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Acronyms

AfDB	African Development Bank
CBI	Centre for the Promotion of Imports from Developing Countries
cmp	Current Market Prices
CSA	Central Statistical Agency
DBE	Development Bank of Ethiopia
EDRI	Ethiopian Development Research Institute
EIA	Ethiopian Investment Agency
ERCA	Ethiopian Revenues and Customs Authority
ESF	Exogenous Shocks Facility
EU	European Union
FDI	Foreign Direct Investment
fob	Free on Board
GDI	Gross Domestic Investment
GDP	Gross Domestic Product
GNI	Gross National Income
GRIPS	Japanese National Graduate Institute for Policy Studies
IDA	International Development Association
IMF	International Monetary Fund
MDG	Millennium Development Goal
MoARD	Ministry of Agriculture and Rural Development
MoFED	Ministry of Finance and Economic Development
MoTI	Ministry of Trade and Industry
NBE	National Bank of Ethiopia
NEER	Nominal Effective Exchange Rate
ODI	Overseas Development Institute
OSF	Oil Stabilization Fund
REER	Real Effective Exchange Rate
SDR	Special Drawing Rights
Sida	Swedish International Development Agency
UK	United Kingdom
UN	United Nations
UNDP	UN Development Program
US	United States
VAT	Value Added Tax

Abstract

This study sought to investigate the channels through which the financial crisis has transmitted its effects in Ethiopia, the effects of the crisis on growth and development, policy responses that have been put in place and whether the country is well placed to respond effectively to crisis in the future.

A mix of both secondary and primary data was used to assess the impact. To see the level, direction and trend of the impact of the crisis, we used before and after comparisons. Among other things, the study identified foreign direct investment (FDI), trade, remittances and aid as channels through which the crisis transmitted its effects. After the crisis hit, it was observed that FDI, remittances, export volumes and export prices declined. The decline in exports and remittances led the government to ration foreign exchange, with a resultant decline in imports. Accordingly, gross domestic investment declined from about 24% of GDP in the past four years to 20.3% in 2008/09. Tax revenue and government expenditure also declined in 2008/09. With regard to impacts on imports, tax revenue and government expenditure, a decline in overall growth would be expected. Despite the Ethiopian government estimating real growth of GDP in 2008/09 at 11.2%, overall growth is estimated to have been as low as 7.5% (IMF, 2009b) and 6% (World Bank, 2009).[3] This estimated decline in growth and the observed decline in public expenditure and private consumption resulting from the crisis are expected to have increased incidence of poverty.

3 Actual growth performance of the Ethiopian economy for 2008/09 is yet to be reported.

1. Introduction

The financial crisis was generated by the crisis in the real estate market, initially triggered by the sub-prime mortgage crisis in the US in mid-2007.[4] The crisis transformed itself into a global financial crisis, most likely in September 2008,[5] hitting major developed countries in particular. Evidence has shown that the crisis has inflicted severe effects on the world's economy in general.

The credit crunch, a by-product of the crisis, is causing reductions in consumption, investment and trade, fuelled by uncertainty and falling consumer confidence (UNDP, 2009). Other key features of the crisis include contraction of gross domestic product (GDP), declining global demand and commodity prices, stock markets falls, depreciation of most African currencies, declining rates of economic growth, global layoffs and activity shutdowns, worsening of fiscal and current account balances in most African countries, declines in remittances, reductions in foreign aid, declines in tourist flow and declines in foreign direct investment (FDI) (AfDB, 2009d; te Velde, 2008; te Velde et al., 2009; UNDP, 2009).

The Ethiopian economy is fairly open, import intensive and aid dependent. Naturally, this makes it vulnerable to the crisis. The economy has already started to feel the negative impacts in the form of reduced export prices, quantities and hence values, reduced remittances and declining FDI inflows. Together, these factors and others have exposed the economy to foreign exchange constraints, with a significant impact on import volumes. How Ethiopia will perform during the crisis period will depend on several factors, such as the severity and duration of the crisis and, above all, the quality of the policies that policymakers implement to cope with the negative effects.

Although the impacts of the crisis have been apparent in Ethiopia, understanding the transmission belts, growth and development effects, the challenges facing the government and coping strategies has not yet been investigated adequately. Such crucial issues need further investigation. This study intends to fill these important research and development gaps.

Because of the nature of the subject, that is, in progress and unfolding, the study relies on intensive usage of web-based information, reports by international and regional organisations and other relevant literature. Data sources include secondary data collected from the National Bank of Ethiopia (NBE), the Ministry of Finance and Economic Development (MoFED), the Ethiopian Revenues and Customs Authority (ECRA), the Ethiopian Investment Agency (EIA) and other relevant agencies.[6] By looking at the integration of the Ethiopian economy with the rest of the world, as allowed by available data, we have identified four transmission channels through which the impact of the crisis has spread. These are FDI, remittances, trade and foreign aid. In order to see the level, direction and trend of the crisis impacts, we use before and after comparisons.

However, it should be noted that, given the various events that have taken place concomitantly, with similar impacts, assessing the impact of the crisis is not likely to be easy. Prior to the crisis, Ethiopia, along with many other developing countries, faced a significant food and oil price increase. In addition, the government has rationed power during the crisis (owing to a shortage of water) to households and small businesses, with a complete cut-off to big industries. This raises questions about the methodology and its ability to disentangle effects related to the crisis from those arising as a result of other events taking place within the same period.

4 The sub-prime mortgage crisis led to credit crunch, affecting the general availability of credit to non-housing-related business and to larger financial institutions not directly connected with mortgage lending.

5 In September 2008, when news about failure, merger or in some cases conservatorship of large US-based financial firms echoed from media to media. The first bell rang on 7 September 2008, when two US government-sponsored enterprises, Fannie Mae and Freddie Mac, went into conservatorship by the Federal Housing Finance Agency (Torbat, 2008).

6 For the main building blocks of the study methodology, see Annex 1.

The paper is structured as follows. Section 2 analyses the key transmission mechanisms of the effects of the crisis into the economy, focusing on the export sector, remittances, foreign aid and private capital flows. Section 3 discusses and assesses the impacts of the crisis on growth and development, in terms of national-level growth, investment and employment, sectoral-level effects, fiscal effects and poverty and distributional effects. Section 4 analyses various policies put in place to cope with the crisis. To this end, this section critically reviews macroeconomic policies devised to manage the impact of the crisis, social policies put in place to respond to the impact of the crisis and economy-wide and sectoral structural policies designed to get the country out of the crisis. It also examines multilateral and bilateral donor responses in-country. Section 5 summarises the paper and tries to shed some light on how well Ethiopia is positioned to gain from a future recovery and to grow sustainably.

2. Effects of the global financial crisis: Key transmission mechanisms

With over 80% of its population with little access to banking and financial services, the Ethiopian economy is one of the least monetised in the world. In addition, there is no stock market and there are no foreign investors in the financial sector. In this context, the country's degree of financial integration with the rest of the world is poor. Therefore, one might expect no stock market financial contagion and no major impacts through the financial transmission channel. Keeping these stylised facts in mind, it may be tempting to say that Ethiopia has little to fear from the current crisis. In line with this thinking, the Prime Minister told Parliament that 'in general, we don't expect drastic effects on our economy, our financial structure is not as liberalised as those of affected countries and the economy is not intertwined to Western economies to face a crisis' (in Teshome, 2008).

2.1 Private capital flows

There seems to be a consensus that FDI brings a great many advantages to the recipient economy, particularly in terms of infusing best practices in corporate governance, accounting rules and legal traditions; transferring technology; promoting competition in domestic input markets; penetrating international markets; contributing to corporate tax revenues; and so on.

In Ethiopia, following the change in the political regime in 1991, there was a policy shift from a command economy towards a market-based economy. As a result, over time the volume of private capital flows has been growing significantly. In spite of this growing trend, data on the amount of private capital flows into Ethiopia are not reliable and consistent. In our analysis, we focus only on FDI inflows, using two main sources to record their trends: 1) the database provided by the EIA, which is not amenable to all the analysis we are trying to make; and 2) the rough estimates generated by the NBE on the basis of estimated unreported cash imports.

FDI flows increased from a mere $81.4 million in 2001 to as high as $951.5 million in 2008. This is an increase of nearly 12 times in eight years (Table 1). The increase has been not only in absolute terms: FDI flows have also increased relative to GDP, exhibiting a consistent increase from 0.8% in 2002/03 to 3.1% in 2007/08 (Table 2). The importance of FDI in the Ethiopian economy and the linkage/integration of the economy with the rest of the world through FDI are clear. This implies that any movement in FDI will have a systematic impact on the economy, depending on the volume and direction of change.

Table 1: FDI flows, 2001-2009 (US$ millions)

2001	2002	2003	2004	2005	2006	2007	2008	2009Q1 and Q2
81.4	82.9	84.5	156.0	275.7	402.5	664.0	951.5	388.4

Source: NBE data.

Table 2: FDI flows, 2000/01-2008/09[7]

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
FDI (US$m)	66.0	97.0	69.0	100.0	212.0	365.1	516.4	814.6	880.1
GDP, current market prices (US$m)	8166.5	7770.7	8572.2	10076.5	12327.4	15185.8	19746.8	27171.9	33922.7
FDI/GDP	0.8	1.2	0.8	1.0	1.7	2.4	2.6	3.0	2.6

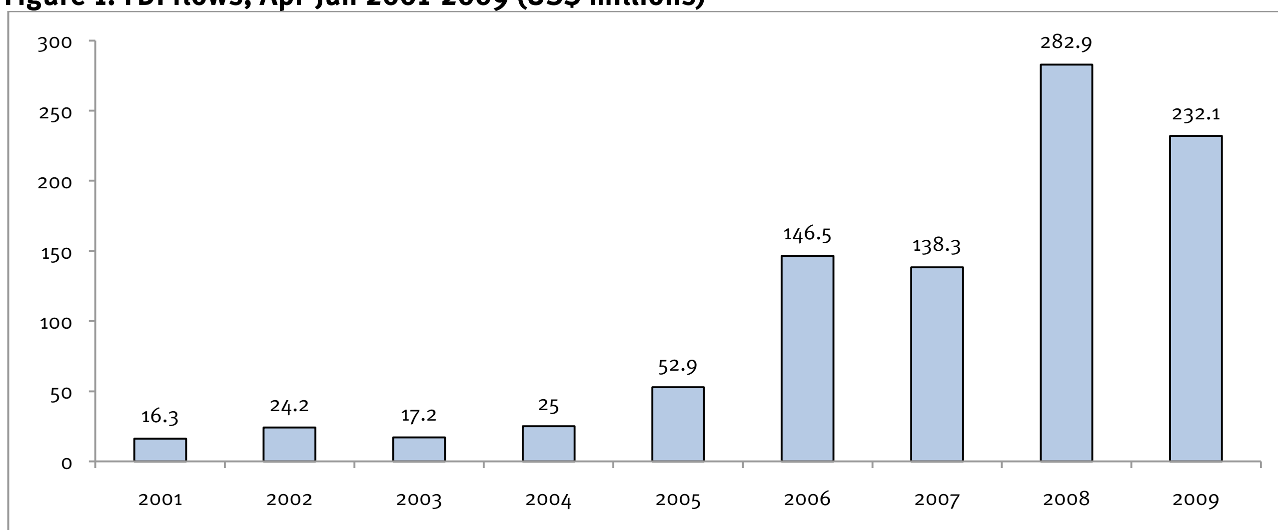
Source: NBE and MoFED data.

7 GDP data are available only for the Ethiopian fiscal year, which runs from 8 July to 7 July.

Following the crisis, particularly after September 2008, FDI inflows are expected to have declined. A decline in consumption and world demand, fuelled by uncertainty, is causing reductions in investment and trade, which will be manifested by reductions in FDI. The major sources of FDI, such as the US, Germany, the UK and France, have been hit by the crisis and the resultant liquidity shortfall in banks, and investors of these countries are expected to reduce FDI inflows to Ethiopia.[8] Data obtained from the EIA show that approved investment projects in 2009 (only the first nine months) sharply declined when compared with 2008. For instance, FDI from the US approved in 2008 was worth $428.2 million. This declined to $166.6 million in 2009. The same is true for the UK, showing a decline from $417 million to $42.1 million in the same years. FDI projects approved from Germany declined from $613 million in 2008 to $66.8 million in 2009.

As seen in Table 2 above, FDI as a share of GDP declined to 2.8% in 2008/09. As such, the consistent increase in FDI relative to GDP that has characterised the past six years was suddenly discontinued in the 2008/09 fiscal year. Significant changes were observed in late 2008 and in 2009. Looking at quarterly flows of FDI in 2009 and comparing this with the same quarters in previous years gives us a clearer picture. Figure 1 shows this for the second quarter of each calendar year.

Figure 1: FDI flows, Apr-Jun 2001-2009 (US$ millions)

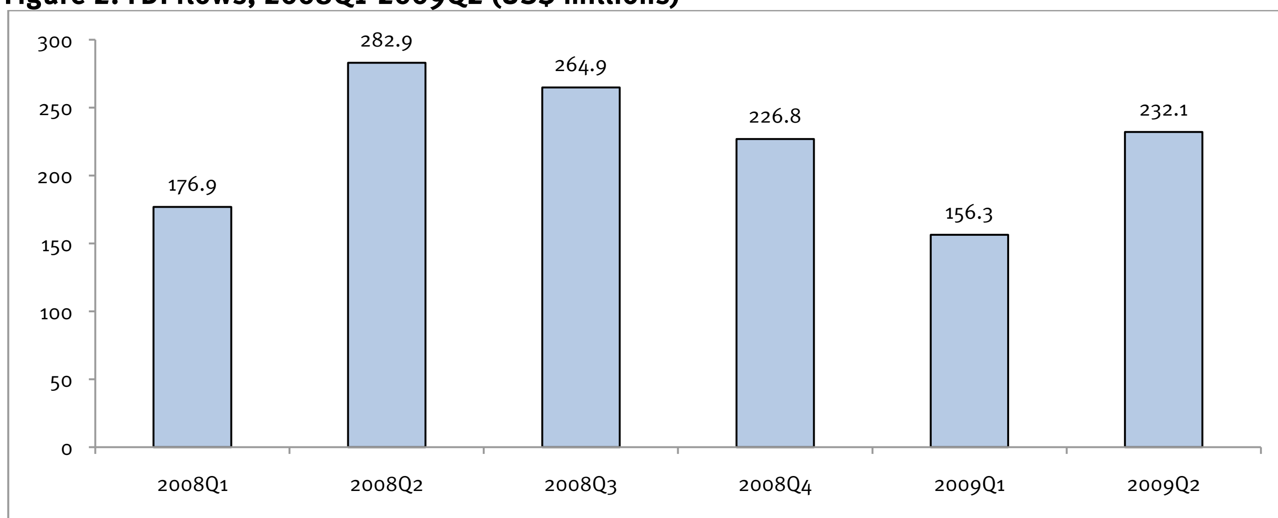


Source: NBE data.

