

Keynote Address by Abebe Aemro Selassie
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Contextualizing Ethiopia's Recent Economic Performance

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Introduction

Good morning.

Let me start with two caveats.

- First, these are my views and not those of the International Monetary Fund (IMF) nor its Executive Board.
- Second, it has been some 25 years since I last lived here. And here I am, in front of this august assembly of our country's celebrated economists to tell you what you likely know very well already.

In keeping with our country's tradition of hospitality, I hope you will forgive the hubris that this entails and allow me to proceed with my presentation.

Known knowns. As I have been reading and learning more about Ethiopia's economy and preparing this address, there seem to be two important points on which there is broad agreement:

- Over the last 25 years, Ethiopia has made incredibly important development progress, underpinned by rapid economic growth.
- Of late however significant macroeconomic imbalances have emerged.

My aim today is threefold:

- To put this progress into an international perspective. This comparative perspective is in many ways what the IMF is good at.
- Second, to consider the factors that have contributed to this success;
- Finally, I will turn my thoughts on how the challenges that have emerged might be addressed.

A Three Act Play

The period I will be focusing on is economic developments since the early 1990s. There are two reasons for this.

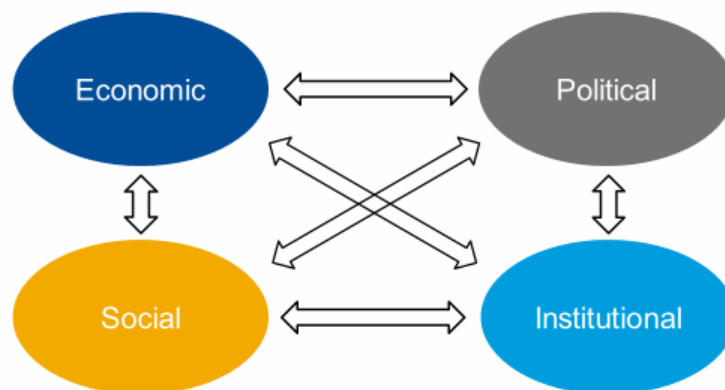
First, the end of the Cold War was a seminal moment that greatly shaped the political and economic history of dozens of countries around the world, many countries in Africa and notably here also. Second, and as I noted at the outset, this period roughly mirrors the start of my own working career as an economist and thus is the period I know best.

My starting point for today's presentation was to ask, from the vantage point of the early 1990s, what was it that Ethiopia, and indeed other developing countries, needed to do to succeed at development?

And while in the rest of my talk I will focus on the economic aspects of development, economic progress of course does not happen in isolation. Indeed, economic transformation in the absence of political, social, and institutional improvements is not unlike building a skyscraper without a foundation.

Economic progress is only complete when there is also progress along these other axes. The specific form of political, social, and institutional arrangements that are compatible with economic progress of course can vary from country to country. My sense is that it is when transformation along one of these axes far exceeds, or is well-behind, transitions in other dimensions, we see deep economic and/or political stresses. There are exceptions of course. But these tend to be very rare.

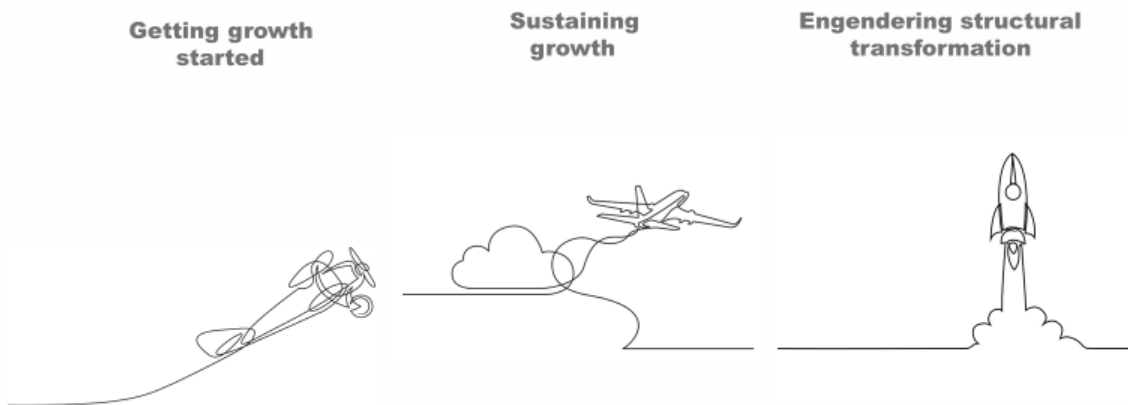
Economic transformation/development occurs along several dimensions



If Gash Tsegaye Gebremedhin or one of our other great playwrights were to dramatize the wishes of many policymakers in the early 1990s, it would likely have been a play with three acts:

- **Act I would have been getting growth started,**
- **Act II, sustaining high growth for decades; and**
- **Act III, engendering structural transformation.**

On the wish list for most developing countries circa 1990



Getting growth started is perhaps the easy part. Two to three years, or even five years of uninterrupted growth are not uncommon. Work by Jones and Olken and others have shown that getting growth started is relatively easy—it can happen for a range of reasons, from a change in the economic climate to random changes in leadership.

Sustained and sufficiently high growth for decades has been the more difficult feat for developing countries.

And effecting structural transformation, the more challenging feat still. And rightly so, since this is the kernel of sustained economic development.

The Stylized Facts

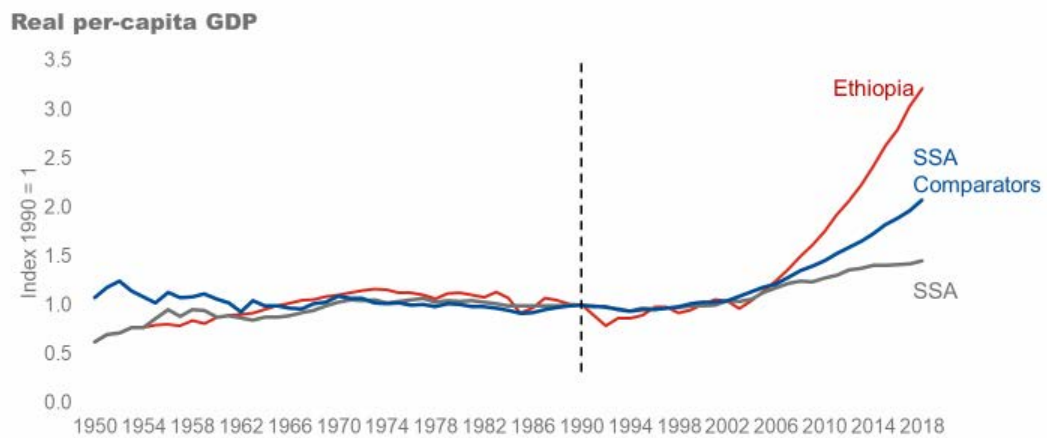
How then have Ethiopia and other sub-Saharan African countries done in these three areas?

