Country Profile 2006

Ethiopia

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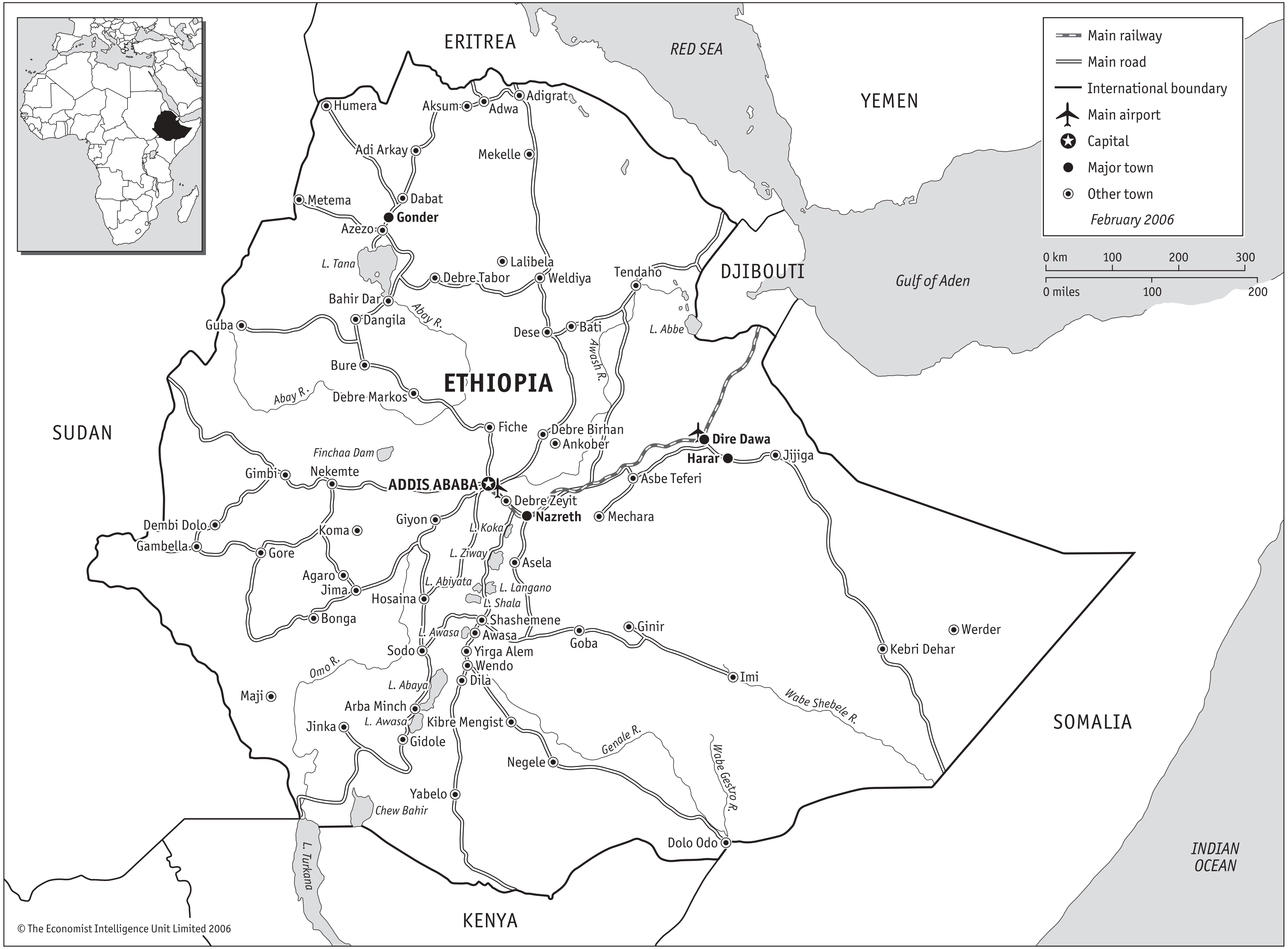
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RED SEA
YEMEN
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Gulf of Aden
SUDAN
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Negele
Wabe Gestro R.
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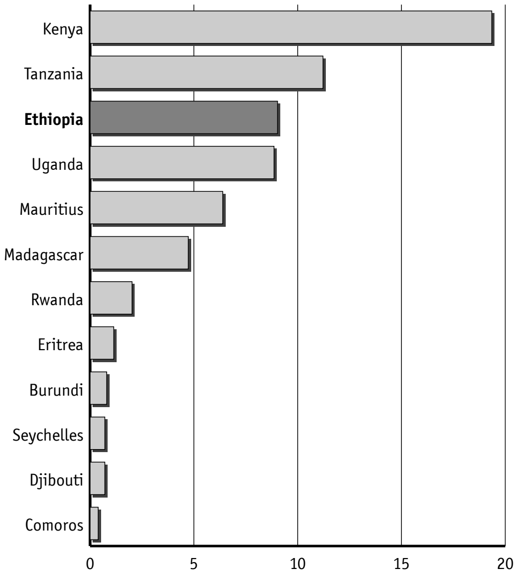
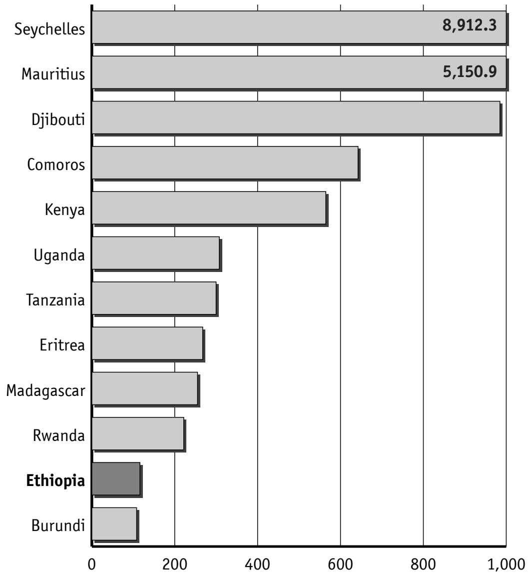
Comparative economic indicators, 2005

Gross domestic product
(US$ bn)



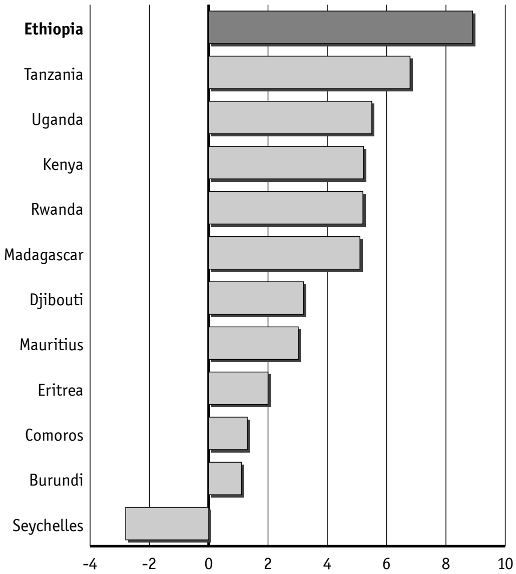
Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product per head
(US$)



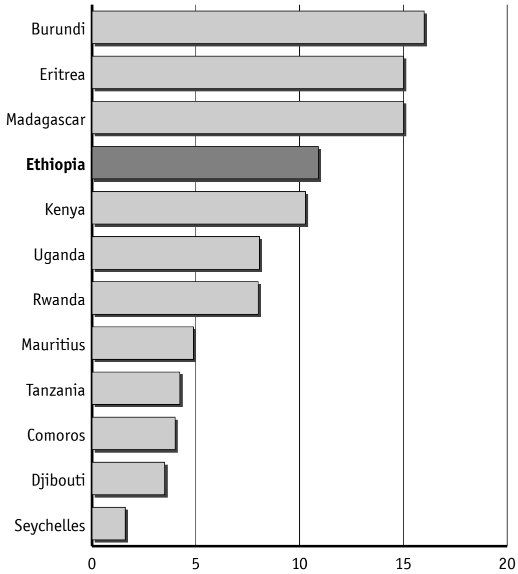
Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product
(% change, year on year)



Sources: Economist Intelligence Unit estimates; national sources.

Consumer prices
(% change, year on year)



Sources: Economist Intelligence Unit estimates; national sources.

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Ethiopia

Ethiopia

Basic data

Land area 1,221,900 sq km

Population 75.6m (IMF mid-year estimate for 2004)

Main regions Population in '000 (1999 official estimates)

Oromiya	21,694	Afar	1,188
Amhara	15,850	Benshangul-Gumaz	523
SNNPR	12,132	Dire Dawa	306
Somali	3,602	Gambella Peoples	206
Tigray	3,593	Harari Peoples	154
Addis Ababa (capital)	2,424		

(Addis Ababa and Dire Dawa are municipalities)

Climate Temperate on plateau, hot in lowlands

Weather in Addis Ababa (altitude 2,450 metres) Hottest months, April-May, 10-30°C; coldest month, December, 5-23°C; driest month, December, 5 mm average rainfall; wettest month, August, 300 mm average rainfall

Languages Amharic, Orominya, Tigrinya, Afar, Somali and others. English and Amharic are mainly used in business

Measures Metric system; also 1 gasha=40 ha, 1 kend=0.5 metres, 1 frasoulla=17 kg

Currency The birr, previously the Ethiopian dollar, = 100 cents. The single legal exchange rate is determined by a weekly auction. Average exchange rate in 2005: Birr8.67:US$1; exchange rate on February 9th 2006: Birr8.72:US$1

Time 3 hours ahead of GMT

Public holidays January 7th (Christmas), January 19th (Epiphany), March 2nd (Battle of Adowa), May 28th (Downfall of the Derg), September 11th (New Year); Good Friday, Easter, Eid el Fitr, Eid el Ahda, Maulid. The Ethiopian calendar has 13 months (see The economy)

Politics

The federal government of Ethiopia is dominated by the Ethiopian People's Revolutionary Democratic Front (EPRDF), which evolved from a coalition of Tigrayan-dominated rebel groups that defeated the previous government in 1991 after a protracted civil war. The EPRDF proclaimed a federal republic and scored comprehensive election victories in 1995 and 2000 under its prime minister, Meles Zenawi. The EPRDF and Mr Meles won again in May 2005, but the opposition made significant gains and disputed the result. The regime has adopted a hard line towards the opposition following a series of protests and riots in June-November 2005, and has jailed many of its leaders on treason charges. These moves have angered donors; and in December 2005 donors including the US, the UK and the EU announced that direct budgetary assistance would be redirected to project-based programmes, so that such aid would not be supporting the government. The situation is tense and uncertain, although the government will retain a firm grip on power.

Political background

Ethiopia is the birthplace of both *Homo sapiens* and coffee, and gave rise to one of Africa’s first civilisations, the Aksumite state, in the second century AD, which adopted orthodox Christianity and lasted for several hundred years. The modern Ethiopian state was created by highland rulers in the latter half of the 19th century. Ras Tafari Mekkonen became the effective ruler as crown prince in 1916, established ascendancy over regional feudal lords and was enthroned as Emperor Haile Selassie in 1930. His modernising ambitions were brought to a halt and he was driven into exile when the army of fascist Italy invaded and occupied Ethiopia between 1936 and 1941. Italy had tried to capture the country in the 19th century, but had been defeated by Ethiopian forces in a famous victory at Adowa in 1896. Italy nevertheless consolidated its holdings on the Muslim coast and the highland plateau, creating the colony of Eritrea. Following Ethiopia’s liberation by allied forces in 1941, Haile Selassie returned from Britain and ruled until his overthrow in 1974. Ethiopia’s status as an independent African state allowed him to secure Addis Ababa as the headquarters for the newly created Organisation of African Unity (OAU) in 1963.

War and imperial demise

A federation between Ethiopia and Eritrea was proclaimed in 1952, but in 1962 Ethiopia abrogated the federation and unilaterally annexed the territory, provoking Eritrean separatists to launch a protracted guerrilla war. One year later, Ethiopia became embroiled in a war with newly independent Somalia over the eastern region of Ogaden. Domestic discontent was fuelled by corruption among feudal officials, as well as by rampant inflation and high unemployment, and was brought to a head by revelations of government indifference towards the 1972-74 famine, which cost an estimated 200,000 lives. Peasant revolts followed, underlining the need for land reform. In January 1974 a series of strikes and mutinies in the armed forces prompted the resignation of the prime minister of the previous 13 years. This event marked the beginning of what evolved into a coup by army officers.

The Derg

Civilian groups lacked the cohesion to mobilise support amid the unrest of 1974, and the embryonic Provisional Military Administrative Council (PMAC, or Derg in Amharic) filled the power vacuum, marking the beginning of 17 years of military rule. The ousting and murder of Haile Selassie in September 1974, and the execution of 57 senior officials, sparked three years of conflict, both within the military and throughout the country. The military government proclaimed Ethiopia a socialist state and by November 1977, after further purges, Colonel Mengistu Haile Mariam had established control of the Derg.

The red terror

Colonel Mengistu used Marxist-Leninist ideology to legitimise his rise to power, but quickly tired of student intellectuals. Vociferous debate degenerated into violence in 1977-78, provoking the brutal eradication of opposition supporters. At a conservative estimate, 100,000 people were killed and several hundred thousands fled to the US and western Europe, establishing a trend of youth emigration. Meanwhile, some opponents launched a rural rebellion in the northern province of Tigray, forming the nucleus of the movement that was to win power in 1991. The government extended its control through a series of radical measures. Land was nationalised and a network of peasant and urban dweller associations established. Known as *kebeles*, these have been retained by the EPRDF. However, as the Derg completed its transformation of Ethiopia into a Marxist-Leninist state, support from the Soviet Union wavered, which fatally weakened the regime.

Overthrow of Mengistu

The EPRDF, a newly created coalition dominated by the Tigray People's Liberation Front (TPLF), launched a decisive assault in early 1991. By May 1991 Sub-Saharan Africa's largest army had been crushed, and Colonel Mengistu fled to Zimbabwe, where he remains. The victorious EPRDF convened a conference in July 1991 to endorse a transitional charter and Eritrea's *de facto* independence. The charter became the legal basis of four years of interim rule under an EPRDF-dominated legislature, with an executive headed by the TPLF leader, Meles Zenawi.

A shift to federalism masks a powerful centre

The transitional government implemented extensive economic reforms and a radical form of devolution along ethnic lines. However, despite this shift to federalism, power remains highly concentrated within a small elite leadership, the legacy of an age-old monarchical system that was followed by Marxist-style totalitarianism. The EPRDF's strength and legitimacy derives from its inclusion of representatives from all of Ethiopia's major ethnic groups. Unsurprisingly, the EPRDF triumphed at the first general election, in 1995; Meles Zenawi was appointed prime minister and the new Federal Democratic Republic of Ethiopia was proclaimed. Mr Meles and the EPRDF emerged similarly victorious in the 2000 ballot, although it was marred by allegations of fraud and a partial opposition boycott.

The war with Eritrea

Eritrea was granted independence in May 1993, but although the separation went smoothly at first, relations between the two countries' leaderships (both of which are Tigrinya-speaking) deteriorated owing to disagreement over border delineation and tension over monetary and trade relations. The dispute erupted into a full-scale war in May 1998, which raged for more than two years. The conflict ended in December 2000, after international mediation, but the two countries remain at loggerheads over their common frontier (see International relations and defence). The unresolved dispute with Eritrea also continues to figure prominently in the domestic political scene. Many continue to blame the EPRDF, and Mr Meles, for allowing "traditional" territories to secede.

Recent political developments

The 2005 elections prove divisive

Ethiopia's political landscape changed profoundly on May 15th 2005, when voters took part in the country's most democratic election so far and deserted the ruling EPRDF in large numbers. The EPRDF won a comfortable majority (when results were finally announced in September), but the party lost more than 150 seats to the two new opposition alliances, the Coalition for Unity and Democracy (CUD) and the United Ethiopian Democratic Forces (UEDF). The opposition also swept to victory in the capital, winning all the seats on the Addis Ababa city council. However, despite the strong showing by opposition parties, they dispute the result and contend that they are the true winners of the election, largely because of fraud at the vote-counting stage. An EU observer mission, reporting in September, confirmed that significant irregularities took place—and that the ballot did not meet international standards—although this is strongly rejected by the government. The EU mission nevertheless noted that the election was a considerable improvement on previous contests.

Final election results
(no. of seats)

	2005	2000
Ethiopian People's Revolutionary Democratic Front (EPRDF)	327	481
Coalition for Unity and Democracy (CUD)	109	3[a]
United Ethiopian Democratic Forces (UEDF)	52	9[a]
Somali People's Democratic Party (SPDP)[b]	24	19
Oromo Federalist Democratic Movement (OFDM)	11	0
Benishangul-Gumuz People's Democratic Unity Front (BGPDUF)[b]	8	6
Afar National Democratic Party (ANDP)[b]	8	8
Others	7	21
Total	**546**[c]	**547**

[a] These alliances did not exist in 2000 but some of their constituent parties won seats. [b] EPRDF allies. [c] One seat, won by the UEDF, will be subject to a by-election.

Source: National Election Board of Ethiopia.

Tension mounted after the ballot

Tension mounted in the aftermath of the poll, owing to delay in announcing the results and rumours of an opposition victory. Street violence erupted in early June, leading to a harsh clampdown by security forces, which left 42 people dead. Peace was restored following EU mediation and an agreement that the National Election Board of Ethiopia (NEBE) would investigate disputed results. However, the NEBE declined to follow up most complaints, to the anger of the opposition. The small number of contests that were re-run in August all went in favour of the EPRDF.

Tension continued to escalate after the official results were announced in September, with the opposition still crying foul. Further EU-led mediation between the EPRDF and the opposition led nowhere, and following grass-roots consultations, the CUD opted to boycott parliament when it reconvened in October (although the UEDF decided to participate). In response, the EPRDF and its allies stripped boycotting MPs of their parliamentary immunity and threatened to hold by-elections in their constituencies. The government also imposed new rules in parliament, requiring an absolute majority to initiate legislation (up from just 20 MPs previously), in a further attempt to marginalise the opposition.

A renewed crackdown on the opposition

The CUD called for a new round of public protests in early November 2005, but the regime again responded in a heavy-handed fashion, using the armed forces to suppress protests (killing at least 46 people), and rounding up thousands of opposition supporters. The entire CUD leadership—including the party's president, Hailu Shawel, and the mayor-to-be of the capital, Addis Ababa, Berhanu Nega—and more than 100 others (including journalists, human rights activists and aid workers) were detained, and remained in prison as of February 2006, charged with trying to overthrow the state by violent means. Some could face the death penalty, and all requests for bail and appeals by donors and non-governmental organisations (NGOs) for their release have been rebuffed. The prime minister appears to be willing to sacrifice his reputation as a modernising democrat in order to keep an unchallenged grip on power. The situation remains very tense and prospects for political accommodation bleak. The 2005 election and its aftermath, instead of advancing the cause of democracy, have seriously set back the process. However, to put things in historical perspective, power has always been highly centralised in Ethiopia and in this sense nothing has changed. The regime clearly hopes that its high standing in the US-led "war on terror" will have a greater impact in Western capitals than its domestic repression, but it may be disappointed.

