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Ethiopia's 'Gorbachev' falters (and may yet fall) – but reforms will soldier on

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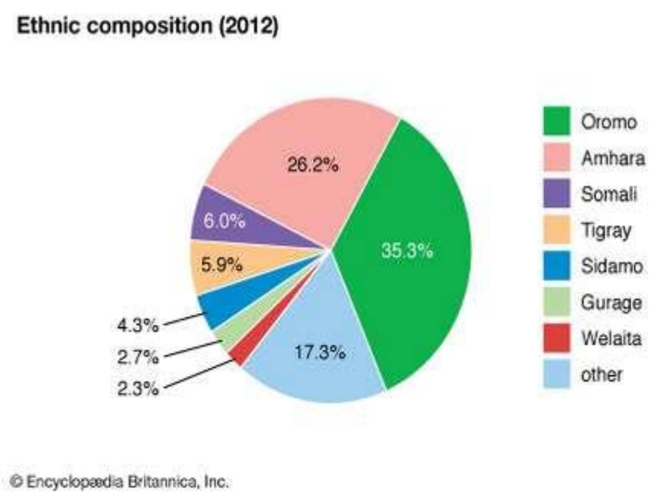
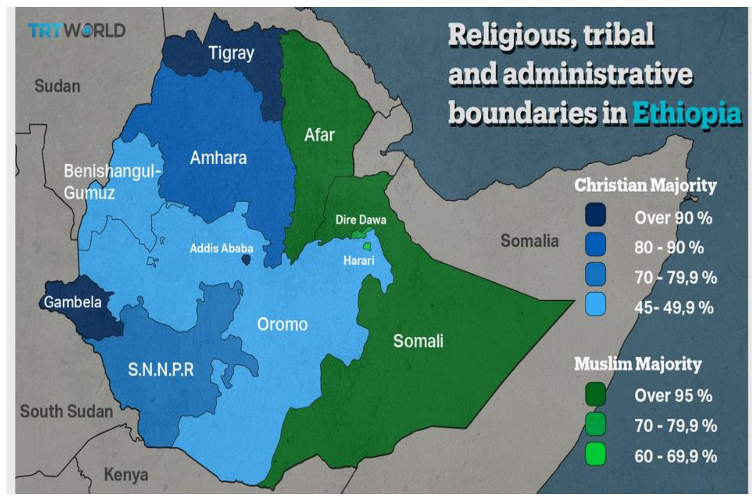
Ethiopia's reformist leader, 42-year old Prime Minister Abiy Ahmed's embattled administration remains committed to accelerated economic liberalization, even as political and security risks limit the scope of his reform initiatives. Abiy, under pressure internally, may yet lose the confidence of the fractured ruling alliance, and even possibly fall from office, but the epic reforms he has unleashed will be hard to stop. Abiy's obstacles include upcoming parliamentary elections in 2020, heightened ethno-regional tensions, elite in-fighting and the multiple competing policy priorities. Any delays in the privatization timetable will curb the ability of the government to generate more hard currency to shore up the local currency, the birr, ahead of the 2020 polls. Still, the Abiy administration may lack political and administrative bandwidth to carry out major reforms beyond the partial divestment of Ethio Telecom if security risks persist.

Looking ahead, Abiy may be distracted by regional diplomacy, domestic instability, and fracturing of the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF) coalition, especially from the marginalized ethnic Tigrayan faction. The attempted coup in Amhara on June 22, which killed three top officials in the state (including the state president), clearly implicated senior and recently-retired military officials, raising questions about Abiy's political capital and his command of military loyalty. In the aftermath of the attack in Ethiopia's second most populous state, Abiy has cracked down on dissent while trying to keep his coalition intact. That could be a difficult balancing act going forward with elections less than a year away, with foreign investors and governments watching.

