 billion and more than 80% from a few agricultural exports). Other sources such as inflows from donors, privatization receipts and FDI are somehow easing the forex shortages, but the lasting solution depends on the development of the export sector. The foreign exchange shortage in the country is reflected in the large and sustained parallel market premium.

The HGER reforms on SOEs focused on two approaches: strengthening corporate governance and privatization. The establishment of SOE supervisory agency and prudent requirements on their debt levels and cost-recovery tariffs (in the case of energy, for example) helped in strengthening SOEs' corporate governance. The second component and less successful has been the (partial or full) privatization of SOEs in the telecom, energy, sugar, logistics and aviation sectors. The sole privatization process that has shown some progress was the partial privatization of the state-owned Ethio-Telecom. The auction process to sell 40% of the state-owned Ethio-Telecom Company was launched, but suddenly the government recently (in March 2022) announced its postponement. Hence, most SOEs including Ethio-Telecom, the Ethiopian Shipping Lines and Logistics Services Company (logistics sector), the Ethiopian Electric Utility Company (power sector), the Ethiopian Sugar Corporation (sugar sector), the Ethiopian Airlines (aviation sector) and many other SOEs remain in the hands of the government.

The HGER plan is not limited to privatization, but also envisaged market liberalization in the state-controlled sectors of logistics, power, finance and telecom. However, market liberalization has taken place only in the telecom sector. In May 2021, a foreign telecom operator was licensed to operate along with the state-owned Ethio-Telecom Company in the Ethiopian telecom market. This marked the end of Ethiopia's public monopoly in the telecom market. Similar market

liberalizations have not taken place in the other much-anticipated sectors of logistics, finance, power, etc. In the financial sector, there are some early groundworks towards liberalization, such as the development of some necessary regulatory frameworks (including capital market proclamation and regulatory body), and the start of a competitive market-based T-bill auction. The plan to liberalize the financial market can capitalize on these early gains.

The structural reforms on improving the business environment in Ethiopia undertook measures making starting a business easier, digitizing some business processes like licensing and tax payment and the implementation of the Single Electronic Window at the Customs office.

While crosscutting challenges such as the COVID-19 pandemic and conflict affected the implementation of the HGER plan across most reforms, our review found that coordination issues, technical capacity, opposition voices and the government's legacy of retaining control of key sectors have impacted the implementation of the HGER plan in one way or another.

The implementation of some structural reform measures may have been impacted by

- Coordination failures – most of the reform activities in the structural reforms category are multi-agency in nature. The reforms require the coming together of various institutions, including the NBE, Customs, EIC, and the Ministry of Transport. A coordination failure at the implementation level is largely the result of a lack of coordination at the plan level. While the structural reform areas are highly interlinked, the institutions seemed to have planned independently with limited consultation and coordination and consensus on responsibilities and sequencing of activities. This resulted in some reform activities being delayed and some not being implemented.
- Based on feedback from the implementing agencies, the bureaucratic capacity was identified as a challenge for implementing the HGER plan. The main HGER document provides only broad reform areas. Detailed plans are left to be worked out by the implementing agencies. However, implementing agencies lack the technical capacity at senior and middle levels to understand the reform areas and concretize them into an action plan with the necessary resources.

- Many of the fundamental reform areas in the structural reform were delayed or postponed. For example, not much progress has been made in the liberalization of key sectors such as logistics, energy, and finance. Although the opening up of these sectors was long overdue and they constitute the bulk of the reform, the plan to liberalize them appears to have been delayed or postponed. Two main reasons could be behind this: first, the government's interest in continuing to control strategic sectors as an instrument of political and economic influence; and the second reason may be related to political economy constraints linked to domestic opposition to reforms by various interest groups, including opposition parties, industry associations, and chamber of commerce. Some opposition parties such as the Ethiopian Citizens for Social Justice Party strongly opposed and petitioned against the partial privatization of the state-owned Ethio-Telecom, arguing that privatization would not bring efficiency gains¹⁰. The other resistance comes from the need for protectionism by industry associations and affiliates who want to remain protected from external competition. These protectionist groups justify their opposition on grounds of incapability to compete with foreign firms.

¹⁰ <https://addisfortune.news/opposition-party-decries-ethio-telecom-privatisation/>

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