Important recent events

1998-2000

Economic and political tensions trigger a savage war with Eritrea, which is ended by the Algiers peace agreement of December 12th 2000.

2001

April: The UN Mission in Ethiopia and Eritrea (UNMEE) supervises disengagement of forces and establishes a 25-km temporary security zone.

2002

April: The UN Eritrea-Ethiopia Boundary Commission (EEBC) of the Permanent Court of Arbitration, based in The Hague, delineates a new frontier between the two countries.

2003

March: The EEBC says that the disputed town of Badme, under Ethiopian administration for decades, belongs to Eritrea, according to colonial treaties.
August: The opposition alliance, the United Ethiopia Democratic Front (UEDF), is founded at a conference in the US.

September: Ethiopia formally rejects the EEBC ruling and border demarcation is suspended indefinitely.

2004

January: The UN secretary-general, Kofi Annan, appoints a special mediator to settle the border impasse, but Eritrea refuses to discuss the issue.
November: The prime minister accepts the EEBC border ruling “in principle”, but this does not satisfy Eritrea. Meanwhile, four opposition parties form an alliance under the banner of the Coalition for Unity and Democracy (CUD).

2005

February: Political parties register their candidates for the planned general election in May. Most legal opposition parties are planning to take part and credible international observers will be allowed for the first time.
May: The elections attract a high turnout and take place in a calm atmosphere, but tension grows as the announcement of results is delayed.
June: Provisional election results give victory to the EPRDF, but accusations of fraud lead to protests in Addis Ababa. Security forces take a hard line, leaving 42 people dead. The EU mediates a peace deal and the authorities agree to checks and recounts.
September: Final election results confirm an EPRDF victory, but a report by EU monitors records serious flaws and the opposition parties reject the outcome.
October: Parliament reconvenes and selects Meles Zenawi for a third term as prime minister. However, the CUD refuses to take up its seats.
November: Security forces react harshly to a new round of protests, leaving at least 46 dead. More than 100 people, including the bulk of the CUD leadership, are jailed and charged with high-level crimes, including treason.
December: The courts refuse bail for detained opposition leaders. Donors signal that direct budgetary support for the government will be re-channelled into anti-poverty projects.

Constitution, institutions and administration

Ethiopia’s first constitution was drafted in 1931, followed by revisions in 1955 incorporating limited reforms. The constitution was suspended in 1974 by the Derg and replaced by a series of military decrees, until a new constitution was promulgated in 1987. The Derg was overthrown in 1991, and a Constituent Assembly was elected by universal suffrage in June 1994. A new constitution was endorsed by a referendum in December 1994 and came into effect in August 1995, establishing the Federal Democratic Republic of Ethiopia. It is based on a bicameral legislature, a ceremonial presidency, and an all-powerful, executive prime minister. There are few checks on executive authority and no mechanism for the smooth transfer of power.

The second republic

Under the 1995 constitution, Ethiopia is a federation of nine states (and two municipal councils—Addis Ababa and Dire Dawa), governed by two federal assemblies: the legislature, known as the Council of Peoples’ Representatives (the lower house), and a smaller, supervisory senate, the Council of the Federation (the upper house). The Council of Peoples’ Representatives has 547 members, who are elected for five-year terms in single-seat constituencies (a “first past the post” system). The Council of the Federation has 108 members, comprising representatives from the nine federal regions and designated ethnic groups, elected both directly and indirectly. The regions (states) are distinguished primarily along ethno-linguistic lines, with the main ones being Oromiya, Amhara, Tigray, Somali and Afar. The EPRDF's federal aspirations are designed to give a fair voice to Ethiopia's diverse peoples, but the building of a ruling coalition comprising the main representatives of major ethnic groups has also served as a mechanism to cement centralised authority. The federal constitution allows for the secession of individual regions or linguistic groups but, following the controversial secession of Eritrea in 1993, it is very unlikely that any further splits will be sanctioned.

The judiciary and the cabinet

The federal constitution provides for an independent judiciary and the devolution of legal powers, but in practice the executive branch of government is virtually all-powerful. The legal system is weak, and opaque to outsiders, but is gradually being modernised, helped by external support. The latest cabinet, named by the prime minister in October 2005, comprises 20 ministers (two more than before), of whom about half are new faces. In line with the principle of ethnic federalism, Mr Meles kept a broad ethnic balance between the Oromos, the Amharas, his fellow Tigrayans and various smaller groups, while cementing his own authority. However, most important decisions, especially on economic policy and security, continue to be made by Mr Meles's inner circle and not by the formal cabinet.

Key agencies

Parliaments in each of the nine regional states mirror the federal structure. Other agencies include a powerful central Security, Immigration and Refugee Authority (SIRA), created in 1995, when the functions of the interior ministry were devolved to the regions. SIRA, as well as the domestic security service and the armed forces, are controlled by senior EPRDF staff. A Federal Revenue Administration Board supervises regional finances. The Disaster Prevention and Preparedness Commission (DPPC) co-ordinates food security efforts, including famine early warning, the maintenance of food reserves and the distribution of emergency food aid.

Political forces

The EPRDF

The EPRDF continues to dominate all the formal institutions of the federal republic. Despite its loss of seats in the 2005 election, the party (and its allies) still commands a solid majority in the Council of Peoples' Representatives. The EPRDF signed a formal alliance in November 2005 with the Somali People's Democratic Party (SPDP), the Afar National Democratic Party (ANDP), the Benishangul-Gumuz People's Democratic Unity Front (BGPDUF), the Gambella People's Democratic Movement (GPDM) and the Harari National League (HNL). Together they hold 371 seats in parliament, just over two-thirds of the total. The EPRDF and its allies also maintained control over all regional parliaments, except in the capital, Addis Ababa, which voted heavily for the opposition. However, the existing city council continues to operate under a transitional mandate because of an opposition boycott. By retaining control of the regions, the EPRDF also maintains its large majority in the Council of the Federation (see Constitution, institutions and administration).

The EPRDF comprises four main components—the Oromo People's Democratic Organisation (OPDO), the Amhara National Democratic Movement (ANDM), the Southern Ethiopia People's Democratic Front (SEPDF) and the Tigray People's Liberation Front (TPLF). The TPLF is by far the smallest, but the most influential, having led the war against the Derg and driven the formation of the EPRDF by drawing in non-Tigrayan groups, and of course by providing the prime minister. Mr Meles has kept a firm grip on the TPLF through periodic purges, and seeks to maintain a balance between parties in the cabinet.

Main political figures

Meles Zenawi

Prime minister and leader of the Tigray People's Liberation Front (TPLF). Served as chairman of the TPLF and the Ethiopian People's Revolutionary Democratic Front (EPRDF) from 1989 to 1991, and then as chairman of the EPRDF and president of the transitional government from 1991 to 1995. He became prime minister after the 1995 general election, and won a second term in 2000 and a third in 2005.

Seyoum Mesfin

Minister of foreign affairs; key power-broker within the TPLF and leading ally of the prime minister. He remained in his post following the October 2005 reshuffle.

Addisu Legesse

Deputy prime minister, an Amhara and another of Mr Meles's key allies. He retained his position in October 2005 and was also given the agriculture portfolio.

Bereket Simeon

The former information minister, and an Amhara. He played a key role in the EPRDF's election campaign, but the party's relatively poor showing led to him being dropped from his portfolio in the October 2005 reshuffle. He is now the prime minister's public relations adviser.

Kassu Illala

Infrastructure development minister since October 2001, and a key economic policymaker. His post was expanded in October 2005 to include urban development.

Teklewolde Atnafu

Governor of the National Bank of Ethiopia (the central bank); his role has become more important as the country undertakes comprehensive economic reforms.

Girma Wolde-Giorgis

Elderly ceremonial president with limited powers.

Hailu Shawel

The president of the opposition Coalition for Unity and Democracy (CUD), and an elected MP, he is one of several CUD leaders who were arrested in November 2005 and charged with treason. He remains in prison and has been refused bail.

Berhanu Nega

A key figure in the CUD, he was nominated by the party in October 2005 to be the mayor of Addis Ababa. He was imprisoned in November 2005 along with other CUD leaders.

Dissent within the EPRDF

Discontent within the TPLF over Mr Meles's policy of peace with Eritrea erupted into open rebellion in March 2001, leading to the suspension of 11 of the 30-strong TPLF central committee and months of internal feuding. By October 2001 Mr Meles had emerged victorious, and silenced the dissidents by imprisoning them on corruption charges—some of them have still not come to trial. Notwithstanding his triumph, however, Mr Meles has never won back the hardline Tigrayan elements, and has consequently moved closer to the other EPRDF parties to bolster his position. Despite the challenges, Mr Meles has maintained the EPRDF as a united entity and remains firmly in command.

The opposition made a strong advance in 2005

The opposition staged a remarkable performance in the May 2005 election, with the Coalition for Unity and Democracy (CUD) capturing 109 seats and the United Ethiopian Democratic Forces (UEDF) taking 52 seats—components of the two groups won just 12 seats in the 2000 election. The CUD and UEDF are both alliances of several other parties: the UEDF was formed in 2003, and groups together the Council of Alternative Forces for Peace and Democracy (CAFPED) and the Oromo National Congress (ONC), as well as several parties in exile; the CUD was formed in 2004 between the All-Ethiopia Unity Party (AEUP), the United Ethiopian Democratic Party (UEDP), the Ethiopian Democratic League (EDL) and the Ethiopian Rainbow Movement for Democracy and Justice (ERMDJ). The CUD draws much of its support from the Amhara ethnic group, while the UEDF performed best in the Oromia region. Although both parties reject the 2005 election results, they have adopted different tactics. The CUD opted to boycott the new parliament (although many of its members have since drifted back), but the UEDF did not. In policy terms, however, the CUD and the UEDF espouse similar agendas. They support economic liberalism (including privatisation and land reform) and press freedom, but oppose the handover of any sensitive territory to Eritrea. The CUD attempted to formalise its alliance in October 2005, but the NEBE rejected the proposed merger, ostensibly on technical grounds, although its decision reflects the regime's drive to neutralise and marginalise the opposition.

Oromia is a troubled region

Oromia, the most populous province, is a key political battleground, often to the detriment of its inhabitants. The region is governed by the OPDO, which is a key member of the EPRDF, although its legitimacy is challenged by a number of groups, including the Oromo Liberation Front (OLF). The OLF was initially allied to the EPRDF in 1991 but subsequently left, seeing little hope of pushing forward its pro-independence agenda. OLF-linked groups have conducted periodic attacks on government installations since then, mainly from bases in neighbouring Somalia. Other, smaller, armed Oromo factions also operate. Disaffection increased in 2003 when the regional state capital was transferred from its traditional base in Addis Ababa to Nazreth. Oromo activists were further angered by the expulsion of several hundred Oromo students from Addis Ababa University in 2004, following unrest there. The OPDO suffered a significant loss of support in the May 2005 election (although it stayed in power)—to the advantage of the UEDF, and to a lesser extent the CUD and the Oromo Federalist Democratic Movement (OFDM)—primarily because of a belief that EPRDF policies were marginalising Oromia. In reaction to the election result, the federal government transferred the state capital back to Addis Ababa.

Apart from appeasing the Oromo, this also helps to cement the EPRDF presence in Addis Ababa following the capture of the city administration by the CUD (although the CUD is still maintaining a boycott).

Other regional conflicts

The federal government is also confronting rebellions in the less populated Afar and Somali regions, which are run by parties allied to the EPRDF. The main problem in both regions is that numerically larger populations of Afaris and Somalis live in the neighbouring countries of Djibouti and Somalia, providing havens for rebel groups. Ethiopia also faces bouts of inter-ethnic strife. Clashes in 2003-04 in Gambella state in the south-west, near the Sudanese border, left several hundred people dead, and led to federal intervention to restore order. Human rights observers criticised the government's ethnic policies for increasing tensions by linking political and economic rights with ethnic identity.

Main political forces

Government

Ethiopian People's Revolutionary Democratic Front (EPRDF), formed in 1990.
Main constituents of the EPRDF:

- Tigray People's Liberation Front (TPLF);
- Oromo People's Democratic Organisation (OPDO);
- Amhara National Democratic Movement (ANDM); and
- Southern Ethiopia People's Democratic Front (SEPDF).

Legal opposition

- The United Ethiopian Democratic Forces (UEDF), formed in 2003 by local and exiled parties.
- The Coalition for Unity and Democracy (CUD), formed in 2004 by disaffected elements of the UEDF and other local parties.

Outlawed opposition

- Oromo Liberation Front (OLF; the principal rural insurgents).
- Afar Revolutionary Democratic Unity Front (ARDUF).
- Ogaden National Liberation Front (ONLF).
- Islamic Front for the Liberation of Oromiya (IFLO; a faction with alleged links to Islamist groups in Somalia).

International relations and defence

The dispute between Eritrea and Ethiopia is deadlocked

A formal peace agreement between Ethiopia and Eritrea was signed in Algiers on December 12th 2000. The 3,500-strong UN Mission in Ethiopia and Eritrea (UNMEE) established a 25-km temporary security zone (TSZ) in April 2001. A key aspect of the peace agreement was the creation of the neutral Eritrea-Ethiopia Boundary Commission (EEBC) of the Permanent Court of Arbitration, based in The Hague. Each side appointed two non-national commissioners to the five-member body, with a fifth appointed by the UN. The commission was charged with delimiting and demarcating the common frontier, based on colonial treaties of 1900, 1902 and 1908 and in accordance with international law. The two countries agreed in advance that the decision of the EEBC would be binding. The EEBC announced its initial ruling in April 2002, and its final ruling in March 2003, confirming that the town of Badme, a flashpoint for the 1998-2000 war, which had been under Ethiopian administration for decades, belonged to Eritrea. This proved unacceptable to Ethiopia, partly for domestic political reasons. It accused the EEBC of having made “a totally illegal, unjust, and irresponsible decision” and refused to implement the ruling. This brought tentative plans to demarcate the border to a halt.

Ethiopia has continued to refuse to implement the EEBC ruling. For its part, Eritrea has refused to hold any further talks on the matter, arguing that the UN should pressure Ethiopia to comply, by imposing sanctions if necessary. In an attempt to find a solution, the UN secretary-general, Kofi Annan, appointed a new trouble-shooter in January 2004—a former Canadian foreign minister, Lloyd Axworthy. Although Mr Axworthy has held several rounds of talks with Ethiopia, Eritrea has refused to meet him, dashing the hopes of UN diplomats.

Ethiopia’s peace plan makes no headway

Mr Meles unveiled a new, five-point peace plan in November 2004 aimed at ending the impasse. In a key move, he accepted the EEBC border ruling “in principle”, but also called for further dialogue with Eritrea and reiterated his opposition to the handover of disputed territory. Unsurprisingly, Eritrea rejected Ethiopia’s proposals, and restated its view that the border ruling should be implemented as it stands. One month later, Ethiopia made major troop deployments in border areas, ostensibly to deter aggression, although they inflamed the situation.

Tension mounts in 2005

The rise in tension within Ethiopia following the May 2005 election has been matched by a similar rise in tension along the disputed border with Eritrea. This reflects the adoption—by both regimes—of the age-old strategy of sabre-rattling abroad to distract attention from problems at home, but this provoking a fresh conflict. Eritrea has been the prime mover in ramping up the tension—by ordering UNMEE to stop helicopter patrols in October 2005, and ordering all European and US nationals in UNMEE to leave the country in December 2005—to try to put pressure on the UN to make Ethiopia comply with the EEBC border ruling. However, the Meles regime is only too happy to have a distraction from its internal difficulties. International frustration at both sides is growing, and the entire future of UNMEE is now under review, especially because of the new restrictions imposed by Eritrea. The UN warned in early 2006 that it was considering all options for UNMEE, including downgrading it to a simple observer mission or withdrawing entirely. UNMEE’s departure could be disastrous, as, although both protagonists are posturing and are not necessarily planning for war, the risk of conflict by miscalculation would rise enormously without the calming presence of the international peacekeepers.

Djibouti handles most Ethiopian trade

Ethiopia lost access to the port at Assab owing to the war with Eritrea (1998-2000) and was obliged to shift the bulk of its international trade to Djibouti, which now handles about 98% of Ethiopia’s traffic. This makes the relationship with Djibouti a critically important one. Bilateral relations remain solid, and they continue to improve following the resolution of disagreements over transit regulations and port fees in 2004.

Ethiopia is deeply involved in Somalia

Ethiopia shares a long southern and eastern border with Somalia (and breakaway Somaliland), and remains deeply involved in the affairs of its neighbour. Ethiopia's relationship with Somalia has always been complex because Ethiopia's Somali province is populated by ethnic Somalis. Ethiopia fears that the rise of an ethnic Somali nation would threaten its own territorial integrity. As a result, Ethiopia has covertly manipulated Somali factions to its own advantage, and has given strong backing to the breakaway entities of Somaliland and Puntland. The new president of Somalia, Abdullahi Yusuf Ahmed (the former Puntland president), who was elected by the Nairobi-based parliament in exile in October 2004, has a close relationship with Mr Meles. However, Ethiopia is unlikely to support Mr Ahmed's goal of reversing Somaliland's *de facto* independence.

Ethiopia, Sudan and Yemen have a tripartite alliance

Ethiopia's regional diplomacy has in recent years focused partly on building stronger ties with Sudan and Yemen in order to isolate Eritrea. After a meeting between the leaders of Ethiopia, Sudan and Yemen in 2002, the leaders signed a charter formalising tripartite co-operation at a second gathering in Addis Ababa in December 2003. However, Sudan and Yemen reject the accusation that the alliance is expressly anti-Eritrean. Relations between Ethiopia and Sudan improved in 2003, when Ethiopia agreed to settle a border dispute and hand back land that it had occupied for seven years, while Sudan offered better access to Port Sudan. Ethiopia's relations with Egypt are sometimes unsettled, owing to disputes over Ethiopia's use of water from the Blue Nile.

US-Ethiopia ties are close

The war with Eritrea in 1998-2000 strained US-Ethiopian relations, but the situation was transformed after the September 11th 2001 terrorist attacks on the US, when Ethiopia emerged as a key ally in the war against global Islamic terrorism, particularly as a result of its proximity to lawless Somalia. Military and intelligence co-operation has increased, and joint operations have been undertaken by Ethiopian forces and the 1,800-strong US Combined Joint Task Force-Horn of Africa, based in Djibouti. The US is also training Ethiopian forces in counter-terror tactics. Ethiopia's failure to comply with the EEBC's ruling on the border with Eritrea, and the crackdown on the opposition since the May 2005 election, pose threats to the relationship, although—under the Bush administration at least—strategic concerns are likely to take precedence.

Post-war demobilisation

The EPRDF doubled the size of its armed forces to fight the 1998-2000 war against Eritrea, mobilising an estimated 250,000 men. Casualty figures are estimated at 123,000 Ethiopians killed, principally in the two major assaults in February-June 1999 and May-June 2000. The post-war period has been marked by lower defence spending and demobilisation (unlike in Eritrea), and the size of the army fell to an estimated 180,000 in 2004.

Military forces, 2004[a]

Army	180,000
Air force	2,500
Total	**182,500**

[a] Ethiopia's navy, berthed in Djibouti from 1991, was auctioned off in 1996 to an unknown buyer.