The government is facing bubbling security risks beyond Amhara, including in Tigray, Sidamo and even within Abiy's own ethnic Omoro base. Abiy faces a difficult Faustian bargain. A heavy-handed crackdown would badly erode Abiy's international standing and potentially deter foreign investors. Signs of weakness, on the other hand, could invite further challenges to the new leader, who has until now distanced himself from his predecessors' ruthless clampdown on dissent. The ethnic Tigrays pose a particular threat, having been sidelined from their political, military and economic dominance under Abiy. For now they have stayed in the ruling coalition but may try to sabotage it from within or leave altogether. That would probably further marginalize them even more but they could play a spoiler role on the peace deal with Eritrea and look to forge a new coalition, possibly including other disaffected elements of the EPRDF.





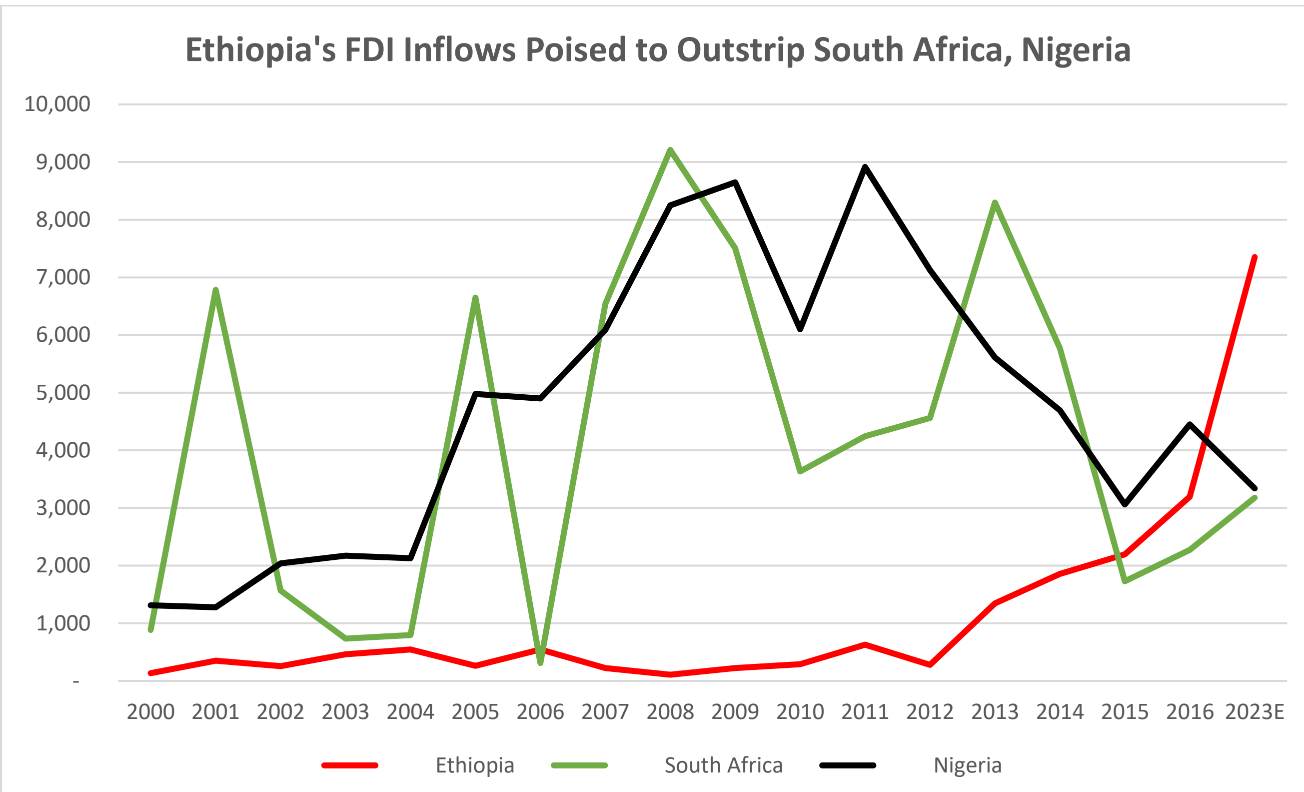
Privatization will strain the limited bureaucratic capacity of the government to manage sweeping economic changes in the near term, although new World Bank assistance will help to ensure that the process does not entirely falter. The prospect of new windfalls from asset sales will help ensure elite buy-in for partial privatization. The attempted coup in Amhara and the subsequent nation-wide Internet blackout underscores risks for investors in Ethio Telecom but investor appetite will remain robust given the company's 60 million subscribers.