As can be observed from Figure 1, and as one would expect under normal circumstances, there was an absolute decline in FDI flows in 2009. In comparison with 2008, FDI flows in the second quarter of 2009 declined by $50.8 million (-18%). When we compare FDI flows in the first quarter of 2009 with that of the first quarter of 2008 (Figure 2), we also find an absolute decline, but only of $20.6 million (-11.6%).

8 The World Bank (2009) has also reported that the crisis has begun to cut FDI inflows to developing countries since the crisis. Although Africa receives only 4% of total FDI, it has also shown a declining trend.

Figure 2: FDI flows, 2008Q1-2009Q2 (US$ millions)



Source: NBE data.

One important feature worth noting in the quarterly flows of FDI is the recovery in the second quarter of 2009. Starting from the second quarter of 2008, there was a sharp decrease in FDI inflows up to the first quarter of 2009. FDI flows were down by 6.4% in the third quarter of 2008 compared with the second quarter of the year. The decline increased to 14.4% in the fourth quarter of 2008 and reached a record level in the first quarter of 2009 (-31.1%). However, the decline discontinued in the second quarter of 2009, when FDI inflows exhibited a recovery (Figure 2). This trend is reflective of and in line with the recovery of most developed countries from the crisis.

Looking at the decline in FDI by sector, information from the EIA shows that the share of agriculture from all FDI projects approved in the first eight months of 2009 had declined by 15.5% relative to its share in the 2008. On the other hand, manufacturing's share had increased by 24.1%.

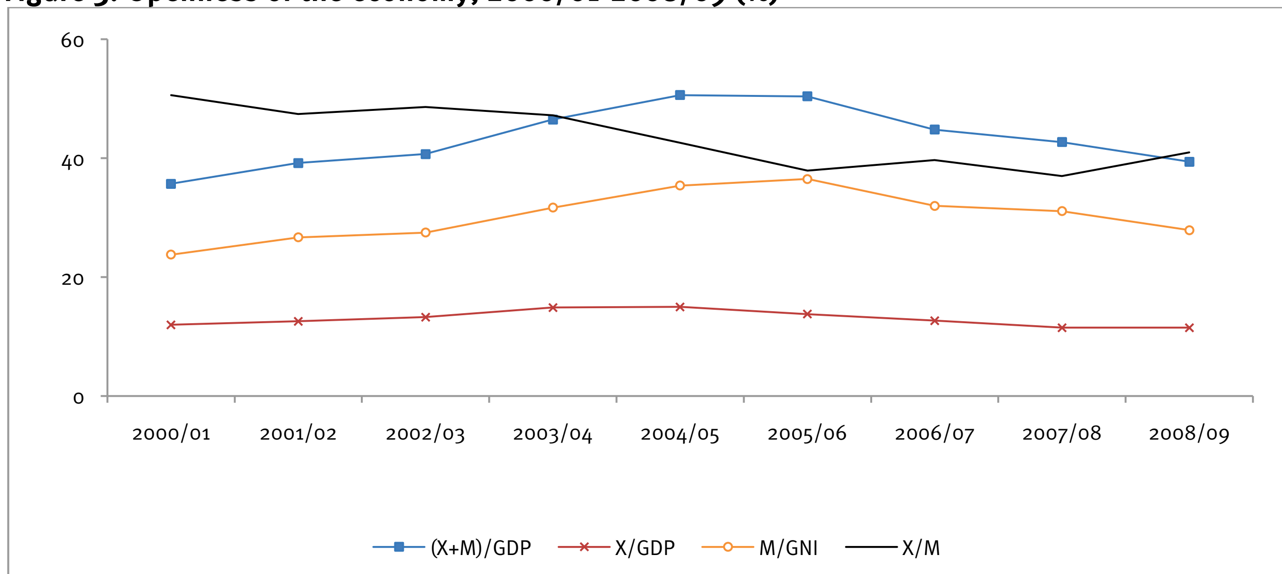
Unavailability of data on international bank lending limits our analysis to FDI.[9] One important note, however, is that the Ethiopian Electric Power Corporation, the only provider of electricity in Ethiopia, has indicated that its investment plans will be severely affected as a result of the crisis. According to the Chief Executive Officer, giant international banks, such as Morgan ING and others, have started to invest in the power sector in Ethiopia. Since these banks are affected by the market turmoil, the corporation expects a knock-on effect: a reduction in investment (Teshome, 2008).

2.2 Trade

The level of trade (export + import) relative to GDP will show the degree of integration of the economy with the rest of the world. As can be observed from Figure 3, the openness of the economy increased consistently, from 35.7% in 2000/01 to 50.6% in 2004/05 and 50.4% in 2005/06. Then it started to decline, with the lowest recorded being 39.4% in 2008/09. In this regard, the country is well integrated with the rest of the world and hence more vulnerable to external shocks.

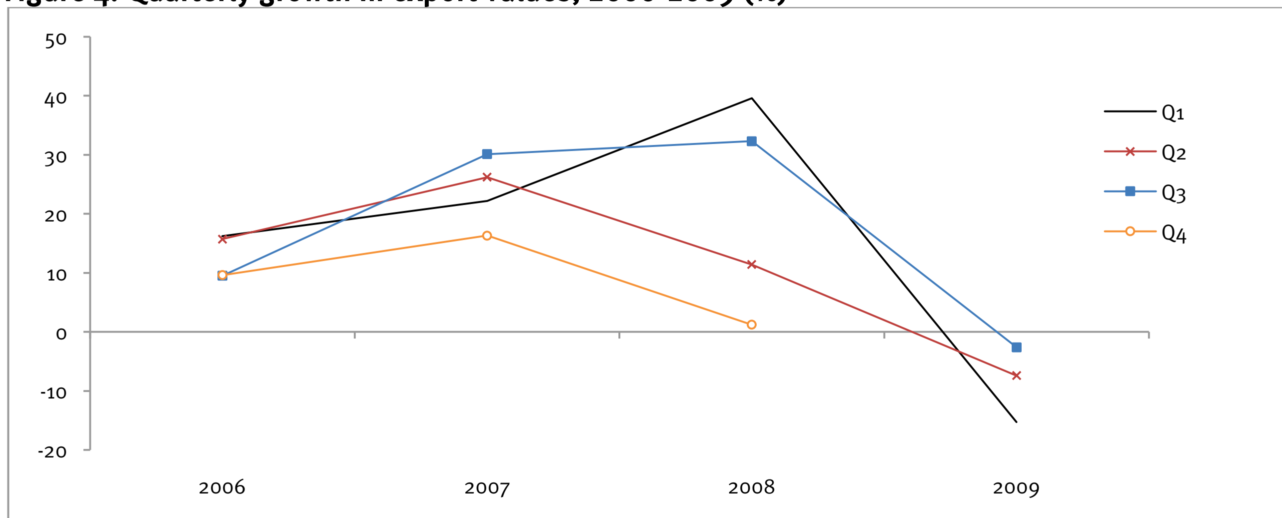
9 It should be noted that there is no portfolio investment data, as there is no stock market in Ethiopia and there are no foreign-owned banks: the financial sector is reserved by policy for local investors and government.

Figure 3: Openness of the economy, 2000/01-2008/09 (%)



Note: X = exports; M = imports; GNI = gross national income.
Source: Annex 2.

Figure 4: Quarterly growth in export values, 2006-2009 (%)



Source: Annex 3.

It can thus be argued that, of the different transmission channels through which the crisis has transmitted its effects into the economy, the decline in trade flows has been the major one. Although the decline is in both imports and exports of goods, the decline in exports has been greater and has led to a significant decline in imports owing to foreign exchange constraints. Values of exports declined from 23.7% in 2007/08 to -1.2% in 2008/09, whereas those of imports declined from 32.8% to 12.8% for the same period (Table 3).

Table 3: Balance of payments, 2000/01-2008/09 (US$ millions)

		2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
1	Exports fob	463	452	483	600	847	1000	1185	1466	1448
2	Imports	1557	1696	1856	2587	3633	4593	5127	6811	7684
3	Trade balance (1-2)	-1094	-1243	-1374	-1986	-2786	-3592	-3942	-5345	-6236
4	Services net	107	112	142	246	268	148	191	159	392
	Non-factor services, net	138	155	169	310	277	149	161	126	419
	Exports of non-factor services	516	530	657	898	1011	1097	1301	1597	1934
	Imports of non-factor services	378	375	488	588	734	948	1140	1472	1514
	Income, net	-23	-29	-15	-39	-9	-1	30	33	-28
	Of which gross official international payment	42	41	32	40	25	25	12	18	22
	Dividend	-8	-14	-12	-25	-22	-29	-17	-13	-24
5	Private transfers	445	446	564	771	1023	1226	1696	2393	2643
6	Current account balance (3+4+5)	-542	-686	-667	-969	-1495	-2218	-2055	-2793	-3202
7	Official transfers	395	435	600	567	750	866	1199	1306	1680
8	Current account balance including official transfers (6+7)	-147	-251	-67	-402	-745	-1352	-856	-1487	-1522
9	Capital account	422	694	468	572	642	634	780	1103	1718
	Official long-term capital, net	231	518	410	258	304	300	340	378	806
	Other pubic long-term capital	-14	19	-4	190	193	-7	0	0	0
	FDI (net)	178	149	123	150	150	365	482	815	880
	Short-term capital	26	8	-61	-26	-6	-24	-42	-89	32
10	Errors and omissions	-316	-36	-63	98	199	510	161	121	181
11	**Overall balance (8+9+10)**	**-41**	**407**	**337**	**268**	**95**	**-208**	**85**	**-263**	**377**
	Growth rate in export goods (%)		-2.3	6.7	24.4	41.1	18.1	18.5	23.7	-1.2
	Growth rate in import goods (%)		8.9	9.5	39.3	40.4	26.4	11.6	32.8	12.8

Source: NBE data.

Exports of goods have registered remarkable growth in the recent past. Export proceeds grew at an average annual rate of 19.3% in 2005-2008 (Table 4). The increase in commodity prices and volume of exports contributed to the observed export performance. However, this momentum failed to continue after the crisis hit, when export values started to decline. The growth rate of export values calculated from the current quarter compared with the same quarter of the previous year increased consistently above 10% before the crisis (see Table 4 and Figure 4). The growth rate decelerated immediately after the crisis to only 1.2% in the fourth quarter of 2008. As the financial crisis deepened, the growth rate further decelerated – a decline of 15.3% in the first quarter of 2009. In the second and third quarters of 2009 there were signs of recovery: -7.4% in the second quarter and only -2.6% in the third quarter of 2009.Aggregate growth of exports, as such, may conceal various processes. The pattern of the aggregate rate of growth is dictated by the contribution of each commodity (share and variability).

Table 4: Growth rates by major export commodities, 2006-2009 (%)

		Coffee	Oil seeds and pulses	Flowers	Gold	Chat	Leather	Others	Total
2006	Q1	5.4	50.6	209.0	-54.2	8.5	20.0	-1.1	**16.2**
	Q2	11.7	-7.9	121.0	251.1	2.3	23.0	-9.7	**15.7**
	Q3	49.0	-18.1	199.1	-4.8	-8.5	4.4	-24.1	**9.5**
	Q4	94.0	-34.1	250.0	-2.9	-3.3	43.2	-10.1	**9.6**
	Annual	25.4	-2.7	198.2	44.7	-0.7	22.4	-10.9	**13.2**
2007	Q1	10.0	12.8	171.1	127.4	19.1	21.5	33.1	**22.2**
	Q2	-1.8	57.2	180.4	73.2	11.0	12.6	50.6	**26.2**
	Q3	1.6	79.5	173.6	45.7	23.7	15.5	36.8	**30.1**
	Q4	-22.6	36.3	66.5	19.8	34.9	28.4	22.8	**16.3**
	Annual	-1.6	38.3	132.5	62.3	22.0	19.6	34.0	**23.7**
2008	Q1	73.4	38.0	46.6	41.8	2.4	3.0	-1.0	**39.6**
	Q2	21.3	30.3	79.6	-46.3	9.2	-1.1	3.9	**11.4**
	Q3	44.3	12.9	34.7	33.6	23.7	24.6	42.5	**32.3**
	Q4	-20.7	18.7	20.0	27.7	19.4	-2.1	-21.5	**1.2**
	Annual	35.1	27.0	43.9	-15.5	14.0	4.9	2.2	**21.1**
2009	Q1	-60.4	17.5	17.4	59.0	45.5	-52.1	11.2	**-15.3**
	Q2	-33.4	39.5	4.3	2.9	25.2	-61.2	-14.7	**-7.4**
	Q3	-21.5	8.1	29.9	48.6	38.3	-55.7	-2.2	**-2.6**

Source: Annex 3.