Source: International Institute for Strategic Studies, *The Military Balance 2005/06*.

Resources and infrastructure

Population

Ethiopia is a large and an ethnically diverse country

Ethiopia's population was 70m in 2004, according to the World Bank (or 75.6m, according to the IMF), making it Sub-Saharan Africa's second most populous nation (after Nigeria). The World Bank estimates that the population growth rate was 1.9% in 2004, although some sources cite a higher figure. Population growth will be constrained by the AIDS pandemic—around 4.4% of adults aged 15-49 were HIV-positive in 2003, according to the joint UN programme on HIV/AIDS (UNAIDS)—although the incidence of the disease is lower than previously thought. The population is still overwhelmingly rural, with only 15% living in towns, and only Addis Ababa, the capital, having a population of over 1m. Several hundred thousand Ethiopians have settled in the US over the past two decades, concentrated largely around Washington DC and Los Angeles. Considerable numbers also live in the EU.

The federal constitution divides the country into nine states and two municipalities, primarily on the basis of ethnicity, although none of the regions is entirely homogenous and some have considerable diversity. The Oromo are the largest group, and are dominant in central/southern areas, followed by the Amharas and Tigrayans in the north. Other large ethnic groups are the Somali, in the south-east, and the Afar, in the north-east. The government recognises 64 distinct ethnic groups. Amharic and English remain the *de facto* languages of state, although greater emphasis is now being placed on regional languages in schools and the official media. Regions are free to choose their own language of administration, although several have kept Amharic for reasons of convenience. Despite the state's traditional association with Orthodox Christianity, the Ethiopian population is split fairly evenly between Christians and Muslims. The post-1991 administration made progress in establishing official parity of esteem and recognition between Christians and Muslims.

Education

Access to education rises slowly and remains low

The education budget was squeezed during the war with Eritrea in 1998-2000, but recovered under the anti-poverty programme, rising from 9.5% in 2000/01 to 11.5% of total spending in 2002/03 (fiscal year July 8th-July 7th).

Education statistics
(%)

Adult literacy rate[a]	
Male	49
Female	34
Gross school enrolment[b]	
Primary	66
Secondary	19
Tertiary	2

[a] 2002. [b] 2002/03.

Source: World Bank, *World Development Indicators*.

Gross school enrolment rates have risen steadily—from 37% in 1980 to 64% in 2000 for primary schools, and from 9% to 18% for secondary schools—although education provision is still inadequate. The government is pinning considerable hopes on an "e-learning" initiative that will link the entire school network, and help to overcome disadvantages associated with a lack of good roads and the absence of traditional telecommunications services.

Health

Health service provision is poor

With 85% of the population living in rural areas, the provision of health services is a major challenge. As with education, spending on health picked up after the 1998-2000 war with Eritrea and the start of the poverty reduction programme in 2001, but remained comparatively low, at just 2.7% of total spending in 2002/03. According to the World Bank, total annual health expenditure averaged only US$5 per person in 1997-2000, compared with an average of US$29 per person for Sub-Saharan Africa as a whole.

HIV/AIDS

Ethiopia has the second highest number of HIV infections and deaths from AIDS in Africa (after South Africa), and the pandemic poses a serious threat to national development. However, a recalculation of the figures by the joint UN programme on HIV/AIDS (UNAIDS), the World Health Organisation and the government in 2003 suggests that the prevalence of the disease is lower than previously thought. According to the latest figures, 1.4m adults (15-49 years old) were infected at the end of 2003 (a rate of 4.4%), compared with an earlier estimate of 1.9m. Similarly, the estimate for the number of children infected was reduced to 120,000, from 230,000. Adult deaths from AIDS in 2003 amounted to 115,000 (about one-third of total adult deaths), compared with an estimated 160,000 in 2001. The latest figures appear to show that the problem is less serious than had been thought, but they partly reflect better measurement and do not give a clear answer to the question of whether the crisis is worsening. Whereas the infection rate in urban areas (15-20% of the population) is much higher than the national average at 12.6%, it appears to have stabilised, whereas the rural rate, despite being low at 2.6%, appears to be on an upward trajectory, with potentially devastating consequences. This is partly linked to the demobilisation of soldiers after the 1998-2000 war with Eritrea and their return to their home areas, as well as the ongoing expansion of the road network.

Despite the downward revision of the disease figures, the number of people infected is still huge, and this is having a debilitating impact on growth and development. The loss of key workers, especially in the health and education sectors, is particularly detrimental to the anti-poverty programme. In an attempt to limit the damage caused by the disease, the government in early 2005 started an official programme of free, anti-retroviral (ARV) drug treatment for infected persons (funded by the US). The programme began on a small scale—involving 30,000 people—but it may be widened to include more than 200,000 within three years. The government estimates that the drugs could prevent 78,000 deaths a year.

The poor level of health provision is reflected by the low life expectancy at birth of just 42 years in 2004. The government's Health Sector Development Programme (HSDP) aims to expand formal health services to reach the entire population by 2008, from about 50% in 2005, by opening hundreds of new medical centres and by employing and training thousands of new staff.

Malaria is a major killer

Malaria, Ethiopia's third largest killer overall and the main cause of death among under-fives, returned with a vengeance following the heavy rains in mid-2003 and spread to highland areas traditionally free from the disease. The World Health Organisation warned of a "very serious impact on the people's health and productivity"—100,000 died during the previous major epidemic in 1998—but a massive donor-funded prevention and treatment campaign helped to alleviate the impact. Malaria will continue to be a major killer, particularly in years of good rainfall.

Natural resources and the environment

Abundant natural resources, but much land is unproductive

Although Ethiopia has abundant natural resources, much agricultural land is unproductive, water shortages remain endemic and major rivers are prone to seasonal flooding. Agricultural land in densely populated areas of the highlands has been deteriorating steadily in recent decades. An acceleration of deforestation has led to severe soil erosion in regions where people are dependent on marginal, rain-fed agriculture. In response, the government has embarked on a series of environmental initiatives, including a National Conservation Action Plan, which includes measures for selective reforestation. An Environmental Protection Agency has been created, and Ethiopia is taking tentative steps towards establishing a biodiversity strategy. This is supported by the government's status as a signatory to the UN Environment Programme (UNEP) Cartagena Protocol on Bio-safety (CPB), ratified in January 2000 (Ethiopia signed up to it in May 2000). The CPB is a supplementary agreement to the Convention on Biological Diversity, which seeks to protect biological diversity from the potential risks posed by modified organisms resulting from modern biotechnology. The CPB also aims to promote the sustainable use of biological diversity. Current projects form part of capacity-building exercises sponsored by UNEP with the objective of preparing a national bio-safety framework in accordance with the relevant provisions of the CPB. It is the support of UNEP that has made such a programme possible, given the current general lack of funds for environmental development programmes.

Lake Tana, Ethiopia's largest lake, has 37 small islands, most of which shelter monasteries and churches, some dating back to the 13th century. The lake is the source of the Blue Nile, although the river running out of the southern end of the lake is called the River Abay, before it turns into the Blue Nile when it enters Sudan. Despite Ethiopia's association with severe drought, the country is well-endowed with water resources, mostly unused. Part of the problem is that Nile-related developments are subject to long-standing treaties with other states, and Egypt, in particular, has sought to block all developments that may affect its downstream share of the river's water.

Aside from agriculture, livestock and forestry, Ethiopia has undeveloped mineral resources. The past few years have seen increased private foreign interest in the mining of gold and other precious metals (see Economic sectors: Mining and semi-processing), as well as oil and gas exploration.

Transport, communications and the Internet

Transport infrastructure is inadequate and unreliable

Ethiopia's inadequate and unreliable transport infrastructure continues to be a significant barrier to economic growth, and access to ports, markets and services is limited. This is especially true of the road network, which carries about 95% of passenger and freight traffic. The spindly network of poorly maintained roads radiating out from Addis Ababa to the provinces is largely a legacy of the Italian occupation during the 1930s. The two main roads going north through the highlands have suffered from decades of neglect and heavy wear from military and food convoys. The 1998-2000 border war with Eritrea had a paradoxical effect, spurring new road construction north to Tigray and Djibouti, while eroding highways through heavy use.

The rehabilitation of road infrastructure is a core element of the economic reform programme. The first Road Sector Development Programme (RSDP I), which ran from 1997 to 2002, attracted funding commitments of US$1.45bn and focused on the rehabilitation of the core network, although not all targets were met. Under the programme, road density rose from 21 km per 1,000 sq km to 31 km per 1,000 sq km (compared with an African average of 50 km per 1,000 sq km), while the share of federal roads (roughly half the 34,000-km total network) classed as in "good" condition increased from 14% to 35%. The second programme, RSDP II, runs from 2003 to 2013 and includes four separate phases. Phase one started in mid-2003 and phase two in mid-2004, with funding from the World Bank of US$127m and US$175m respectively. The programme's main components are to rehabilitate and upgrade key federal roads, and to build regional link roads. Another key aim is to create an environment that is conducive to private investment in the form of public-private partnerships or long-term contracts, in order to create a self-sustaining road construction and maintenance industry.

The first two stages of the Addis Ababa ring road were opened in 2002, in a bid to relieve congestion, and work on the final stage started in 2004, after funding was received from China. The combination of poor public transport and heavy congestion limits access to public services and constrains economic activity. The government plans two mass transit schemes—the Awara-Addis Ababa railway and the West-East busway—if private-sector partners can be found.

Djibouti replaces Assab as the key port

The Eritrean port of Assab was the principal port of entry and exit for Ethiopian trade until May 1998, when the border conflict resulted in the diversion of all Ethiopian cargo to Djibouti, whose port authorities responded swiftly to the crisis. Nevertheless, Djibouti initially lacked sufficient port-handling equipment and warehousing capacity to cope with the increase in traffic, and road links to Ethiopia were in need of upgrading. Renovation of the road via Galafi was completed in October 2003, using a US$6m World Bank loan, but an EU-funded project to develop a second corridor via Ali Sabieh has been delayed. Djibouti currently handles 98% of Ethiopia's trade and is likely to remain the principal outlet in the medium term, although use of Berbera port in Somaliland is set to increase (see Economic sectors: Other services).

The railway is offered to a concessionaire

Ethiopia's only railway, which is jointly owned by the Ethiopian and Djiboutian governments, is the 850-km link from Addis Ababa to Djibouti, via the eastern market centre of Dire Dawa. It carries 700,000-800,000 passengers and 200,000-250,000 tonnes of freight per year, 2.6% and 3.8% respectively of total national traffic. The railway has suffered from weak management, poor maintenance and a lack of commercial focus, and is in urgent need of rehabilitation to improve capacity, reliability and safety. To try to bring this about, Ethiopia and Djibouti invited expressions of interest from potential strategic partners in 2004 to invest in and manage the line. The concessionaire will be obliged to run freight and passenger services, maintain and renew the track, and procure more rolling stock, under a 25-year contract. A contract winner was due to be named in 2005, but the process has been postponed. In the medium term, the railway aims to capture more bulk business, including fertilisers, fuel and food aid, most of which are currently transported by road.

Air traffic volume is growing

Given the poor state of the road and rail networks and the long distances to be covered, air transport is more significant in Ethiopia than in many other developing countries. Addis Ababa, boosted by its status as Africa's diplomatic capital (it is the home of the African Union), and its pivotal location between Asia, the Middle East and Africa, has become a major regional hub for air traffic. Activity is centred on Bole International Airport, one of only five in Africa to enjoy Category 1 status, which allows for direct flights to the US. Facilities at Bole improved in early 2003 with the opening of a new passenger terminal and runway, which cost US$135m and quadrupled the airport's capacity. A new cargo terminal is due to open in 2006, with a capacity of 104,000 tonnes per year, and will relieve delays experienced by horticulture exporters. Smaller international airports are situated at Dire Dawa and Bahir Dar, and the Civil Aviation Authority has embarked on a programme to upgrade the extensive network of small regional airports. The national carrier, Ethiopian Airlines (EAL), is the key player in the market and has significantly expanded passenger and cargo services in recent years. With a fleet of more than 25 aircraft, EAL serves 49 international and 30 domestic destinations, and enjoys a sound reputation. EAL purchased new Boeings in 2003-05, financed by a US$350m commercial loan from Barclays Capital, repayable over 12 years, and embarked on a new round of expansion in 2005 by placing an order for five next-generation Boeing 787s (dubbed the "dreamliner"), costing a total of US$600m, with delivery starting in 2008. Ethiopia signed an "open skies" aviation agreement with the US in May 2005 that will facilitate connections and traffic between the two countries.

The government tries to control the press

Despite economic liberalisation, television and radio remain under government control. As part of its policy for devolution, the government is encouraging broadcasting in local languages and the formation of regional radio stations. The print media reach only a small fraction of the population, which is unsurprising, given the high levels of poverty, low literacy rates and limited newspaper distribution. The many official government and party newspapers espouse predictably anodyne views. Private weekly and monthly newspapers and magazines have flourished since 1991. Many are in the Amharic language, and their sales are concentrated overwhelmingly in the capital.

Press freedom has deteriorated

Ethiopia's record on press freedom is relatively poor, however, and the government has harassed and imprisoned scores of independent journalists and editors in recent years. The situation has worsened significantly since the general election in May 2005 and the subsequent crackdown on the opposition. According to the latest annual press freedom rankings from Reporters sans frontières (RSF), a French-based NGO, Ethiopia slipped from 111th position in 2004 to 131st position in 2005 (out of 167 countries). Ethiopia's score slid from 37 to 42 over the same period, on a scale where zero is totally free and 100 totally controlled. In late 2005 RSF said that Ethiopia had become the worst-ranked country in Africa (and the third worst in the world) for the number of journalists in prison. Even before the latest election crisis, the threat to press freedom had been escalating, following the drafting of a new restrictive media law in 2003. However, the legislation has still not been brought before parliament, and the prime minister announced in February 2006 that a new review of the planned law would first be undertaken.

Telecommunications coverage is relatively poor

Ethiopia's telecommunications and information technology systems are among the world's least developed, constituting a serious impediment to economic activity and foreign investment. With a telephone network in 2004 of just 435,000 fixed lines and 178,000 mobile-phone lines, according to data from the International Telecommunications Union, Ethiopia's teledensity was 1.1 per 100 inhabitants, against 11.5 per 100 for Africa as a whole. Services are concentrated in Addis Ababa, which has the highest teledensity. The country's numbers of Internet users (113,000) and personal computers (225,000) in 2004 were also well below African averages, on a per head basis.

Mobile-phone roll-out gathers pace

The mobile-phone network was launched in 1999 by the state-run monopoly provider, Ethiopian Telecommunications Corporation (ETC), in partnership with the Swedish company Eriksson. The sector is underdeveloped compared with those in many other African countries, and users have complained about persistent congestion. To expand connectivity, the ETC is targeting a rapid rise in subscriber numbers. In 2004 it awarded a US$50m contract to Nokia of Finland to provide additional capacity for 350,000 mobile connections—200,000 in Addis Ababa and 150,000 in other towns and along five key highways radiating out from the capital—by April 2005. The ETC also appears to have firmed up plans for an additional 1m mobile connections—Nokia is to provide 600,000 and a French company, Alcatel, 400,000—over the next two years.

The ETC invests in broadband Internet

The government views information and communication technology (ICT) as a key weapon in the war against poverty. In April 2005 broadband Internet was launched in a US$40m joint venture between the ETC and foreign private partners. In what is the first phase of a three-year project, a broadband Internet service is now available in Addis Ababa and eight other towns, at speeds of up to eight megabytes per second. This is thought to have increased the number of Internet users in Ethiopia to nearer 500,000. The ETC and partners are also laying 10,000 km of fibre-optic cables to link up with the underwater cable outside Djibouti, thereby fully linking the telecoms system to the rest of the world. The ultimate aim is to have universal access to the Internet by 2008.

Broadband Internet access is a boon for business (although the service is expensive), enabling vastly improved communications and networking, and also the development of a retail Internet market and other related service activities. It will also help to attract foreign direct investment. However, the project is geared as much, if not more, to the social sector, including the "school-net" and "health-net" initiatives. The plans call for all schools and health centres to be connected to the Internet by 2008, which will significantly boost their effectiveness. To help facilitate the roll-out of modern technology, the World Bank approved a US$25m loan for ICT development in September 2004.

Energy provision

Major potential for hydroelectricity generation

Ethiopia is poor in energy resources, with the exception of hydroelectricity. Approximately 98% of power is generated from hydroelectric sources, and there is enormous untapped potential along the rivers draining from the central highlands. However, reliance on hydroelectric power (HEP) has left the country vulnerable to drought. Extensive power cuts occurred in 2003, to the detriment of domestic and business consumers, although the subsequent improvement in rainfall has alleviated the problem. Ethiopia's largest power plant to date, the 184-mw Gilgel Gibe I hydropower facility on the Omo River in the south-west, opened in February 2004 after a five-year construction period. The US$300m cost was jointly met by the World Bank (68%), the European Investment Bank (EIB, 16%) and the state-run Ethiopian Electric Power Company (EEPCo, 16%).

Investment rising to tap into hydroelectric power sources

To meet rapidly rising demand for electricity, EEPCo plans to almost quadruple power generation capacity in the next five years, from about 790 mw to 2,800 mw, mainly through the construction of new hydroelectric dams but also from thermal and geothermal sources. EEPCo's five-year plan is based on nine key projects, which are in varying stages of development. The most advanced are the Gilgel Gibe II dam (480 mw), which is being built by Salini of Italy with funding from the Italian government, and the Tekeze dam (300 mw), which is being built by Sinohydro of China and local partners; both are due to come on stream by 2009. In other developments, Salini won the contract in mid-2005 to build the Beles dam (435 mw), costing US$628m, while three firms are bidding for the Neshi dam (96 mw). Other major dams are planned at Halale Worbesa (436 mw) and Chemo Geyada (278 mw). Ethiopia is also considering building its largest ever dam, at Kara Dombe, on the Blue Nile, at a cost of US$800m. Construction would take place under the 2001 framework agreement between Ethiopia, Sudan and Egypt (concerning the use of Nile waters) and would receive financial backing from the latter two countries. A pre-feasibility study by foreign and local consultants is expected to be completed by mid-2006.

In line with the ongoing rise in power generation capacity, Ethiopia is undertaking a massive expansion in the power distribution network under the banner of the government's Universal Electrification Access Programme (UEAP). Only 6% of the population has access to electricity (rising to 33% in Addis Ababa). The World Bank proposes funding of US$100m for the first phase of the UEAP in 2005, with the remaining US$77m coming from the government: the first phase aims to extend network coverage to 200 rural towns over the next two years. The full UEAP has a more ambitious aim of raising network coverage to 50% of the country within ten years, at a cost of US$1.3bn, although funding is not yet in place. Notably, EEPCo tariffs remain below the cost of production, necessitating state subsidies, although the World Bank has called for tariffs to be raised. The government is expected to make a final decision in the first half of 2006, pending a review.