The privatization bill is before Parliament and will likely pass this year given the ruling EPRDF's near-unanimous control of the legislature, along with the other levers of power. Limited administrative capacity and other constraints noted above will likely postpone privatization of Ethiopian Airlines, especially in the wake of the airline's deadly crash in March.

WTO accession remains a priority but will likely not be finalized until next year. The economic reforms will not entirely stall, however, and will be buttressed by the World Bank's $1.2 billion Development Policy Financing (DPF) loan. International investor interest in Ethiopia and its largely untapped 100 million-strong market will remain elevated in sectors like light manufacturing, textiles, horticulture, infrastructure and eventually the airline industry, in addition to telecom.

One year has passed since the Abiy administration first announced its privatization initiative. The government has set up a new 21-member Macro Economic Affairs Advisory Council on privatization, comprised of business leaders, economists, academics and opposition members, and a technical committee which will likely work closely with the World Bank under its new DPF loan. The government has also launched a Doing Business Initiative to cut red tape and streamline byzantine regulations.

Still, implementation will be piecemeal and marred by delays in a highly charged political and security climate marked by growing tensions in the ruling EPRDF coalition. Privatization will not touch key sectors of the economy, like banking, and will not be accompanied by land reform. The Advisory Committee will have a two-year tenure underscoring the government's resolve not to rush the process. Plans to launch a stock market by 2020 are likely to face considerable delays and pushback.



Source: UNCTAD/ DaMina Advisors

Privatization will be piecemeal and partial

Ethiopia will maintain a majority stake in its prized state owned companies, though it could sell off as much as 49% in Ethio Telecom and a few other state owned enterprises, like Ethiopian Electric Power Corporation and Ethiopian Shipping and Logistics Services Enterprises. The Abiy administration will also look to sell minority stakes in target industries including sugar, tourism and industrial parks; there may also be outright privatizations of a few select companies not deemed strategic.

In a February 2019 interview with the Financial Times, Prime Minsiter Abiy said flatly “My economic model is capitalism,” which marks an important departure from Ethiopia’s history of state-led economic development. The reality is likely to be a hybrid model that incorporates more space for the private sector, including for foreign investors, while preserving a central role for the state in most realms of the economy. This includes the preservation of a tightly-managed currency (the birr) and monetary policy more broadly, along with an ambitious industrial policy that will support labor intensive and export-oriented industries. Elite and military-tied firms will continue to benefit from state largesse. Incoming investors will face a structurally undervalued birr (by 10-15%), chronic shortages of foreign exchange, and a thicket of bureaucratic red tape.

Up first: Ethio Telecom privatization will be fast-tracked

Ethio Telecom has been valued at about $15 billion and has Africa’s largest subscription base, with over 60 million customers. The top telecom companies in Africa are all positioning to enter the market, including MTN, Safaricom, and Vodacom, along with Western giants like Orange. The government may auction spectrum to a couple of foreign companies as part of the managed liberalization. The government plans to unbundle regulatory, infrastructure operations, and service provision function while breaking the enterprise into two competing business units to foster competition.

The government’s expectations of a multi-billion dollar windfall may be tempered, though by Ethio Telecom’s toxic debts and its low per-costumer earnings. Another challenge is posed by Ethiopia’s low internet penetration rate of just 16%. Politics could also intervene should the current trends of EPRDG infighting and (interrelated) communal violence surge—Ethio Telecom has traditionally been used as a tool of state surveillance, especially in times of turmoil, including recently.

