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# Ethiopia's Privatization Drive to Trigger FDI Inflows 3X South Africa's

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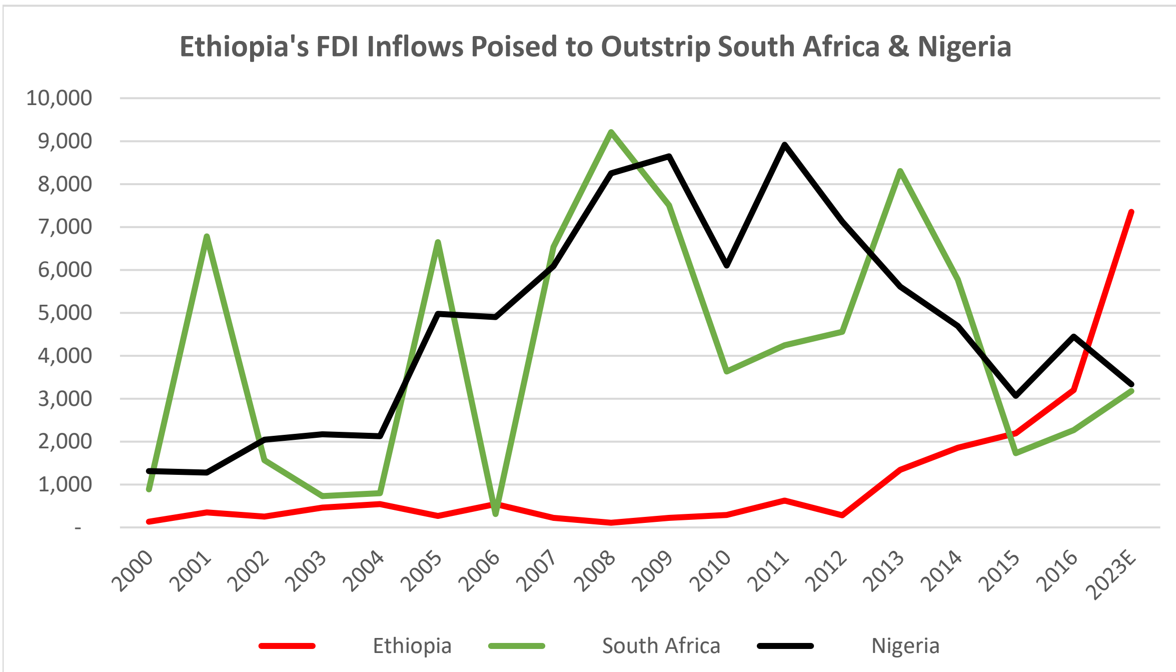
Ethiopia's new reform-oriented Prime Minister, Abiy Ahmed, Africa's second most populous and fastest-growing nation looks poised to finally attract significant trade and investment interest beyond China. Its FDI inflows are poised to surpass South Africa and Nigeria's by 2023. Prime Minister Abiy surprised domestic and foreign audiences in May 2018 by announcing dramatic privatization initiatives in sectors long dominated by the government, including elites and national champions and elites affiliated with the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF). The move towards partial privatization, was reached by consensus in the ruling party's 36-member Executive Committee, ensuring institutional buy-in for the reform despite a likely backlash from political and military elites that have benefited from the status quo.




Source: UNCTAD/ DaMina Advisors

## Investment outlook to improve

The investment outlook for foreign investors will improve in the near-to-medium term. Of note, previously closed sectors will liberalize: telecommunications and airlines, more specifically, **Ethio Telecom and Ethiopian Airlines**. These are two of the economy's crown jewels, the former because of the size and potential of the under-served local market and the latter because it is one of Africa's best-managed and capitalized state-owned enterprises, with capital Addis Ababa already a major hub for regional air travel. The EPRDF has clarified that both domestic (including the formidable diaspora in the US and elsewhere) and foreign investors are welcome to participate in the privatization.