Gas reserves remain undeveloped

Ethiopia imports 100% of its petroleum requirements, but has commercially viable gas reserves at Calub, in the remote south-east. However, none of the many development plans proposed has come to fruition because of the difficult location and financial uncertainties. In the latest development proposal, put forward in 2003, SIL of Jordan signed an agreement with the government to exploit the Calub reserves. This called for investment of US$1.5bn over 25 years, as well as the construction of a gas-fired power station and a gas-to-liquids plant at Dire Dawa with a capacity of 34,000 barrels/day of petroleum products. However, SIL, which has no record in the petroleum sector, missed several deadlines for starting work, and the government withdrew the concession in January 2006. A new developer will be sought.

Searching for oil in Ethiopia

With world oil prices remaining at a high level, the search for other oil and gas reserves in Ethiopia is intensifying. Malaysia's state oil company, Petronas, signed an agreement in June 2005 covering a large block in the south-eastern Somali region, giving it exclusive exploration and development rights for an initial four-year period, extendable to 25 years. Petronas also continues to explore in the western Gambella region of Ethiopia, and a first test well will be sunk in 2006, at a cost of US$16m, following positive exploration results. In other developments, the National Mining Corporation (a vehicle of Saudi tycoon Mohamed Al-Moudi and his Mohamed International Development Research Organisation Companies—MIDROC), won exploration rights in the Awash basin (in the east) in October 2004; White Nile (a UK-Sudanese group) signed an exploration agreement for a block in the south-west (next to Petronas's Gambella concession) in July 2005; Pexco (a private Malaysian firm) won an exploration in the south-east Ogaden basin (where Calub is situated) in October 2005, for an initial payment of US$1m; and two other small firms—Afar Exploration and South West Energy—also won concessions in 2005.

Traditional sources of energy still dominate

The vast majority of Ethiopia's energy needs are met from natural sources. Tree-felling for firewood has denuded vast tracts of highland woodlands in the course of just one generation, greatly exacerbating soil erosion. Around Addis Ababa and other towns, firewood and charcoal are relatively scarce and expensive, leaving kerosene as the main cooking and lighting fuel. Consumers have been hit hard by the steep rise in world petroleum prices, although these have been partly offset by a rise in government fuel subsidies.

The economy

Economic structure

The economy is dependent on agriculture

The Ethiopian economy is highly dependent on agriculture (virtually all of it rain-fed), which accounted for 42% of GDP in fiscal year 2003/04 (July 8th-July 7th), according to official sources. The figure was 3 percentage points higher than in 2002/03, when drought struck, but remains on a long-term downward path. About 85% of the population gain their livelihood directly or indirectly from agricultural production, including livestock. Coffee is the main cash crop, but its share of total export earnings slipped from 50-60% in the 1990s to a record low of 34% in 2002/03 because of the collapse in world prices, before recovering to 42% in 2004/05 as world prices rebounded and production rose. Other key exports are khat (locally known as chat—a mild stimulant), leather, gold and oilseeds, while flower sales are growing quickly.

There are two growing seasons in Ethiopia: the primary, *meher*, harvest late in the year, and the secondary, *belg*, harvest during March-May, which accounts for only 10% of overall annual cereal production. Nonetheless, the *belg* harvest is crucially important for the avoidance of a food deficit in the marginal eastern and northern highland regions, and thus strongly influences Ethiopia's food aid requirement. It also facilitates the cultivation of crops in the *meher* harvest.

Agricultural activity is uneven in geographical distribution. A grain surplus is produced largely in central and western regions. The northern highlands are far more vulnerable to variations in rainfall. Coffee growing is prominent in central and southern areas. Pastoralism predominates in the eastern and south-eastern lowlands, notably among Afar and Somali peoples. Geographical barriers to inter-regional trade are accentuated by the fact that all main roads converge on Addis Ababa, where agricultural distribution and marketing are concentrated. Current roadbuilding schemes are designed to facilitate inter-regional transfers.

Origins of gross domestic product, 2003/04[a]
(% of total)

Agriculture & allied activities	42.1
Industry	11.4
Services	46.5
GDP at factor cost	**100.0**

[a] Fiscal year ending July 7th; provisional figures.

Sources: IMF, *Statistical Appendix*; Ministry of Finance and Economic Development.

The services sector becomes the most important

The services sector expanded rapidly in the 1990s after the overthrow of the former military government, the Derg, and its contribution overtook that of agriculture in 1999/2000. Services accounted for almost 49% of GDP in 2002/03, including distribution (16.2% of GDP), public administration and defence (15.4% of GDP), and banking (7.4% of GDP). The share of services slipped to 46.5% of GDP in 2003/04, as agriculture staged a recovery after drought, although the services sector grew by 6.7% in real terms, against growth of just 2.3% in 2002/03. Strong performance in agriculture typically drives faster growth in demand for services, because of the rise in household income.

Measuring time: the Gregorian and Ethiopian calendars

Ethiopia uses a calendar in which the year begins on September 11th and contains 12 months of 30 days plus a 13th month of five or six days. The Ethiopian calendar (EC) is based on solar cycles and is the traditional calendar of the Ethiopian church. The EC is roughly seven years and eight months "behind" the Gregorian calendar; 1998 EC began in September 2004 (Ethiopian New Year usually begins on 11th September Gregorian). However, the Ethiopian fiscal year begins on July 8th, and all domestic economic statistics are produced on an annual July 8th-July 7th basis; 1997 EC in National Bank of Ethiopia statistics therefore refers to July 8th 2003-July 7th 2004. Hourly time in Ethiopia is conventionally expressed as beginning at 6 am Western time; 1 am is thus equivalent to 7 am in the West, 6 am to 12 noon etc. However, all businesses and ministries use the conventional 24-hour clock.

The 13 months of the year are as follows:

Meskerem—Sep 11th-Oct 10th

Tekemit—Oct 11th-Nov 9th

Hidar—November

Tahsas—December

Tir—January

Yekatit—February

Megabit—March

Maiza—April

Ginbot—May

Sene—June

Hamle—July

Nehasse—August

Paguemen—Sep 6th-11th

Industry registers steady growth

The industrial sector has grown by about 5% a year in real terms since 2000/01, raising its contribution to 11.9% of GDP in 2002/03, helped by expansion in all subsectors. Manufacturing is the largest subsector (4.8% of GDP in 2002/03), followed by construction (3% of GDP), small-scale industry and handicrafts (1.9% of GDP), power and water (1.6% of GDP), and mining (0.6% of GDP).

Main economic indicators, 2004/05[a]

GDP growth (%)	8.9
Consumer price inflation (%)	6.8
Current-account balance (US$ m)	-1,210
Merchandise exports fob (US$ m)	824
Merchandise imports fob (US$ m)	3,178
Exchange rate (av; Birr:US$)	8.65
Population (m)	74.0[b]

[a] Fiscal year ending July 7th. [b] Economist Intelligence Unit estimate.

Sources: IMF; Economist Intelligence Unit.

Manufacturing is concentrated around Addis Ababa and Dire Dawa, but the government hopes to extend activity to regional capitals such as Mekelle and Bahir Dar, and ultimately to smaller centres, as part of the official policy of agriculture-led industrialisation. Industry's share of GDP slipped to 11.4% in

2003/04, due to the rebound in agriculture, but the sector grew by 6.9% in real terms because of the improved supply of farm raw materials. Industrial growth in 2004/05 remained robust at a provisional 6.3%.

Private consumption is largest part of GDP by expenditure

Private consumption forms by far the largest component of demand-side GDP, accounting for 75.4% of the total in 2003/04, up from 73.9% in 2001/02, according to the National Bank of Ethiopia (the central bank). Government consumption slipped to 21.8% of GDP in 2003/04, from 23.8% in 2002/03, as farm sector recovery cut emergency spending. Gross fixed capital formation rose to 22.6% of GDP in 2003/04, from 20.5% of GDP in 2002/03, reflecting higher project funding by donors. The resource balance worsened to 19.8% of GDP in 2003/04, from 18.1% of GDP in 2002/03, as the trade deficit widened.

Comparative economic indicators, 2005[a]

	Ethiopia	Sudan	Kenya	Uganda	Tanzania
GDP (US$ bn)	9.0	26.8	17.8	8.9	10.0
GDP per head (US$)	116	740	519	308	267
GDP per head (US$ at PPP)	801	624	1,397	1,448	1,183
Consumer price inflation (av; %)	10.9	11.0	10.5	8.4	4.2
Current-account balance (US$ bn)	-0.9	-1.5	-1.2	-0.4	-0.5
Current-account balance (% of GDP)	-9.9	-5.8	-6.5	-4.0	-4.9
Exports of goods fob (US$ bn)	0.9	5.1	3.3	0.9	1.6
Imports of goods fob (US$ bn)	-3.4	-5.0	-5.8	-1.8	-2.4
External debt (US$ bn)	6.0	20.1	7.3	5.1	7.7
Debt-service ratio, paid (%)	6.5	5.5	9.1	7.1	6.6

[a] Economist Intelligence Unit estimates.

Source: Economist Intelligence Unit, CountryData.

Economic policy

The EPRDF government undertakes economic reform

Fundamental economic reform was initiated by the Ethiopian People's Revolutionary Democratic Front (EPRDF) regime after it assumed power in 1991. "Local ownership" of the reform process remains a key tenet of economic policy. In practical terms, this means that land remains in public ownership and that powers have been devolved to the *woredas* (districts). The government nevertheless adopted a fairly typical IMF structural adjustment programme in 1992-95, while also undertaking a US$657m World Bank-led economic recovery and reconstruction programme. Reform continued under an IMF enhanced structural adjustment facility (ESAF) from 1996, although disbursement was temporarily suspended in 1997 owing to disagreements over the pace and scope of financial sector reforms, which remains a key area of policy conflict. The government has opened up banking to the local private sector, and appointed foreign, private managers to state banks, but continues to bar foreign ownership or the introduction of foreign banks. Donors and the government also remain in disagreement over official land tenure policy, which bars private ownership (while allowing the leasing of land in urban areas).

Major donors maintained cordial relations with Ethiopia during the 1998-2000 war with Eritrea, although they temporarily scaled down their involvement. The relationship between donors and the government has grown increasingly close since the end of the war, with Ethiopia emerging as a "model" performer in the battle against poverty. However, the crackdown on the opposition since the disputed election in May 2005 has begun to sour relations and has left donors with a dilemma over whether to continue to give high levels of aid to a country where the government is oppressing the opposition.

Key measures of economic reform and donor support

2001

March: The IMF agrees a SDR100m (US$150m) loan under a three-year poverty reduction and growth facility (PRGF).
November: Ethiopia is declared eligible for heavily indebted poor countries (HIPC) debt relief.

2002

August: The full poverty reduction strategy paper (PRSP) is published; the World Bank and the IMF issue a largely positive joint evaluation of the paper.
December: A full Consultative Group meeting of donors, the first for five years, pledges US$3.6bn for the period July 2002-June 2005.

2003

March: The World Bank launches a three-year (2003-06) country assistance strategy.

2004

April: Ethiopia reaches completion point under HIPC.
September: Ethiopia formally completes its PRGF with a successful sixth review.

2005

December: Key donors announce that some funding will be transferred from the general budget, to specific projects, in protest at the government's clampdown on the opposition following a disputed election in May 2005.

Reforms are refocused towards poverty alleviation

The IMF approved a three-year poverty reduction and growth facility (PRGF; the successor to the ESAF) for Ethiopia in March 2001, worth SDR100.3m (about US$150m). Ethiopia qualified for debt relief under the IMF-World Bank heavily indebted poor countries (HIPC) initiative in November 2001.

The framework for reforms is provided by the government's poverty reduction strategy paper (PRSP) of 2002, known locally as the Sustainable Development and Poverty Reduction Programme (SDPRP). This has four main objectives: macroeconomic adjustment; structural reforms; poverty reduction and food security; and a less clearly defined notion of "agricultural development-led industrialisation". The government has traditionally been wary of dialogue with the private sector and civil society, but widespread consultation was carried out as part of the programme's formulation. The SDPRP is a wide-ranging document of over 160 pages, covering such areas as capacity building, governance, agriculture and food security, export promotion, infrastructure, education, health and the role of the private sector. It also addresses the fiscal and monetary framework, as well as structural reforms including privatisation and trade deregulation.

Sustainable Development and Poverty Reduction Programme

The Sustainable Development and Poverty Reduction Programme (SDPRP) has several strengths, including:

- local ownership of reforms, and broad-based participation;
- an emphasis on rural and agrarian development, to increase non-farm income and generate growth;
- recognition of the importance of private-sector development; and
- a primary focus on poverty alleviation, bolstered by a switch from military to social spending.

However, the SDPRP remains a work in progress, and the strategy needs to be further elaborated in a number of areas, including:

- a better understanding of the linkages between macroeconomic policy and poverty;
- devising specific policy measures to encourage private-sector and agricultural development (and an implementation timetable); and
- tailoring the strategy to fit the decentralisation of power to the regions.

Donors endorse the SDPRP

The Bretton Woods institutions endorsed the SDPRP and held a full Consultative Group meeting with other donors in December 2002, the first for five years (because of the war with Eritrea). The group reviewed financing needs from mid-2002 to mid-2005, and pledged US$3.6bn. Donors welcomed the SDPRP's emphasis on governance, although some queried the government's commitment to the involvement of private-sector and other non-state actors in the policy process.

The World Bank's country assistance strategy (CAS) for mid-2003 to mid-2006 followed in March 2003. It proposed base-level funding of US$1.5bn (including amounts committed at the Consultative Group meeting in December 2002). The CAS will focus in particular on public-sector capacity building (including reform of the judiciary and the civil service), promotion of the private sector, and infrastructure development (particularly roads and energy). The World Bank approved large new loans in 2004 for a variety of purposes, including road-sector development (US$160m); water and sanitation (US$100m); public-sector capacity building (US$100m); food safety nets (US$70m); higher education (US$40m); information technology (US$25m); and private-sector capacity building (US$24m). No new loans were approved in 2005, although several are pending, worth US$565m in total.

Ethiopia completes the PRGF programme

The severe drought in 2002/03 temporarily stalled reform efforts, but Ethiopia got back on track and completed the three-year PRGF programme in September 2004, six months later than originally envisaged. The IMF executive board, making a sixth and final review of the programme in September 2004, declared that Ethiopia had complied with all structural performance criteria, and released the final US$15m loan tranche. Key measures undertaken in the final year of the PRGF, which focused on the financial sector, included:

- initiating a restructuring programme for the Commercial Bank of Ethiopia (CBE), the dominant market player;
- starting a similar restructuring programme for the National Bank of Ethiopia (NBE, the central bank); and
- achieving full compliance with the regulation that governs banks' provisioning for non-performing loans.

Even before the final year of the PRGF, reform of the CBE was a priority. Following the signing of the performance contract between the government and the bank in June 2002, an independent audit was carried out by KPMG and, in June 2003, management of the institution was handed over to the UK's Royal Bank of Scotland for a two-year period (which was subsequently extended to February 2006). However, despite donor pressure, the government has continued to reject splitting the CBE into parts, opening it to foreign capital or allowing foreign banks into the sector, arguing that local financial institutions are not strong enough to cope with competition. Instead, the government aims to strengthen the financial sector as a whole and to expand the supervisory capability of the central bank. At the same time, the growth of local banks—as well as mergers between them—will be encouraged.

Apart from financial-sector reforms, Ethiopia fulfilled two fiscal conditions in the final year of the PRGF (which had been held over from the previous year): the consolidation of regional and federal budgets, and the reconciliation of fiscal and monetary accounts. The introduction of value-added tax (VAT), another key fiscal reform, was carried out in January 2003 (see box: The government introduces VAT).

Despite the success of the PRGF, the IMF warns that far deeper reforms are needed in coming years, particularly to encourage private-sector activity. The Fund highlighted Ethiopia's continued vulnerability to exogenous shocks (principally drought and world commodity price fluctuations) and noted that poverty indicators are still among the worst in the world. Achieving food security and diversifying exports remain key challenges. The IMF also calls for continued macroeconomic prudence and more ambitious structural reforms (especially in agriculture, industry and the financial sector) in order to raise productivity, improve competitiveness, enhance resilience to shocks and bring about faster growth.

The IMF examines past and future relations with Ethiopia

Accompanying the final review of the PRGF, the IMF also published an *ex post* assessment of its involvement in Ethiopia over the last decade, and considered the development of future relations. The IMF and the government were largely positive about the Fund's role in the economy, with the government stating that the IMF had kept them "on their toes". However, the government also criticised the IMF for a "lack of new thinking" in assuming that liberalisation was always the best policy. In particular, the government again took the opportunity to reject banking liberalisation (without first having a functioning money market) and said that the IMF should recognise that the government had a different, but valid, view. Ethiopia and the IMF are currently discussing the nature of a follow-up to the PRGF. Ethiopia recognises that IMF approval remains important to securing other donor assistance, but that direct IMF funding is relatively insignificant. As a result, Ethiopia is likely to seek a "low-access" PRGF or the IMF's new policy support instrument (PSI—which only monitors progress and does not disburse funding), rather than a "high-access" facility that would provide for more direct funding.

The IMF undertakes an Article IV consultation

An IMF mission in October 2005 for the annual Article IV consultations gave a mixed verdict. It commended rapid GDP growth and the maintenance of macroeconomic stability, but warned of the negative impact of high oil prices on the current account and the government budget, especially as Ethiopia has not raised local petroleum prices since January 2005, leading to increased government fuel subsidies and hence pressure on the budget. The mission advised that local fuel prices be raised to reflect their true market cost, but in February 2006 the government postponed its decision. The IMF is also concerned that the birr is overvalued, which is contributing to rapid growth in imports and in the current-account deficit.

The IMF mission endorsed the government's view that maintaining rapid growth requires increased public capital spending on physical infrastructure, but warned of the negative impact on the balance of payments and the fiscal deficit unless additional donor funding is secured. Higher levels of public spending may also drive inflation upwards unless measures are taken to counter the threat and the IMF again urged action to boost domestic revenue collection. The IMF also reiterated its long-held view that deeper reforms were needed, particularly in the financial sector, to encourage private-sector participation in development. The mission's full report is likely to be made public after the IMF executive board has considered it, probably in mid-2006.

Donors threaten to withhold aid as political tensions rise

Ethiopia had hoped to secure a large rise in donor funding, to help it to meet the UN's millennium development goals—including a halving of poverty by 2015—but instead it faces a possible reduction in aid as donors protest against the heavy-handed clampdown on the opposition since the May 2005 election. The situation remains fluid, but key donors (such as the World Bank, the EU and the UK) have warned that promised direct budget support (worth US$375m in 2005/06)—over which the state has control—may be switched to specific anti-poverty projects. However, this will take time to organise and could lead to delays in disbursement. It will also impact on the budget, leading either to a wider deficit or to the non-implementation of some planned outlays. Any significant and sustained loss of foreign support would be highly damaging for the economy and the fight against poverty and, although the worst-case scenario has not yet materialised, the regime must take steps to restore confidence if such an outcome is to be avoided.

Fiscal reforms are a key part of the reform agenda

Fiscal consolidation, within the context of improved tax collection and a switch in spending towards the social sectors, remains a fundamental aspect of the economic reform programme. Nevertheless, government finances—especially capital spending—would not be sustainable without large infusions of donor funds. Despite the constraints, Ethiopia has made progress in boosting domestic revenue and redirecting expenditure since the end of the 1998-2000 war, but headline deficits remain high, even with the inclusion of donor grants.

