

Ethiopia Inclusive Growth Diagnostic (IGD) Screening Profile¹

Economic Overview

Ethiopia is a country of 84.7 million people, 31 percent of whom live in extreme poverty (below \$1.25/day). Its average per capita income (PPP GNI) was \$1,110 in 2011, having grown by an average 5.9% annually over the last 10 years, which has resulted in a decline in extreme poverty of 3.9% per year. Its Gini index, at 33.6, indicates a more egalitarian distribution of income than most countries, albeit at a very low average level. The adult labor force participation rate is quite high, at 84.0%, as is the adult female labor force participation rate of 78.4%, which is typical of poor countries where everyone must either work or starve. (The corresponding average figures for Sub-Saharan Africa are 69.6% and 63.1%, respectively.)

The country receives fairly good marks for maintaining a low general government debt (37.3% of GDP), a modest fiscal deficit (-1.6% of GDP) and a healthy gross national savings ratio (25.6% of GDP). However, it has had a high rate of inflation and a low country credit rating, ranking 139 and 135 out of 144 countries, respectively, in these two categories of the 2012-2013 World Economic Forum (WEF) Global Competitiveness Index (GCI). This resulted in a fairly low ranking in that index for its macroeconomic environment (114 out of 144).

Based on the indicators discussed below, there appears to be substantial potential for income growth both in smallholder agriculture and in higher wage non-farm employment. Despite recent improvements in the former, fertilizer use and crop yields are still below par, as are crop storage and communication facilities and access to finance. Whether there are important binding constraints for continued improvement in this sector could be the subject of in-depth analysis. However, this cursory examination of online indicators points to more rapid growth of more productive non-farm employment as having the largest potential for improvement, as it is lagging far behind comparator countries worldwide. Net foreign direct investment has been low, but domestic investment and gross capital formation is relatively high. However, this investment has not generated much formal sector employment. Prime candidates for binding constraints in this area are the poor business climate, inadequate electric power, poor human capital, both in terms of education and skills and in health status, and policies that provide disincentives for employment generation. Domestic credit to the private sector is very low and access to finance is considered a serious problem by business leaders, as was the level of corruption and government inefficiency.

1) Potential for higher smallholder agricultural production and rural incomes

Ethiopia is predominantly rural, with 83% of the population living in rural areas, and 79.3% of employment is in agriculture. However, agriculture contributes only 46.4% to GDP, indicating much lower productivity per worker than in the non-agricultural sectors. Cereal yield was 1,832.8 kg. per hectare in 2011, higher than the average for Sub-Saharan Africa (1,362 kg.) but less than that achieved by low income countries worldwide (2,035 kg.) and lower middle income countries (3,078 kg.). Having said that, Ethiopia has achieved significant improvement in agricultural production since the year 2000, with

¹ This country profile presents indicators available online that are relevant to the IGD analytical nodes of the “Analytic Guide for an Inclusive Growth Diagnostic (the productive employment model),” which is available from <https://dec.usaid.gov/dec>

total value added almost doubling in constant price terms by 2011. Cereal yields increased by 64% between 2000 and 2011 and livestock production increased by 114%.

1A&B) On-farm productivity & Processing and marketing of farm products

1Aa) Agricultural research & extension services

1Ab) Access to credit for farm inputs & capital improvements

1Ac) Rural infrastructure for irrigation and farm-to-market roads

1Ad) Land tenure and land markets

1Ba) Market and pricing policies

1Bb) Availability of information about and contacts with higher value markets

1Bc) Rural infrastructure for transport, electric power, storage, markets, communication

1Bd) Access to rural credit for agriculture product processing, storage, marketing, etc.

The EIU Global Food Security Index (GFI) indicates Ethiopia spends only 1% of the agricultural contribution to GDP on agricultural research and development, placing it in the bottom 39% of the 105 countries covered. The same index placed Ethiopia in the bottom third in access to finance for farmers, and the bottom 34% in agricultural infrastructure. As components of the latter index, it scored low in the existence of crop storage facilities, but in the middle group for both road and port infrastructure. Fertilizer consumption was only 17.7 kg. per hectare of arable land in 2009, above the Sub-Sahara average of 11.4 kg. but below the low income country average of 25 kg. and the lower middle income average of 122 kg. (WB WDI) In 2013 the MCC scored Ethiopia as better than 86% of a comparable group of 81 developing countries in land rights and access. The World Bank Doing Business Indicators ranked Ethiopia poorly, 112 out of 185, for registering property. The 2012-2013 WEF Global Competitive Index ranked Ethiopia 59 out of 144 in agricultural policy costs.

