

Executive Summary: Ethiopia Country Strategy Note

Economic and Political Context

Ethiopia is the second most populous country in Africa, home to more than 110 million people and one of the world's fastest growing economies. With annual economic growth averaging 10 percent over the last decade. Ethiopia has also made considerable strides in infrastructure investment and human capital development, with public-sector investment demand being a key driver of growth. Services sector were some of the fastest growing, notably, construction and wholesale and retail trade, overtaking the agriculture sector as the most important contributor to GDP. While the backbone of government's industrialization policy since 2010 has been investment in enabling infrastructure and industrial parks, manufacturing's contribution to GDP has remained modest at 5 percent of GDP.

Along with the government's greater investment in infrastructure there has been improvements in access to clean water, road infrastructure, electric power supply, and telecommunications infrastructure. With a decline in the national level headcount poverty ratio from 38 percent in 2004-05 to 22 percent in 2018-19 financial years with a higher prevalence in rural areas. Social indicators have also improved, with a halving of maternal and infant mortality rates since 2001 and rapid increase in enrolment rates at all levels of education. However, a large proportion of the population still faces multi-dimensional poverty.

Despite this, more recently economic growth has slowed, declining below 10 percent since 2016 and it being expected to be 4 percent lower because of the COVID-19 pandemic.¹ While this downward trend may in-part reflect productivity growth in agriculture and manufacturing not having kept pace with public investment, severe macroeconomic imbalances have also revealed tensions and may pose a challenge to the sustainability of the growth and structural transformation model. While risks are also posed by large and growing urban youth unemployment, acute trade imbalances and foreign exchange shortages, and persistent double-digit inflation affected both economic and political stability.

Waves of protests in the Oromia and Amhara regions since 2015 culminated in the resignation of the former Prime Minister and election of a new leader and thus new Prime Minister, Dr. Abiy Ahmed, in early 2018. With the new administration started undertaking economic and political reforms in response to protests and political space having opened and the government's expressing a commitment to adopt more evidence-based policymaking. Reflected by a significant increase in the number of political parties and debates about nation building, federalism, and national identity. Nonetheless, unrest and ethnic-based conflicts have continued, presenting serious political and economic challenges, most recently in the Tigray region of the country.

The economic challenges have prompted the new administration in 2018 led by Prime Minister Abiy Ahmed to change gears in the country's growth drivers. Building on the achievements of the past decade, the country entered a reform period to realign incentives and encourage private sector-driven and supply-led growth. This includes a focus on addressing macroeconomic imbalances and addressing youth unemployment, as laid out in the 'Home Grown Economic Reform Program' in late 2019 and more recently in the 'Ten Year Perspective Plan'. Boosting agricultural productivity in light of small size of average land holdings of farm households and land degradation remains an important policy challenge.

¹ <https://blogs.worldbank.org/africacan/tackling-impacts-covid-19-imperative-ethiopia-journey-prosperity>

Strategy note

Industrialization challenges include boosting the returns to energy, telecommunication and transport infrastructure through market reforms and aligning with urbanization policy. Mining, tourism and ICT sectors are also identified as priority sectors in the reform and perspective plans.

The Covid-19 pandemic has posed additional challenges to inclusive growth in Ethiopia. While the Ethiopian government has taken a number of mitigating and preventive measures, including border controls and increased social distancing measures in businesses and schools, the overall economic impact is expected to be substantial. With the major impact of Covid-19 on Ethiopia being a result of the global economic slowdown. With IGC modeling suggesting that shocks to external trade and remittances shocks would reduce growth by total of roughly 4 percent a year (2 percent via each channel).

These impacts are expected to be felt across income groups, with the export and remittance shocks particularly acute for rural poor and urban poor, respectively. To support livelihoods, Government responded with a range of fiscal, financial, and external support measures in addition to containment measures, including expansion of the social safety net and business tax relief. Yet the combination of the domestic and external shocks can only exacerbate the pre-existing macroeconomic imbalances. Hence, addressing these imbalances remains a high government priority.

The Covid-19 crisis is also diminishing new job creation and increasing unemployment in Ethiopia. Informal workers, roughly 40 percent of employment, are particularly vulnerable including farm and non-farm rural jobs. Given impacts of the pandemic on industries and global supply chains around the globe, Covid-19 also poses a grave challenge to Ethiopia's industrialization strategy. For example, garment production and employment has slowed, and firms are anticipating further disruptions in demand. Adjusting to a post-Covid world will be an important challenge.