Domestic revenue as a proportion of GDP showed little change between 1999/2000 and 2003/04, rising from 18.3% to just 18.6% of GDP over the period, according to the IMF's final review of the PRGF. Although tax collection improved from 12.5% to 14.8% of GDP, the upward trend was dampened by the drought-induced recession in 2002/03, and non-tax revenue is volatile. Measures undertaken to enhance tax collection include the imposition of VAT; a strengthening of the large taxpayers' unit, which accounts for 75% of federal revenue; the expansion of branch offices to the regions; a crackdown on contraband trade; and the introduction of taxpayers' identification numbers. With domestic revenue struggling to grow, foreign grants have become increasingly important. These averaged 4.1% of GDP in the four years from 1998/99 to 2001/02, but more than doubled, to 8% of GDP, in 2002/03 (partly because of emergency drought assistance) and remained high, at 7.8% of GDP, in 2003/04. Overall, donor inflows have accounted for roughly 40% of the government's budget in the last few years.

The government introduces VAT

The introduction of value-added tax (VAT), levied at a 15% rate, on January 1st 2003 was a structural benchmark under the PRGF, and part of the attempt to rationalise the tax system. VAT applies to firms with a turnover of more than Birr500,000 (US$58,000). Although companies complained, the new tax simply replaced the former sales tax (also levied at 15%) and so added little to companies' tax burdens. Some firms nevertheless took advantage of the confusion to raise prices, causing public resentment. Most firms registered for VAT as required, although some resisted and faced legal sanctions.

Summary of government finances
(Birr bn; fiscal years ending Jul 7th)

	2003/04[a]	2004/05[a]
Total revenue & grants	18.4	18.8
Revenue	12.9	14.3
Grants	5.5	4.5
Total expenditure & net lending (cash basis)	21.1	23.3
Current expenditure	12.8	13.8
Capital expenditure	8.4	9.5
Special programmes	0.6	0.7
Unidentified	0.0	1.5
Overall balance (incl grants)	**-3.3**	**-3.7**
% of GDP	-4.8	-4.7

[a] Estimates.

Sources: IMF; National Bank of Ethiopia.

Total spending, as a proportion of GDP, fell after the end of the war with Eritrea in 2000, owing to reduced defence outlays. However, it rose again to 34.8% of GDP in 2002/03 because of drought-related expenditure, before subsiding to an estimated 30.3% of GDP in 2003/04, according to the IMF. Within this overall picture there has been a marked shift in resource allocation towards poverty alleviation, and a related shift from recurrent to capital spending. Total poverty-related outlays (both recurrent and capital) doubled from 8.4% of GDP in 1999/2000 to an estimated 16.3% of GDP in 2003/04, and rose again to an estimated 18.5% of GDP in 2004/05.

Donor funds keep the budget deadline manageable

The headline budget deficit (including grants) fell as a proportion of GDP after the war with Eritrea, but climbed to 9.7% of GDP in 2002/03 because of drought-related outlays (and would have been a massive 17.7% of GDP without donor contributions). The deficit eased to 4.8% of GDP in 2003/04, as domestic revenue and donor grants posted solid growth, while spending was constrained. The IMF estimates a similar deficit, of 4.7% of GDP, in 2004/05. The latest budget for 2005/06 targets a sharp rise in total spending to Birr30bn, with capital outlays climbing to Birr13.5bn.Priority sectors include food security, rural electrification and road construction.

Monetary policy stays disciplined

Monetary policy in Ethiopia is not highly developed, reflecting the overall state of financial markets, but has been disciplined and geared to exchange-rate stability and low inflation. In pursuing these aims, the authorities have achieved considerable success, by moderating the rate of depreciation of the birr against the US dollar and by keeping core inflation around 3%. However, headline inflation, driven by wide fluctuations in food prices, has shown much greater variability. Broad money (M2) growth averaged 14.1% in 2000-04, and amounted to 22% in the year to September 2005, reflecting rapid growth in nominal (and real) GDP. In response to subdued economic activity and low levels of inflation, the NBE lowered the rate on savings deposits to 3% (from 6%) in early March 2002. All banks adjusted their deposit and lending rates in line with the NBE's move. The minimum savings rate is legally determined, but others are fixed by the (admittedly undeveloped) market.

Privatisation stalls after a fast start

The first wave of privatisation in the mid-1990s led to the sale of about 160 small and medium-sized enterprises for about US$400m (80% of which, by value, went to foreign investors), including state concerns in tea, tobacco, bottling, brewing, meat processing and leather tanning, as well as the Lega Dembi gold mine—by far the largest sale, at US$175m. However, the planned second wave of privatisation from 2001—involving 114 firms, including larger enterprises—has been slow to materialise for a variety of reasons, including policy disagreements within the EPRDF over the sale of "strategic national assets", continued wrangles over the allocation of land titles by regional authorities and ongoing restrictions on foreign investment in several sectors of the economy (such as banking). In common with the approach taken by many African governments, resistance to sell-offs has been justified on the grounds that enterprises need to be restored to profitability if a reasonable price is to be obtained. This argument has some merit and has been largely, if reluctantly, accepted by the IMF and the World Bank.

The privatisation programme has also been impeded by the government's anti-corruption campaign. Several offers for firms have been rejected by the Ethiopian Privatisation Agency (EPA) because of an alleged lack of transparency, and five enterprises, including Ethiopia's oldest hotel, the Taitu in Piazza, were returned to the state sector in 2001 following investigations by the Federal Ethics and Anti-Corruption Commission. The privatisations of a soap factory, a printing press and a flour mill were also reversed.

To help to speed the privatisation process, the government in 2004 announced the merger of the EPA, the Public Enterprises Supervising Authority and the Basic Metals Engineering and Industry Agency (BMEI) into a new body—the Privatisation and Public Enterprises Supervising Authority (PPESA). The EPA, the lead privatisation agency to date, was set up in 1994 but has not functioned as effectively as had been hoped, partly because of overlapping responsibility with the other bodies. The PPESA is autonomous, and is charged with guiding state-owned enterprises to commercial viability before introduction of private capital. Privatisation slowly gathered pace under PPESA in 2005; investors were sought for a range of enterprises and some sales took place, although most were small-scale. Privatisation of large firms will take longer to materialise.

Private business faces a difficult environment

Ethiopia's business environment has a number of failings, according to the World Bank, although a US$25m private-sector capacity-building loan, approved in November 2004, is intended to help to correct some of the faults. According to project documents, Ethiopia's private sector has a low number of firms; small-sized firms; low labour productivity (50% lower than China, although local wages are only 30% lower); and little propensity to export (most private firms produce for the local market). Apart from the obvious problem of high transport costs, the World Bank identifies several related constraints to private-sector development, including:

- the dominant role of the state;
- an absence of fair competition;
- weak institutional support for business;
- low skill levels in the private sector; and
- a lack of external integration.

Despite some deregulation, the state runs all major utilities, dominates the financial sector and accounts for the bulk of manufacturing value-added (72%). The local private sector suffers from skills shortfalls and difficulties in accessing credit. Public- and private-sector institutions, such as professional associations, chambers of commerce and standards agencies, also have limited capacity.

Ethiopia ranked 101st out of 155 countries in terms of its regulatory environment, according to the World Bank's *Doing Business in 2006* report. Ethiopia was thus ranked below Kenya and Uganda but above Tanzania. In terms of the ten specific categories assessed in the report, Ethiopia's best scores were for the ease of paying taxes and their cost (26th in the world), the rigidity of labour laws (47th), closing a business (48th), dealing with licences (57th), enforcing contracts (71st) and starting a business (94th). Ethiopia ranked worse than its overall score on obtaining credit (114th), trading across borders (129th), protecting investors (137th) and registering property (140th). The latter two in particular deter foreign investment. In terms of investor protection, Ethiopia scored especially poorly on the "disclosure" index (meriting just one out of ten), as company directors are not required to reveal their interests in a transaction to the rest of the board, even when voting on it. However, the World Bank business indices have their limitations, as they assess only the regulatory environment and not other key aspects of the business climate, such as corruption, macroeconomic stability and proximity to major markets.

Selected business indicators

	Overall ease of business (rank out of 155)	Starting a business Time (days)	Rigidity of labour laws index (0-100) [a]	Trading across borders Average time for exports (days)	Enforcing contracts Time (days)	Protecting investors index (0-10) [b]	Registering property Time (days)	Paying taxes % of gross profit
Kenya	68	54	28	45	360	5.3	73	68
Uganda	72	36	13	58	209	5.3	48	43
Ethiopia	**101**	**32**	**41**	**46**	**420**	**2.7**	**56**	**44**
Tanzania	140	35	69	30	242	2.0	61	51
World average	-	47	41	31	393	5.1	85	46

[a] 0 = minimum rigidity, 100 = maximum rigidity. [b] 0 = minimum protection, 10 = maximum protection.

Source: World Bank, *Doing Business in 2006*.

Corruption remains a serious deterrent to business

Corruption continues to increase in Ethiopia, according to a Berlin-based non-governmental organisation (NGO), Transparency International (TI), with the country's score on its Corruption Perceptions Index slipping for the third consecutive year, to 2.2 in 2005 (where zero is totally corrupt and ten totally clean). This kept Ethiopia in TI's category of "rampant" corruption (2.0 to 3.0) and further away from being described as "clean" (5.0 and above). As a result, Ethiopia slipped to 137th out of 159 countries in the 2005 world rankings, and was in joint 28th position in Sub-Saharan Africa out of 39 states, alongside Cameroon and Liberia. As in previous years, it is hard to judge whether corruption is getting worse in Ethiopia or whether the measurement of corruption has improved—or whether both are true. The number of surveys used to compile Ethiopia's score rose from five in 2003 to six in 2004 and eight in 2005, suggesting that most of the perceived increase may be due to better measurement. However, the gradual opening up of the economy to market forces (and commercialisation) has created more opportunities for graft, which the unscrupulous are exploiting. Ethiopia does not have a reputation for routine bureaucratic corruption, but the existence of close links between the officials of the ruling party and firms owned by members of the party does not foster a culture of accountability and transparency. Ethiopia established the Federal Ethics and Anti-Corruption Commission (FEACC) in 2001 to root out graft, although some of the regime's critics contend that its actions are at least partly driven by political motives (namely to isolate critics of the prime minister). The FEACC has investigated many cases, and brought criminal charges, although it is doubtful whether it has the capacity to tackle corruption at the highest level.

Economic performance

Good harvests drive rapid economic growth

Ethiopia's GDP growth rate remains largely dependent on the performance of rain-fed agriculture, and displays wide variation. The real economy contracted by 3.9% in 2002/03 as a result of the worst drought for a generation, but it surged by 11.6% in 2003/04 and 8.9% in 2004/05 because of two successive bumper harvests. The dominant agricultural sector grew by 12.3% in 2004/05—with both food and cash crops benefiting—underpinning a solid performance in other sectors: industry grew by 6.3% and services by 5.3%, although both growth rates were lower than in 2003/04. Electricity production is also dependent on the climate, as the country relies on hydroelectricity for most of its needs. The 2002/03 drought caused power cuts, but subsequent rainfall has been satisfactory, and ongoing investment in new dams will spread the load. Looking ahead to 2005/06, a third consecutive bumper *meher* harvest (October-January) is likely to yield real GDP growth of 7%. However, overall growth would probably likely be higher were it not for the tense sociopolitical situation. Commercial activity in the capital and other centres virtually ceased during the first week of November because of clashes between security forces and protesters and, although security has been restored, traders and investors remain cautious. Other factors that are likely to dampen activity are likely delays in the disbursements of donor funds, the persistence of high oil prices and the projected decline in coffee prices.

Gross domestic product[a]
(% real change)

	2004/05	Annual average 2000/01-2004/05
GDP	8.9	5.1

[a] Fiscal years ending July 7th.

Sources: IMF, National Bank of Ethiopia.

Food prices are the main determinant of inflation

Food prices have about a 50% weighting in the consumer price index, but display considerable variation, depending on the size of the harvest. Inflation leapt from 1.5% in 2002 to 17.8% in 2003 because of the severe drought, but fell back to 3.3% in 2004 as food production recovered. The Economist Intelligence Unit estimates that inflation jumped to 10.9% in 2005, owing to higher food and petroleum prices. The strength of food prices is surprising, given recent good harvests, but can be explained by several factors, such as hoarding by farmers and traders (in the hope of further price rises), donor purchases for emergency relief, and distribution inefficiencies. Moreover, there is still a suspicion that the 2004/05 harvest was overestimated. We forecast that inflation will ease to 8% in 2006. Despite large annual shifts in headline inflation, the figure for core inflation (excluding cereals and pulses) has remained at around 3% on a medium-term basis, which testifies to both weak development of market demand and disciplined monetary policy.

Inflation
(% change)

	2005	Annual average 2000-04
Consumer prices[a]	10.9	3.0

[a] National price index.

Sources: Central Statistical Authority, National Bank of Ethiopia.

Regional trends

The regions' economic powers are untested

Ethiopia's regional governments have a considerable degree of economic autonomy under the constitution, although in practice their powers are far more limited. The constitution limits the federal government's influence on economic policy to monetary matters, land ownership, foreign trade and investment, interstate commerce and nationwide transport, and devolves all other economic powers to the regions, including taxation. Clarifying confusion or disputes over fiscal matters is the prerogative of the upper house of parliament, the Council of the Federation, which is controlled by regional representatives. In practice, however, the regions remain politically subservient to—and financially dependent on—central government and require hefty subsidies. Allocations to the regions account for about 30% of the national budget. Only the capital, Addis Ababa, has a wide tax base. However, some progress has been made in devolving economic authority (if not political power) to the regions, especially in areas such as the provision of social services and the organisation of investment.

Economic sectors

Agriculture

Food security remains fragile

Agriculture, including the important livestock sector, employs about 80% of Ethiopia's labour force and accounted for 42% of GDP in 2003/04, although its share has tended to decline in recent years. Production remains mainly at a peasant, smallholding level, which makes it difficult to measure accurately. Ethiopia's highlands are highly fertile (at least in non-drought years), enabling the country to support a large population, but long-term output is potentially threatened by inefficient land tenure (including frequent subdivision of holdings), soil degradation and climate change. The vast majority of farming is rain-fed, leading to a perpetual cycle of drought and plenty. The savage drought in 1984 shocked the world by causing a famine of biblical scale, while the almost equally severe situation of 2002/03 left 13.2m people (one in five of the population) dependent on outside support.

Ethiopia's main food crops

Some 80% of food production consists of cereals, mainly maize, teff, barley and sorghum. Teff, a fine highland grain, forms the staple diet of many Ethiopians and is used to make *injera* bread, while sorghum is the principal lowland crop. Pulses and oilseeds are also grown extensively. The sparsely populated southern and eastern regions are largely pastoral. The livelihood of pastoralists has been seriously damaged by successive droughts since the late 1990s and pastoralists have not benefited much from the better rains in the last two seasons, which fell largely on cropping areas.

Despite the recovery in agriculture in the past two seasons (2003/04 and 2004/05), Ethiopia has a structural food deficiency, and about 8.8m Ethiopians needed some form of assistance in 2005. In an innovative development, backed by donors, the government transferred 5m people from emergency relief to the new productive safety nets programme (PSNP) in 2005, as part of a longer-term strategy to end reliance on food aid. This left 3.8m needing emergency aid. The PSNP involves a switch from direct food aid to a mixture of food and cash aid (either via direct grants or public works programmes), and will cost about US$200m a year over five years. It is intended to stimulate the development of local markets and enable internal trading between surplus and deficit localities, facilitated by an expanding road network. Although the PSNP suffered teething problems, it was largely operating as planned by the end of 2005. As a result of better weather and the PSNP, the numbers requiring emergency aid may fall to the lowest level for many years in 2006, but Ethiopia still has large pockets of food insecurity, and a severe drought in the pastoral Somali region at the end of 2005 left more than 1m in the region needing food aid. Stocks in the country are sufficient, leaving distribution as the main challenge.

The government rolls out partial land tenure reform

Ethiopia's restrictive land tenure system is a major point of controversy. All land is owned by the state, giving farmers little incentive to invest in vital productivity improvements. However, the government continues to resist calls to allow private ownership on the grounds that it would lead to the sale of land to speculators and encourage rural-urban migration, which has been relatively constrained in Ethiopia. The government is seeking a compromise and, after successful trials, started to roll out a new "certification" programme in January 2005, granting specific leasehold rights. In theory, this will allow farmers to use land as collateral, but the impact of the scheme is hard to predict, particularly as traditional systems of land tenure are being threatened by HIV/AIDS and increased urbanisation and industrialisation. The locally based Forum for Social Studies believes that the rights being conferred on farmers will not be sufficient to encourage investment, particularly as the government retains the ultimate authority to deal with any land as it sees fit, although a compensation scheme is also promised, to deal with cases of expropriation.

Coffee earnings are hit by falling world prices

Coffee originated in Ethiopia and has long been the country's main export, although, uniquely in Sub-Saharan Africa, domestic consumption is high and accounts for roughly half of the crop. Rising world prices and increased output pushed coffee export earnings to an all-time peak of US$420m in 1997/98, equivalent to 70% of total export receipts. Thereafter, world prices collapsed, owing to excess supply, from 185 US cents/lb in 1998 to just 60-65 US cents/lb in 2001-03, and coffee exports shrank to US$163m in 2001/02 (36% of total exports) and US$165m in 2002/03 (34% of total exports). Coffee production remained relatively stable, at 220,000-250,000 tonnes in the five seasons to 2002/03, according to the Ethiopia Coffee and Tea Authority (ECTA), although some farmers switched to other crops in response to low prices.

Coffee export earnings recovered strongly in 2003/04 (up 35% year on year to US$223m) and 2004/05 (up 50% year on year to US$335m), largely because of an improvement in world prices. These rose to 80.5 US cents/lb in 2004 and an estimated average of 115 US cents/lb in 2005. However, a renewed price decline is forecast in 2006 and 2007 because of global oversupply. To help sustain the rebound in the sector, the government overhauled the institutional framework for coffee in 2005, separating ECTA's production and marketing departments into the Agriculture Development Department and the Coffee, Tea, Spices and Cotton Marketing Department, respectively. Growers and the state also want to increase coffee value-added, by undertaking more processing in Ethiopia, and by finding new, high-value outlets for the country's premium varieties.

Arabica coffee production and exports
('000 tonnes unless otherwise indicated)

	2003/04	2004/05
Production	260	300
Export volume	170	190
Export earnings (US$ m)[a]	223	335

[a] Fiscal year (ending July 7th).

Sources: Ethiopian Coffee and Tea Authority; National Bank of Ethiopia.

Ethiopia auctions high-quality coffee on the Internet

An Internet auction of Ethiopian fine coffees took place on June 30th 2005, organised by e-Cafe Foundation (a non-profit organisation), and was a success. About 30 tonnes of coffee were sold, comprising 26 lots selected by tasting experts, which raised US$187,800, at an average price of 322 US cents/lb, about 200 US cents/lb higher than typical market prices. Wotona Bultuma Co-operative's fair trade and organic coffee attracted the highest price, of 650 US cents/lb, from a US-based speciality roaster, Green Mountain. Although the auction price did not quite match the expectations of Ethiopia's Ministry of Agriculture, which had been hoping for an average price of 400 US cents/lb, the event is likely to be repeated. The auction also served to improve Ethiopia's reputation as a producer of high-quality coffee.