2) Potential for more productive, higher wage non-farm employment.

As noted above, adult labor force participation rates are high. However, vulnerable employment (family workers and self-employed) rates have also been very high: 91.2% of total employment in 2005, 89.3% for men and 93.3% for women. (WB WDI. These were the highest rates in the world. The rate for lower middle income countries in 2009 was 70.9%.) This implies that the more productive formal sectors of the economy provide only a very small portion of total employment. The non-farm sector is hampered by a poor business climate, as the country ranks 127 out of 185 in the 2013 World Bank Ease of Doing Business Index. Women comprise only 41.6% of total non-agricultural employment, men 58.4%.

2A) Private Sector Demand for More Productive Employment

2Aa) Level of Private Investment (HRV Constraints Analysis)

2Aai) Private returns to economic activity

Gross capital formation in Ethiopia has been fairly high, reaching 25.5% of GDP in 2011, compared with an average of only 21.3% for Sub-Saharan Africa and 24.8% for low income countries, but lower than the 28.9% average for lower middle income countries (WB WDI). The 5-year Ethiopian average was 23.2% from 2007-2011. Net foreign direct investment was equal to 2.1% of GDP in 2011, but averaged only 1.1% over the last 5 years. This is low compared with the 5-year averages of 3.3% for all Sub-Saharan and low income countries and 2.9% for all lower middle income countries. According to the IMF World Economic Outlook, total investment in Ethiopia reached 28.1% of GDP in 2012, having risen steadily from 22.1% in 2007. Ethiopia was the 34th highest in 2012 among 173 countries for this indicator.

2Aai1) Evidence of low social returns

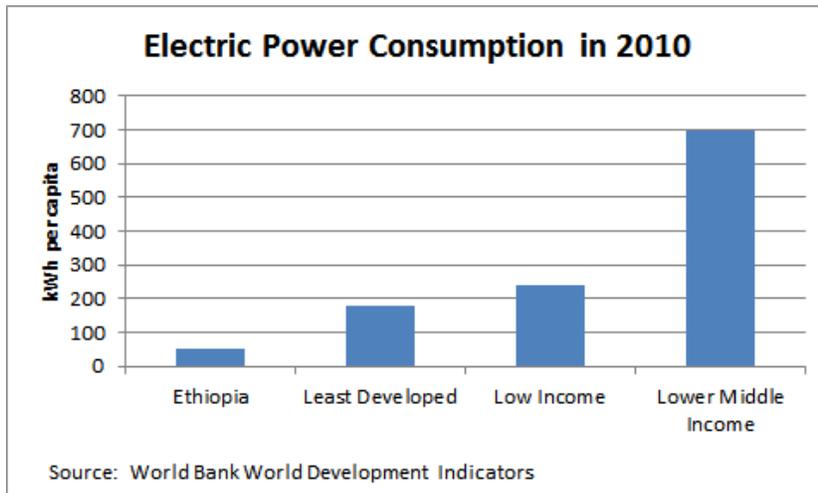
Is there inadequate human capital to run a business successfully?

In the 2012-2013 World Economic Forum (WEF) survey of business leaders, 5.9% listed an inadequately educated workforce as the most problematic factors for doing business in Ethiopia. (See Table 1) However, only 39% of the adult population were recorded as literate in 2007 (latest data available for Ethiopia), compared with a 63% average in low income countries and Sub-Sahara Africa and 71% in lower middle income countries (in 2010)(WB WDI). Only 29% of Ethiopian women were literate in 2007.

Is there a lack of or poor condition of productive infrastructure?

The 2012-2013 WEF survey results about infrastructure placed Ethiopia 119th out of 144 countries. The country received average marks for the quality of its roads and air transport infrastructure, but inferior ratings for the quality of its electric supply, railroads and access to the sea. It is near the bottom of the heap with respect to fixed telephone lines and mobile telephone subscriptions, in the latter ranking second from the very bottom (143 out of 144). (See Table 2)

This is supported by other sources. According to the World Bank World Development Indicators (WB WDI) Ethiopia's electric power consumption, in KWH per capita, was only 52 in 2010, compared with averages of 178 for Least Developed Countries, 240 for Low Income Countries, 546 for Sub-Saharan Africa, and 695 for lower middle income countries. Private firms reported an average of 5.6 power outages per month. And according to the UNDP Human Development Report only 17% of the Ethiopian population had access to electric power in 2009. The WB WDI reports that only 13.7% of Ethiopia's roads were paved in 2007, compared with 18.7% of Sub-Saharan African roads in 2005, 16.3% in 2010.