Table 5: Share of major commodity exports in total exports of goods, 2005-2009 (%)

		Coffee	Oil seeds and pulses	Flowers	Gold	Chat	Leather	Others
2005	Q1	39.9	24.3	1.1	4.4	8.1	6.7	15.5
	Q2	50.1	19.7	1.1	3.7	7.9	6.7	10.8
	Q3	32.7	21.5	1.3	5.1	12.6	9.0	17.9
	Q4	16.7	33.2	2.0	6.5	10.5	7.5	23.6
	Annual	36.3	24.3	1.3	4.8	9.5	7.4	16.4
2006	Q1	36.2	31.5	3.0	1.7	7.5	6.9	13.2
	Q2	48.4	15.7	2.1	11.3	6.9	7.1	8.4
	Q3	44.5	16.1	3.6	4.4	10.5	8.6	12.4
	Q4	29.5	19.9	6.3	5.8	9.3	9.9	19.4
	Annual	40.2	20.9	3.6	6.2	8.3	8.0	12.9
2007	Q1	32.6	29.1	6.6	3.2	7.3	6.9	14.4
	Q2	37.6	19.5	4.8	15.5	6.1	6.4	10.1
	Q3	34.7	22.2	7.5	4.9	10.0	7.6	13.0
	Q4	19.6	23.3	9.0	5.9	10.8	10.9	20.5
	Annual	32.0	23.4	6.7	8.1	8.2	7.7	14.0
2008	Q1	40.5	28.7	6.9	3.3	5.4	5.1	10.2
	Q2	41.0	22.8	7.7	7.5	6.0	5.6	9.4
	Q3	37.9	18.9	7.6	5.0	9.4	7.2	14.0
	Q4	15.4	27.4	10.6	7.5	12.7	10.5	15.9
	Annual	35.7	24.5	7.9	5.6	7.7	6.7	11.8
2009	Q1	18.9	39.9	9.6	6.2	9.2	2.9	13.4
	Q2	29.5	34.4	8.7	8.3	8.1	2.4	8.7
	Q3	30.6	21.0	10.2	7.6	13.3	3.3	14.1

Source: Annex 3.

Total value of export is the sum of each commodity value. By considering major commodities and the rest as others, total export value TEV is given by:

$$TEX_t=CF_t+OSP_t+F_t+G_t+CH_t+L_t+O_t \qquad (1)$$

where CF, OSP, F, G, CH, L and O stand for coffee, oils seeds and pulses, flowers, gold, chat, leather and related and others and the subscript t stands for time.

The contribution of each commodity to the overall growth of export value depends not only on their share but also on their variability. By differentiating Equation 1, we can incorporate these two elements as follows:

$$\frac{TEX_t - TEX_{t-1}}{TEX_{t-1}} = (\frac{CF_t - CF_{t-1}}{CF_{t-1}})(\frac{CF_{t-1}}{TEX_{t-1}}) + (\frac{OSP_t - OSP_{t-1}}{OSP_{t-1}})(\frac{OSP_{t-1}}{TEX_{t-1}}) + (\frac{F_t - F_{t-1}}{F_{t-1}})(\frac{F_{t-1}}{TEX_{t-1}}) + (\frac{G_t - G_{t-1}}{G_{t-1}})(\frac{G_{t-1}}{TEX_{t-1}}) + (\frac{CH_t - CH_{t-1}}{CH_{t-1}})(\frac{CH_{t-1}}{TEX_{t-1}}) + (\frac{L_t - L_{t-1}}{L_{t-1}})(\frac{L_{t-1}}{TEX_{t-1}}) + (\frac{O_t - O_{t-1}}{O_{t-1}})(\frac{O_{t-1}}{TEX_{t-1}}) \quad (2)$$

By applying this to the total quarterly export value, we arrive at the data summarised in Table 6.

Table 6: Major commodity contributions to growth rate of total export values, 2006-2009 (%)

		Coffee	Oil seeds and pulses	Flowers	Gold	Chat	Leather	Others	Total growth
Q1	2006	2.1	12.3	2.3	-2.4	0.7	1.3	-0.2	16.2
	2007	3.6	4.0	5.1	2.2	1.4	1.5	4.4	22.2
	2008	23.9	11.0	3.1	1.4	0.2	0.2	-0.1	39.6
	2009	-24.5	5.0	1.2	1.9	2.4	-2.6	1.1	-15.3
Q2	2006	5.9	-1.5	1.4	9.3	0.2	1.5	-1.0	15.7
	2007	-0.9	9.0	3.9	8.3	0.8	0.9	4.3	26.2
	2008	8.0	5.9	3.8	-7.2	0.6	-0.1	0.4	11.4
	2009	-13.7	9.0	0.3	0.2	1.5	-3.5	-1.4	-7.4
Q3	2006	16.0	-3.9	2.6	-0.2	-1.1	0.4	-4.3	9.5
	2007	0.7	12.8	6.2	2.0	2.5	1.3	4.6	30.1
	2008	15.4	2.9	2.6	1.7	2.4	1.9	5.5	32.3
	2009	-8.1	1.5	2.3	2.4	3.6	-4.0	-0.3	-2.6
Q4	2006	15.7	-11.3	4.9	-0.2	-0.3	3.3	-2.4	9.6
	2007	-6.7	7.2	4.2	1.1	3.2	2.8	4.4	16.3
	2008	-4.1	4.4	1.8	1.6	2.1	-0.2	-4.4	1.2

Note: Calculated from values in US dollars.
Source: Calculated from Annex 3.

As shown in Table 6, coffee is the single most important export commodity dictating the decline in total export value. This is because of its largest share and high variability. As can be observed from Table 7, the value, volume and unit price of coffee exports declined in 2009 when compared with the same quarter of 2008. The second, third and fourth contributors to the deceleration in export growth are oilseeds and pulses, leather and flowers (to a different degree in each quarter, of course – Table 6).

The global financial crisis impinges on Ethiopian exports through weakening demand caused by recession in developed countries, the major destination of Ethiopian exports. In the third quarter of 2006, 53.0% of Ethiopian exports were destined for Europe, the US and Japan. Looking at specific commodity exports, 77% of coffee (49% Europe, 5% US and 23.3% Japan), 61.9% of leather and leather products (including skins), 95.9% of flowers and 20.4% of oilseeds and pulses were exported to these areas in the period. These exports comprised 72.7% of the country's total exports. In the third quarter of 2009, 48.8% of Ethiopian exports were destined for Europe, the US and Japan. Looking at specific commodity exports, 71.8% of coffee (59.3% Europe, 10% US and 2.6% Japan), 63.7% of leather and leather products (including skins), 97.4% of flowers and 21.0% of oilseeds and pulses were exported to these areas in the period.[10] These exports comprised 65% of the country's total exports. There are two implications here: contraction in the volume of exports and deterioration in their prices.

If quarterly export volumes are compared with the same quarter of the previous year, it is possible to observe a decline in the volume of major commodities (Table 7). The volume of coffee declined by 15%, 53.5%, 19.78% and 19.77% during 2008Q4, 2009Q1, 2009Q2 and 2009Q3, respectively. Accordingly, the foreign exchange generated from coffee indicated comparable declines of 20.6%, 60.4%, 33.4%

10 In both periods, Japan did not import oilseeds and pulses.

and 21.4%. The volume of leather and related exports also exhibited a declining trend in the period. A lesser impact is expected to seen in commodities like *chat* and live animals (both accounted for 18.5% of total export proceeds in 2009Q3). This is because these commodities are usually destined for countries in Africa (which accounts for 90.9% of *chat* and 52.2% of live animals) and Asia (2.8% of *chat* and 49.8% of live animals) where, at least in the short run, the impact of the financial crisis has not been as critical as in developed countries.

Table 7: Value (US$ millions), volume ('000 metric tonnes) and unit price of exports, 2005-2009

		Coffee			Leather and related			Flowers			Live animals			Chat		
		Val.	Vol.	Price ($/ kg)	Val.	Vol.	Unit price	Val.	Vol.	Unit price	Val.	Vol.	Unit price	Val.	Vol.	Unit price
2005	Q1	95.48	44.02	2.17	15.97	4.07	3.92	2.66	0.84	3.19	3.63	7.72	0.47	19.28	4.83	3.99
	Q2	141.10	58.24	2.42	18.84	3.72	5.06	3.16	1.21	2.62	5.78	7.86	0.73	22.10	5.50	4.02
	Q3	61.03	25.65	2.38	16.84	3.52	4.78	2.43	0.90	2.71	5.86	5.93	0.99	23.49	5.96	3.94
	Q4	35.02	15.79	2.22	15.83	3.03	5.23	4.12	1.30	3.18	8.70	10.97	0.79	22.07	5.14	4.29
2006	Q1	100.61	40.41	2.49	19.17	3.76	5.09	8.23	1.97	4.19	7.74	8.84	0.88	20.91	5.09	4.11
	Q2	157.60	65.87	2.39	23.18	5.08	4.56	6.99	2.10	3.33	5.27	7.56	0.70	22.61	6.07	3.72
	Q3	90.94	41.38	2.20	17.57	3.87	4.54	7.27	1.54	4.71	7.96	9.93	0.80	21.50	5.37	4.01
	Q4	67.92	30.20	2.25	22.67	3.90	5.81	14.41	3.33	4.32	11.16	12.56	0.89	21.34	4.97	4.29
2007	Q1	110.67	42.62	2.60	23.30	3.81	6.12	22.32	4.35	5.13	10.55	12.19	0.87	24.88	6.03	4.13
	Q2	154.66	62.24	2.48	26.05	4.19	6.21	19.62	4.37	4.48	7.09	8.99	0.79	25.09	6.30	3.98
	Q3	92.38	33.96	2.72	20.32	3.42	5.95	19.90	4.39	4.53	7.80	8.74	0.89	26.57	6.44	4.12
	Q4	52.56	17.87	2.94	29.08	4.49	6.48	23.96	4.81	4.98	16.12	15.04	1.07	28.76	5.84	4.93
2008	Q1	191.90	61.08	3.14	24.02	3.78	6.35	32.72	6.06	5.40	8.25	8.77	0.94	25.53	5.01	5.10
	Q2	187.65	57.84	3.24	25.78	3.23	7.97	35.17	7.13	4.93	8.69	7.42	1.17	27.44	5.12	5.36
	Q3	133.29	44.00	3.03	25.29	2.92	8.65	26.78	5.56	4.82	15.72	11.72	1.34	32.94	6.49	5.07
	Q4	41.71	15.19	2.75	28.48	3.34	8.53	28.82	6.63	4.35	16.85	11.39	1.48	34.39	6.75	5.09
2009	Q1	75.91	28.41	2.67	11.54	0.61	18.86	38.35	8.80	4.36	12.07	7.98	1.51	37.12	6.31	5.88
	Q2	124.96	46.40	2.69	9.95	0.42	23.87	36.74	8.17	4.50	8.04	5.64	1.42	34.27	5.84	5.87
	Q3	104.70	35.32	2.96	11.21	0.57	19.78	34.83	7.30	4.77	17.64	13.71	1.29	45.48	7.78	5.84

Source: ERCA data.

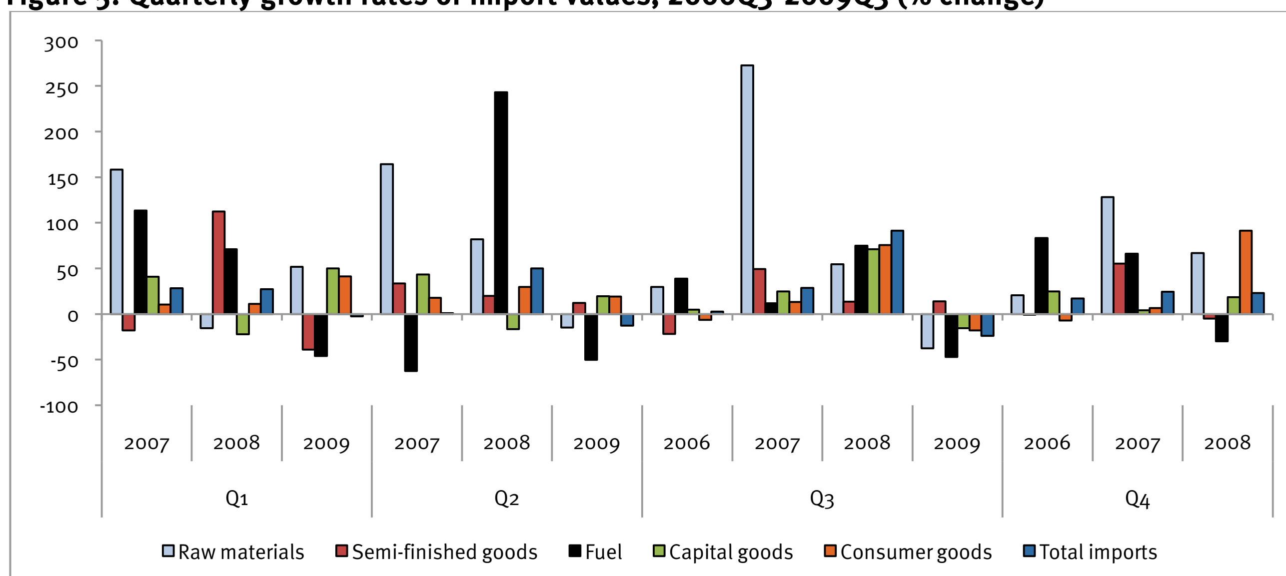
Concerning prices, since Ethiopian exports are predominantly commodity exports, their prices are highly associated with trends of commodity prices in the world market. Global commodity prices were increasing early in the global financial crisis. However, their outlook changed dramatically during and after the second half of 2008, showing a sharp decline. According to International Monetary Fund (IMF) data, the global commodity price index by end-2008 had reached the level of 2005. The contraction in commodity prices will have knock-on effects on export earnings of developing countries, which overwhelming rely on these. If we look at quarterly export unit prices compared with the same quarter of the previous year, it is possible to see a decline in the price of coffee, by 6.6%, 15.0%, 17.0% and 2.1% during 2008Q4, 2009Q1, 2009Q2 and 2009Q3, respectively. Prices of pulses and oilseeds and flower also declined (Table 7).