Khat is an important commodity for many farmers

Khat (known as chat in Ethiopia) is a mild stimulant harvested from a shrub, *catha edulis*, the fresh leaves of which are chewed, principally in Somalia and Djibouti. Consumption is also rising in Ethiopia, and 1 tonne is shipped to the UK every day. Chat is a major source of revenue in south-eastern areas, with the bulk of the crop being ferried out by air and truck on a daily basis, as the leaves lose their potency within 24 hours of being picked. With farm-gate prices of US$9/kg, chat is much more valuable than coffee, and the bushes can be harvested up to three times a year. Chat export earnings have increased sharply in recent years, and rose by 52% year on year, to US$88m in 2003/04, confirming chat's second place in the earnings league, after coffee. The drug is legal in some Western countries (such as the UK, but not the US), but has a damaging effect on long-term users and is not officially encouraged in Ethiopia, although the prime minister, Meles Zenawi, has said that he will not clamp down on chat.

Horticulture is a new boom sector

The export-based horticulture sector, based mainly on flowers, is growing rapidly in Ethiopia, attracted by good growing conditions and government investment incentives. Flower exports are expected to reach US$20m in 2005, and could reach US$100m by 2007, according to the Ethiopian Horticultural Producers and Exporters' Association (EHPEA), partly because of the relocation of growers from Kenya, where the costs of transport, power, land, labour and tax are higher. Ethiopia now has more than 30 flower producers (including 15 foreign entities)—up from just three in 2001—and expects a further rise in 2006, with new investors from the Netherlands, Germany, India and Israel. Golden Rose, a private firm that is majority-owned by UK-based Rina Investment, is the largest flower producer. The sector faces the constraint of a shortage of air freight capacity, although Ethiopian Airlines (EAL) is taking steps to correct this.

Livestock sector grows in importance

Ethiopia is the one of the largest livestock producers in Africa, with about 35m cattle, 25m sheep and 18m goats, according to a survey in 2003. The sector accounts for almost 20% of GDP and employs over 30% of the agricultural labour force. Activity has picked up since the government ended its monopoly on livestock trading in 1999, thereby encouraging local and foreign private investment in ranches, meat-processing companies and abattoirs.

Livestock and livestock by-products are an important export, earning US$53m in 2003/04, although sales have since stagnated. Hides and skins, principally leather, made up 95% of the total, while the rest comprises meat products and live animals. The sector remains under-exploited, according to the Livestock Marketing Authority, but will benefit from a 20-year development plan being implemented by the government and the African Development Bank. Apart from the challenge of low world prices for animal products and vulnerability to drought, the sector faces a number of other problems, including a high level of illegal crossborder trade in live animals; periodic import bans imposed on health grounds by key Middle Eastern buyers; unreliable supplies because of weak links between buyers and pastoralists; a scarcity of bank credit; and poor transport infrastructure. Saudi Arabia is the main market for meat and live animals, although sales to Egypt started in 2005 following investment in new and upgraded abattoirs.

Mining and semi-processing

Gold attracts foreign investment

Mining accounts for less than 1% of GDP, although the extraction and sale of gold has become increasingly important since in the mid-1990s. In 1997 the government awarded the licence to operate the country's largest existing gold deposit, at Lega Dembi, to a Saudi-owned conglomerate, MIDROC, for US$175m. Production started in 1998, and reached about 4 tonnes in 2002. Total gold exports, including from artisanal miners, earned US$49m in 2004/05, up from US$42m in 2003/04, although this mainly reflected the rise in world prices. Several firms are engaged in exploration, and production could reach 20-30 tonnes/year with sufficient investment. In mid-2005 the National Bank of Ethiopia (NBE, the central bank) lifted a 28-year ban on gold trading in an attempt to boost small-scale production and curb smuggling and black-market trading. Under the new rules, the NBE will purchase gold from licensed traders and producers, at the world market rate, and re-sell it to retailers. The NBE also plans to offer loans to businessmen wishing to set up gold-exporting ventures. Production of non-metallic minerals, including limestone, clay and marble for the construction sector, is also important, as is salt mining, for household use and the leather tanning industry.

Manufacturing

The manufacturing sector remains state-dominated

Manufacturing accounts for a relatively small 4-5% of GDP, and despite a first wave of privatisation in the mid-1990s involving small and medium-sized entities, the sell-off process subsequently slowed, and the bulk of the sector remains in state hands. However, a new wave of privatisation gained momentum in 2005. Manufacturing production is dominated by food (especially flour products, vegetable oil, and sugar), beverages (soft drinks and beer) and textiles/garments. The bulk of production is concentrated in Addis Ababa—especially in the southern suburbs—followed by Dire Dawa in the east.

Ethiopia has four sugar refineries, at Wonji, Shoa, Metahara and Fincha, all owned by the state. Production totals about 275,000 tonnes/year (t/y), about 85% of domestic consumption. Fincha is the largest (85,000 t/y) and the newest (built in 1999) and produces the higher-quality sugar needed for the soft drinks sector. The government is seeking private involvement in the sugar sector and plans to increase production to fully satisfy local demand and generate a surplus for export.

New developments in the non-food sector

In the non-food sector, Slovakia's Matador (a large, family-owned firm) joined forces with the Ethiopian state-owned Addis Tyre Company (ATC) in mid-2004, taking a 61% stake in the new joint venture—Matador Addis Tyre (MAT)—and assuming management control. MAT will produce tyres for trucks and small passenger vehicles, and aims to become the market leader in Ethiopia before diversifying into regional markets. Matador has promised investment of US$23m, and aims to triple output by 2006, but acknowledges the long-standing problem of competition with illegal imports.

Another recent venture is the US$25m Ethio-Iran Aluminium Factory at Sululta, 25 km from Addis Ababa, which was officially opened in December 2005. Production capacity is expected to double by the end of 2006, from 1,500 t/y at present, making Ethiopia self-sufficient in aluminium. In addition, the state-owned Ethiopian Water Works Construction Enterprise and a US-Egyptian company, Golden Trade, agreed in October 2005 to create a joint venture, Geosynthetics Industrial Works, with initial capital of US$5m. It will manufacture plastic pipes and sheeting for irrigation projects, and is to start production in February 2006. Another new venture is a pharmaceutical factory, 20 km south of Addis Ababa, on which India's Kadila group began work in early 2005. The US$9m facility, which is expected to open in early 2006, will produce medicines used in the treatment of tuberculosis and malaria.

Leather and textiles

Leather production is important in Ethiopia, and export earnings rose by 38% year on year to US$66m in 2004/05. The sector was largely liberalised in the 1990s, and the private sector owns 17 of the 20 tanneries. Although most leather is exported, local processing (in the form of shoe manufacturing) is expanding. The government, with help from the UN Industrial Development Organisation (UNIDO), plans to invest US$7m in new shoe factories over the next five years. Ethiopia produces some of the world's finest leather (from the highland cabretta sheep), although most output is of much poorer quality. As with other sectors, the government seeks foreign expertise and investment, and in mid-2005 handed management of the largest state tannery, Ethiopia Tannery, to UK firm Pittards, a long-term buyer of Ethiopian leather, for a five-year period.

Ethiopia's garment sector has grown rapidly from small beginnings, spurred by duty-free access to US markets under the terms of the African Growth and Opportunity Act (AGOA), passed in 2001. Garment sales under AGOA rose from US$1.8m in 2003 to US$3.3m in 2004, although they stagnated in 2005. Exports to the EU are of roughly similar magnitude. The government is seeking private and foreign investment to boost activity in the sector, and is also seeking buyers for state-owned garment factories, with mixed results. Better linkages between the textile and cotton sectors are also required, according to an International Labour Organisation (ILO) study in 2005.

Private industry is dominated by leading politicians

Fifteen years after the Ethiopian People's Revolutionary Democratic Front (EPRDF) came to power, the private sector is dominated by two interlocking conglomerates: one set of companies is associated with an Ethiopian-Saudi entrepreneur, Mohammed al-Moudi, and the other with members of the ruling party or regional government bodies. The predominance of party-owned companies in key sectors is bitterly resented by independent private entrepreneurs. The World Bank notes that party-owned enterprises enjoy preferential access to contracts, physical infrastructure and administrative services. In order to "level the playing field", the Bank has started working with the government to devise a competition policy, although progress will be slow.

Construction

Building booms

The construction sector has seen rapid growth since 1991, including large state-driven projects and smaller private ones. Hundreds of commercial buildings have been constructed throughout Addis Ababa, and in provincial centres such as Dire Dawa, Mekelle and Bahir Dar. Private firms with close links to the ruling party (and the Saudi-owned conglomerate MIDROC) have been particularly successful in winning contracts, as have Chinese outfits, leading to complaints by some European competitors of unfair competition—although the government denies that non-commercial considerations apply. The Chinese firm Sinohydro has been particularly prominent, winning the US$226m contract for the Tekeze dam in 2002, in a joint venture with a local construction firm, Sur, which has links to the ruling elite. In 2004 Sinohydro formed a US$100m joint venture with the Ministry of Defence-owned Lalibela Engineering, to carry out construction activities throughout the country. Chinese firms are also involved in the construction of the Addis Ababa ring road, and have won contracts in housing, water supply and telecommunications. Italian firm Salini is a key player in dam construction, carrying out works funded by the Italian government.

Financial services

A nascent private financial sector

The regime has approached financial liberalisation extremely cautiously. The sector was nationalised following the 1974 revolution, giving the Commercial Bank of Ethiopia (CBE) a virtual monopoly on retail banking. Local private-sector banks have been allowed to operate since the mid-1990s, but foreign banks remain barred. The government has resisted IMF pressure to open up the sector, believing that local institutions are not yet strong enough to compete. The National Bank of Ethiopia (NBE, the central bank) was established in 1964. Since 1991 the NBE has held Treasury-bill auctions and has overseen the gradual liberalisation of foreign-exchange markets. Moves to legalise market-determined foreign-exchange trading in private- and state-sector financial institutions began in 1997. Regular foreign-exchange auctions were replaced by an interbank market in October 2001.

The CBE dominates commercial banking

The CBE remains the dominant market player, but faced financial meltdown a few years ago as its level of non-performing loans (NPLs) passed the 50% mark, because of unregulated lending to state-owned companies. Restructuring of the CBE was a key aspect of the IMF-backed reform programme in 2001-04. An independent audit was carried out in 2003 and a private management contract was awarded to the UK's Royal Bank of Scotland for an initial two-year period. This was later extended by six months to February 2006. Other measures adopted included a timed programme to cut the share of NPLs to 20% of total loans, a rise in the capital-adequacy ratio, the establishment of an audit committee and the transfer of lending authority from the bank's board to its management. As a result, the CBE has now returned to profitability and posted gross profits of Birr787m (US$91m) in 2004/05, about 60% higher than the previous year. However, NPLs remain too high, at about one-third of total loans.

Private banks build market share

Six local private banks have been established since liberalisation in the mid-1990s—Dashen, Awash, Abyssinia, Wegagen, NIB and United (listed in order of size). They have taken an increasing share of business and accounted for 26% of deposits as of March 2005, compared with about 10% in 1999. Private banks are still concentrated in Addis Ababa but are expanding to rural areas and supporting the growing web of micro-finance. Despite their expansion, private banks have suffered from corruption and high levels of NPLs but, like the CBE, they have trimmed their holdings of bad debt and posted better results. Dashen announced a 40% rise in gross profits in 2004/05 to Birr110m and has consistently been named as Ethiopia's "best bank" by publications such as *Euromoney* and *The Banker*. Other private banks have also reported rising profits in 2004/05, including Abyssinia (up 41% to Birr82m), Wegagen (up 42% to Birr63m), and NIB (up 37% to Birr46m).

No official stockmarket yet

A formal stockmarket has not been legislated for, although informal equity markets, based on private share placements, existed before the 1974 revolution, and have become commonplace. A private-sector steering committee has been set up to push for a stockmarket, but the government has not yet heeded the demands, and aims to first put the banking sector on a sound footing.

Other services

Tourism is vulnerable to sociopolitical uncertainty

Ethiopia has enormous tourism potential, based on its wealth of historical and natural sites. Visitor numbers totalled 75,000 in 1973, but collapsed under the rule of the Derg (1974-91), while the subsequent recovery was derailed by the war with Eritrea in 1998-2000. Tourist arrivals climbed 17% year on year to 200,000 in 2004, earning the country about US$100m (equivalent to 15% of merchandise exports), according to the latest annual report from the Ethiopia Tourism Council. However, numbers are thought to have fallen in 2005 because of post-election violence in June and November, leading to a swathe of cancellations. Ethiopia hopes to raise visitor numbers to 700,000 annually in the medium term. However, as well as political violence, the sector faces other problems, such as poor hotel facilities (particularly outside the capital), a poor road network and lack of co-ordination among stakeholders. Ethiopia gained a new tourist attraction in 2005 with the return from Italy of the ancient Axum obelisk that had been looted by fascist troops in the 1930s. Work began on two new hotels in Addis Ababa's Meskel Square in 2005, in a joint venture between Kuwait's Al-Kharafi construction group (60%) and French hotel group Accor (40%), although these will mainly cater for business and diplomatic travellers.

Ethiopia's landlocked status complicates foreign trade

Landlocked Ethiopia relies on Djibouti port for about 98% of its international trade, although such heavy dependence leaves it vulnerable to factors beyond its control. In a positive development, the two countries resolved several outstanding disagreements in 2004. Ethiopia gained the right to process inbound goods on its own territory, and offered concessions in return, including the payment of outstanding bills for services rendered. Nevertheless, Ethiopia still seeks alternative outlets, and in 2005 reached agreement with neighbouring Somaliland for the use of Berbera port. Small volumes are already shipped via Berbera, but the new agreement will formalise this arrangement and lead to increased traffic. Somaliland is the relatively peaceful northern part of Somalia that has declared *de facto* independence, although this is not recognised by the international community. However, Ethiopia and Somaliland legalised bilateral trade in August 2003 and established customs posts. Berbera will be used for both goods and fuel—the port has an oil terminal—although the quantities are likely to remain small in the short term, pending new investments at the port and in the limited road network linking Somaliland with eastern Ethiopia.

The external sector

Trade in goods

Dependence on coffee leaves Ethiopia vulnerable

Ethiopia depends heavily on coffee, its main export, but earnings are vulnerable to shifts in world prices. Coffee receipts crashed from a peak of US$420m in 1997/98 (70% of total export earnings) to US$163m in 2001/02 and US$165m in 2002/03 (34% of total earnings). Receipts recovered to US$223m in 2003/04 and to US$335m in 2004/05 (42% of total earnings), owing to the rebound in world prices and higher production. However, a renewed price decline is forecast in 2006 and 2007, owing to global oversupply (see Economic sectors: Agriculture). Other important exports include chat (a mild stimulant sold mainly to Djibouti and Somalia), oilseeds, gold and leather; together, these accounted for 44% of export receipts in 2003/04, up from 38% in 2001/02. Exports of horticultural products (especially flowers) and garments are growing rapidly from a small base. Although final figures are not available, the Economist Intelligence Unit estimates that horticulture sales reached US$20m and garment sales US$10m in 2004/05. Total exports have grown rapidly in recent years, from US$452m in 2001/02 to US$601m in 2003/04 and an estimated US$793m in 2004/05, according to provisional data from the National Bank of Ethiopia (the central bank), spurred by rising coffee prices and increased sales of other commodities.

Ethiopia's import needs are vast and have risen very rapidly—from US$1.7bn in 2001/02 to nearly US$2.6bn in 2003/04 and an estimated US$3.2bn in 2004/05. The surge in imports reflects several factors, including higher purchases of capital equipment (for donor-backed projects and for new aircraft by Ethiopia Airlines), the rapid rise in world oil prices (from US$28.8/barrel in 2003 to US$55/b in 2005) and an overall increase in economic activity (as indicated by faster GDP growth). As a result of export and import trends, Ethiopia has a large structural deficit on its merchandise trade account. This rose from US$1.2bn in 2001/02 to almost US$2bn in 2003/04 and an estimated US$2.4bn in 2004/05.

Foreign trade 2003/04[a]

(% of total based on Birr values; fiscal year ending Jul 7th)

Exports fob	
Coffee	37.2
Chat	14.7
Oilseeds	13.8
Gold	8.1
Leather & leather products	7.3
Others	18.9
Imports cif	
Consumer goods	34.6
Capital goods	33.9
Fuel	12.0
Semi-finished goods	16.8
Others	2.7

[a] Official estimates.

Source: National Bank of Ethiopia, *Annual Report*.

Germany, Japan and the US are the major export markets

Western countries have traditionally dominated the market for Ethiopian goods, mainly because of demand for coffee. Germany was Ethiopia's main outlet in the late 1990s: sales dipped sharply in 2001 but subsequently recovered to make Germany Ethiopia's second largest export market by 2004, with Japan not far behind. Djibouti is now Ethiopia's main export market, accounting for around 15% of export traffic in 2004. The US, Italy and the UK remain important export markets, accounting for 15% of Ethiopian exports between them. Exports to Somalia are also likely to be significant, but are largely unrecorded. Saudi Arabia is Ethiopia's most important supplier, because of petroleum sales, but the US overtook China to move into second place in 2003 and remained there in 2004, owing to the sale of a Boeing aircraft.

Invisibles and the current account

Ethiopia generates a healthy surplus on the invisibles account, although this stems almost entirely from high levels of current transfers, both from donors and the Ethiopian diaspora. The country has run a small surplus on trade in non-factor services in recent years (owing to inflows from Ethiopia Airlines, Ethiopia Shipping Lines and tourism), amounting to US$40m in 2004, but the account moved into deficit in the first half of 2005 because of higher costs associated with booming import transactions. Debt-servicing costs have kept the income account in deficit, at a level of US$60m in 2004, although the shortfall fell sharply in the first half of 2005, reflecting debt relief from donors. Movements on the current transfers account are far larger, with net inflows climbing to US$1.37bn in 2004 (from US$1.2bn in 2003). Roughly half comes from official donor sources and half from the diaspora in the form of remittances. Net current transfers slipped in the first half of 2005, probably as a result of lower emergency food needs and also political uncertainty associated with the election. However, the surplus on the invisibles account is not sufficient to offset the trade gap, leaving Ethiopia with a persistent current-account deficit. The shortfall widened sharply from US$172m in 2003 to US$750m in 2004 (10.1% of GDP), in line with the rise in the trade deficit, and continued to grow in the first half of 2005.

Current account, 2004
(US$ m)

Merchandise trade balance	-2,134
Services balance	40
Income balance	-60
Private & official transfers balance	1,372
Current-account balance	**-750**

Source: IMF, *International Financial Statistics*.