2Aai2) Private appropriability

Government failure/poor governance

The Heritage Foundation/Wall Street Journal Economic Freedom Index gave Ethiopia a score of 50.5 in 2011 (with 100 being the best). It ranked 144 out of 183 countries in the overall index. It ranked 121 out of 144 in the 2012-2013 WEF Global Competitiveness Index (GCI) (See Table 2). The Canadian Fraser Institute, in its annual Economic Freedom of the World Report for 2013, ranked Ethiopia 126th out of 152 countries in its overall index. Ethiopia scored -0.40 in the 2011 Government Effectiveness Estimate of the World Bank Governance Indicators, out of a -2.5 to +2.5 range, ranking 123 in a list of 212 countries,

a little worse than the median. It scored -0.71 in the WB Rule of Law Estimate, tied for 151st place out of 214.

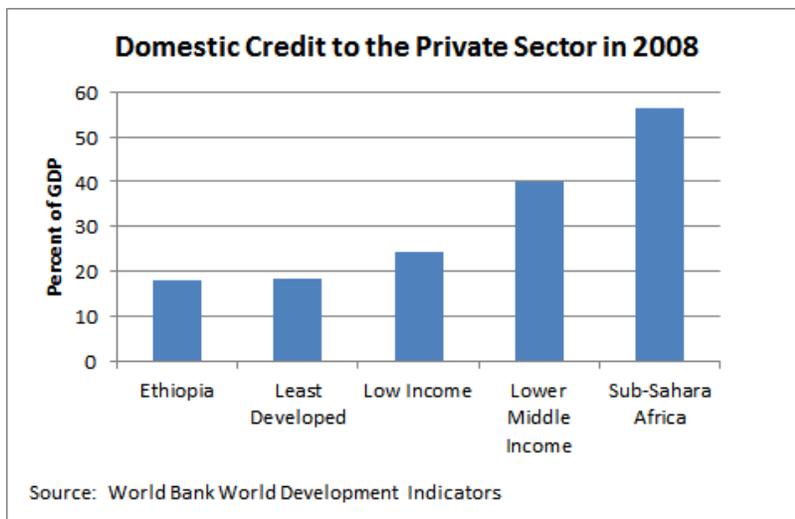
Corruption was cited by the second largest percentage (13.9) of WEF respondents as the most problematic factor in Ethiopia, inefficient government bureaucracy came in third, followed by inflation and policy instability. Ethiopia was given an average score of 3.8 in the WEF GCI for Institutions, ranking 74 out of 144. Its worst showing in this area was in the transparency of government policymaking (ranking 129). The other areas where it ranked worse than 100 were judicial independence, strength of auditing and reporting standards, irregular payments and bribes, the ethical behavior of firms and the strength of investor protection. (See Table 5) Ethiopia scored only 33 out of 100 possible points in the Transparency International Corruption Perceptions Index in 2012 and placed in a 5-way tie for 113th among 176 countries. The World Bank Governance Matters Control of Corruption estimate of 2011 scored Ethiopia -0.69 in the -2.5 to +2.5 range, ranking 156 out of 212 countries.

Market failures in the availability of information for innovation and “coordination”

Ethiopia ranked a very low 140 (out of 144) in the 2012-13 WEF GCI Technological Readiness Index and a low 125 in its Business Innovation & Sophistication Index (See Table 2).