A look at the path of real GDP growth shows what is by now a familiar story.

There was relatively little change in per-capita income levels until the mid-1990s—indeed, a decline relative to much the rest of the world, followed by a marked, and to date, sustained increase.

Growth accelerated in the mid-1990s in many African countries. In the case of Ethiopia, it was closer to 2003. I have split the sub-Saharan Africa (SSA) sample into two—the full sub-Saharan sample, depicted by the grey line—and the fast growing SSA countries, depicted by the blue line.

Limited progress, followed by rapid growth



[Note: SSA comparator countries comprise Senegal, Rwanda, Tanzania, Kenya, Uganda and Ghana.]

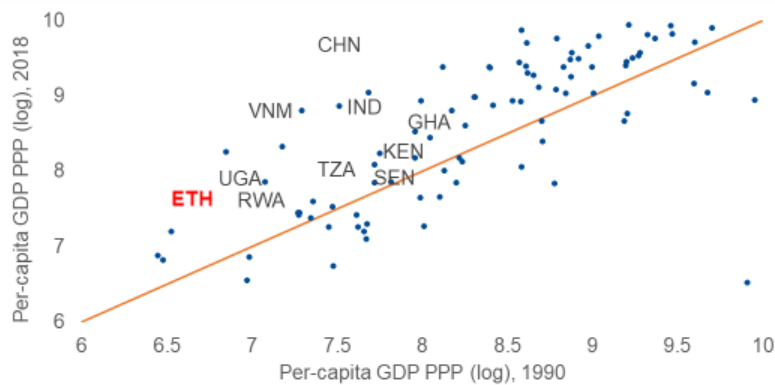
Ethiopia's performance is also fairly impressive relative to many countries in the rest of the world. This chart compares per-capita income in 1990 vs 2018. The further above the diagonal line a country is, the larger the improvement in per-capita income.

Since 1990, per capita income in the world has increased by about 50 percent. For the median SSA country, this increase was 45 percent. In the case of Ethiopia, it was over 200 percent!

Of course, there are countries that have done better still—China (960 percent increase) and India (280 percent increase).

Since 1990, Ethiopia has had one of the highest growth rates in the world

Per-capita GDP PPP, 1990 vs. 2018

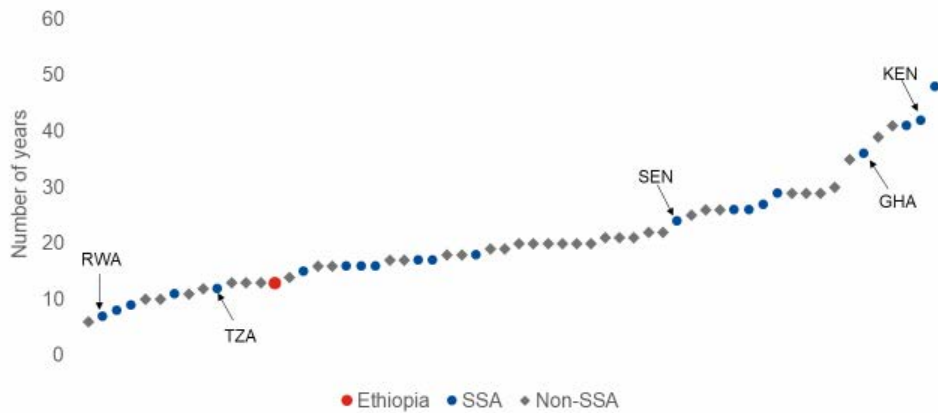


Source: IMF World Economic Outlook database.

But as we know, it is not just growth that matters for well-being. Have other development outcomes mirrored the strong comparative growth outcomes?

One of the clearest indicators of well-being is life expectancy. In Ethiopia it increased from 50 to 60 years in a little over 10 years—that puts Ethiopia in the top quartile globally in terms of speed of raising life expectancy.

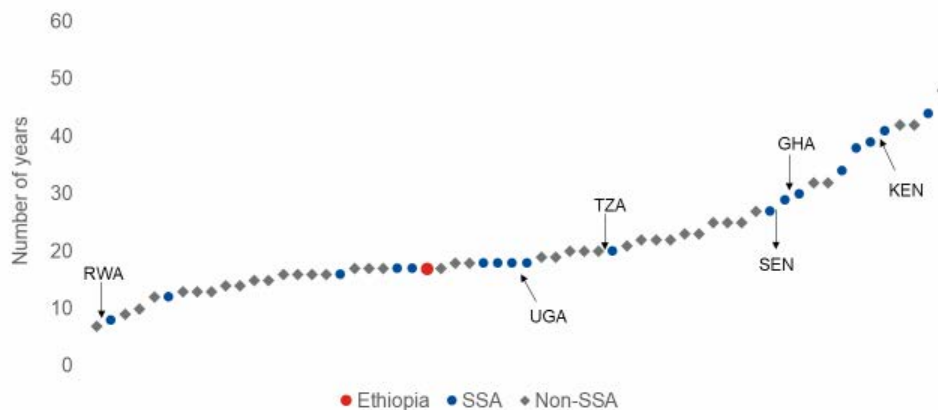
Ethiopia is in the top quartile globally in terms of the time taken to increase life expectancy from 50 to 60



Sources: World Bank, World Development Indicators database.

The improvement in health indicators appears to be broad based - infant mortality decreased rapidly from 100 deaths per 1000 live births to 50.

Other health indicators have also improved, infant mortality decreased rapidly from 100 to 50



Sources: World Bank, World Development Indicators database.