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**Key Country Facts on Ethiopia**

**Population**: 107 million (second only to Nigeria in Africa)
**Main ethnic groups:** Oromo (34%), Amhara (27%). Political elite dominated by Tigray (just 6%)
**Religious breakdown:** Christians are about 60% and Muslims about 40%
**Median population age:** 18
**Borders**: Somalia, Eritrea, Sudan, South Sudan, Kenya and Djibouti
One of the world's largest landlocked countries
**Average GDP growth over past decade:** 7%
**Long-term GDP growth forecast:** 8%
**Recurrent foreign exchange scarcity**: Forex reserves under 2 months import cover
**Largest investment**: Chinese led Grand Renaissance Dam (to produce 6,450 MW)
Ethiopia now a net exporter of power
**Expected FDI in 2018**: $4.5 billion; $7.3bn by 2023E
**Main allies:** China, US, EU, India, most African nations with notable exceptions of Eritrea, Somalia and Egypt

Less clear, however, is the scale and scope of liberalization on offer. It is not clear if foreign companies like South Africa's MTN Group or Vodacom (both of whom are highly interested in Ethiopia) will witness significant opening for market entry. The government has still not granted licenses to foreign telecom firms. More likely, at the outset, Ethiopian Airways and Ethio Telecom and others in tourism, railroads, agribusiness, industrial parks and hotels will see partial divestment by the state, which will probably retain majority stakes in most cases. That will keep at bay the sovereignty concerns, retain predominance by the state in key sectors seen as strategic, keep EPRDF elite rents at least partially intact and crucially, provide a windfall of much-needed foreign exchange for the state and its benefactors.

**Privatization to shore up the birr after temporary instability**

The Ethiopian birr remains under pressure despite a 15% devaluation late last year and a newly capable Central Bank governor committed to monetary tightening, per IMF recommendations. Another devaluation, which exacts a heavy toll on the country's vast poor population, could be in the offing before the end of the year. However as new FDI inflows accelerate, the birr will stabilize and appreciate. Foreign exchange shortages are acute and the country's import cover spans less than two months generally seen as the bare minimum by capital markets. The imperative for foreign exchange outweighs the nationalist and crony capitalist constituencies for the status quo.

Beyond that, Prime Minister Abiy is truly reform-oriented and sees windows of opportunity for incremental economic liberalization, diversification, and diplomatic opening (with long time adversaries including Egypt, Eritrea and Somalia—major investor-relevant developments we will explore in a future note).

Abiy's willingness to curtail the powerful military's favored position in infrastructure and manufacturing projects underscores his ability, so far, to take on some of the elite's most entrenched interests. The Abiy administration is keen to diversify its trade and investment partners beyond the current over-reliance on China. Ethiopia received about $11 billion in loans from China (albeit it much of that money went to pay for Chinese-run infrastructure projects ranging from hydropower to rail to telecom) from 2010 to 2015. It is not clear whether the Chinese will sustain that degree of largesse and the EPRDF is increasingly concerned (along with the IMF, Washington and others) about the accumulation of debt.

**The Abiy administration looks to diversify its investment partners (beyond China)**

The government is looking to diversify its investment partners, recently welcoming a $3 billion commitment from the UAE, which will include $1 billion to the central bank to help shore up the birr and $2 billion in promising sectors like tourism, agriculture and renewable energy. Other investors that are hungrily eyeing Ethiopia include GE, Indochine International (manufacturing), Guess, H&M, Soufflet (agriculture), and Standard Chartered among others.

Ethiopia offers relatively strong investor incentives, especially in priority sectors like export-focused manufacturing, infrastructure and agriculture. Indochine International, which just opened its apparel factory two years ago plans to employ 20,000 local workers by 2020. Participation in Chinese-modeled (and often funded) industrial parks, is encouraged by supporting infrastructure and tax breaks. Industrialists are exempt from income tax for their first five years and do not have to pay taxes on the import of capital goods and construction supplies.

The World Bank has a multi-year $270 million program in place to encourage business competitiveness beyond just cheap labor which is abundant so that local businesses can provide more goods and services for global supply chains targeting African, Middle East and Asian markets. This ties into the government's ambitious, but increasingly viable, strategy to complement infrastructure-led economic development with diversified foreign investment and export-led growth. Ironically infrastructure, while vastly improved over a nearly nonexistent baseline, remains one of the biggest barriers faced by foreign investors along with a highly bureaucratic style of governance that creates excessive red tape for domestic and foreign investors alike, regardless of their essential role in helping the government achieve its lofty goals.

Without a doubt, Ethiopia may be at a 1978 Deng Xiaoping moment. A dramatic economic lift off is likely in the offing.

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To schedule in-depth Q&A on Ethiopia with DaMina Advisors

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