2Aa) Cost of finance

Domestic credit to the private sector was only 17.8% of GDP in 2008 (the latest figure available for Ethiopia), down from 23.8% in 2006. (WB WDI) This compares unfavorably with the Sub-Saharan African country average of 56.3% of GDP in 2008, down from 66.2% in 2006 and which went back up to 60.6% in 2011. The low income country average was 24.1% in 2008 and rose to 30.1% in 2011. The lower middle income country average was 40.1% in 2008 and 40.4% in 2011. However, the MCC ranked Ethiopia as scoring higher than 73% of its “peer” group of 85 developing countries providing access to credit. Its real interest rate fell from a positive +17.6% in 2001 to a negative -17.1% in 2008, the latest date for which these figures are available (in WB WDI). The lending interest rate rose from 7.0% in 2003-2006 to 8.0% in 2008, while the interest rate spread fell slowly from 4.9% in 2000-2002 to 3.3% in 2008. (WB WDI) The Heritage Foundation/Wall Street Journal Investment Freedom Index scored Ethiopia a very low 20 out of 100 possible points in 2011, indicating strong government influence over the financial sector. In the 2012-13 WEF GCI Ethiopia scored 3.2 (from 1-7 high) and ranked a low 129 out of 144 in Financial Market Development, and access to financing was listed as the most problematic factor for doing business by the largest percentage (14.9) of entrepreneurs surveyed. (See Tables 1 and 2) It ranked particularly low in the availability of financial services, the ease of access to loans, and the affordability of financial services, but also worse than 100 out of 144 in venture capital availability, the regulation of security exchanges, and the soundness of banks. (See Table 4)



2Ab) Conversion from Informal to Formal Sector

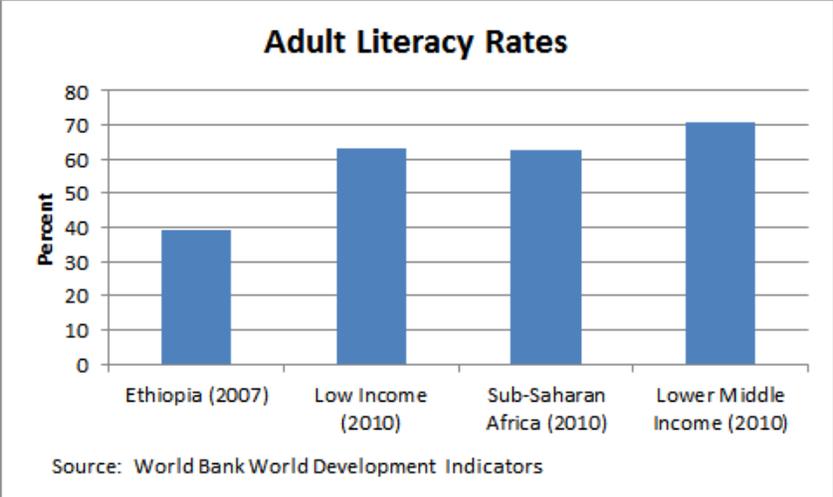
The World Bank Doing Business Report for 2013 ranked Ethiopia 127 out of 185 countries in business climate indicators. Starting a business is particularly troublesome, ranking 163, as it costs an average 135% of income per capita to do so and the minimum capital requirement is 2.5 times income per capita. Trading across borders is the next most troublesome area, ranking 161, as it takes 42-44 days to either export or import a shipment of commodities.

2Ac) Labor Intensity of Production

The 2012-2013 WEF GCI survey in the Goods Market Efficiency category (ranking Ethiopia 120 out of 144 overall) scored Ethiopia next to the bottom in the prevalence of trade barriers, ranking 143 out of 144. Its extremely low rankings included intensity of local competition (139), extent of market dominance (135), prevalence of foreign ownership (135), effectiveness of anti-monopoly policy (129), trade tariffs (percentage duty) (128), burden of customs procedures (125), degree of customer orientation (119), and the business impact of rules on foreign direct investment (114). (See Table 6) Although Ethiopia scored only moderately low in most aspects of Labor Market Efficiency, its low ranking on the brain drain question (118) implies a lack of good jobs at home. (See Table 7)

2B) Employability of the Workforce:

Adult literacy rates are extremely low in Ethiopia, as only 39% of the adult population were recorded as literate in 2007 (latest data available for Ethiopia), compared with a 63% average in low income countries and Sub-Saharan Africa and 71% in lower middle income countries (in 2010)(WB WDI). Only 29% of Ethiopian women were literate in 2007. It was ranked 122 out of 144 countries in primary education enrollment in the 2012-2013 WEF GCI with only 81.3% enrolled, and ranked 105 in terms of the quality of primary education. The gross percentage of students enrolled in secondary education was only 35.7%, and only 5.5% in tertiary education, ranking Ethiopia 129th and 124th, respectively. (See Tables 8 and 9) Ethiopia also scores very poorly in the availability of research and training services and the extent of staff training, as well as in most other aspects of higher education and training, in which its overall ranking was 134 out of 144. (See Tables 2 and 9)



Even more worrying from an employability standpoint, however, is the poor health of the workforce. The 2012-2013 WEF GCI overall ranking for Ethiopia in Health and Primary Education is 116 out of 144 (Table 2). It ranked worse than 100 in all 8 health indicators surveyed, including the business impacts of malaria, TB and HIV/AIDS. Life expectancy is only 58.7 years. (See Table 8)

Ethiopia’s population growth rate has declined from 2.6% in 2001, but is still relatively high at 2.1% per year (WB WDI), which makes it difficult for the country to improve its health and education services fast enough to keep up with the increasing need for them.