As a whole, compared with the upward trend export earnings observed during the first, second and third quarters of 2005-2008, the first, second and third quarters of 2009 were significantly divergent in terms of both volume and value to the opposite side. It will be possible to see the impact of the crisis here if it is possible to forecast export performance had there not been a crisis, then comparing it with forecasts accommodating the crisis. In this regard, the African Development Bank (AfDB, 2009e) reports revenue projections for 2009 and 2010 made before and after the crisis for African countries. The export revenue projections for Ethiopia for before and after the crisis indicated $1.68 billion for 2009 and $1.78 billion for 2010 (before) and $1.22 billion for 2009 and $1.37 billion for 2010 (after). This implies that Ethiopia will forego a total of $0.87 billion in export revenue within the two years as a result of the global financial crisis.

The decline in growth of export earnings has affected the growth of imports. Comparing quarterly import values with the same quarter of the previous year reveals that the value of imports declined by 2.7%, 12.8% and 23.8% during 2009Q1, 2009Q2 and 2009Q3, respectively. An examination of specific import commodities is even more telling. Values of imports of fuel, for example, declined by 46%, 50.3% and 47% in the period. Values of raw material declined by 14.7% and 37.5% in 2009Q2 and 2009Q3, respectively. Capital goods (-15.7%) and consumer goods (-18.1%) also declined in the third

quarter of 2009 when compared with 2008. These commodities, along with fuel, comprised 80.6% of total import values for the third quarter of 2009 (Figure 5).

Figure 5: Quarterly growth rates of import values, 2006Q3-2009Q3 (% change)



Note: Data are not available for comparison before 2006Q3 and Q4.
Source: Annex 3.

2.3 Remittances

In a recent study, the World Bank (2009) noted that the global financial crisis was expected to adversely affect developing countries through slowing down remittances as a result of weakening economic performance in developed countries; almost two-thirds of the remittances that migrants send home to developing countries are sent from developed countries. Historically, remittances have proved to be less volatile, less pro-cyclical and less subject to political barriers and controls, and are therefore regarded as a more reliable source of foreign exchange (thereby sustaining the balance of payments) for developing economies than any other capital flows. They also form a crucial source of income and hence improve the living conditions of receiving households in these countries.

Table 8: Private transfers, 1997-2009 (US$ millions)

	Official cash	In kind	Underground	Total
1997	53.9	38.3	-	92.1
1998	113.1	23.4	-	136.5
1999	68.5	16.7	-	85.2
2000	124.5	7.9	-	132.3
2001	86.5	6.3	81.4	174.2
2002	116.2	21.2	82.9	220.3
2003	169.4	20.3	84.5	274.2
2004	285.6	20.1	156.0	461.8
2005	363.6	23.4	275.7	662.7
2006	383.0	14.1	402.5	799.6
2007	686.3	152.8	664.0	1503.1
2008	779.6	167.0	951.5	1898.1
2009Q1&Q2	723.2	195.5	880.1	1798.8

Source: NBE data.

Remittances have become important a foreign exchange source in Ethiopia. Officially recorded private cash remittance flows to Ethiopia increased from $53.9 million in 1997 to as high as $779.6 million in 2008, a growth of more than 14 times in 11 years. If we include official private remittances in kind, overall official private remittances saw a significant increase, from $92.1 million to $946.6 million. The

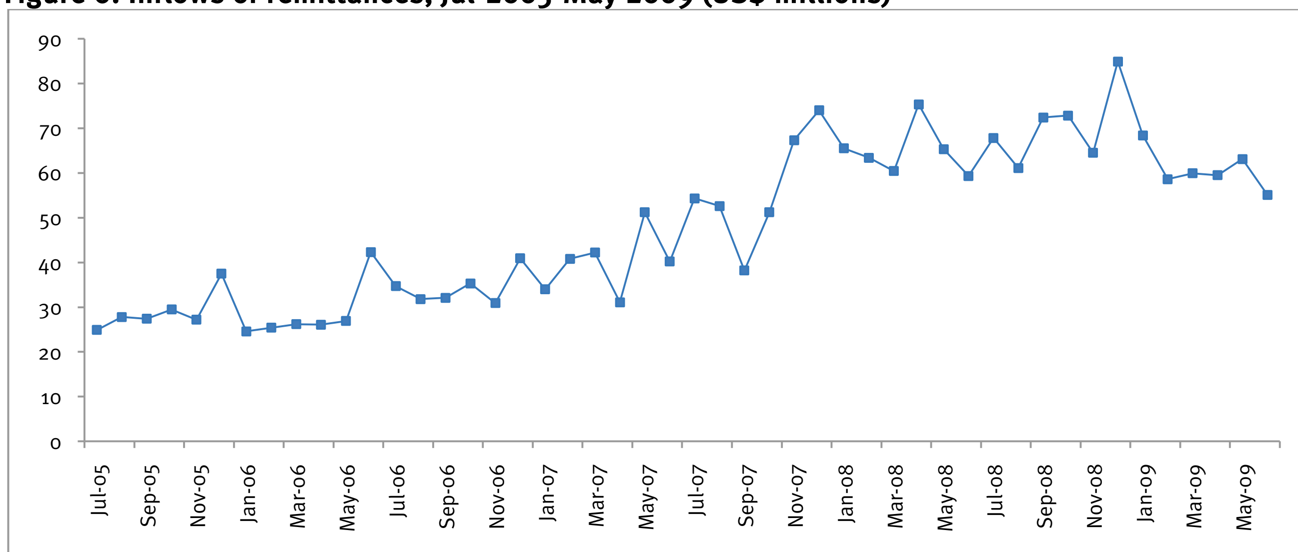
NBE's estimation of non-official remittances since 2001 indicates that they grew from $81.4 million in 2001 to $951.5 million in 2008 (Table 8).

The significance of the increase in remittances is not only in absolute terms: it has also increased relative to GDP. The official cash remittance share of GDP increased from 1.3% in 2000/01 to 2.3% in 2008/09. If we include official transfers in kind, the share increases from 1.4% to 2.9% for the same period. The share of private remittances in GDP also grew, from 2.2% to 5.7%, once we include private remittances through informal channels. Since informal channels are fast, do not involve paper work, charge a low fee, have low transaction costs and can access remote places, informally channelled remittances in Ethiopia are quite substantial. Thus, the importance of private remittances in the Ethiopian economy and the linkage/integration of the economy with the rest of the world through remittances are clear. This implies that any movement in private remittances will have a systematic impact on the economy and household spending, depending on the volume and direction of the change. It should be noted, however, that the macroeconomic impact of remittances will not be strong, as it accounts for a small proportion of GDP. The micro-level impact is expected to be significant, as some households depend on remittances for more than half of their incomes.

After September 2008, however, private remittances are expected to have declined. Two factors may be involved in this. First, the crisis and its global economic recession have put a great deal of pressure on the labour market. Thus, as labour markets in the developed world slacken, foreign/migrant workers are likely to suffer disproportionate impacts on their earnings, since they tend be the first victims of layoffs or reductions in working hours. Most of the Ethiopian diaspora is in the US, with a significant number in Europe. As these countries have been hard hit by the crisis, there will be a strong impact on the level of remittances. Second, fewer economic migrants will go to developed countries when these are in recession, owing to a decline in job availability for migrants or tightened migration policies in the receiving countries. This factor is expected to have a relatively more medium-term impact than the first. Overall, fewer remittances are expected and also probably lower remittance volumes per migrant.

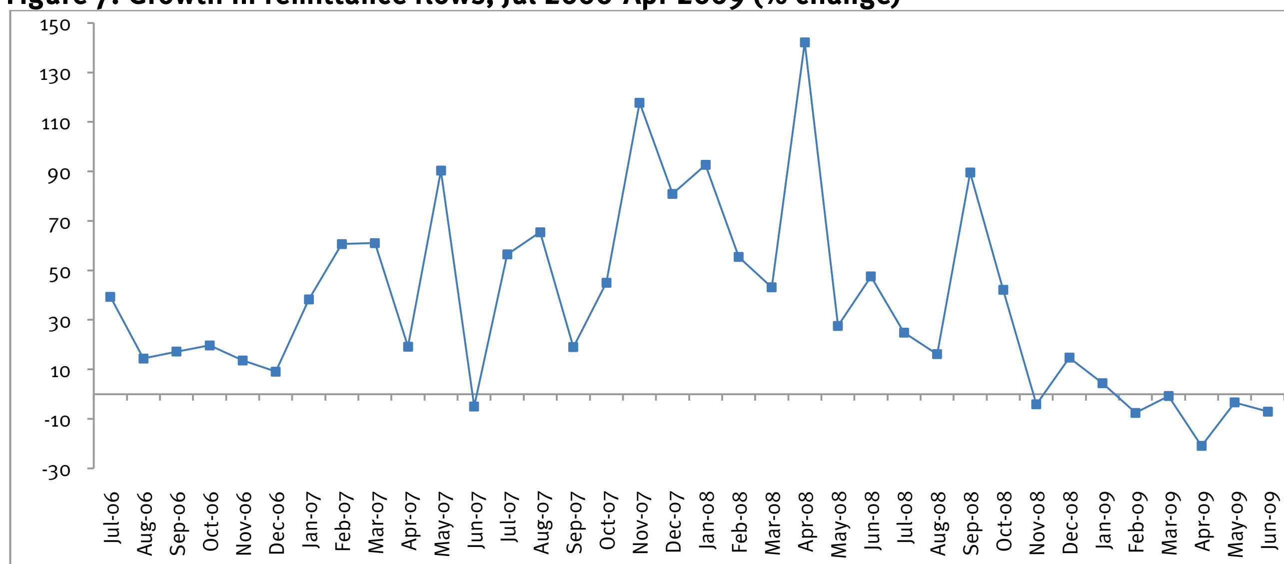
As the crisis manifested itself as a global phenomenon in September 2008, a significant decline is likely to have occurred in late 2008 and may continue in 2009. A close examination of the monthly flows of official cash remittances between 2005 and 2009 and monthly growth rates in the same period (compared with the same month of the previous year) gives a clearer picture (Figures 6 and 7).

Figure 6: Inflows of remittances, Jul-2005-May 2009 (US$ millions)



Source: Annex 4.

Figure 7: Growth in remittance flows, Jul 2006-Apr 2009 (% change)



Source: Annex 4.

As is shown in Figure 6, the monthly level of remittance inflow has declined since December 2008. Growth compared with the same month of the previous year has become consistently negative since the beginning of 2009. The prospects for the inflow of remittances are likely to depend on how fast source countries recover from the financial crisis.

2.4 Aid

The high import intensity of the economy, limited capacity to produce capital goods, low levels of domestic savings and limited capacity to generate foreign exchange make the development effort in Ethiopian beyond domestic capacity. All these factors have provided an apparently objective justification for the huge inflow of foreign aid. Consequently, foreign aid has been playing a critical role in the development efforts of Ethiopia since the 1950s.

Ethiopia relies on various multilateral and bilateral donors to finance many of its development programmes. Funds come in the form of aid (loan and grants) from countries that have been hard hit by the crisis. Therefore, the crisis is likely to reduce the flow of aid and investment as countries strive to solve the domestic financial crisis (e.g. the numerous bailout programmes launched in North America and Europe).

As mentioned above, aid has been an important source of deficit financing in Ethiopia. Taking into account the consistency of the balance of payments, the national account and the government account, we can locate the role of aid within the accumulation balance. The starting point for the macroeconomic accounting of aid is the identity that equates the savings gap with the current account and capital account as follows:

$$GDI - GDS = M - X = Fs - \Delta R \qquad (3)$$ [11]

11 ΔR takes the values of the overall balance from the balance of payment. This is because in any balance of payments analytic presentation the overall balance, sometimes called the net monetary movements in the balance of payments, is what is left from the total net foreign capital inflow after financing of the current account deficit. Thus overall balance = Fs-(M-X). This is exactly equal to the change in international reserves (ΔR), where a positive sign represents an increase in reserves, or an 'outflow' of capital from the capital account.

where GDI, GDS, M, X, Fs (includes aid, FDI, remittance, other flows and errors and omissions) R and Δ stand for gross domestic investment, gross domestic savings, import of goods and services, export of goods and services, foreign savings, international reserves and change.

Based on this consistent macroeconomic accounting framework, which ensures equality across the savings investment account, current account and resulting capital account, we now attempt to place the evolution of aid in the accumulation balance of Ethiopia. The accumulation balance for an economy as a whole sets out how total investment is financed. By rearranging Equation 3, it follows that:

$$GDI = GDS + Fs - \Delta R \quad (4)$$

Based on this identity, the location of aid within the actual evolution of the accumulation balance over the period 2000/01-2008/09 is presented in Table 9.

Table 9: Financing investment, 2000/01-2008/09 (% share in GDI)[12]

	GDS	Fs	ΔR
2000/01	46.6	51.1	-2.3
2001/02	25.1	96.8	21.8
2002/03	18.3	99.7	18.0
2003/04	19.6	90.9	10.5
2004/05	12.9	90.5	3.4
2005/06	15.0	79.3	-5.7
2006/07	25.4	76.3	1.8
2007/08	15.1	80.2	-4.7
2008 /09	21.5	83.7	5.2

Source: Based on MoFED data.

It follows from the above that foreign savings, which are largely aid, are the major financing source of the country's investment and one of the determinant factors for the country's macroeconomic stability. The importance of aid has increased over time and it now constitutes an important source of foreign exchange for the government. On average, it covers more than three-quarters of domestic investment. Thus, any decline in foreign aid not only may pose a challenge to Ethiopia's foreign reserves but also is likely to slow down developmental activities undertaken using aid. Given that most donor home countries have been hit hard by the global financial crisis and have pumped huge sums of their budgets into bailing out their domestic financial institutions and other business enterprises, aid inflows may have been expected to be on the decline. However, what has happened so far is not indicative of these claims.

Comparing the level of aid inflows with the same quarter of the previous year reveals a consistent increase, with the largest contribution coming from multilateral sources. A look at second quarters shows that aid generally increased in 2009, notwithstanding a decline in the second quarter of 2008 (Table 10).