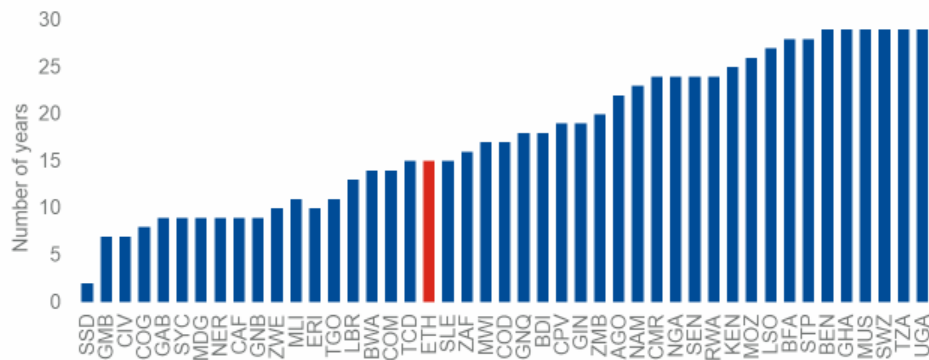
There are many other indicators that one can look at of course. This presentation is not meant to be exhaustive. By and large, what most indicators point to is that Ethiopia's the level of development has been below the SSA average in many cases before its growth acceleration and have caught up and/or exceeded the SSA averages over the last 20-30 years.

So, in terms of the first challenge that faced Ethiopia and many other African countries in the early 1990s, initiating high growth has been achieved and this has been accompanied by broad based improvements in living standards.

On the second challenge, sustaining growth, the picture has been generally good. There are 18 countries that have sustained positive GDP growth for 20 years.

However, positive growth has only been sustained for 15 years

Sub-Saharan Africa: Years with Continuous Positive Real GDP Growth, 1990–2018



Source: IMF World Economic Outlook database.

All the more so because the global economic environment has not been consistently supportive. To be sure, global growth has been higher for significant parts of this period relative to the 1970s and 80s. But there were also many challenges. To mention just one of these: the terms of trade facing non-oil commodity producing countries that comprise many sub-Saharan fast growers have worsened as global commodity prices have been high for a sustained period of time.

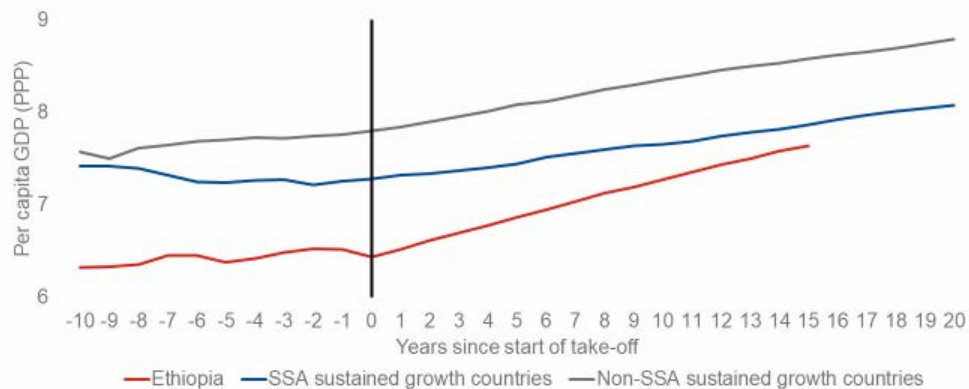
The duration of Ethiopia's growth phase has been somewhat shorter though—some 15 years. For this reason, we also considered the evolution of key aggregates in a different way. This also takes into account that growth takes-offs begin at different points for different countries.

These charts look at economic and development performance before and after take-off time in Ethiopia and a group of comparator countries in sub-Saharan Africa and the rest of the world that experienced sustained growth episodes.

Here we show real GDP per capita in Ethiopia, it began much lower than peers at the point of take-off but has since been feverishly catching up.

In "take-off" time per-capita real GDP started at a lower level and has been catching up rapidly

Log of Per-capita GDP (PPP)



Sources: IMF World Economic Outlook database; Penn World Tables

[Note: Sustained-growth case countries based on Johnson, Ostry, and Subramanian (2007). The criteria are as follows: Countries must have experienced: (a) an improvement in growth rates of at least 2 percentage points per capita; (b) sustained growth of at least 3½ percent per capita for seven years; and (c) higher post-acceleration income level than the pre-acceleration peak. In addition, growth per capita must remain above 3 percent after seven years.

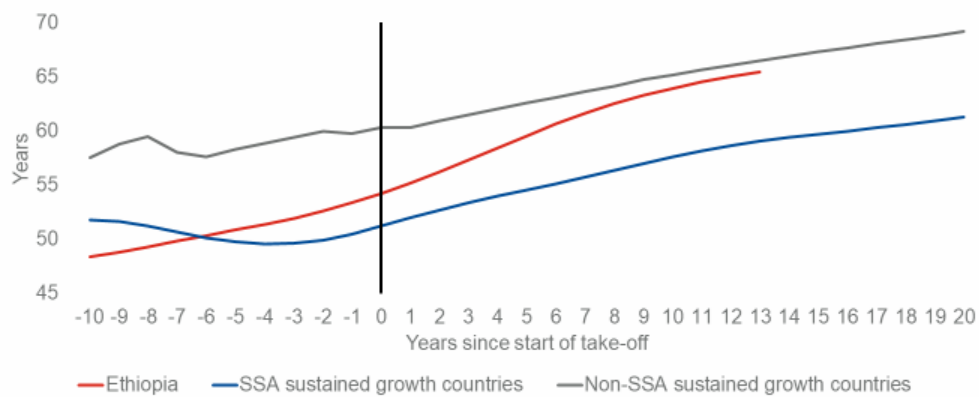
- Non-SSA countries are Chile (1985), China (1977), Dominican Republic (1968), Egypt (1975), Indonesia (1966), Korea (1961), Malaysia (1969), Singapore (1968), Taiwan Province of China (1960), Thailand (1959), Tunisia (1967), and Vietnam (1984).
- SSA countries are Botswana (1966), Ghana (1990), Lesotho (1984), Mauritius (1970), Rwanda (1996), Tanzania (1994), and Uganda (1993).]

There is an even better picture when we look at non-income indicators such as life expectancy. Taking as given that per capita income and health outcomes are correlated—in the broadest of terms—we see Ethiopia’s furious pace of progress since the 2000s or so.

Ethiopia began with life expectancy well below other sustained growth countries and has now almost caught up to the fast-growing countries in the rest of the world at the same time as their take-offs.

Life expectancy has improved at a rapid pace...