Appendix

Table 1. The most problematic factors for doing business	
(Percent of responses)	
Access to financing	14.9
Corruption	13.9
Inefficient government bureaucracy	12.8
Inflation	12.0
Policy instability	9.6
Tax regulations	7.8
Inadequate supply of infrastructure	7.1
Inadequately educated workforce	5.9
Foreign currency regulations	5.7
Tax rates	3.8
Poor work ethic in national labor force	2.5
Restrictive labor regulations	1.7
Insufficient capacity to innovate	1.3
Poor public health	1.0
Crime and theft	0.0
Government instability/coups	0.0
<p>Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.</p>	
<p>Source: The Global Competitiveness Report 2012–2013, p. 164</p>	

Table 2. The Global Competitiveness Index	Rank	Score
	<u>(out of 144)</u>	<u>(1–7)</u>
GCI 2012–2013	121	3.6
GCI 2011–2012 (out of 142)	106	3.8
GCI 2010–2011 (out of 139)	119	3.5
Basic requirements (60.0%)	118	3.7
Institutions	74	3.8
Infrastructure	119	2.6
Macroeconomic environment	114	3.9
Health and primary education	116	4.6
Efficiency enhancers (35.0%)	123	3.3
Higher education and training	134	2.7
Goods market efficiency	120	3.8
Labor market efficiency	87	4.2
Financial market development	129	3.2
Technological readiness	140	2.5
Market size	66	3.6
Innovation and sophistication factors (5.0%)	125	3.0
Business sophistication	129	3.2
Innovation	114	2.7
Source: The Global Competitiveness Report 2012–2013, p. 164		

Table 3. Infrastructure	Rank	Score
	<u>(out of 144)</u>	<u>(1–7)</u>
2.08 Mobile telephone subscriptions/100 pop.*	143	16.7
2.09 Fixed telephone lines/100 pop.*	128	1.0
2.03 Quality of railroad infrastructure	112	1.4
2.07 Quality of electricity supply	112	3.2
2.04 Quality of port infrastructure	110	3.5
2.01 Quality of overall infrastructure	100	3.6
2.02 Quality of roads	64	4.1
2.06 Available airline seat kms/week, millions*	60	223.8
2.05 Quality of air transport infrastructure.....	50	5.1
Notes: Values are on a 1-to-7 scale unless otherwise annotated with an asterisk (*).		
SOURCE: WEF, <i>Global Competitiveness Report 2012-13</i> , p. 165		

Table 4. Financial market development	Rank	Score
	<u>(out of 144)</u>	<u>(1-7)</u>
8.01 Availability of financial services	137	3.0
8.04 Ease of access to loans	133	1.9
8.02 Affordability of financial services	130	3.2
8.05 Venture capital availability	118	2.1
8.07 Regulation of securities exchanges	113	3.4
8.06 Soundness of banks	105	4.6
8.08 Legal rights index, 0–10 (best)*	99	4.0
8.03 Financing through local equity market	85	3.2
Notes: Values are on a 1-to-7 scale unless otherwise annotated with an asterisk (*).		
SOURCE: WEF, <i>Global Competitiveness Report 2012-13</i> , p. 165		