In general, it seems that aid inflows have not been affected by the crisis. One possible reason for this could be previous commitments. Information obtained from experts from MoFED and the NBE shows that most country assistance strategies were prepared and signed before the global financial crisis, and are still on. In addition, following the modification of the Exogenous Shocks Facility (ESF) by the Executive Board of the IMF in September 2008, the Ethiopian government managed to obtain about $240.6 million in August 2009 under the high access component. Moreover, the Ethiopian government managed to obtain a significant increase in aid from the World Bank (mainly the International Development Association (IDA)) in the second quarter of 2009.

12 For simplicity, Fs also include private capital flows, other non-aid flows and errors and omissions.

Table 10: Quarterly trends in aid flows, 2005-2009 (US$ millions)

			Multilateral	Bilateral	Total
2005	Q3	Loan	112	16	127
		Grant	66	35	101
	Q4	Loan	98	25	123
		Grant	162	99	261
2006	Q1	Loan	63	182	244
		Grant	40	182	221
	Q2	Loan	58	3	61
		Grant	419	181	600
	Q3	Loan	112	16	127
		Grant	66	35	101
	Q4	Loan	98	25	123
		Grant	162	99	261
2007	Q1	Loan	63	13	75
		Grant	40	182	221
	Q2	Loan	58	3	61
		Grant	419	181	600
	Q3	Loan	54	26	79
		Grant	98	43	141
	Q4	Loan	91	25	116
		Grant	0	148	148
2008	Q1	Loan	46	18	64
		Grant	181	153	334
	Q2	Loan	78	32	110
		Grant	348	128	477
	Q3	Loan	101	14	114
		Grant	133	111	244
	Q4	Loan	171	18	189
		Grant	315	161	476
2009	Q1	Loan	194	49	243
		Grant	70	125	195
	Q2	Loan	104	0	104
		Grant	403	123	525

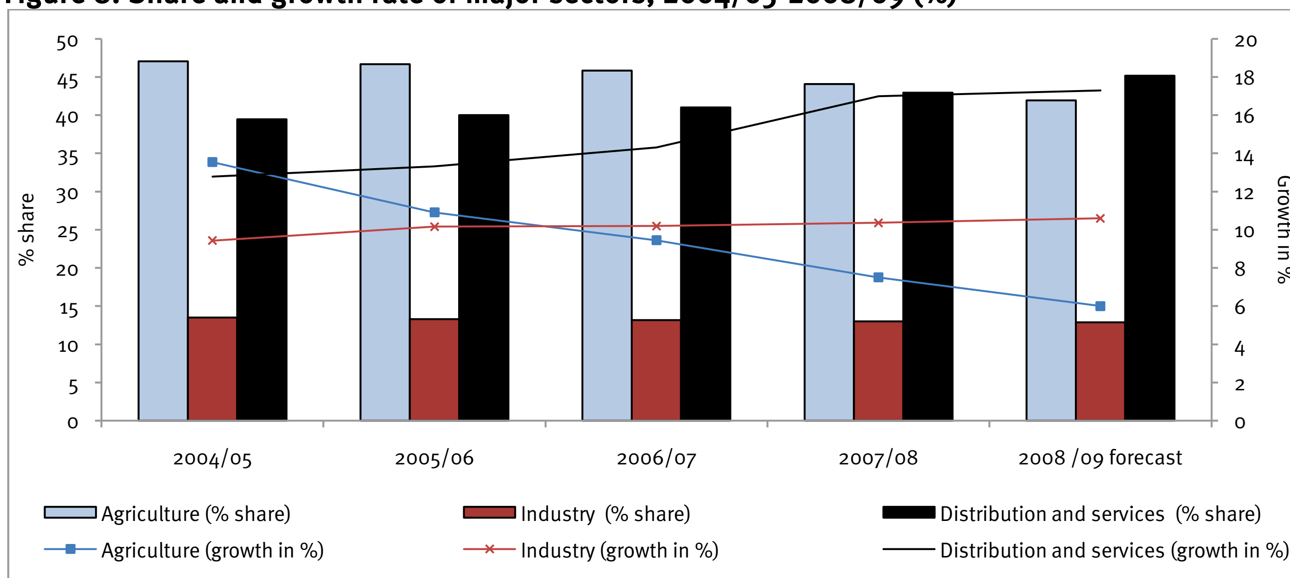
Source: MoFED data.

3. Growth and development effects

3.1 National-level growth, investment and employment

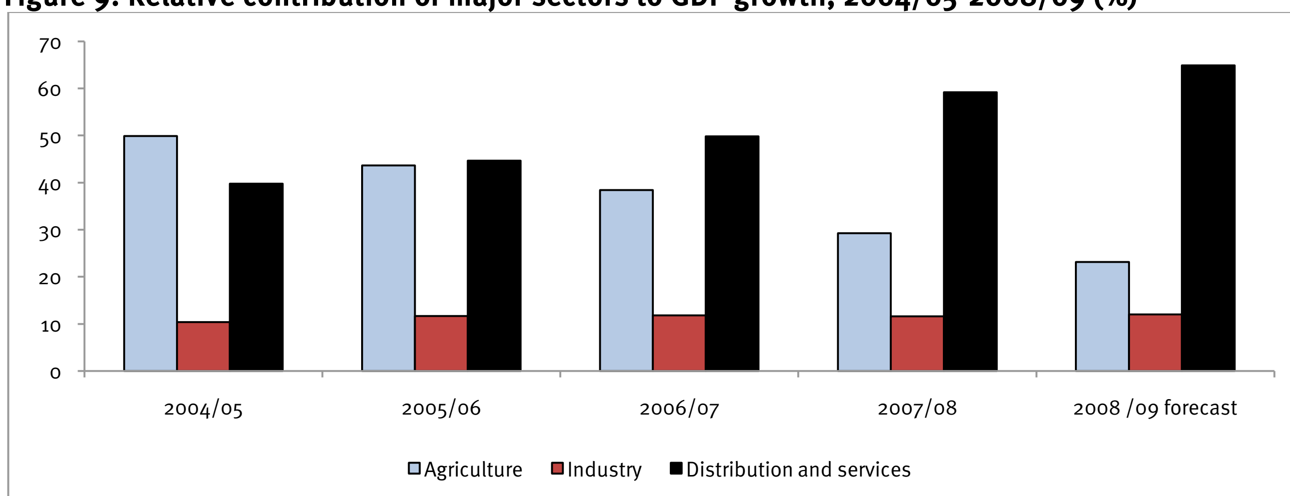
Ethiopia's economy grew at an annual average of about 11% during 2005/06-2007/08. The growth was broad based, as all sectors contributed (see Figures 8 and 9).

Figure 8: Share and growth rate of major sectors, 2004/05-2008/09 (%)



Source: MoFED data.

Figure 9: Relative contribution of major sectors to GDP growth, 2004/05-2008/09 (%)



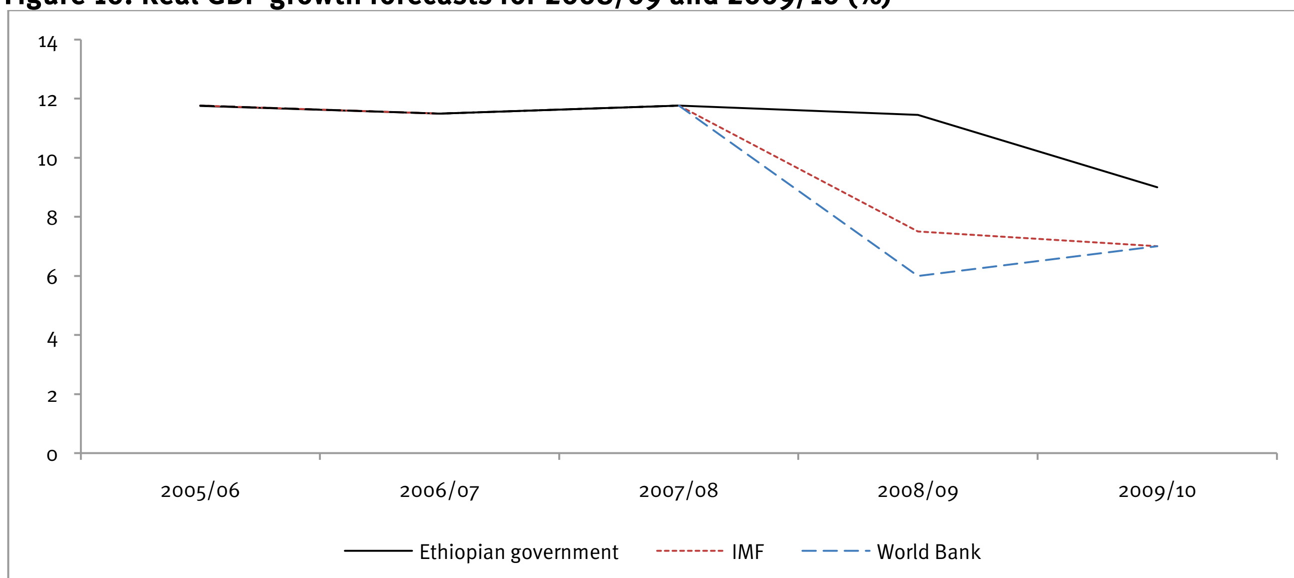
Source: MoFED data.

Representing close to half of the country's GDP, agriculture was the driving force behind the earlier growth takeoff. Agriculture grew at 13.5% in 2004/05 and 10.9% in 2005/06, contributing 50% and 44% to overall growth. Recently, the contribution to growth has been overtaken by the services sector. The growth performance of services has consistently improved over the years to a stage where it contributed 60% of annual economic growth in 2007/08. The industrial sector contributed about 10% to overall growth during 2004/05 to 2008/09 and remained unchanged in its GDP share over these years, at about 13%.

The performance of the Ethiopian economy in 2008/09 was tainted by the global financial crisis. It has been widely acknowledged that the effects of the crisis on developing economies will largely be a function of three factors: 1) structure of the economy and dependence on commodities; 2) degree of reliance on external inflows of various types; and 3) capacity to respond in terms of fiscal space, level of external reserves, etc. As discussed in the preceding chapter, the crisis has been impacting Ethiopian exports, FDI and remittances since the last quarter of 2008, thereby adding pressure to the country's already constrained balance of payments situation and meagre foreign exchange reserves. Moreover, the fact that investment depends overwhelmingly on foreign financial inflows, which are clearly now being affected adversely, implies that the crisis is, to some extent, exerting pressure on the economy's growth performance. The capacity of the government in terms of fiscal space and availability of foreign exchange reserves is weak. This concurs with the observations of Takatoshi Kato, IMF Deputy Managing Director and Acting Chair, that Ethiopia's economy has been adversely affected by a series of shocks, first by surging commodity prices in 2008 and most recently by the global recession (Alemayehu, 2009a). He further noted that, while the government authorities have been successfully implementing a macroeconomic adjustment package since late 2008 to help lower inflation and build up international reserves, the global recession is now putting renewed pressure on the external position as export receipts and remittances weaken and inward direct investments slows.

Figure 10 shows the different growth trajectories forwarded by different institutions for the years 2008/09 and 2009/10. The Ethiopian government has from the outset posted an 11.2% growth rate of real GDP for the year 2008/09. However, the IMF (2009a) indicates that the government authorities anticipate that real GDP will increase by only 10% in fiscal year 2008/09, implying a downward revision from the original estimate. The IMF itself (2009b) puts expected real growth at 7.5% for 2008/09 and 7% for 2009/10. Sukhwinder Singh, IMF Resident Representative for Ethiopia, has rightly underscored the difficulty lying in the Ethiopian economy registering 11.2% GDP growth given the current situation (Alemayehu, 2009b). He stated that the IMF forecast for the Ethiopian economy is 6.5% for the year 2008/09, even smaller than the 7.5% forecast reported recently. He added that the country should be proud if it can maintain such growth, bearing in mind the slowing down of investment in poor countries and the reduction in exports, with the resultant foreign exchange constraints. The World Bank (2009) has forecast growth at 6% in 2008/09 and 7% in 2009/10, citing the impacts of the turbulent external economic environment, volatile commodity price movements and the global recession.

Figure 10: Real GDP growth forecasts for 2008/09 and 2009/10 (%)



Sources: IMF (2009b); MoFED data; World Bank (2009).

Most believe that the adverse effects of the global recession will significantly dent the growth of the Ethiopian economy. Alemayehu (2009c) concludes that growth may be reduced even further, by 3%, because of the slowdown in world commodity prices and related phenomena associated with the global crisis. Actual growth performance of the Ethiopian economy for 2008/09 is yet to be reported.

Scrutiny of components of GDP by expenditure indicates that private final consumption expenditure declined slightly early on but jumped in 2007/08, remaining the same in 2008/09; final government expenditure has consistently declined owing to fiscal consolidation. Investment was almost 24% of GDP for the years 2004/05-2006/07, but declined to 21% in 2007/08 and further to 20.3% in 2008/09. It is possible that the contraction in investment as a percentage of GDP observed in the past two years could partly be a reflection of the decline observed in inward financial inflows.

Table 11: Value of some macroeconomic figures at current prices, 2004/05-2008/09

	2004/05	2005/06	2006/07	2007/08	2008/09 (forecast)
In Birr millions					
GDP	106,473	131,641	171,834	245,585	328,809
Government final consumption expenditure	13,066	15,910	17,850	24,043	30,054
Private final consumption expenditure	90,251	110,936	143,148	213,659	284,420
Gross capital formation (investment)	24,483	31,894	42,650	52,081	66,663
Exports of goods and services	16,077	18,205	21,857	28,317	37,661
Imports of goods and services	37,776	48,092	55,082	76,564	91,877
Resource balance (deficit)	(21,699)	(29,887)	(33,224)	(48,248)	(54,216)
As % of GDP					
Government final consumption expenditure	12.3	12.1	10.4	9.8	9.1
Private final consumption expenditure	84.8	84.3	83.3	87.0	86.5
Gross capital formation (investment)	23.0	24.2	24.8	21.2	20.3
Exports of goods and services	15.1	13.8	12.7	11.5	11.5
Imports of goods and services	35.5	36.5	32.1	31.2	27.9
Gross domestic savings	3.0	3.6	6.3	3.2	4.4
Resource balance	(20.4)	(22.7)	(19.3)	(19.6)	(16.5)
Growth rates in %					
GDP	22.9	23.6	30.5	42.9	33.9
Government final consumption expenditure	15.5	21.8	12.2	34.7	25.0
Private final consumption expenditure	27.1	22.9	29.0	49.3	33.1
Gross capital formation (investment)	10.9	30.3	33.7	22.1	28.0
Exports of goods and services	24.5	13.2	20.1	29.6	33.0
Imports of goods and services	38.0	27.3	14.5	39.0	20.0
Per capita GDP: nominal (US$)	171	205	257	340	443
Per capita GDP: real (US$)	155	167	181	196	213

Source: MoFED data.