Despite the obstacles ahead, the government will pursue its piecemeal privatization in large part to shore up its precarious reserves, the birr and its budget. The government has reportedly defaulted on over $ 1 billion in Chinese debt and some companies have faced year-long delays in receiving their foreign currency allocations. Foreign currency debt has reached 350% of annual export earnings. For all the talk of change under Abiy, the government remains committed to the model of heavy government spending in infrastructure to propel growth; it needs an estimated $7.5 billion to complete ongoing infrastructure projects—privatization will help fund the gap.

Headwinds loom heading into 2020

The Abiy administration’s privatization agenda could face headwinds from a potentially deteriorating political and security climate heading into the 2020 parliamentary elections. These could prove to be major distractions, at best, for an administration that is already juggling multiple reforms. It could also embolden privatization skeptics within the ruling coalition, including the Tigrayan community, labor, and nationalists who see privatization as a breach of sovereignty.

Leaders of the once-mighty Tigrayan People’s Liberation Front (TPLF) have already come out against privatization, arguing that the state-led economic model has delivered over a decade of near-double digit growth; Tigrayan elites are also concerned they will be shut out of the process. Corruption allegations are likely to follow the privatization process, potentially putting the ruling EPRDF on the defensive in an election year.

The TPLF is reconsidering its membership in the ruling coalition and threatening to undermine Abiy's peace agreement with neighboring Eritrea's leadership whom many Tigrayans deeply distrust. The TPLF departure from the coalition would destabilize the already-unsteady alliance and possibly prompt other parties to follow suit and probably raise tensions with Eritrea. Another stressor is the marred census process, which was delayed for a third time in April amid intense jockeying between ethno-regional parties and communities. The census informs crucial political and budget allocations, so is highly politicized and polarizing. If the Abiy administration fails to finalize a credible census ahead of the elections, it could either postpone the polls or mar its legitimacy.

The security climate across much of the country has deteriorated since Abiy came to power. Local governments have grown stronger. Regional politicians are increasingly pushing ethnic agendas in regions such as Oromia, Amhara, Sidamo, and Somali. Communal violence over land and resources are on the rise, often pitting ethnic groups against one another, including those that form the core of the ruling coalition.

Amid all of the fanfare around Abiy's diplomatic, political and economic reforms, regional instability caused a skyrocketing of internally displaced people (IDP) in 2018, which reached over 3 million, the highest in the world by far. Competing land claims are pitting the Tigrayans against the Amhara, the Sidamo against their southern neighbors, and the Oromo against the Amhara and other neighbors. Despite considerable diplomatic successes in the region (especially with Eritrea, Djibouti and Somalia) Abiy has not managed to tamp down the instability in the country's own borders.

The Ethiopian constitution created nine ethnically based, semi-autonomous regions, but also gave each of Ethiopia's more than 80 recognized groups the right to form its own region or to secede. Prior governments kept the federation together through violent repression. Now separatists are trying again. Already four ethnic groups have demanded plebiscites on self-rule since late 2018. The four-million-strong Sidamas have threatened to unilaterally declare a new regional state around 18 July, a year after the referendum request. If this deteriorates it could overwhelm Abiy's agenda, including the privatization initiative.

The outlook for privatization is mixed. Despite the political and security headwinds, the Abiy administration will probably retain enough political capital to embark on the initiative, beginning with Ethio Telecom. Fiscal and monetary imperatives will likely ensure that partial privatization will get off the ground in select industries, including not only telecommunications, but power, sugar and industrial parks in the first phase. The rollout will face delays, however, and significant pushback from within the ruling EPRDF as well as from opposition parties and labor. Administrative and bureaucratic constraints will also hamper the effort. Fragmentation of the ruling coalition, growing ethnic violence and the possibility of renewed tensions with Eritrea all pose downside risks over the next year.

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