Life Expectancy

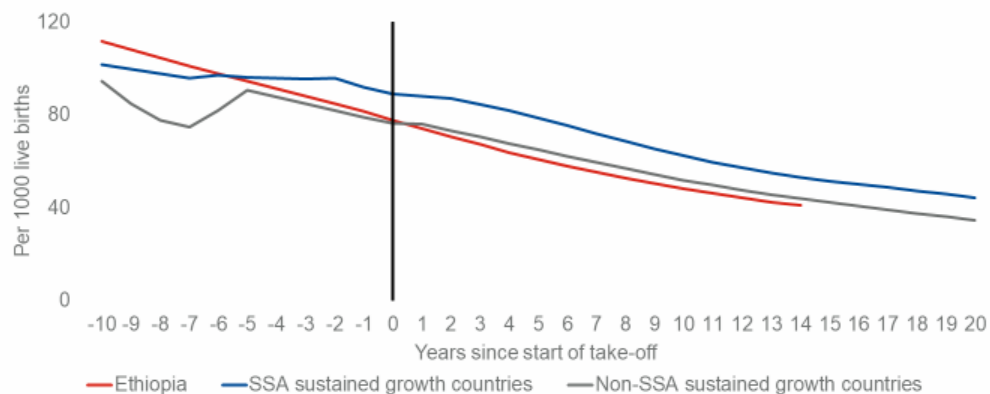


Sources: World Bank, World Development Indicators.

And infant mortality has also declined significantly.

...as has infant mortality

Infant Mortality



Sources: World Bank, World Development Indicators.

What of the third act of the play, economic transformation?

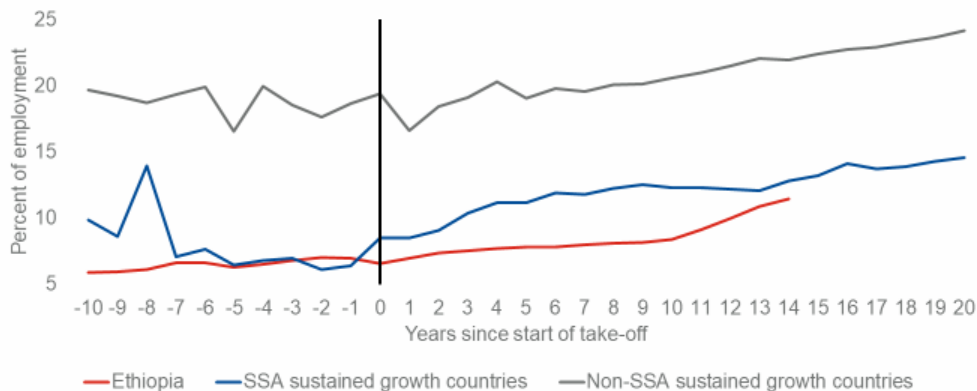
How effective have Ethiopia and other African countries been at engendering economic transformation? This question is perhaps even more salient in the case of Ethiopia because of the concerted effort that has been made to foster a manufacturing-led take-off.

This is an area where the picture is less benign for the region as a whole. Specifically, on Ethiopia, Stefan Dercon, in his keynote presentation last year has very clearly laid out where things stand. More generally, most of you in this audience know much more about where things stand. So, I will be brief on this point.

In Ethiopia, as elsewhere in sub-Saharan Africa, structural transformation has progressed, though very little in terms of the share of employment in the industrial sector.

But what of structural transformation?

Share of Employment in Industrial Sector

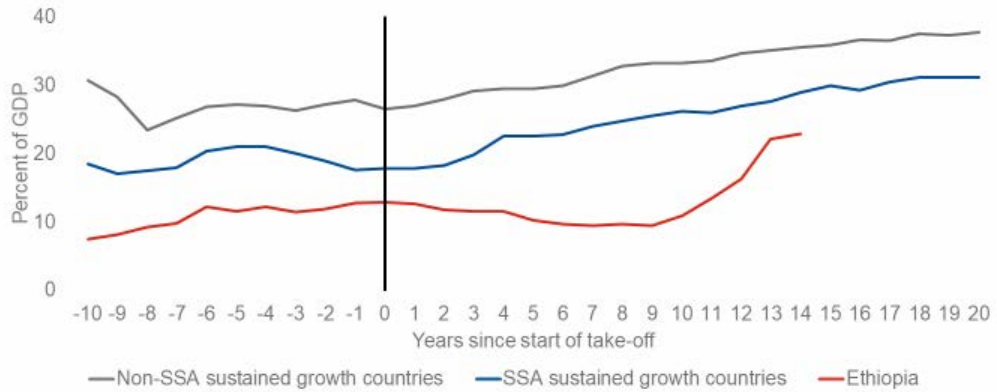


Sources: World Bank, World Development Indicators.

In terms of the industrial sector's value added in GDP, this has increased sharply in recent years in Ethiopia getting closer to the other comparator groups.

The large increase in value added of the industrial sector in recent years...

Share of Industry in GDP

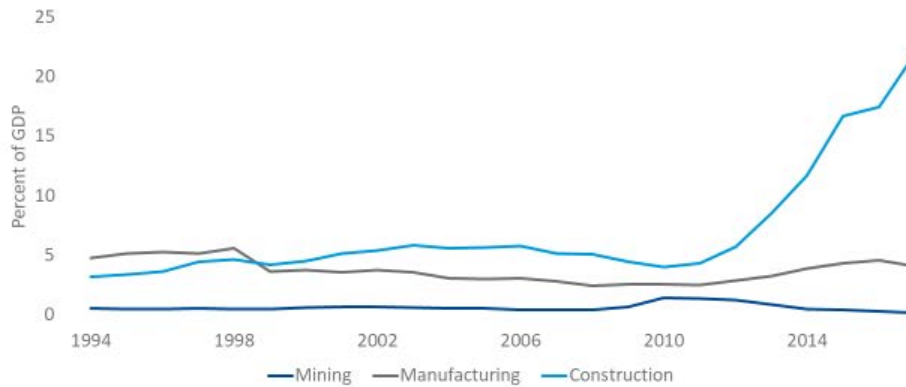


Sources: World Bank, World Development Indicators

But this has been driven predominantly by the construction sector.

...has been driven by a construction boom

Share of Industrial Sub-Sectors in GDP



Sources: IMF Staff Calculations

Similar to other observers, my conclusion is that it is too soon to say if the recent industrialization push will have an enduring effect. Much of the “hardware” necessary for rapid industrialization—industrial parks, road and electricity infrastructure, etc.—have been put in place.