Country Programme:

Overview

The IGC Ethiopia programme was established in 2010 and has been hosted by the Policy Studies Institute (formerly known as Ethiopian Development Research Institute), a government think tank currently under the Planning and Development Commission. The programme has provided demand-driven research for growth-promoting evidence-based policy in Ethiopia, drawing on close engagement between international and domestic researchers and government partners. The Ethiopia team comprises a Country Director (Kathie Krumm), two Country Economists (Tewodros Gebrewolde and Seneshaw Beyene), two Lead Academics (Pramila Krishnan and Stefan Caria), a Senior Adviser (Alemayehu Taffesse), and an office manager (Feben Abraham).

IGC Ethiopia: Recent Work and Impact

IGC has built a body of policy relevant knowledge particularly in the areas of firm capability and cities with specific focus on manufacturing sector, labour markets and housing. IGC-commissioned research projects mostly used experimental methods and new data to rigorously study the features of and outcomes in the labour market, including skills signalling, matching, networks, self-employment, labour mobility, recruitment, labour retention and turnover. IGC also contributed to insights on other

Strategy note

related firm performance and industrial policy issues such as industrial park, productivity, managerial effectiveness, trade and infrastructure impacts and other low-cost housing. These provided credible answers to several policy-relevant questions and established IGC as a leading knowledge hub on urban labour market and firm performance issues with a close working relationship with the Jobs Creation Commission and other partners.

The flagship project undertaken by the IGC at the Ethiopian Investment Commission resulted in a more conducive environment for foreign investment with the subsequent establishment of a Relationship Building Programme and continuing engagement of the researcher with the implementing partners including (former) DFID. Another example of a tri-partite engagement was the project on civil service productivity where the results of the research are directly informing a policy change at the Civil Service Commission in collaboration with the World Bank.

The new government opened additional avenues for evidence-based policy making. This included the microeconomic underpinnings of the macroeconomy. Part of IGC engagement included direct support by the Country Economists to the Prime Minister's Office and the National Bank of Ethiopia and other support to monetary and exchange rate policy. IGC's report on State Fragility also was timely.

IGC Ethiopia: Outlook

The thematic focus for the Ethiopia programme in IGC's Phase 3 builds on established engagements as well as responds to the economic policy priorities of the Ethiopian administration, including in the recovery phase from the global COVID-19 crisis. These thematic focus areas include Jobs; Industrial Transformation; and Micro Underpinnings of Macroeconomic Imbalances. As gaps in knowledge in other longer-term challenges emerge, the IGC remains committed to generating evidence to guide policy makers.

Jobs (Firms/Cities)

A cluster of research is emerging around the labour market and Jobs agenda. One of the major challenges and opportunities facing Ethiopia is a growing and increasingly educated labour force. Jobs will follow from a broad-based growth strategy, including a more dynamic private sector investment climate and including agriculture and informal services. Nonetheless, high urban youth unemployment is striking and may pose a risk to stability. IGC Ethiopia intends to help policymakers address this by providing research support to the Jobs Creation Commission and other agencies and helping building consensus on the medium-term research program needed to achieve the country's objectives.

Facilitating school to work transition. Skills mismatch, weak skill signalling, recruitment based on personal networks and other information frictions challenge the functioning of the labour market in Ethiopia. Active labour market programs can play a supportive secondary role. IGC research will continue to inform design of these programs to ensure effectiveness. For example, IGC Ethiopia intends to address this by working with policymakers to improve the urban social safety net program and assist with the design of the proposed internship program. IGC also will support the Job Creation

Strategy note

Commission's approach to skills development to enhance quality and relevance of education to the needs of the market.

Linking improved labour market functioning and firm growth. Existing work suggests that labour market frictions may have under-appreciated negative consequences for firms, as they may distort recruitment, retention, and the workings of performance incentives. More work is needed to carefully identify these costs and how they can be addressed by policy.

Using labour market policy to benefit vulnerable and rural populations. Given existing work has mostly focused on young urban jobseekers with at least secondary education, a focus will be to examine what can be done to include in the labour market specific groups that may face even stronger barriers, for example mothers, internally displaced individuals and refugees, or individuals who have not completed high school. In addition, even significant growth in manufacturing and related employment in urban areas as part of structural transformation cannot absorb the ever increasing and better educated rural young population; hence, IGC intends to work on the potential for rural farm and off-farm jobs with a particular focus on gender.