3.2 Sectoral-level effects: The flower sector in focus

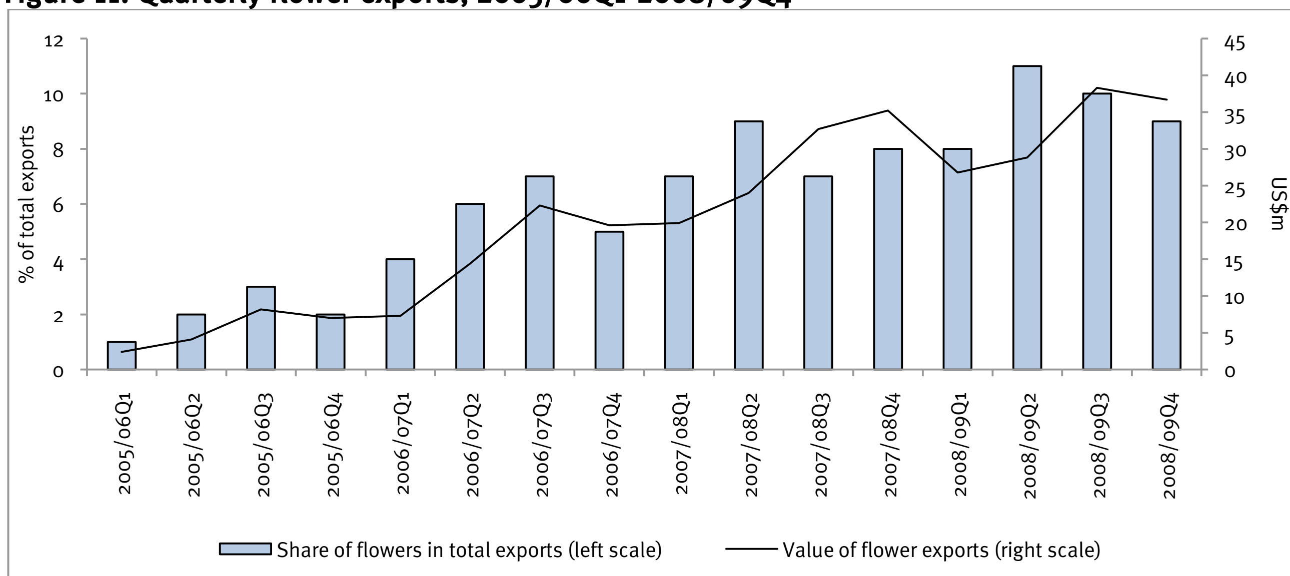
Here, we examine the effects of the global financial crisis on the flower sector, based on available data. The flower industry is a dynamic sector that has flourished within a short period of time. Ethiopia did not have a working flower farm until 2000, and it had only three until 2003. The sector began to take off in 2005. A joint survey conducted by the Ethiopian Development Research Institute (EDRI) and the Japanese National Graduate Institute for Policy Studies (GRIPS) in January to March 2008 has a wealth of information on the development of the floriculture sector in the country (Gebreyesus, 2008). According to the survey, the sector had over 67 operational farms in the year 2007 and over 235 farms in the process of establishment.

One of the characteristics of the sector is that it employs a great deal of labour. The survey demonstrated that flower farms employ at least 20 people per hectare. The same survey suggested that the sector employs 25,000 permanent workers. This number increases to over 50,000 if workers who have been employed in the establishment of new farms and the expansion of new ones are included. Recent figures put the employment figure at 60,000 (Reuters, 2009). Government support in terms of financing, training, logistics and regulatory issues, as well as setting up an attractive incentive structure, have provided impetus for the expansion of the sector. Among other incentives, investors in

the sector were provided with up to 70% of their initial capital through loans from the government-owned development bank without collateral, an income tax holiday of up to five years, VAT and import duty exemptions and favoured access to transport, electricity, internet and storage facilities.

FDI is prominent in the flower sector. The survey results showed that 64% of flower farms are either fully or majorly share owned by foreigners. As shown in Figure 11, flower exports have increased in terms of value and share in total exports within a couple of years. Flower exports generated less than $5 million and represented 1% of exports in the first quarter of 2005/06. This figure jumped to almost $40 million, accounting for 10% of total exports in the third quarter of 2008/09. More than 90% of Ethiopian flower exports are destined for European countries, with 81% going to the Netherlands.

Figure 11: Quarterly flower exports, 2005/06Q1-2008/09Q4



Source: ERCA data.

However, since the onset of the financial crisis, particularly after December 2008, the world flower market has been adversely affected. According to research carried out on flower sectors in developing countries (CBI, 2009), demand for flowers within the European Union (EU) has declined considerably since December 2008. Demand from the US was already on the decline before then. The consequence has been oversupply, which has led to lower prices. Importers in the Netherlands indicated that prices have gone down by 15% to 30% since December 2008. Declining order numbers and volumes, together with decreasing prices, have caused a turnover drop among Netherlands importers of 0% to 30%, depending on the product range.

The global crisis has been critically affecting the Ethiopian flower sector because its main buyers, European countries, have been in recession. As a result of the contraction in demand and declining prices, Ethiopia earned only 47% of a projected $280 million from flower exports in 2008/09. According to an investor in the sector, a single stem of rose from flower farms in Ethiopia used to be sold for, on average, €0.13 in European countries in 2008/09. The same item is now sold (late 2008/09) for €0.11 in the same markets, indicating a 15% decline in prices. In peak seasons, the price for a stem used to be, on average, as high as €1; this year it went down to €0.20 (Alemu, 2009). The decline in prices and the lack of adequate buyers are hurting the revenues of the flower industry in Ethiopia. This has led to a situation whereby flower producers are unable to service their debt owed to the state-owned Development Bank of Ethiopia (DBE), which has lent out over 800 million birr. Not surprisingly, the Chairman of the Ethiopian Horticulture Producers and Exporters Association admitted that 'it is unfeasible to service our debts with the current economic downturn unless banks become willing to reschedule our obligation and freighters cutback their tariff' (Sisay, 2009). Recently, the DBE granted debt rescheduling of close to 1 billion birr to flower producers and exporters for up to three years (Taye, 2009). Being a labour-intensive industry and the third major export item, with a chance of

becoming the prime export of the country in the future, the fallout in the flower sector has spillover effects on growth, employment, poverty and the balance of payments.

3.3 Fiscal effects

The fiscal impact of the financial crisis will be reflected in both government revenues and expenditures. The possible contraction in tax revenue resulting from the slowdown in GDP growth (since tax revenue is closely related to GDP growth) and the decline in trade may drive down government revenue. Moreover, there will be pressure to cut expenditures as a result of the decline in revenue and possibly grants. Paradoxically, there will also be pressure to expand expenditures because of the stress that will come from the increased need to maintain a safety net for those low-income households that will be affected by the financial crisis and economic slowdown. As a result, the global crisis will tend to erode and exhaust the fiscal space of governments, especially those which had unsustainable deficits in the period leading up to the crisis. According to the IMF (2009b), the fiscal impact of the crisis in sub-Saharan Africa will be large; in particular, revenues have suffered because of less economic activity and lower commodity prices.

Table 12 shows the performance of general government finance over the period 2003/04-2008/09. Government revenue shows on average a declining trend during this period, from a level of 16.1% of GDP to 12.2% of GDP. Tax revenue, which accounts for on average 77% of revenue, has a consistent straight decline and hence places significant constraints on the government's ability to finance its spending objectives. Import duties and taxes alone represented 56% of tax revenue and 40% of total revenue in 2007/08. With this structure of the revenue base, the impact of the crisis will be felt first as a possible reduction in import duties and taxes owing to an expected deceleration in import growth. The fact that the crisis is taking its toll on remittances and exports, and that the government is focused on rebuilding the meagre reserve position, leaves no space for a continuation of the rapid increase in imports observed in the past several years. Second, the expected deceleration in growth and exports is very likely to have an adverse effect on income taxes in particular and tax revenue in general.

Table 12: Summary of general government finance performance, 2003/04-2008/09 (% of GDP)

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Revenue	16.1	14.6	14.8	12.7	12.1	12.2
Tax revenue	12.6	11.6	10.8	10.1	9.7	8.8
Non-tax revenue	3.5	3.0	4.1	2.6	2.4	3.4
Grants	4.6	4.3	2.8	4.4	4.0	4.4
Expenditure	23.7	23.3	22.3	20.7	19.1	17.6
Current expenditure	13.8	12.4	11.6	10.0	9.3	8.3
Capital expenditure	9.5	10.7	10.7	10.7	9.8	9.3
Overall balance including grants	-3.0	-4.4	-4.6	-3.6	-2.9	-1.0
Overall balance excluding grants	-7.6	-8.7	-7.4	-8.0	-7.0	-5.4
Financing	3.0	4.4	4.6	3.6	2.9	1.0
External (net)	2.8	2.2	1.1	1.1	1.0	1.0
Domestic	2.5	3.3	2.1	3.6	2.7	-0.1
Banking system	2.5	3.0	2.2	2.5	1.6	-0.3

Source: MoFED data.

It is likely that the crisis will depress government revenue but it is quite difficult to say so explicitly in the case of Ethiopia, given the difficulty in disentangling the effects of the crisis from the ongoing poor trajectory of revenue collection over the past several years.

Fiscal consolidation led current expenditures to fall from 13.8% in 2003/04 to 8.3% in 2008/09. Capital expenditure has been more or less in the region of 10%, reflecting the huge investment that the government has made in infrastructural developments. Poverty-targeted expenditures (spending on education, health, agriculture and roads) feature strongly in both current and capital expenditures. In the past three years, poverty-targeted expenditures have accounted for about 63% of total government

expenditure. In particular, poverty-targeted expenditures are financed largely from external grants and loans. From this structure of government spending, it can be inferred that any effect of the financial crisis on external grants and loans will have serious implications for poverty.

Because of the sharp fall in government spending in 2008/09 (particularly associated with government restraint from inflationary deficit financing so as to contribute partly to the abatement of inflation), government deficit (including grants) has declined to 1% of GDP. Last but not least, with grants amounting to 4% to 5% of GDP (except 2005/06), donor support continues to be critical in keeping the budget deficit manageable.

3.4 Poverty and distributional effects

The main sources of quantitative information on poverty and welfare in Ethiopia are the Household Income, Consumption and Expenditure and Welfare Monitoring Surveys. The two surveys were conducted in tandem in 1996, 2000 and 2004/05. Analysis of the results as reported in the annual progress report of the five-year medium-term plan (2005/06-2009/10) of the country for the year 2006/07 indicated the following major findings:-

- The magnitude of poverty elasticity with respect to growth reached -1.7 in 2005, from -1.3 in 2000.
- The Poverty Headcount Index declined to 38.7% in 2005 from 45.5% in 1996.
- The Poverty Gap Index declined to 8.3% in 2005 from 12.9% in 1996.
- The Poverty Severity Index also declined to 2.7% in 2005 from 5.1% in 1996.

It is difficult to estimate accurately the implications of the global crisis on poverty, since up-to-date data are unavailable. Nevertheless, in the discussion that follows, a rough assessment is given, carried out mainly done on the basis of the method proposed by Cline (2002). Cline used a relatively simple but rough method in estimating the impacts of financial crisis on poverty in emerging market economies by constructing elasticity of poverty incidence with respect to per capita growth. He noted that a number of international sources suggest that a reasonable central empirical estimate for the elasticity of poverty incidence with respect to per capita growth is around -2. Said differently, per capita growth of 1% is likely to reduce the number in poverty by 2%. The World Bank (2001, cited in Cline) used consumption per capita instead of GDP per capita and found that, on average, every additional percentage point of growth in average household consumption reduces the share of people living on less than $1 a day by about 2%. Taking the assumption that 2005 poverty elasticity with respect to growth and the Poverty Headcount Index remains the same in 2008/09, and considering the 1.2% reduction in growth acknowledged by the government as a least case scenario and the estimated total population in 2008/09 as 80.3 million, the crisis has led to an increase in the number of people in poverty of 634,000, people who otherwise would have exited poverty.

The impacts of the crisis on poverty could also be looked at by means of the adverse implications of remittances (caused by the crisis) on poverty. It has been observed that remittance inflows to Ethiopia dipped immediately after the crisis hit (Section 2.3). This decline, in addition to its effect on the economy through foreign exchange availability, has a direct and severe adverse impact on households that depend on remittances for their regular household expenses. Dejene (2005), cited in Gebremariam (2008), examined the effects of remittances, both domestic and foreign, on urban households in Ethiopia, which are more vulnerable than rural households to different sorts of urban shocks. The study found that remittances cushion urban households from ever-deepening poverty and vulnerability to recurrent shocks and help vulnerable households to smooth their consumption.

4. Policy responses to the crisis: A critical review

Ethiopia has faced an unstable and challenging external economic environment in the past two and a half years. The shock has emanated from sharp movements in import prices and the current global financial and economic turmoil. As reported by the authorities, surging import prices, especially of fertiliser, fuel and other capital goods, before the start of the crisis put undue pressure on the country's foreign exchange reserves, forcing the cancellation of many letters of credit of private firms and some government-owned enterprises. The foreign exchange pressure was reinforced after the advent of the global crisis, which has affected remittances and export revenues, among others.