But the economic transformation risks being stifled because the “software” that is as important for effective industrialization is missing—things like access to credit and sufficient foreign exchange for the private sector.

Even here, the picture is not uniformly weak. The strides that have been made to increase tertiary education is quite impressive. I will return to this point later in my presentation.

What has Differentiated Ethiopia’s Performance?

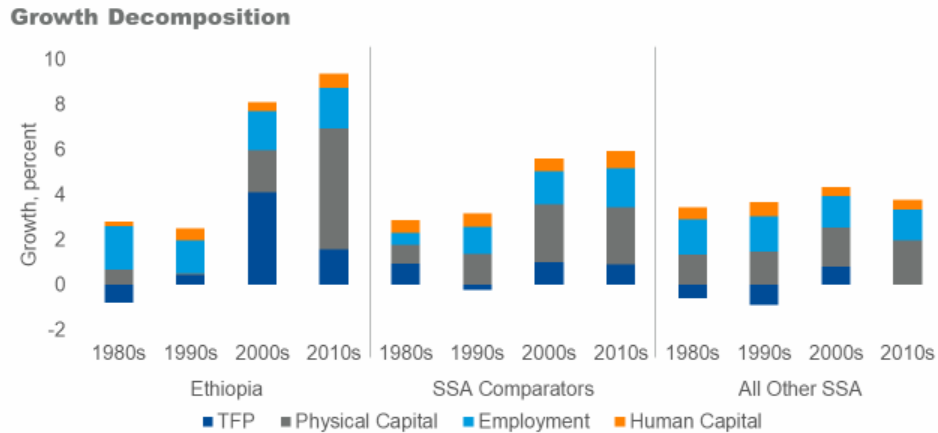
Growth in Ethiopia, on average, has been 8.1 percent in 2000-10 and 9.5 percent in 2010-18, this compares with 5.6 and 5.9 percent respectively in other fast-growing countries in sub-Saharan Africa.

I will look at the composition of growth in a couple of different ways in the next two slides. Here, I focus on the last four decades and rely on a sample of sub-Saharan African and non-sub-Saharan African comparator countries with similar levels of income as Ethiopia and which have witnessed high growth in recent years.

[Note: SSA comparators are Senegal, Rwanda, Tanzania, Kenya, Uganda, Ghana. Non-SSA comparators are Egypt, Tunisia, Vietnam, Bangladesh, Cambodia.]

First, I consider the contributions to growth from human and physical capital accumulation, labor force growth, and improvement in productivity. What is most striking is the shift from the lion's share of growth coming from productivity improvements in the decade to 2010 to physical capital accumulation being the main source of growth in the more recent period.

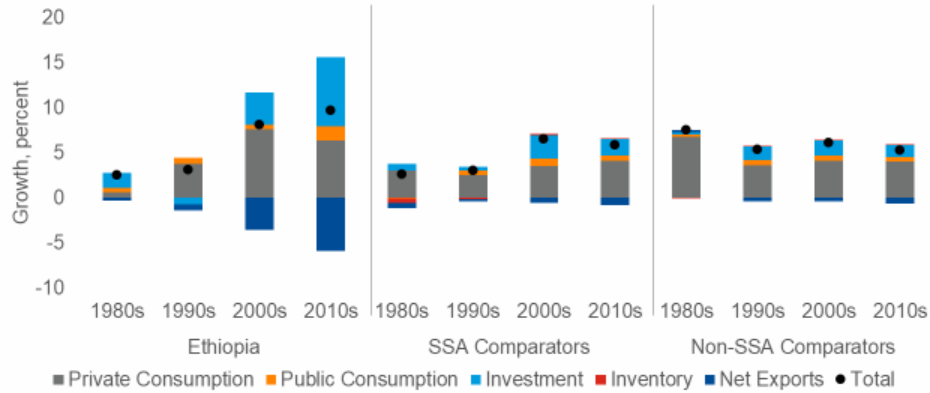
TFP drove growth in the 2000s, but less so in recent years...



[Note: Methodology follows Hall and Jones (1999), benchmark Cobb-Douglas technology such that: $Y = AK^\alpha(Lh)^{1-\alpha}$. The stock of capital, K , is computed using the perpetual inventory equation using WEO investment data and the depreciation rate set to 6 percent, initial capital stock is from Penn World Tables 9.0. L is the number of workers from ILO. h is based on the average years of schooling in the population over 25 years of age from Penn World Tables 9.0. α , the share of wages in total value added, is from Penn World Tables 9.0. For countries where it is not available, including Ethiopia, the cross-sectional average in SSA for each year is used. Simple average of SSA comparators and all other SSA countries reported.]

Looking at developments from the demand side of the national accounts, again, much the same picture emerges. Investment, and to lesser degree private consumption, have contributed the most to growth.

...with investment and private consumption being the main contributors to growth from the demand side...



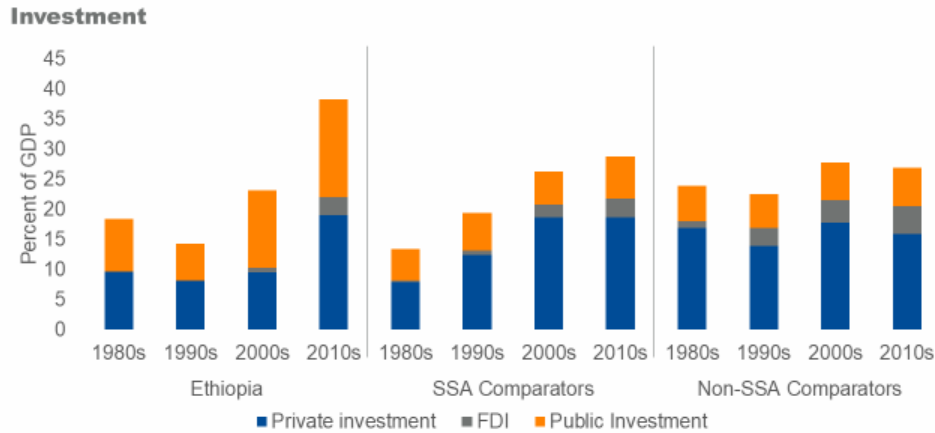
Sources: IMF World Economic Outlook database.

[Note: Simple average of SSA and non-SSA Comparators. Non-SSA comparator group includes Egypt, Tunisia, Vietnam, Bangladesh, Cambodia where growth is driven mainly by consumption, partly reflecting the fact that consumption is a much larger share of GDP.]