Industrial Transformation (Firms/Cities)

Formal and informal private sector firm demand will be important to the jobs agenda. IGC intends to continue to support evidence-based research on firm-level growth constraints and industrial development as an important component of structural transformation.

Addressing long-standing challenges. Labour productivity in Ethiopian firms remains low by international standards (e.g. in the manufacturing sector). An expansion of the private sector without a commensurate acceleration of productivity growth is unlikely to be sustainable. Key constraints plausibly include access to input and output markets, including export markets, infrastructure and energy costs, regulation, taxation, and the quality of management. For example, what has prevented Ethiopian firms from improving the quality of their management remains a puzzle. Similarly, access to export markets is limited by different kinds of barriers. Yet, export markets have the potential to spur firm growth, make the economy more resilient to internal shocks, and help address some of the existing macroeconomic imbalances.

IGC will support research that aims to identify what interventions could be used to relax some of these constraints, with particular attention to interventions that could be scalable and design that can identify general equilibrium effects.

Revisiting investment promotion. The shift in strategy toward a private-sector and supply-driven approach to growth calls for reaching out to a broader set of potential investors. Building on its earlier work with the Ethiopia Investment Commission, IGC intends to re-engage on these issues.

Aligning industrial policy with urbanization including housing. Urbanization and agglomeration have important synergies with industrialization. Key challenges for urban areas in the context of industrial parks and beyond are how to maximize returns to the infrastructure investments and expand urban housing. The IGC has already commissioned research on housing issues which have emerged for workers migrating

Strategy note

to industrial parks. It also has commissioned research on effectiveness of public housing, notably in rapidly growing Addis Ababa. However, key research gaps remain, related to the functioning of rental markets and the potential to combine public and private-led solutions to urban housing challenges. As this will be key to integrate urbanization and industrialization policies. IGC Ethiopia will continue to focus on the area by integrating cross-country lessons and filling other Ethiopia-specific research gaps.

Microeconomic Underpinnings of Macroeconomic Imbalances (State)

Addressing macroeconomic imbalances is essential to structural transformation and inclusive growth and is a high priority of the Ethiopian government.

Informing macroeconomic policy. IGC will maintain the momentum in its work on microeconomic underpinnings of macroeconomic imbalances. IGC has carried out high level dialogue in the last two years which identified issues where IGC analysis could contribute. This included analysis of the parallel foreign exchange market as the authorities reformed their exchange regime as well as the underlying explanatory factors for stubbornly high inflation in Ethiopia. IGC will continue to carry out empirical research to meet demands in other priority areas such as revenue strengthening or civil service capacity as they arise.

Exploring sub-national impact. Regional differentiation is an important element of the Ethiopian federal system. As part of its response to the COVID pandemic, IGC is supporting the Amhara regional government in understanding the impact on its economy.

Other focus areas.

Thematic research priorities will be refined further with a longer-term perspective as the government's ten-year perspective plan is fleshed out. For example, while other stakeholders are specialized in the environment and energy, IGC may identify research gaps on issues linking growth, poverty and the changing environment including sustainable growth in the mining sector and internal migration. Given political developments and the focus of policy makers on developing ICT, other areas could include technology impact on growth and employment, capitalizing on the earlier Fragility Report.

Country Team's Inclusive Growth Strategy

The Country Team's inclusive growth strategy has three central themes: gender, urban poverty, and broader vulnerabilities. Key elements of Ethiopia's inclusive growth strategy are imbedded in IGC's thematic areas of work.

Gender issues are systematically highlighted across the labour market research. IGC-commissioned research includes analysis of women entrepreneurship and the disaggregated study of the impacts of labour market policy on female employment. This analysis has shown that young urban women experience particularly strong benefits from interventions that provide liquidity and labour market information. Going forward, more attention will be given to issues related to gender-based violence in the

Strategy note

workplace (e.g. in the industrial parks) and at home (e.g. linked to the research on housing).

Urban poverty is also a key focus of much of the research across the various themes. The labour market interventions that have been studied focus specifically on unemployed youth at high risk of poverty. Further, the recent wave of research on industrial parks looks specifically at a new set of employment opportunities offered to individuals from high-poverty rural communities. Additionally, much of the focus in urbanization has been on low-cost housing, and the work on inflation has particular relevance for the urban poor, whose wages have been shown to be eroded by inflation.