The reserve level was also down, at 1.2 months of imports by mid-2008. This worsening external performance has contributed to a hike in inflation, reinforcing already high food and non-food prices. The worsening global economic recession is putting more pressure on the deteriorating external position through weaker export receipts, sluggish remittances and slowing inward FDI. This weakening external position has contributed to the worsening of the fiscal position.

After an initial 'wait and see' strategy, the Ethiopian government has responded by taking concerted monetary, banking and financial, fiscal, external and administrative measures to mitigate the inflationary and foreign exchange challenges that existed before the crisis. Such earlier measures have reinforced the effort to minimise the foreign exchange-induced impacts of the crisis. The measures were implemented with the coordination and consultation of the country's key institutions, including MoFED, the NBE and the Ministry of Trade and Industry (MoTI).

What have been the detailed policy actions implemented by the government? Has the policy response been adequate to mitigate such shocks? What would be the optimal policy response for the rapid achievement of macroeconomic stability and a maintaining of the growth momentum? Answers to these three questions are important to enhancing policy intervention effectiveness.

It is worth mentioning at the outset that, to resolve the unsustainable fiscal and current account deficit, reduced access to international financing and the vulnerable external debt position, as well as rising inflationary pressure, the optimal policy mix for Ethiopia would include tighter monetary policy, a fiscal deficit reduction, depreciation of the exchange rate, currency swap arrangements, enhanced private and public saving, strengthened social safety nets, a deepened domestic financial system and supply-enhancing interventions.

4.1 Macroeconomic policies to manage the impact of the crisis

4.1.1 Monetary policy response

While the global crisis has led to monetary easing in other countries, the observed reinforcement of inflationary pressure and the adverse impact of the external shocks have forced the NBE to shift its policy stance from monetary easing to monetary tightening since July 2007. Accordingly, it has increased both the minimum deposit interest rate and reserve and liquidity requirements, and instituted credit restrictions. The NBE has set a ceiling on the loan amount it will provide, considering market share. The authorities believe that this is a temporary measure, to be removed after the inflationary challenge is over. The minimum deposit interest rate was increased from 3% to 4% in July 2007, and reserve and liquidity requirements of banks were raised from 5% to 10% during the same period. In order to restrain domestic credit expansion and monetary growth at a greater scale, the reserve and liquidity requirements of banks were raised further to 15% in April 2008. The NBE's intention was to contain broad money growth below 20% in the 2008/09 fiscal year by discouraging private sector credit to low priority areas, and to maintain net claims of the domestic banking system on the general government at zero over the course of 2008/09.

Given the country's underdeveloped financial markets, the use of the interest rate as an inflation mitigation mechanism is less effective in Ethiopia. Instead, the optimal policy response would be to use direct instruments of monetary policy such as controls on credit expansion. More specifically, cutting back significantly on domestic credit, particularly on government borrowing from the banking system, is an optimal strategy in fiscal deficit reduction, to combat inflationary pressure and overcome the worsening external position. This is because the majority of domestic credit has ended up as letters of credit at commercial banks claiming foreign exchange. However, this is a short-term solution; in the long run, the focus should be on developing financial markets and resorting to indirect instruments of monetary policy.

Benefiting from the lowering of commodity prices in the international market, the monetary policy response, coupled with other administrative measures, such as a government-subsidised wheat import and distribution programme, has worked very well in reversing the inflationary trend. Headline inflation, which went up from 15.8% in June 2007 to 46.1% in February 2009, went down dramatically to reach 18.7% in September 2009. Food and non-food inflation also subsided to a respective 17.5% and 21% during the same period, from their elevated levels of 61.1% and 24.2% in February 2008 (Table 13).

Table 13: National general, food and non-food inflation, 2007-2009 (%)

		General	Food	Cereal	Non-food
2007	Jun	15.8	17.5	16.5	13.5
2008	Jun	25.3	34.9	38.3	12.5
	Jul	29.6	41.4	52.2	13.8
	Aug	33.6	46.9	65.5	15.4
	Sep	37.2	51.8	77.8	17.0
	Oct	40.3	55.7	88.2	18.8
	Nov	42.8	58.7	96.1	20.4
	Dec	44.4	60.0	100.4	21.9
2009	Jan	45.6	60.9	104.1	23.4
	Feb	46.1	61.1	106.7	24.2
	Mar	45.2	59.2	104.3	24.4
	Apr	44.3	57.2	101.3	24.6
	May	41.6	52.6	92.2	24.6
	Jun	36.4	44.2	74.8	23.8
	Jul	30.0	34.2	53.9	22.9
	Aug	24.1	25.4	36.7	21.8
	Sep	18.7	17.5	22.1	21.0

Source: CSA data.

4.1.2 Banking and financial policy response

The government also strengthened regulation of banking, insurance and microfinance by issuing a revised proclamation, taking account of emerging developments in the local and external environment and international core principles and practices. It alerted commercial banks to give due attention to risk management and to reduce non-performing loans to below 5% by instituting strict follow-up on overdraft facilities. In addition, the NBE urged banks to be cautious in their lending activities, to improve the quality of credit and not to take excessive risks while working with their correspondent banks. As a result, financial institutions have remained orderly, financially sound and profitable.

The NBE reduced exposure in the international financial market by collecting and transferring maturing funds available in commercial banks to central banks such as the Federal Reserve, the Bank of England and Deutsche Bundesbank. As the crisis remains severe, affecting even 'A' rated banks and financial institutions, investment in commercial banks remains risky. Investing in low-paying central banks is thus the only feasible option for the NBE, although this strategy indirectly affects the benefits available.

Other possible responses in this area include improving mechanisms of information sharing among financial institutions and adequate risk assessment and mitigation strategies.

4.1.3 Fiscal policy response

On the fiscal front, the response was to enhance revenue collection and reduction of lower priority expenditure. This was to be achieved without compromising the need to increase spending on key poverty-oriented sectors. Accordingly, the government decided not to borrow domestically from the banking system on a net basis in 2008/09 (domestic borrowing was 2.7% of GDP in 2007/08).

On the revenue side, the outreach of the VAT system expanded to cover more traders and sectors, such as restaurants, cafes, etc. This resulted in a 31.5% increase in VAT revenue, to Birr 2.83 billion in 2008/09 from Birr 2.15 billion in 2007/08. The government also exerted efforts to collect long overdue tax arrears in 2008/09. These and related measures led to growth of total government revenue from Birr 24 billion in 2007/08 to Birr 31.9 billion in 2008/09. Government expenditure on priority sectors such as health, education and infrastructure recorded a 24.3% increase, whereas non-priority expenditure showed a lesser rate of growth of 15.6%.

A related fiscal response was the commitment to follow closely the activities of public enterprises and reduce their domestic borrowing to between Birr 4 and 8 billion (no more than 2.5% of GDP) in 2008/09. A committee comprising officials from MoFED and the NBE was established to conduct monthly follow-up. The committee monitors the domestic financing of public enterprises and other public institutions and informs high-level policymakers to carry out corrective actions, if necessary.

According to NBE data, the government has paid its outstanding debt to the banking system of Birr 875 million, compared with Birr 4.2 billion borrowing in 2007/08, a significant shift in the fiscal policy stance. Bond financing of public expenditure is the best option to finance infrastructural projects. However, to be attractive for investors, the interest rate on the bond must be reasonable.

4.1.4 External sector response

The government continued to create a conducive environment to enhance exports and private remittance transfers through greater flexibility in the foreign exchange market and by undertaking structural reforms to improve productivity and external competitiveness. To achieve greater exchange rate flexibility, the birr was depreciated by 10% vis-à-vis the US dollar in January 2009, and by end-June had depreciated by some 16% since September 2008. This nominal depreciation (Table 14), coupled with the easing of inflation, reversed some of the accumulated real appreciation of recent years.

With the objective of minimising the widening parallel market premium and increasing foreign exchange inflows through the banking system, the government tried to crack down on parallel foreign exchange market operators. According to the authorities, this policy measure worked well in enhancing foreign exchange inflows through the banking system and helped minimise the parallel market premium. However, the optimal strategy is to allow increased flexibility of the exchange rate in the inter-bank foreign exchange market.

Table 14: Trends in nominal and real effective exchange rates, 2004/05-2008/09 (2000/01=100)

		NEER	REER
2004/05	Q1	88.2	97.2
	Q2	84.1	93.7
	Q3	80.1	91.1
	Q4	80.0	94.3
2005/06	Q1	81.7	99.9
	Q2	83.4	101.8
	Q3	80.2	99.0
	Q4	78.3	110.8
2006/07	Q1	78.9	117.8
	Q2	78.1	119.9
	Q3	77.4	122.3
	Q4	76.0	125.2
2007/08	Q1	74.4	128.3
	Q2	72.7	129.8
	Q3	70.9	133.7
	Q4	71.6	153.4
2008/09	Q1	73.9	185.5
	Q2	83.6	204.3
	Q3	77.5	179.8
	Q4	71.1	166.4

Source: NBE data.

Efforts were also exerted by the government to increase reserves to $1.6 billion (8-10 weeks of imports of goods and non-factor services) through limited foreign exchange sales by the NBE in the inter-bank foreign exchange market and by putting in place foreign exchange rationing practices.

To enhance its reserves, the government of Ethiopia implemented a foreign currency-denominated diaspora bond and currency swap arrangement with China. There is still the chance to enhance currency swap arrangements with China, Japan and Italy, as these countries are undertaking extensive infrastructural development projects, such as road construction and dam building. Similar arrangements can be made with the Western Union, Money Gram and other international money transfer agencies. Other possible intervention areas include expanding scope for co-financing of trade between private and public banks, allowing *franco valuta* imports, establishing export processing zones and introducing pre- and post-shipment export financing schemes.

4.2 Social and administrative policies to respond to the impact of the crisis

Although not related to the global crisis, the government of Ethiopia has minimised the adverse household effects of domestically generated inflationary pressure through the following set of measures:

- In order to provide a more effective subsidy to the poor, the government has continued to import grains and distributed them at cost through local markets and subsidised fuel prices up to end-September 2008, although the impact on Ethiopian farmers is not yet known.
- It has also waived VAT on grain and edible oil to stabilise prices.
- In order to curb the pickup in the price of cement, the government has put in place a mechanism to import cement and supply it to users through the government-owned Wholesale Trade Enterprise.

However, the deteriorating fiscal position following the adverse external shocks has led to the elimination of fuel subsidies, with a significant negative welfare impact on poor households. The deteriorating fiscal position is associated with relatively lower import tax revenue as the level of imports has been severely constrained by the foreign exchange shortage. Accordingly, domestic fuel prices have been adjusted monthly since October 2008, with prices now set somewhat higher than import costs to enable the Oil Stabilization Fund (OSF) to repay its accumulated debt to the banking system. As discussed earlier, electricity rationing has also been practised by the Ethiopian government to overcome the significant power shortages caused by a water shortfall in power-generating dams.

Considering that the social impact of the global financial and economic crisis is now becoming visible, donor agency responses are required in the form of grants for fuel price stabilisation in the domestic market. Also, the existing social safety net programme should be expanded to cover the increased number of poor households that will in one way or another be affected by the expected impact of the global recession on government revenues, foreign exchange reserves and remittances.

4.3 Economy-wide and sectoral structural policies for getting the country out of the crisis

The global financial and economic crisis has not resulted in a significant shift in economy-wide and sectoral structural policies in Ethiopia. However, to overcome the ongoing food security and foreign exchange shortage problems, the government is taking supply-enhancing policies and reforming the product market into an organised form. It is inviting FDI in the agriculture sector, especially along its border areas in the west and northwest parts of the country. Regarding the product market, the government has established Africa's first commodity exchange, believed to enhance market-oriented agriculture in the economy. It has also taken a firm stand not to adjust the deposit interest rate further, despite pressures from professionals at home and abroad. The IMF seems to be accepting this government stand, as the issue of raising the deposit interest rate is not part of the recently signed memorandum of understanding with Ethiopia.

Very recently, the government of Ethiopia extended the loan repayment schedule for 42 flower producer exporters to two to three years to enable them to cope with the sluggish demand in the flower market following the crisis and during the subsequent economic slowdown. This decision was made after a thorough assessment of the loan extension request by an *ad hoc* committee comprising officials from the DBE, the NBE and the Ministry of Agriculture and Rural Development (MoARD) and representatives from other relevant organisations.

On top of this, the government is trying to diversify the market for flowers. To offset declining sales of flowers in the Netherlands, its main market, the government is making concerted efforts to attract buyers from Dubai, Asia, Scandinavia, Russia and the US. By doing this, it is hoping to boost its flower exports in these countries.

4.4 Multilateral responses

The Ethiopian government has been playing an active role in both the global and the African initiative to increase external financing from multilateral and bilateral donors to help poor countries cope with the growing financing gap. In response, G-20 leaders have pledged more aid to crisis-affected countries and the Executive Board of the IMF approved modifications to the ESF in September 2008. The adjustment, which came into effect in late November 2008, is reported to be making the facility faster to access, easier and more flexible to use, as well as capable of providing more financing.

In response to the Ethiopian government request for such financing, the Executive Board of the IMF approved disbursement in an amount equivalent to Special Drawing Rights (SDR) 33.425 million (about $50 million) to Ethiopia under the rapid access component of the ESF on 23 January 2009. In August 2009, the Executive Board of the IMF approved SDR 153.75 million ($240.6 million) to Ethiopia under the high access component of the ESF. Of these, SDR 73.55 million ($115.1 million) has already been disbursed.

The disbursement to Ethiopia under the rapid access and high access components of the ESF will definitely contribute to its efforts to rebuild international reserves. The optimal strategy here is fast-track disbursement of the aid pledged at the G-20 summit.

5. Conclusions

5.1 The impact of the crisis: An update

This study has identified FDI, trade, remittances and aid as channels through which the crisis is transmitting its effects. The crisis outbreak was followed by a decline in FDI inflows, remittances and volume and price of exports. Aid inflows were found not to be declining, mainly because of the immediate and positive government reaction to take up the opportunities offered by the IMF and the World Bank.