There has been a surge in investment this decade. This is perhaps the most important point of departure in Ethiopia's strong growth performance. As such, this bears looking at a bit more closely.

Perhaps the first issue to consider is whether it has been private or public investment that has been the main driver. It looks like both, but most likely, public investment numbers understate the activities of the many state-owned enterprises.

...with a strong impulse from public investment

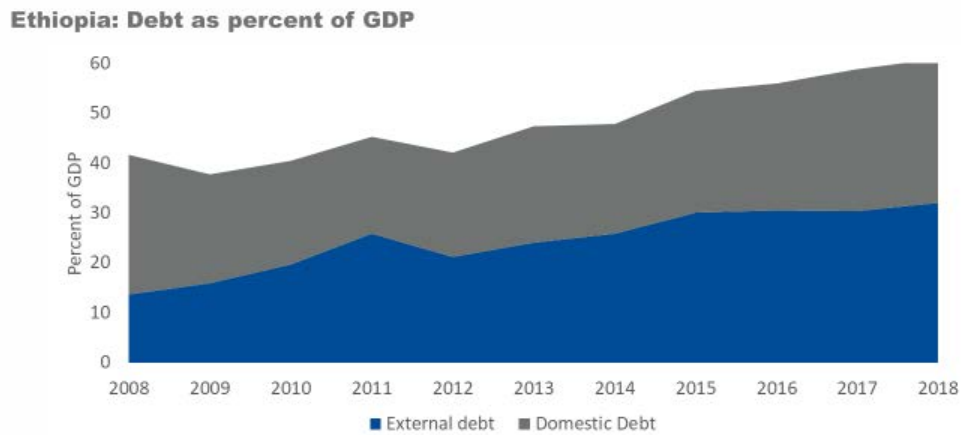


Sources: IMF World Economic Outlook database.

This is a good segue to a discussion of the policies that have engendered this outcome.

Starting with fiscal policy, the path of public debt points to a fairly expansionary fiscal stance. For one, the level of public debt has increased from some 40 percent of GDP in 2008 to 60 percent of GDP last year. Note that we are normalizing by GDP which has been increasing furiously over this period. The fact that the debt to GDP ratio has increased markedly in this context shows just how pro-cyclical fiscal policy has been.

There has been a pronounced increase in public debt reflecting the strong investment push...

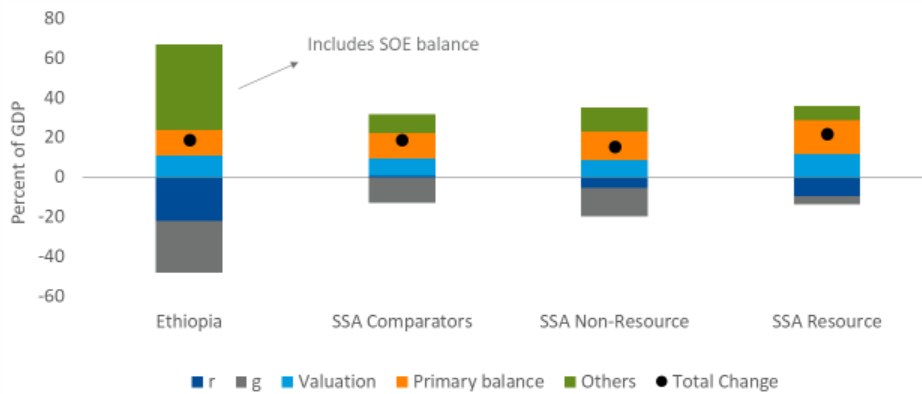


Sources: IMF World Economic Outlook database.

The rate of increase in public debt relative to GDP is comparable to the other country groupings. But the scale of borrowing in Ethiopia has been an order of magnitude different. This has pushed up debt vulnerability ratios, placing Ethiopia at high risk of debt distress according to the IMF/World Bank debt sustainability analysis.

...despite favorable debt dynamics from high growth

Decomposition of Change in Debt: 2012 to 2018



Sources: IMF World Economic Outlook database; IMF Staff Calculations.

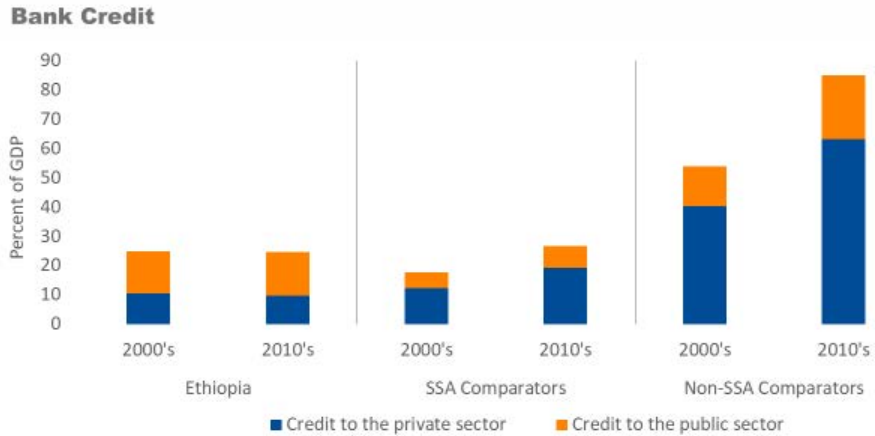
In the monetary and exchange rate policy sphere, too, there has perhaps been a fairly different approach in Ethiopia.

Rather than the pro-market approach that has been evident in many African countries, there has been here more of a pro-business emphasis. This is evident in the government's strong efforts to direct financial savings to itself and to priority sectors, largely through state-owned enterprises.

Over the last two decades the share of credit to the public sector has been about 60 percent of total credit to the economy, while in sub-Saharan African comparator countries it has been just 30 percent of total credit.

Relatedly, the cost of credit has been kept low—either very low in real-terms or even negative at times.