Table 5. Institutions	Rank	Score
	<u>(out of 144)</u>	<u>(1-7)</u>
1.12 Transparency of government policymaking	129	3.5
1.06 Judicial independence	109	2.8
1.19 Strength of auditing and reporting standards	106	4.0
1.05 Irregular payments and bribes	105	3.3
1.20 Efficacy of corporate boards	104	4.2
1.18 Ethical behavior of firms	103	3.5
1.22 Strength of investor protection, 0–10 (best)*	101	4.3
1.17 Reliability of police services	82	4.0
1.01 Property rights	79	4.1
1.11 Efficiency of legal framework in challenging regs.	75	3.5
1.21 Protection of minority shareholders' interests	74	4.1
1.07 Favoritism in decisions of government officials	71	3.0
1.02 Intellectual property protection	65	3.7
1.14 Business costs of terrorism	64	5.6
1.09 Burden of government regulation	63	3.4
1.03 Diversion of public funds	62	3.4
1.10 Efficiency of legal framework in settling disputes	62	3.8
1.04 Public trust in politicians	48	3.2
1.13 Gov't services for improved business performance	48	4.0
1.08 Wastefulness of government spending	29	3.9
1.16 Organized crime	24	6.2
1.15 Business costs of crime and violence	22	5.8
Notes: Values are on a 1-to-7 scale unless otherwise annotated with an asterisk (*).		
SOURCE: WEF, <i>Global Competitiveness Report 2012-13</i> , p. 165		

Table 6. Goods market efficiency	Rank	Score
	<u>(out of 144)</u>	<u>(1-7)</u>
6.09 Prevalence of trade barriers	143	2.9
6.01 Intensity of local competition	139	3.6
6.02 Extent of market dominance	135	2.8
6.11 Prevalence of foreign ownership	135	3.3
6.03 Effectiveness of anti-monopoly policy	129	3.2
6.10 Trade tariffs, % duty*	128	12.8
6.13 Burden of customs procedures	125	3.2
6.15 Degree of customer orientation	119	3.9
6.16 Buyer sophistication	117	2.8
6.12 Business impact of rules on FDI	114	3.9
6.14 Imports as a percentage of GDP*	91	37.5
6.04 Extent and effect of taxation	69	3.5
6.08 Agricultural policy costs.....	59	4.0
6.07 No. days to start a business*	43	9.0
6.05 Total tax rate, % profits*	37	31.1
6.06 No. procedures to start a business*	29	5.0
Notes: Values are on a 1-to-7 scale unless otherwise annotated with an asterisk (*).		
SOURCE: WEF, <i>Global Competitiveness Report 2012-13</i> , p. 165		

Table 7. Labor market efficiency	Rank	Score
	<u>(out of 144)</u>	<u>(1-7)</u>
7.07 Brain drain	118	2.7
7.06 Reliance on professional management	117	3.5
7.01 Cooperation in labor-employer relations	100	4.0
7.02 Flexibility of wage determination	93	4.8
7.05 Pay and productivity	93	3.6
7.04 Redundancy costs, weeks of salary*	91	21
7.03 Hiring and firing practices	81	3.8
7.08 Women in labor force, ratio to men*	32	0.89
Notes: Values are on a 1-to-7 scale unless otherwise annotated with an asterisk (*).		
SOURCE: WEF, <i>Global Competitiveness Report 2012-13</i> , p. 165		

Table 8. Health and primary education	Rank	Score
	<u>(out of 144)</u>	<u>(1–7)</u>
4.03 Business impact of tuberculosis	129	3.7
4.07 Infant mortality, deaths/1,000 live births*	128	67.8
4.05 Business impact of HIV/AIDS	126	3.7
4.06 HIV prevalence, % adult pop.*	124	2.1
4.04 Tuberculosis cases/100,000 pop.*	123	261
4.10 Primary education enrollment, net %*	122	81.3
4.08 Life expectancy, years*	119	58.7
4.01 Business impact of malaria	116	4.2
4.02 Malaria cases/100,000 pop.*	115	2,995.5
4.09 Quality of primary education	105	3.2
Notes: Values are on a 1-to-7 scale unless otherwise annotated with an asterisk (*).		
SOURCE: WEF, <i>Global Competitiveness Report 2012-13</i> , p. 165		

Table 9. Higher education and training	Rank	Score
	<u>(out of 144)</u>	<u>(1–7)</u>
5.07 Availability of research and training services	133	2.9
5.08 Extent of staff training	130	3.1
5.01 Secondary education enrollment, gross %*	129	35.7
5.02 Tertiary education enrollment, gross %*	124	5.5
5.06 Internet access in schools	119	2.8
5.05 Quality of management schools	108	3.6
5.04 Quality of math and science education	105	3.4
5.03 Quality of the educational system	85	3.4
Notes: Values are on a 1-to-7 scale unless otherwise annotated with an asterisk (*).		
SOURCE: WEF, <i>Global Competitiveness Report 2012-13</i> , p. 165		