The decline in export revenues and remittances led the government to ration foreign exchange with resultant impacts on import volumes, growth and development. Imports have declined and this has further limited the growth of domestic investment, government expenditure and private consumption. Gross domestic investment as a percentage of GDP has declined from about 24% of GDP in the past four years, to 20.3% in 2008/09. Considering that import duties and taxes contributed 56% of tax revenue and 40% of total revenue in 2007/08, the decline in imports in 2008/09 slowed down the growth of tax revenue in the same fiscal year. In this context, one would expect a decline in overall growth. Despite the Ethiopian government's 11.2% estimate of real growth of GDP in 2008/09, overall growth is estimated to be as low as 7.5% (IMF, 2009b) and 6% (World Bank, 2009).[13] The estimated decline in growth and the observed decline in public expenditure and private consumption as a result of the crisis are believed to have increased incidence of poverty above what it otherwise would have been.

The adverse effects of the crisis would have been more severe than observed had it not been for the government's appropriate policy responses. It is believed that the level of the crisis impact depends, among other things, on the quality of the policies put in place. Although the government used a 'wait and see' strategy in the initial stages of the crisis, it later on responded by taking concerted monetary, banking and financial, fiscal, external and administrative measures. Such measures were implemented in consultation with key institutions of the country, including MoFED, the NBE and the MoTI. The government has also pursued tighter monetary policy, a fiscal deficit reduction, a depreciation of the exchange rate, currency swap arrangements, enhanced private and public saving, strengthened social safety nets, a deepening domestic financial system and supply-enhancing interventions.

The Ethiopian government has also put a great deal of pressure on multilateral and bilateral donors to increase their aid. In response to this, and to other similar initiatives in Africa and elsewhere, the Executive Board of the IMF approved disbursement in an amount equivalent to SDR 33.425 million (about $50 million) to Ethiopia under the rapid access component of the ESF on 23 January 2009. In August 2009, the Executive Board of the IMF approved SDR 153.75 million ($240.6 million) to Ethiopia under the high access component of the ESF. This has enhanced the government's efforts in rebuilding the country's international reserves.

5.2 Looking ahead: How well is the country positioned to gain from a future recovery and grow sustainably?

So as to combat shocks and enable the country to achieve the Millennium Development Goals (MDGs), there is a need for further concerted effort by the government to achieve macroeconomic stability and sustain economic growth. This calls for measures geared towards sustaining macroeconomic reforms; effective monetary management; deepening of the financial system and financial sector soundness; fiscal prudence; enhancing supply capacity; augmenting domestic saving; increasing foreign exchange

13 The actual growth performance of the Ethiopian economy for 2008/09 is yet to be reported.

generation; and enhancing social protection. This needs to be complemented by greater external financing in the short to medium term as the self-financing capacity of the economy is still precarious.

However, the long-run strategy should be greater domestic resource mobilisation to support domestic investment and, thus, growth from within. Mobilisation of domestic resources is the foundation for self-sustaining development. In this regard, the experience of East Asian countries, where domestic savings by the public and private sector and individuals have played the main role in financing gross domestic investment, could be educative for the Ethiopian government.

The basic issue in domestic resource mobilisation is achieving the dual objective of generating more domestic resources and efficiently channelling them to investment and increased productive capacity. This requires, among other things, measures such as:

- A sound macroeconomic policy environment conducive to private savings;
- A concerted saving mobilisation campaign and tax education;
- Increased access to financial services by supporting the establishment and expansion of financial institutions, financial markets and innovative schemes, including:
    - Establishing postal saving schemes;
    - Expanding the social retirement scheme to permanent employees of private companies throughout the country;
    - Encouraging life insurance;
    - Establishing and expanding youth saving schemes;
    - Introducing saving bonds;
    - Establishing deposit insurance;
    - Expanding microfinance institutions;
    - Encouraging expansion of branch networks;
    - Enhancing prudential supervision of financial institutions, etc;
- An extensive tax reform programme geared towards expansion of the tax base and enhancing the effectiveness of tax collection and administration; and
- Efficient, effective and transparent mechanisms for the allocation of public expenditure.

However, all of this needs further investigation as to feasibility in view of the global crisis.

In line with this, in the letter of intent submitted to the IMF on 7 August 2009, the government of Ethiopia has rightly shown commitment to implementing additional policy measures, as the country's improved macroeconomic performance is being threatened by the difficult global economic environment. According to the authorities, despite the ease in commodity price pressures, receipts from merchandise exports, remittances and FDI are still under severe pressure.

So, the main focus of the policy stance of the authorities for the 2009/10 fiscal year is maintaining macroeconomic stability, controlling monetary growth, fiscal tightening and the achievement of appropriate foreign exchange liquidity in the economy through greater exchange rate flexibility and external debt management strategies. It should be noted, however, that the envisaged measures are not exhaustive as far as domestic resource mobilisation is concerned.

5.2.1 Maintaining macroeconomic stability

The government of Ethiopia has stated that the overarching objective of the economic programme for 2009/10 is to maintain macroeconomic stability in the face of the difficult external environment. More specifically, the planned objectives of policy interventions include maintaining 7% GDP growth, keeping annual inflation below 10% and increasing foreign reserves to $1.67 billion (1.9 months of import coverage).

5.2.2 Monetary policy

The authorities are planning to continue orienting monetary policy towards containing inflation and supporting the gradual rebuilding of reserves. Accordingly, the following targets are set for 2009/10:

- Broad money growth is targeted at 17.1%.
- Real growth in credit to the private sector is set at 6%, representing some easing in real credit availability vis-à-vis 2008/09.
- The existing auctions of treasury bills (held every two weeks) are to be continued as an instrument to control liquidity in the short run. The setting of sales volumes is planned in line with the reserve money target. In order to improve the setting of auction volumes, the development of an effective liquidity forecasting capability, deploying the appropriate staff and resources as well as close cooperation and weekly information sharing between the NBE and MoFED, is envisaged to be implemented by the government.
- In the medium term, the authorities are planning to develop central bank open market operations using diversified government securities.

5.2.3 Fiscal policies and public sector management

On the fiscal front, the plan is to maintain a tight fiscal stance in 2009/10. This includes limiting government and public sector borrowing, increased revenue mobilisation and prioritisation of government expenditure. More specific mechanisms include:

- Containing the overall public sector domestic borrowing level at 3.0% of GDP, Birr 5.8 billion (1.4% of GDP) domestic borrowing of the general government and Birr 6.3 billion (1.6% of GDP) domestic borrowing by public enterprises.
- Strengthening control over financial operations of public enterprises and agencies.
- Domestic borrowing of the federal government to be financed by a mix of direct advance and sales of government securities.
- General government domestic revenues of at least Birr 49.0 billion (12.2% of GDP) by eliminating temporary exemption from VAT for food and food-related items and by intensifying efforts to improve revenue collection. To improve tax collection, strengthening tax payers' education, enhancing enforcement capacity, repealing of the exemption privilege of tax on personal effects, applying biometric data management, implementation of cash register machines at full scale, a focus on high risk areas for audits and investigation of tax fraud and enhancement of the use of cargo scanning machines are to be executed by the ERCA. Planned tax revenues for the year 2009/10 are set at 8.7% of GDP.
- Reviewing both tax administration processes and tax policies in the medium term through technical assistance from the IMF's Fiscal Affairs Department.
- Total domestically funded outlays set at Birr 54.9 billion (13.6% of GDP).
- Protecting poverty-reducing spending and strategic capital projects in prioritising public expenditures. Total expenditure and net lending of the general government is planned at 18.4% of GDP, recurrent spending at 8.3%, poverty-reducing spending at 13.1% and government-funded capital spending at 7.2% of GDP. Non-priority investments are to be postponed.
- Continuing the current practice of setting fuel price above costs to allow repayment of the accumulated debts of the OSF. Also, the government is planning to maintain the policy of ensuring that electricity tariffs are set at levels that yield full recovery of costs by the state-owned electricity company.

5.2.4 Exchange rate and external debt policy

The foreign exchange market pressure is expected to intensify as the global recession exerts greater impacts on the country's foreign currency receipts. So, the authorities are planning policy interventions to enhance exchange rate flexibility aimed at promoting better allocation of scarce foreign exchange and enhancing incentives for exporters, domestic producers and remittance senders. More specifically, further depreciation of the exchange rate is envisaged to be implemented in due course. However, such

interventions should not destabilise inflation expectations, which have become a major driver of price formation in Ethiopia.

The other planned intervention by the government is the maintenance of effective oversight over the evolution of public sector external debt and ensuring that new borrowings are contracted at concessional terms. Added to this, large foreign-financed projects are going to be subjected to rigorous economic appraisal before being approved.

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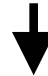
Annex 1: Mapping out the effects of the global crisis and policy responses

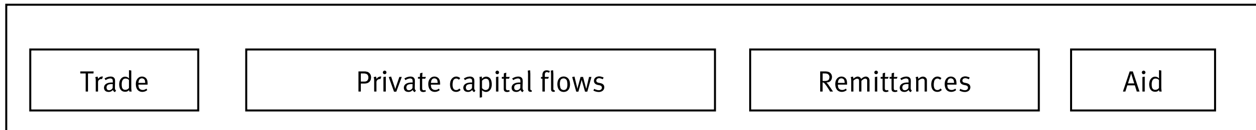
What is the shock at global level?

Level and type of economic and financial integration

- Structure of economy
- Policy

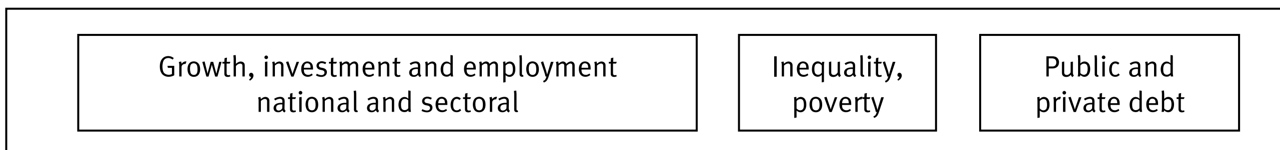


What are the components of the shock at national level?



- Economic/social structures
- Institutions/policies
- Assets, prices, employment
- Access to goods and services

What are the broad macro effects? (effects so far, possible effects)



Critical review of policy responses

Annex 2: Values at current market prices (US$ millions)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
GDP	8166	7771	8572	10,077	12,327	15,186	19,747	27,172	33,923
GNI at cmp	8133	7746	8545	10,038	12,340	15,213	19,794	27,221	33,971
GCF	1752	1859	1873	2566	2835	3679	4901	5762	6878
X	978	979	1142	1502	1861	2100	2512	3133	3885
M	1934	2067	2350	3182	4374	5548	6330	8471	9479
GNS	1555	1217	1412	1562	2153	2676	4217	4711	6474

Source: MoFED data.

Annex 3: Export and import values at current market prices (US$ millions)

	2005				2006				2007				2008				2009		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Major exports of goods																			
Coffee	95	141	61	35	101	158	91	68	111	155	92	53	192	188	133	42	76	125	105
Oil seeds and pulses	58	55	40	70	88	51	33	46	99	80	59	63	136	105	67	74	160	146	72
Flowers	3	3	2	4	8	7	7	14	22	20	20	24	33	35	27	29	38	37	35
Gold	11	10	9	14	5	37	9	13	11	64	13	16	16	34	18	20	25	35	26
Chat	19	22	23	22	21	23	21	21	25	25	27	29	26	27	33	34	37	34	46
Leather	16	19	17	16	19	23	18	23	23	26	20	29	24	26	25	29	12	10	11
Others	37	30	33	50	37	27	25	45	49	41	35	55	48	43	49	43	54	37	48
Total	239	282	187	210	278	326	204	230	340	411	266	268	474	458	352	271	402	424	342
Major imports of goods																			
Raw materials			13	26	23	15	17	31	60	41	62	70	51	74	96	118	77	64	60
Semi-finished goods			190	168	260	204	148	167	214	272	221	259	454	326	252	246	277	366	287
Fuel			187	114	112	448	259	210	238	168	290	349	408	575	506	244	220	286	268
Capital goods			350	373	362	368	366	466	509	528	456	485	396	440	779	574	595	526	657
Consumer goods			309	378	306	289	288	352	338	339	326	375	375	439	573	718	530	523	470
Durables			96	100	101	118	137	139	119	125	116	123	107	113	162	148	157	169	168
Non-durables			213	278	205	171	151	212	219	215	210	252	268	326	412	570	373	354	302
Miscellaneous			20	24	21	32	17	47	33	20	53	43	88	195	66	43	25	24	32
Total imports			1068	1084	1085	1356	1095	1271	1392	1368	1408	1580	1771	2051	2273	1942	1723	1788	1732

Source: ERCA data.

Annex 4: Private cash transfers (remittances) (US$ millions)

Period	Remittances
Jul-05	24.9
Aug-05	27.8
Sep-05	27.4
Oct-05	29.5
Nov-05	27.2
Dec-05	37.5
Jan-06	24.6
Feb-06	25.4
Mar-06	26.2
Apr-06	26.1
May-06	26.9
Jun-06	42.3
Jul-06	34.7
Aug-06	31.8
Sep-06	32.1
Oct-06	35.3
Nov-06	30.9
Dec-06	40.9
Jan-07	34.0
Feb-07	40.8
Mar-07	42.2
Apr-07	31.1
May-07	51.2
Jun-07	40.2
Jul-07	54.3
Aug-07	52.6
Sep-07	38.2
Oct-07	51.2
Nov-07	67.3
Dec-07	74.0
Jan-08	65.5
Feb-08	63.4
Mar-08	60.4
Apr-08	75.3
May-08	65.3
Jun-08	59.3
Jul-08	67.8
Aug-08	61.1
Sep-08	72.4
Oct-08	72.8
Nov-08	64.5
Dec-08	84.9
Jan-09	68.4
Feb-09	58.6
Mar-09	59.9
Apr-09	59.5
May-09	63.1
Jun-09	55.1

Source: NBE data.

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