Capital flows and foreign debt

Foreign investment appears to be rising strongly

Foreign direct investment (FDI) inflows rose strongly, from US$255m in 2002 to US$545m in 2004, according to the latest *World Investment Review* (2005) from the UN Conference on Trade and Development (UNCTAD). This took the total stock of FDI in Ethiopia to just over US$2.5bn at the end of 2004 (equivalent to 31% of GDP). The new UNCTAD figures suggest that FDI into Ethiopia has been rising much faster—and has reached much higher levels—than previously thought, placing the country on a par with Tanzania, the best performer in the East African Community. The new data put Ethiopia in 24th place (out of 140 countries) on the UNCTAD performance index for 2002-04 (which is based on a comparison between a country's share of global GDP and its share of global FDI), its best ever showing. FDI accounted for almost 33% of gross fixed capital formation in 2004, approximately double the average for Sub-Saharan Africa. However, the difficult investment environment in Ethiopia is clearly illustrated by its poor showing on UNCTAD's more sophisticated investment potential index, which is based on a range of structural variables such as telephone density, commercial energy use and the number of students in tertiary education. Ethiopia was ranked in 121st position in the latest (2001-03) period, and remains in the bottom 20 performers. This makes it more surprising that FDI has risen so strongly.

UNCTAD gives no explanation for Ethiopia's sharp rise in FDI, or of which sectors it might have taken place in. The figures appear overstated and it is possible that they will be revised downwards. However, investment by a Saudi tycoon, Mohamed Al Moudi, and his Mohamed International Development Research Organisation Companies (MIDROC) group remains significant, if not well-measured, and could account for some of the apparent discrepancy. Moreover, Ethiopia is also attracting investment from other "non-traditional" sources, such as India, Turkey and Iran.

The positive trend in FDI continued in 2005, according to the Ethiopian Investment Agency (EIA), which granted permits for 672 projects, worth Birr19.5bn (US$2.25bn)—up from Birr8.6bn in 2004—in a variety of sectors, led by manufacturing and agriculture, but also in construction, power, education and health, potentially creating 59,000 permanent and 75,000 casual jobs. However, the granting of a licence is no guarantee that a project will proceed, even under favourable circumstances. Given the rise in political uncertainty, several proposed ventures are likely to be postponed or cancelled. The EIA also admitted to weaknesses in the investment climate, including poor transport infrastructure, difficulty in obtaining bank loans, delays in securing suitable land and the rising cost of cement.

A more liberal FDI regime

Ethiopia started to liberalise its investment code in the mid-1990s, providing for a partial opening of the telecommunications and energy sectors, but initial efforts were undermined by the 1998-2000 war with Eritrea. Another phase of liberalisation followed in April 2003, lifting restrictions faced by both domestic and foreign investors, although the former benefited the most. All activities are now open to the domestic private sector, except three: the supply of electricity via the national grid; postal services (apart from couriers); and air transport using planes with more than 20 seats. Sectors newly opened to foreigners include air freight and the import of cooking gas, although banking and domestic wholesale and retail, among a host of others, remain closed. Significantly, minimum investment by foreign firms was reduced from US$500,000 to US$100,000, or from US$300,000 to US$60,000 in the case of joint ventures. Minimum capital requirements were lifted entirely for investors exporting at least 75% of their output. The three-year tax holiday for agribusiness ventures that export at least 50% of their production was extended to five years.

Donors support Ethiopian development

Historically, Ethiopia was not a major aid recipient (apart from emergency assistance received linked to the 1984/85 drought), but the volume and nature of external support changed significantly in the 1990s as bilateral and multilateral donors made long-term commitments to support the development process (see The economy: Economic policy). Donor funding declined in 1998-2000 because of the war with Eritrea, but subsequently gained new momentum. Donors pledged US$3.6bn over three years at their Consultative Group meeting in 2002 and most commitments have been realised. Some experts call for a doubling of donor aid to Ethiopia, to more than US$2bn a year, in order to help the country realise its Millennium Development Goals (including a halving of poverty) by the target date of 2015, but Ethiopia may lack the capacity to absorb such a high level of funding, and the process would have to be carefully managed to prevent possible macroeconomic distortions. Recent political tension also makes a doubling of aid less likely, and could even threaten existing levels of support. According to the OECD, net official development assistance (ODA, defined as grants plus loans with at least a 25% grant element) averaged US$643.8m per year in 1997-2000. After the war with Eritrea ended in 2000, ODA rose rapidly to US$1.1bn in 2001, US$1.5bn in 2003 and US$1.8bn in 2004, as a result of an increase in funding from the World Bank and higher bilateral aid flows.

HIPC debt reduction is secured

Ethiopia's total stock of external debt rose by 10% year on year, to US$7.15bn (108% of GDP) in 2003, according to the most recent World Bank data, owing to fresh donor disbursements. The bulk (96%) comprised public and publicly guaranteed long-term debt. The World Bank remained Ethiopia's main creditor, with the amount owed rising by 15% year on year to US$3.2bn in 2003 (45% of the total). Debt-service payments edged up to US$90m, but the debt-service ratio declined fell to 6.8% because of improved export performance.

The debt figures for 2003 do not reflect the relief granted under the heavily indebted poor countries (HIPC) initiative. Ethiopia was declared eligible for the programme in 2001 and reached completion point in April 2004. This led to the write-off by donors of debt worth US$1.3bn (in net present value terms). Ethiopia was also granted additional topping-up relief, taking the total amount forgiven to nearly US$2bn (in net present value terms). However, although bilateral debt relief took place with immediate effect, multilateral relief was scheduled to be phased in over a 20-year period, although this may now happen far more quickly because of the new debt-relief initiative launched by the G8 in mid-2005.

HIPC debt write-off

(US$ m net present value unless otherwise indicated)

	Relief at decision point	Topping-up relief	Total relief	% of total relief
Bilateral	482.0	154.5	636.5	32.1
Multilateral	763.0	552.3	1,315.3	66.3
African Development Bank	216.5	123.0	339.5	17.1
World Bank	463.0	368.7	831.7	42.0
IMF	34.0	26.5	60.5	3.1
Others	50.0	34.1	84.1	4.2
Commercial	30.0	0.0	30.0	1.5
Total	**1,275.0**	**706.9**	**1,982.0**	**100.0**

Source: African Development Bank.

Ethiopia benefits from the new G8 debt-relief initiative

Ethiopia is to be one of the beneficiaries of the US$40bn debt-relief initiative agreed by the G8 in mid-2005 at the Gleneagles summit. The G8 proposes a full write-off of all debts owed to the World Bank, the IMF and the African Development Bank by 18 poor countries that have reached completion point under the HIPC initiative. If fully implemented, this could reduce Ethiopia's external debt by US$4.4bn (about 60% of the total). In December 2005 the IMF executive board agreed a write-off of debts owed to the Fund by the 18 states—amounting to US$161m in Ethiopia's case—although the World Bank board (Ethiopia's main creditor) will not make a final decision until later in 2006.

Effects of debt relief on external debt and debt service[a]
(US$ bn unless otherwise indicated)

	2000/01	2001/02	2002/03	2003/04[b]
Before traditional debt relief[c]				
Total debt stock	5.6	6.1	6.5	6.6
Net present value	3.3	3.5	3.6	3.7
Total debt service (US$ m)	222	163	162	182
After traditional debt relief[c]				
Total debt stock	5.3	5.9	6.3	6.7
Net present value	2.7	2.9	3.0	3.2
Total debt service (US$ m)	189	158	164	176
After enhanced HIPC debt relief				
Total debt service (US$ m)	–	105	74	85

[a] Fiscal years ending July 7th. [b] Estimates. [c] Traditional debt relief includes Paris Club rescheduling, bilateral and commercial institutions.

Source: IMF, *HIPC Decision Point Document for the Enhanced Heavily Indebted Poor Countries Initiative (HIPC)*, October 2001.

Soviet debt is cancelled

Ethiopia built up a large debt to the former Soviet Union under the Derg regime (1974-91), mainly for military purchases, the bulk of which was taken on by Russia after the communist bloc disintegrated. After Russia's entry into the Paris Club in 1997, it agreed to write off US$4.8bn of Ethiopia's bilateral debt. This cut Ethiopia's total external debt from US$10.4bn in 1998 to US$5.5bn in 1999. Russia announced a new write-off in April 2005, worth US$1.1bn, under the HIPC initiative. This cut the total owed by Ethiopia to Russia to just US$163m.

Foreign reserves and the exchange rate

Foreign-exchange levels recover after the Eritrean war

Ethiopia's official foreign-exchange reserves declined steadily in the late 1990s, to US$306m in 2000, owing mainly to the costs of buying arms and munitions to prosecute the war with Eritrea. The return to normality, coupled with high levels of donor support, pushed reserves to an historic high of nearly US$1.5bn at the end of 2004, equivalent to a healthy five months of goods and services imports. Reserves weakened in 2005, because of rising imports, partly driven by high oil prices, falling to US$1.29bn in November, the latest figure available.

Gradual depreciation of the birr

Ethiopia established an interbank foreign-exchange market in October 2001, replacing part-managed foreign-exchange auctions, as part of the move to a market-determined exchange rate. However, some restrictions on the movement of money persist. The foreign-exchange market remains dominated by the Commercial Bank of Ethiopia (CBE), although private banks are handling a rising share of remittances. Ethiopian policy favours a cautious depreciation of the birr, which gently subsided against the dollar, by 0.4% a year, from Birr8.57:US$1 in 2002 to Birr8.67:US$1 in 2005. The birr has been underpinned by strong foreign-exchange inflows from exports, international donors, and remittances from Ethiopians living abroad. However, the gap between the official exchange rate and the informal, parallel rate widened from 0.5% in the first half of 2005 to about 3.5% in the second half, owing to a loss of confidence associated with political turmoil, as well as higher oil costs. This suggests that the birr is slightly overvalued (a position endorsed by the IMF) although rapid depreciation is unlikely, unless there is a sustained reduction in donor funding.

Regional overview

Membership of organisations

Common Market for Eastern and Southern Africa (Comesa)

Based in Lusaka, Zambia, the Common Market for Eastern and Southern Africa (Comesa) is the successor organisation to the regional Preferential Trading Area (PTA), and came into force on December 8th 1994 with 12 members. Comesa now has 20 members: Angola, Burundi, Comoros, the Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. The Comesa region has a total population of around 374m and GDP of over US$203bn. Lesotho, Mozambique and Tanzania have all withdrawn from Comesa since 1997 to concentrate on their membership of the Southern African Development Community (SADC), and Namibia withdrew in July 2003, stating that its industries were too weak to compete with Comesa's Free Trade Area (FTA). South Africa's decision not to join Comesa makes SADC membership more attractive to its main trading partners.

The original PTA, launched in 1981, aimed to liberalise trade and encourage co-operation in industry, agriculture, transport and communications. Comesa's principal aims build on these ideals; its main goals are to eliminate the structural and institutional weaknesses of member states and to promote the political security and stability necessary for sustained development, both individually and collectively as a regional bloc. These aims are to be achieved through monetary union with a single currency and a common central bank. The creation of an FTA on October 31st 2000 was to be a major step towards achieving them. By end-2005 11 of the 19 members had agreed to participate (Burundi, Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Zambia and Zimbabwe), with Comoros expected to join in early 2006. Swaziland has been granted a derogation to participate on a non-reciprocal basis. In order to reciprocate, it would require the permission of other member states of the Southern African Customs Union (SACU), to which it also belongs. SACU has so far refused to let Swaziland reciprocate, and it is unclear whether the country will be allowed to continue its membership of the FTA on a non-reciprocal basis. The 11 FTA members have removed all barriers to trade between themselves, granted trade preferences to the Comesa members not part of the FTA and retain tariffs on imports from outside Comesa.

The 11 FTA members have removed all barriers to intra-regional trade, although they retain tariffs on imports from outside Comesa, and the Rwandan government has stated that it will only offer zero tariffs on goods produced by Comesa countries participating in the FTA. To encourage other members to join the FTA, a fund was created in 2002 to compensate those countries facing revenue loss, although the source and extent of this funding is not clear. Indeed, this fund does not appear to have been used when Burundi and Rwanda joined in early 2004, with both countries estimating large drops in customs revenue as a result of participating.

The reluctance of most of the remaining eight member countries outside the FTA to join, coupled with intense disagreements over a Common External Tariff (CET), caused the organisation to miss its objective of a customs union by December 2004. The proposed move by Comesa from the FTA to a customs union has now been set for 2008, but further delays are likely. The target of full monetary union by 2025 remains, but seems similarly improbable.

Much of the intra-Comesa trade has been concentrated within a few of its members. In 2004 intra-Comesa trade as a proportion of total trade ranged from 1.6% for Egypt to 24.6% for Uganda. Indeed, Kenya, Sudan, Uganda and Zambia accounted for 56.2% of the total trade between members of Comesa in 2004. In addition, over the past four years the share of Comesa exports as a percentage of total exports from Comesa members has actually shrunk, from 6.1% in 2000 to 5.4% in 2004 (although these figures do not capture the high level of illegal crossborder trade). Reasons for the low level of intra-Comesa trade include a lack of political commitment and political stability in member countries and weak balance-of-payments and foreign-reserves positions. In some cases there are hardly any official trade links between member states.

As industry and manufacturing are generally poorly developed, many members are unprepared to reduce tariffs further for fear of undermining local industries (Tanzania's main reason for leaving) and fiscal revenue collection. A further constraint has been the strict and cumbersome rules of origin, which are open to conflicting interpretations, and there have been some instances of member countries refusing to honour the relevant certificate of origin presented with Comesa imports. In addition to these impediments, progress towards free trade is hampered by political tensions between member states.

Regional free-trade areas like Comesa's FTA aim to increase intra-regional commerce, leading to higher economic growth rates, but they attract criticism from many who feel that this cannot be achieved while supply-side constraints—such as poor infrastructure, inefficient transport links, low education and skills levels, and cumbersome bureaucracy—remain. Comesa has concentrated on trade integration, but the lack of uniformity in investment codes and regulatory arrangements has been an impediment to crossborder trade and investment. The commitment to Comesa of many of its members is weak and meetings are frequently cancelled. Moreover, attempts at promoting crossborder investment and monetary harmonisation have been superseded by initiatives introduced by the East African Community and SADC.

Under the old PTA system, a multilateral clearing facility was established and a PTA unit of account (UAPTA), equivalent to the IMF's SDR, was used to settle debts between members, the balance being payable in US dollars. In 1997 the UAPTA was replaced by the Comesa dollar, which is pegged to the US dollar. A Comesa court was officially opened in March 2001, although it had been established three years earlier. In theory, the court, which aims to be an independent arbitrator in trade-related disputes, has jurisdiction over national courts, but in practice it does not have the powers to enforce its rulings and has been hamstrung by a lack of finance.

Intergovernmental Authority on Development (IGAD)

The Intergovernmental Authority on Drought and Development (IGADD), the brainchild of the then president of Djibouti, Hassan Gouled Aptidon, was established in January 1986 with six East African members: Djibouti (where the secretariat is based), Ethiopia, Kenya, Somalia, Sudan and Uganda. Its aim was to co-ordinate and channel funding into agricultural development and the alleviation of drought and desertification. Progress on development and environmental projects was slow, but the organisation made headway as a forum for regional politics and facilitated the successful reconciliation of Somalia and Ethiopia in 1988. However, regional events in 1991 undermined IGADD: the presidents of Ethiopia and Somalia were overthrown, Eritrea gained independence, and the self-proclaimed Somaliland Republic emerged.

Although IGADD gained a seventh member, Eritrea, in September 1993, it achieved little success in its attempts to help to resolve internal conflicts in Sudan and Somalia. Thus, in March 1996, at a summit in Nairobi, IGADD renamed itself the Intergovernmental Authority on Development (IGAD) and adopted a new charter proclaiming conflict resolution to be its priority. IGAD also pledged to pay more attention to economic integration. However, with the outbreak of war between Ethiopia and Eritrea in May 1998, Sudan's increasingly tense relations with both Eritrea and Uganda, and with Ethiopia and Eritrea supporting different factions in the civil conflict in Somalia, the organisation was severely handicapped in the late 1990s.

IGAD's fortunes have improved since the turn of the decade. The uneasy UN-monitored peace between Ethiopia and Eritrea has held, and progress has been made in the quest for peace in Sudan. The latter culminated in the agreement, signed in Machakos, Kenya, in July 2002, that a referendum on self-determination for the south would be held after a six-year interim period. After the resumption of fighting a few months later IGAD quickly brokered a ceasefire, which was swiftly followed by the resumption of talks. However, it is US pressure on both sides, as well as US influence over the debate within IGAD, rather than IGAD itself, that has been moving the rapprochement ahead. IGAD's ongoing Somali reconciliation talks finally bore fruit in September 2004, with the creation of a new, 275-member Federal Transitional Parliament and the selection of a house speaker and interim president. However, the transitional government immediately ran into problems over the location of the seat of government (some arguing the Mogadishu was too dangerous at the time). Two factions within the transitional government/parliament currently exist and are based in Jowhar and Mogadishu respectively. Long-term prospects for the Somali peace process do not look promising. In addition, IGAD holds regular discussions on economic integration and infrastructural co-operation but, given the tensions between its members, these are unlikely to result in concrete action.

African Union (AU)

The African Union (AU) is the successor to the Organisation of African Unity (OAU) and is based in the Ethiopian capital, Addis Ababa. The AU was formally launched in July 2002 at a meeting of African heads of state in the South

African city of Durban. This came two years after the AU's formation was first agreed in Togo in July 2000, and followed a one-year transitional period that began after the ratification of the constitutive act of the AU by two-thirds of the member states in May 2001. The AU is modelled on the EU and has ambitious plans for a parliament, a central bank, a single currency, a court of justice and an investment bank. The most advanced of these is for the Pan-African Parliament, which was inaugurated in March 2004 and has since held a number of sessions, although it will not play a legislative role for five years. The president is currently Gertrude Mongella from Tanzania, and it is currently located near Johannesburg, in South Africa. The AU also aims to have common defence, foreign and communications policies, based loosely on those of the EU. Even if these goals are not fulfilled, the organisation fills the need for a forum for discussing the continent's problems, and the idea of pan-African unity exerts a strong hold over member countries.

In practical terms, the most high-profile AU event is the annual conference of heads of state, which is hosted by the member state that is due to hold the chairmanship of the organisation for the following year. The day-to-day affairs of the AU are managed by the AU commission, which is modelled on the EU commission and was endorsed by the AU heads of state summit in July 2003. The commission is headed by the former Malian president, Alpha Konaré, aided by a deputy, Patrick Mazimhaka of Rwanda, both of whom were elected at the summit. There are also seven appointed AU commissioners.

One of the main problems facing the AU is that many of the proposed new institutions and policy co-ordination mechanisms are costly and cannot be funded within the AU's current resource allocations. To help to counter this, at the July 2004 Annual Summit Mr Konaré presented a 2004-07 Strategic Framework aimed at launching Africa into the 21st century. Under this, member states are supposed to pledge 0.5% of GDP to fund the AU, which will allow it to double the staff at its headquarters and to push ahead with the implementation of the New Partnership for Africa's Development (Nepad). This is a potential bone of contention with the South African government, which is keen for Nepad to remain in its South African headquarters. However, to date, many members still fail to pay their membership dues, so further commitments, other than from external donors, are unlikely. In December 2003 donors and external lenders expressed their full support for the AU's initiatives and the creation of new institutions.