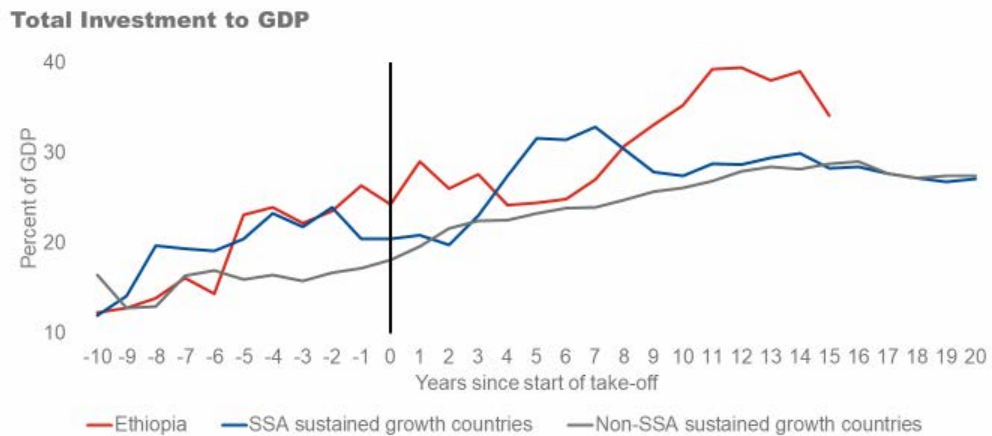
Policies have also directed financial savings to the public sector



Sources: IMF World Economic Outlook database, and IMF, International Financial Statistics.

The effect of this has been to engender the very high levels of public investment that we have seen—indeed, higher than even some of the fastest growing countries globally at the time of their take-off.

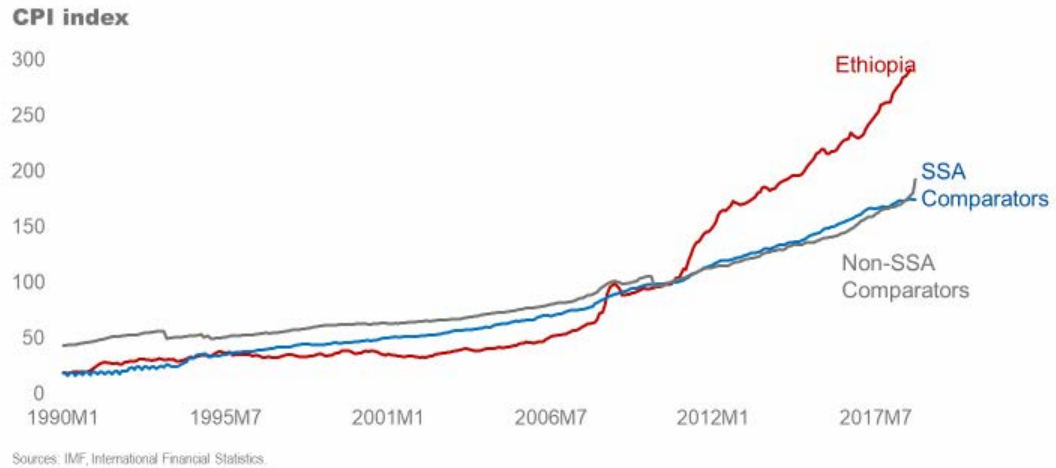
Indeed, investment in Ethiopia is higher than strong performers globally at the same time as their take-offs



Sources: IMF World Economic Outlook database, Penn World Tables.

That financial conditions have been looser is evident from the higher level of inflation in Ethiopia.

The sustained higher rate of inflation points to accommodative financial conditions...

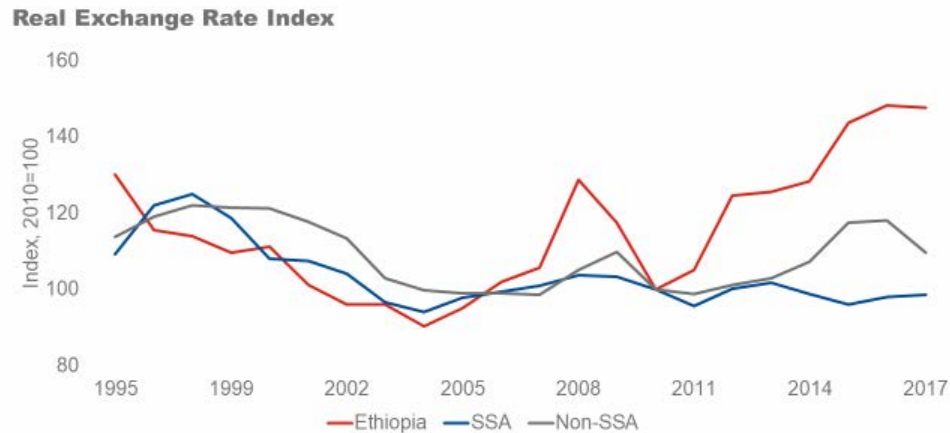


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I would add here that this higher inflation has resulted in a more appreciated real exchange rate, which kept import prices low and supported public investment further still.

...which has translated into a more appreciated real exchange rate. While this kept import prices and investment costs low...



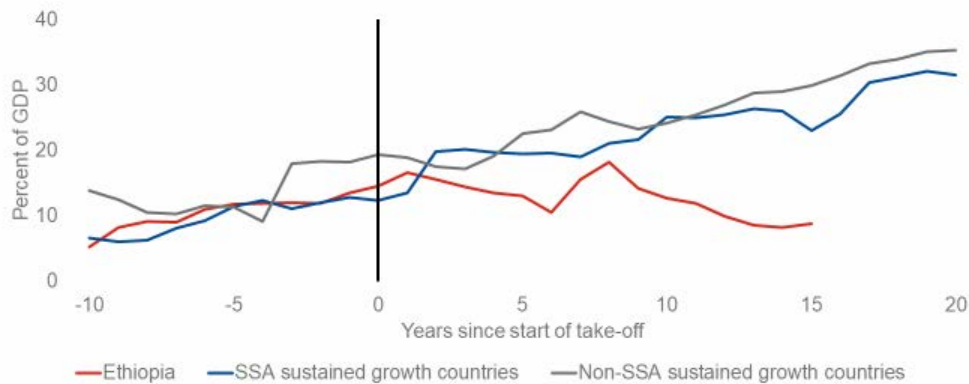
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But one consequence of this has been weak export performance. Most other sustained growth cases saw exports as a share of GDP increase substantially during the transition, but this has not been the case in Ethiopia. Exports as a share of GDP remains well below that of comparators, even as imports have risen sharply. Exports as a share of GDP has actually declined in recent years, which is highly unusual.

... it has also had an adverse impact on export performance which has been very weak.

Exports to GDP



Sources: IMF, World Economic Outlook database.

One last point for this section I want to touch on quickly is whether Ethiopia's performance has been driven by policies alone? My sense is that in addition to policies, stronger institutional capacity and government effectiveness in Ethiopia has also played a role.