Broader vulnerabilities related to both health and livelihoods that may result from inadequate housing quality and from a changing climate are also considered in several pieces of existing work – for example ongoing work on rural jobs -- and will be looked at in more depth in future work.

The IGC in Ethiopia also aims to strengthen inclusivity in the way it works, combining the strengths of national and international researchers as well as leveraging the capacity of its own team of economists.

Partnerships, Policy Engagements and collaborations:

The IGC in Ethiopia is committed to being responsive to filling knowledge gaps in priority areas identified by our partners. IGC cultivated partnerships with a range of ministries, commissions, and think tanks, and the country team has established strong relationships with the new administration where much of the research demand is concentrated on the reform process.

Existing relationships with stakeholders and partners by theme

Theme	Relevant Stakeholders and Partners
Jobs (Firms/Cities)	Jobs Creation Commission Planning and Development Commission Central Statistical Authority
Industrial Transformation (Firms/Cities)	Ethiopia Investment Commission Ministry of Trade and Industry Planning and Development Commission Ministry of Urban Development and Construction Ethiopian Electric Power Central Statistical Authority

Strategy note

Micro Underpinnings of Macro Imbalances (State)	Office of the Prime Minister Ministry of Finance and Economic Cooperation National Bank of Ethiopia Ministry of Revenue Planning and Development Commission
--	---

IGC works in collaboration with a number of development partners, including the World Bank and UNECA, often on a tri-partite basis. It also has active partnerships with the Ethiopian researcher community, for example, Ethiopian Economics Association, IFPRI, Open Society Foundation, and Forum for Social Studies. These both strengthen the policy relevance of IGC research as well as draw on the capacity of a diverse group of researchers.

Sharing the findings of our work as they become available will play an important role in building IGC’s presence in policy and development circles. Our communications strategy includes both direct dissemination of policy analysis and research with key stakeholders and translation of findings into shorter articles for a wider audience to inform public debate.

Country Covid-19 Strategy: Response and Recovery

Response Strategy

As noted, the Covid-19 pandemic has exacerbated many of the policy challenges in the areas of IGC-supported research, including macroeconomic imbalances and diminishing employment opportunities. Addressing these will be as important if not more important as policymakers’ focus turns to minimising long-term economic harm and supporting longer-term recovery. In addition, there will be some specific Covid-driven issues in structural transformation in a post-Covid global economy.

Policy decisions regarding Covid response require data on impact and trends. IGC is particularly active in collecting data on households and businesses through high frequency surveys. This data also can provide insights on the reach of government policies and programs. Notably, IGC has been supporting a large survey among individuals (including recent migrants) and firms in Addis and surrounding urban areas and analyzing recent surveys of workers and firms in industrial parks, in both cases where baseline data already exist. The Covid-19 crisis is expected to have a differentiated impact across the country. In this regard, IGC is supporting Amhara Region to estimate the impacts using regional data as well as to identify policy responses to accelerate recovery.

Recovery Strategy

IGC also will support research providing insights on how Ethiopia can best recover and respond to a post-Covid world. This will be built into the program of work on jobs, industrial transformation and macroeconomic imbalances. The Jobs research program

Strategy note

will help identify labour supply shifts from Covid-risks including internal migration; and evaluate policies for stimulating large scale job creation post-crisis. In addition to the direct impact of COVID-19 on firm productivity, the global pandemic also calls for firm technological and supply-chain adaptation. IGC intends to continue supporting detailed survey work in the country's most rapidly urbanizing areas to inform policy makers as to directions this may take, for example, the extent to which COVID-19 is driving Ethiopian business online, how this transition typically occurs, and whether the shift to online business has spurred the creation of new types of intermediary businesses in the supply chain. IGC also will examine the impact of ICT programs and policies on growth and employment, including mobile phone technology whose centrality has been heightened by the pandemic. IGC also will provide an assessment of the impacts of COVID-19 on Ethiopia's industrial parks, building on existing IGC research in this area. IGC cross-country work on global supply chain disruptions and potential implications of increased diversification ('just in case' instead of 'just in time') also intends to inform Ethiopia on how it can best position itself in export markets. Pressures on the exchange regime and inflation from the global Covid-19 crisis will continue to be a challenge in Ethiopia, and IGC research will continue to inform policy. To strengthen fiscal ability to support the recovery, IGC will support property tax strengthening, for example, in the area of commercial property assessment. It also will use its labour market and industrialization research to inform adjustments to fiscal programs to enhance recovery.