The main criticism levelled at the OAU in the last decade was that little real action resulted from its policy announcements. There are concerns that the AU, like its predecessor, will be undermined by a lack of real commitment to its initiatives among the 53 member states, many of which suffer from very weak governance. This problem is further compounded by the fact that many member states are unlikely to give up the sovereignty required to make several of the proposed initiatives—such as a single currency or a court of justice—operate effectively.

However, on a more positive note, in the last few years the AU has taken a more active role in helping to resolve political crises, such as in Côte d'Ivoire, Togo and Comoros. In this respect, it has shown a much greater willingness to overcome opposition to the principle of non-interference, which remains a contentious issue among member governments and was a major hindrance to the OAU's ability to function effectively. However, its intervention has had a mixed success rate, particularly in Côte d'Ivoire where little progress has been made, while it has avoided a wider involvement in more contentious political crises, such as that in Zimbabwe. This has opened it to charges that it is able to impose solutions on smaller states, but not deal with problems in its larger members.

In 2003 the AU established a Peace and Security Council (PSC; to replace the OAU's Mechanism for Conflict Prevention, Management and Resolution) modelled on the UN Security Council. It is envisaged that the PSC will sanction military intervention in member states in cases of genocide, unconstitutional changes of government and gross human rights abuse. The proposed military intervention by the AU is to be through a standing armed force. This is projected to comprise five battalions by 2010 and will be part of a wider peacekeeping initiative proposed by the G8 in 2004, which seeks a commitment to train and, where appropriate, equip some 75,000 troops by 2010 to take part in peace support operations worldwide "with a sustained focus on Africa". However, even without the establishment of the PSC, since May 2003 the AU has had an observer mission in Burundi, led by South Africa and including troops from Mozambique and Ethiopia, to help enforce a peace agreement in Burundi's civil war. An AU observer mission was also sent to the Darfur region of Sudan in July 2004, and a protection force is being deployed although this has proved much too under-resourced to be effective. However, if it was increased, to become a real peacekeeping force, it could prove to be the first real test of the AU's commitment to intervening in member countries' domestic affairs.

Appendices

Sources of information

National statistical sources

Although the quality and scope of Ethiopia's economic statistics have improved since 1991, continuity, coverage and timeliness all leave much to be desired. The primary sources of public economic data are the quarterly and annual reports of the National Bank of Ethiopia (NBE, the central bank). More up-to-date individual series are published, notably the Addis Ababa retail price index and other series compiled by the Central Statistical Agency (CSA). The Economic Policy Advisory Unit of the prime minister's office has issued periodic economic reviews, although these have a restricted circulation. The Investment Office of Ethiopia publishes data on private investment.

Growing interest in Ethiopia from foreign research bodies, universities, bilateral aid agencies and non-governmental organisations is gradually expanding the data available on rural and urban economic conditions, but this information remains largely the preserve of specialists. Addis Ababa University's Institute of Development Research and Economics also produces economic research, often in conjunction with foreign donors. The lack of regional data has been an obstacle to policy formulation by the regional authorities.

Official GDP statistics provide only a crude indication of economic activity in Ethiopia. Only since 1991 have more extensive rural economic surveys led to a better understanding of both rural grain markets and non-market activity. In urban centres the bulk of economic activity is in the informal sector, with most people engaged in petty trading or artisanal production in firms with fewer than ten employees.

International statistical sources

Timely international data are increasingly being made available by the World Bank and the IMF electronically. The Ethiopian government is also producing regular data. The IMF and the World Bank produce internal documents that form the basis for lending decisions by the institutions' boards of directors.

The main international sources are:

IMF, *Direction of Trade Statistics* (annual)

IMF, *International Financial Statistics* (monthly)

IMF, *HIPC Decision Point Document for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative*, October 2001

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OECD, *Geographical Distribution of Financial Flows to Aid Recipients*

World Bank, *Global Development Finance* (annual)

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Getachew Yared and Abdulhamid Bedri Kello (eds), *The Ethiopian Economy: Problems and Prospects of Private-Sector Development*, Addis Ababa, 1994

Bahru Zewde, *A Modern History of Ethiopia*, James Currey, 1991

Addis Tribune: www.addistribune.ethiopiaonline.net—local and regional news articles from the local press

UN Mission in Ethiopia and Eritrea (UNMEE) site: www.un.org/Depts/dpko/unmee/body_unmee.htm—UNMEE operations and mandates

Ethiopia news site: www.ethiopiadaily.com—contains news articles from local sources

National Bank of Ethiopia: www.nbe.gov.et—reports and statistical information on the Ethiopian economy

Ethiopian Privatisation Agency: www.telecom.net.et/~epa—privatisation statistics and opportunities in Ethiopia

Ethiopian Investment Authority: www.ethioinvestment.org—investment statistics and past and current investment opportunities in Ethiopia

Walta Information Centre: www.waltainfo.com—a pro-government news and information service with a network throughout Ethiopia that provides daily news in Amharic and English

Capital: www.capitalethiopia.com—a pro-business and private sector weekly newspaper that covers both microeconomic and macroeconomic issues

Reference tables

Population

(m; mid-year estimates)

	2000	2001	2002	2003	2004
Total[a]	68.5	70.3	72.0	73.8	75.6
% change	2.6	2.6	2.4	2.5	2.4
Total[b]	64.3	65.8	67.3	68.6	70.0
% change	2.4	2.3	2.3	2.0	2.0

[a] IMF data. [b] World Bank data.

Sources: IMF, *International Financial Statistics*; World Bank.

Government finances[a]

(Birr bn unless otherwise indicated)

	1998/99	1999/2000	2000/01	2001/02	2002/03
Tax revenue	5.4	6.3	7.3	7.9	9.0
Direct taxes	2.0	2.4	2.7	3.1	3.0
Domestic indirect taxes	1.2	1.4	1.4	1.5	1.7
Import duties and taxes	2.2	2.5	3.2	3.3	3.6
Total revenue incl others	8.8	9.5	10.2	10.4	12.2
% of GDP	18.0	17.9	23.6	20.0	19.5
Total revenue & grants	10.4	11.2	12.8	12.8	15.7
Current expenditure	10.5	13.7	10.4	10.6	13.5
Defence	4.3	6.8	3.3	2.6	2.3
Education	1.2	1.3	1.5	1.8	2.3
Health	0.5	0.4	0.5	0.5	0.5
Capital expenditure	4.9	3.4	5.0	6.1	6.3
Total expenditure & net lending	15.5	17.2	15.4	16.7	19.8
% of GDP	31.7	32.3	29.1	34.0	35.9
Overall balance (incl grants)[b]	-5.1	-6.0	-3.0	-4.8	-5.5
% of GDP	-10.4	-11.2	-5.5	-9.3	-9.7

[a] Fiscal years ending July 7th. [b] Cash basis.

Source: IMF, *Statistical Appendix*.

Money supply

(Birr bn unless otherwise indicated; end-period)

	2000	2001	2002	2003	2004
Money (M1) incl others	**13.2**	**13.9**	**16.6**	**18.6**	**22.3**
% change, year on year	9.6	4.8	19.4	12.3	20.0
Quasi-money	10.0	11.6	13.0	14.6	17.3
Money (M2)	**23.2**	**25.5**	**29.5**	**33.2**	**39.6**
% change, year on year	13.1	9.7	15.9	12.4	19.3

Source: IMF, *International Financial Statistics*.

Interest rates

(%; period averages unless otherwise indicated)

	2000	2001	2002	2003	2004
Lending interest rate (%)	10.9	10.9	8.7	7.0	7.0
Deposit interest rate (%)	6.0	6.0	3.8	3.4	3.4

Source: IMF, *International Financial Statistics*.

Gross domestic product at factor cost[a]

(Birr m at constant 1980/81 prices unless otherwise indicated)

	1998/99	1999/2000	2000/01	2001/02	2002/03
GDP at current prices (Birr m)	**48,803**	**53,190**	**54,211**	**51,933**	**57,077**
GDP per head (Birr)[b]	785	817	794	763	803
Agriculture & allied activities	6,874	7,025	7,831	7,651	6,687
Industry	1,701	1,731	1,818	1,923	2,012
Mining & quarrying	75	83	90	98	102
Manufacturing	688	713	736	773	812
Small-scale industry & handicrafts	294	302	317	324	325
Electricity & water	226	235	243	260	271
Construction	418	399	431	468	502
Services	6,720	7,356	7,705	8,058	8,242
Distribution services	2,254	2,423	2,550	2,663	2,749
Other services	4,466	4,933	5,155	5,395	5,493
Banking, insurance & property	1,046	1,144	1,207	1,204	1,259
Public administration & defence	2,138	2,449	2,513	2,665	2,617
Education	356	388	439	487	550
Health	188	187	202	216	218
Domestic & other	738	766	795	823	849
GDP	**15,294**	**16,112**	**17,354**	**17,632**	**16,941**
% change, year on year	6.0	5.4	7.7	1.6	-3.9

[a] Fiscal years ending July 7th. [b] Economist Intelligence Unit estimates based on IMF population estimates.

Source: IMF, *Statistical Appendix*.

Gross domestic product by expenditure[a]

(Birr m at current prices)

	1998/99	1999/2000	2000/01	2001/02	2002/03
Consumption	47,773	52,714	52,541	50,636	56,479
Private consumption	38,593	40,661	43,426	40,621	45,576
Government consumption	9,181	12,053	9,115	10,015	10,904
Investment	8,268	8,432	9,646	10,614	11,675
Private	4,327	5,678	5,039	4,660	5,698
Public	3,941	2,754	4,607	5,954	5,976
Gross domestic expenditure	**56,042**	**61,146**	**62,187**	**61,249**	**68,154**
Exports of goods & services	6,894	8,020	8,162	8,395	9,778
Imports of goods & services	-14,132	-15,976	-16,139	-17,712	-20,855
GDP at market prices	**48,803**	**53,190**	**54,211**	**51,933**	**57,077**

[a] Fiscal years ending July 7th.

Source: IMF, *Statistical Appendix*.

Prices

(% change, year on year)

	2000	2001	2002	2003	2004
Consumer prices (av)	0.7	-8.2	1.6	17.8	3.3

Source: IMF, *International Financial Statistics*.

Coffee production and exports, domestic figures[a]

('000 tonnes unless otherwise indicated)

	2000/01	2001/02	2002/03	2003/04	2004/05
Production	221	245	250	260	300
Domestic consumption	100	110	110	110	110
Exports[b]	85	116	137	170	190
Export earnings (US$ m)	182	163	165	223	335

[a] Fiscal years ending July 7th; does not include movements in stocks (smuggling etc). [b] As recorded at port.

Source: Ethiopian Coffee and Tea Authority.

Exports[a]

(US$ m; fiscal years Jul 8th-Jul 7th)

	1999/2000	2000/01	2001/02	2002/03	2003/04
Coffee	262.0	182.0	163.2	165.1	223.6
Pulses	9.8	8.7	32.9	19.8	22.6
Oilseeds	31.4	32.4	32.6	46.5	82.7
Sugar & molasses	2.9	8.0	10.0	17.7	10.3
Leather & leather products	35.2	76.0	55.5	51.9	43.6
Live animals	1.7	0.3	0.8	0.5	1.9
Meat (canned & frozen)	4.0	1.8	1.1	2.4	7.7
Fruits & vegetables	5.4	5.3	9.4	9.6	12.7
Chat	76.0	61.2	49.0	57.5	88.1
Gold	31.9	28.2	35.0	42.1	48.7
Others[b]	25.6	58.8	62.9	69.4	58.8
Total	**485.9**	**462.7**	**452.4**	**482.7**	**600.7**

[a] Data based on customs records except gold, data for which are sourced from the National Bank of Ethiopia. [b] Includes textiles, essential oils and spices.

Sources: IMF, *Statistical Appendix;* National Bank of Ethiopia.

Imports cif[a]

(US$ m; fiscal years Jul 8th-Jul 7th)

	1999/2000	2000/01	2001/02	2002/03	2003/04
Raw materials	19.8	24.0	29.7	21.8	26.0
Semi-finished goods	204.9	284.3	288.3	274.6	435.3
Fuel	250.1	292.6	267.7	287.7	310.6
Capital goods	470.5	444.9	480.1	549.5	876.7
Transport	140.1	153.5	139.9	174.0	298.4
Agricultural	10.5	8.1	7.0	5.9	10.8
Industrial	319.9	283.3	333.3	369.6	567.6
Consumer goods	432.0	467.7	587.1	654.3	895.8
Durables	141.1	152.0	153.1	183.6	294.7
Non-durables	290.8	315.7	434.0	470.8	601.1
Miscellaneous goods[b]	233.5	43.4	42.8	68.4	43.1
Total	**1,610.8**	**1,556.8**	**1,695.7**	**1,856.4**	**2,587.4**

[a] Customs basis. [b] Includes military equipment.

Sources: IMF, *Statistical Appendix;* National Bank of Ethiopia.

Main trading partners

(% of total)

	2000	2001	2002	2003	2004
Exports fob to:					
Djibouti	11.0	13.0	13.3	16.3	15.7
Germany	19.0	7.3	9.0	13.9	11.8
Japan	11.2	9.0	8.2	8.3	9.9
Saudi Arabia	7.6	8.1	7.9	8.5	6.6
Imports cif from:					
Saudi Arabia	38.8	29.1	28.7	32.2	28.7
US	13.8	4.1	3.8	23.7	17.9
China	5.4	5.4	6.0	8.9	7.4
Italy	10.5	7.1	5.9	5.6	4.4

Source: IMF: *Direction of Trade Statistics*.

Balance of payments, IMF series

(US$ m)

	2000	2001	2002	2003	2004
Goods: exports fob	486	456	480	496	680
Goods: imports fob	-1,131	-1,626	-1,455	-1,895	-2,814
Trade balance	**-645**	**-1,170**	**-975**	**-1,399**	**-2,134**
Services: credit	506	523	586	762	1,004
Services: debit	-490	-525	-580	-709	-964
Income: credit	16.1	16.3	14.3	18.8	31.7
Income: debit	-52.0	-48.3	-36.9	-43.0	-60.3
Current transfers: credit	697.8	854.3	876.5	1,266.4	1,407.8
Current transfers: debit	-23.1	-52.1	-53.8	-68.5	-36.0
Current-account balance	**10.2**	**-401.5**	**-169.8**	**-171.8**	**-750.6**
Other investment assets	116.1	22.8	-4.2	68.9	-261.6
Other investment liabilities	-87.7	-201.4	-65.5	196.8	156.2
Financial balance	**28.4**	**-178.6**	**-69.7**	**265.7**	**-105.4**
Net errors & omissions	-228.1	-201.0	-881.3	-267.2	239.4
Overall balance	**-189.5**	**-780.7**	**-1,120.6**	**-173.4**	**-616.6**
Financing (– indicates inflow)					
Movement of reserves	152.2	-126.9	-448.5	-73.6	-541.2
Use of IMF credit & loans	–	–	–	–	–

Source: IMF, *International Financial Statistics*.

Balance of payments, national series

(US$ m; fiscal years Jul 8th-Jul 7th)

	1999/2000	2000/01	2001/02	2002/03	2003/04[a]
Exports fob	486	463	452	483	601
Coffee	262	182	163	165	224
Imports cif	-1,611	-1,557	-1,696	-1,856	2587
Trade balance	**-1,125**	**-1,094**	**-1,243**	**-1,374**	**-1,987**
Net services	149	137	105	122	248
Net current transfers	701	775	783	1,095	1,239
Net private transfers	410	379	349	495	672
Net official transfers	291	395	435	600	567
Current-account balance	**-335**	**-233**	**-356**	**-156**	**-500**

[a] Estimates.

Sources: National Bank of Ethiopia; Ministry of Finance and Economic Development; IMF, *Statistical Appendix*.

External debt, World Bank series

(US$ m unless otherwise indicated; debt stocks as at year-end)

	1999	2000	2001	2002	2003
Public & publicly guaranteed long-term debt[a]	**5,362**	**5,327**	**5,561**	**6,307**	**6,906**
Official creditors	5,235	5,210	5,466	6,213	6,834
Multilateral	2,738	2,741	3,099	3,868	4,392
Bilateral	2,497	2,469	2,367	2,346	2,442
Private creditors	127	117	96	94	72
Commercial banks	16	12	7	3	1
Short-term debt	87	79	60	64	87
Interest arrears on long-term debt	62	65	48	46	45
Use of IMF credit	95	77	60	64	87
Total external debt	**5,544**	**5,483**	**5,727**	**6,515**	**7,151**
Total debt service	155	137	182	85	90
Principal	98	84	120	48	45
Interest	57	53	63	37	45
Short-term debt	2	1	1	1	1
Ratios (%)					
Total external debt/GNI	78.9	84.8	88.7	108.2	108.4
Debt-service ratio, paid[b]	15.7	12.9	18.0	7.6	6.8
Short-term debt/total external debt	1.6	1.4	1.0	1.0	1.2

[a] Long-term debt is defined as having original maturity of more than one year. [b] Debt service as a percentage of earnings from exports of goods and services.

Source: World Bank, *Global Development Finance*.

Net official development assistance[a]

(US$ m)

	2000	2001	2002	2003	2004
Bilateral	**379.5**	**367.1**	**489.2**	**1,033.3**	**1,026.2**
US	129.8	94.4	156.4	567.8	402.3
Germany	38.6	25.9	40.6	47.6	126.1
Japan	34.0	52.4	50.5	56.5	33.3
Netherlands	25.7	44.2	34.8	57.2	57.5
Norway	23.6	16.3	28.5	37.2	34.0
Multilateral	**298.4**	**720.8**	**783.6**	**486.9**	**759.9**
World Food Programme	36.0	27.3	23.5	15.2	9.8
International Development Association	115.6	434.4	464.3	246.6	476.3
EU	69.0	100.0	116.6	149.1	112.7
UN High Commissioner for Refugees	16.3	18.4	19.2	14.4	8.8
African Development Fund	22.2	29.0	78.2	10.9	63.9
Total incl others	**693.0**	**1,115.7**	**1,306.7**	**1,552.7**	**1,823.1**
Grants	552.1	582.2	705.8	1,382.0	1,632.8

[a] Disbursements minus repayments. Official development assistance is defined as grants plus loans with at least a 25% grant element, provided by OECD and OPEC member countries and multilateral agencies, and administered with the aim of promoting development and welfare in the recipient country.

Source: OECD Development Assistance Committee, *Geographical Distribution of Financial Flows to Aid Recipients.*

Foreign reserves

(US$m ; end-period)

	2000	2001	2002	2003	2004
Total reserves incl gold	306.6	433.5	882.0	955.6	1,496.8
Total international reserves excl gold	306.3	433.2	881.7	955.6	1,496.8
Gold, national valuation	0.3	0.3	0.3	0.0	0.0

Source: IMF, *International Financial Statistics*.

Exchange rates

(Birr per unit of currency unless otherwise indicated; annual averages)

	2001	2002	2003	2004	2005
US$	8.46	8.57	7.12	8.64	8.67
£	12.2	12.8	11.6	15.8	15.8
€	7.6	8.1	8.1	10.7	10.8
SR	2.26	2.28	1.90	2.30	2.32
Rmb	1.02	1.04	0.86	1.04	1.06
¥	0.070	0.068	0.061	0.080	0.079

Source: IMF, *International Financial Statistics*.

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