This is evident from cross-country indicators of institutional strength. Just before Ethiopia's growth take-off, institutional quality was significantly higher than other countries with similar levels of income, even after controlling for trade openness and geography. This indicates that there was substantial potential for high growth, which has been realized in the period since.

Stronger institutional capacity helped support stronger growth

Institutional Quality versus Per-capita GDP, 2000



Sources: IMF World Economic Outlook database; The International Country Risk Guide; IMF Staff calculations.

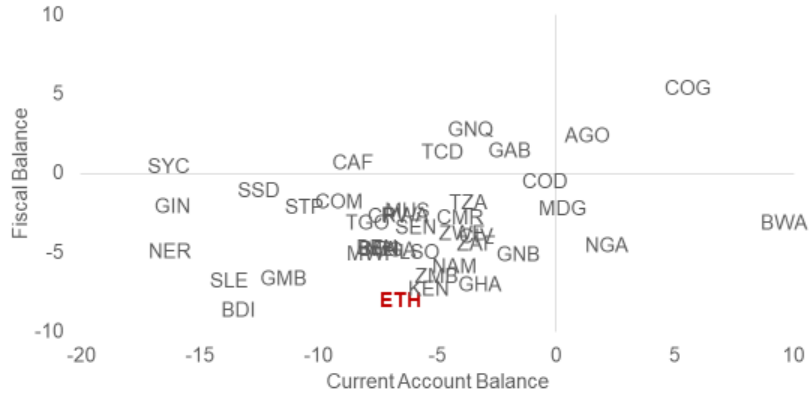
But the effectiveness of government is also visible indirectly from the very, very rapid progress that the country has been able to make in improving health and education outcomes despite spending levels having been broadly comparable (or even lower) than in other countries.

In all, the much higher rate of growth that has been evident in Ethiopia, particularly since around 2010, has been facilitated by policies that have sought to keep the cost of financing low for the public sector and public enterprises. But this has come at some cost—a marked increase in public debt, as well as a crowding out of the private sector and very disappointing export growth performance.

The flow aspect of the challenge facing the economy is evident in the pronounced elevated fiscal and external current-account deficits at the moment—this of course against the backdrop of binding stock constraints, a high debt burden and a foreign currency shortage.

Managing twin deficits: fiscal and external

Sub-Saharan Africa: Balances as a percent of GDP in 2018



Sources: IMF World Economic Outlook database.

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I want to be very clear on one point. It is important to note that while the investment drive in Ethiopia has come at some cost in terms of elevating macroeconomic imbalances, much of it has gone towards creating the strong infrastructure network that I noted earlier. Provided the economic returns of this investment are sufficiently high and can be captured by the state, the benefits in the long-run will be considerable.

Conclusion: What Next?

I want to end my presentation by offering a few concluding thoughts.

They say that to a hammer, everything looks like a nail. As a macroeconomist working in an institution whose *raison d'être* is to avert macroeconomic crisis, I hope you will forgive my preoccupation on the macroeconomic pressure points that I have been dwelling on at some length this morning.

It is not for lack of appreciation on the developmental progress that has been made. Some 30 years after the end of the Cold War, Ethiopia and much the rest of sub-Saharan Africa are much-changed. It goes without saying that poverty remains unbearably high, the fruits of strong growth in some countries have accrued disproportionately to the better off, and far too many people are still impacted by conflict. But there has also been much progress and transformation. And, I am not talking about skin-deep changes such as shiny new buildings or a better sky line, but fundamental progress that has shifted the opportunity set of a generation.

All the same, with so much effort and sacrifice having been made to get to this point it would be a great pity if the elevated macroeconomic imbalances that we are seeing in some countries across the region were to reduce growth or, worse still, create financial crisis.

Needless to say, this would be detrimental to the ultimate goal of raising living standards for all and creating much needed jobs for a growing, and youthful population.

This can be avoided with strong attention to two policy areas:

First, there is an urgent need to increase government revenues.

Over the last couple of decades, countries have made a huge investment effort, particularly in infrastructure. Notably so here of course, as just laid out. But the returns on this investment have not been captured in tax revenues. Unless tax revenue increase markedly, how is the debt that has been contracted to undertake this investment going to be repaid?

More generally, how will the additional investment that is still needed in many, many areas going to be sustained? This really is a pressing priority here and elsewhere. Tax to GDP ratios have to increase to the 20 percent of GDP mark or more in the coming years.

To date, progress in capturing the rate of return on all the investment by the tax system has been very weak

Tax revenue to GDP ratio



Sources: IMF World Economic Outlook database.

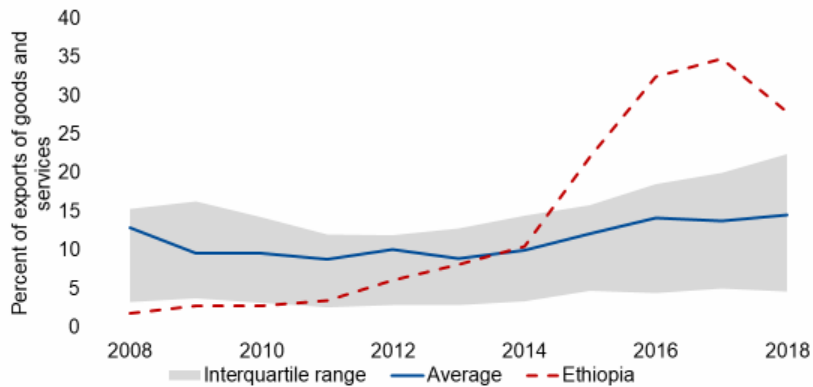
Second, there is a strong need to boost export growth by creating room for higher levels of domestic and foreign private investment.

While the export mix has diversified in recent years and manufactured exports are growing at double-digit rates, the levels of most new export lines remain low and, as noted above, the overall export to GDP ratio is declining. Coupled with the higher debt level, this makes the country vulnerable to external shocks and potential difficulties in servicing its debt obligations.

Policies need to continue to focus on reducing these external vulnerabilities and achieving the medium-term goal of improving competitiveness and the business climate. To the extent that export diversification can stimulate resource reallocation towards higher-productivity sectors, it will also contribute to higher long-term growth potential.

Debt Service to Exports

Debt service to exports ratio



Sources: IMF World Economic Outlook database.

I will stop here. Thank you very much.