Country Report

Ethiopia

May 2004

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The Economist Intelligence Unit

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Ethiopia

May 2004

Summary

Outlook for 2004-05

The Eritrea border issue will continue to drive the political agenda. The prime minister, Meles Zenawi, will be particularly concerned about mounting resistance to Ethiopia's loss of land within his own party, the Tigray People's Liberation Front (TPLF), as well as from opposition parties. However, the virtual monopoly on power held by the Ethiopian People's Revolutionary Democratic Front is unlikely to be challenged in 2004-05. Normalisation of relations with Eritrea is not expected. The recovery of agriculture, following healthy rains and good harvests, will support real GDP growth of 6.7% in fiscal year 2003/04 (ending July 7th), real GDP having contracted by 3.8% in 2002/03. Assuming normal rainfall, real GDP growth should remain strong, at 6.4%, in 2004/05, slowing slightly as the rebound effects after the 2002/03 drought wear off.

The political scene

Mr Zenawi has reorganised the TPLF's central committee in a move to silence his critics. Dissent within the Oromo community has been on the increase in recent months. The police have broken up protests by Oromo students. Donors and parliament have called for an enquiry into the Gambella massacres. The government has held the first ever official talks with the opposition. The Ethiopia-Eritrea border dispute remains deadlocked with no end in sight.

Economic policy

The IMF has endorsed Ethiopia's reform efforts under its current poverty reduction and growth facility (PRGF). The government has continued to meet its reform targets under the IMF programme. Figures suggest that revenue collection may exceed expectations in 2003/04, helping to narrow the budget deficit. A World Bank report has highlighted the difficult business climate in Ethiopia. Several top businessmen have been charged with tax evasion.

The domestic economy

Food shortages fuelled high inflation in 2003. Harvest figures have suggested that food import requirements will fall sharply in 2004. Donor investment has raised electricity generating capacity by one third. The government is looking for a foreign concessionaire to manage the Ethiopia-Djibouti railway. Ethiopia airlines has reported rising profits in the first half of 2003/04.

Foreign trade and payments

It was announced in late April that Ethiopia had reached completion point under the IMF-World Bank's heavily indebted poor countries (HIPC) initiative, resulting in total debt relief of around US$2.3bn in net present value terms. According to the latest IMF country report, the current-account deficit is forecast to jump sharply in fiscal year 2003/04 to 7.9% of GDP, from 4.7% of GDP in 2002/03, owing mainly to imports associated with development projects.

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Political structure

Official name	Federal Democratic Republic of Ethiopia
Form of state	Federal republic
Legal system	The federal constitution was promulgated by the transitional authorities in December 1994. In May 1995 representatives were elected to the institutions of the new republic, which formally came into being in August 1995
National legislature	The Federal Assembly consists of the Council of Peoples' Representatives (lower house; 548 members) and the Council of the Federation (upper house; 108 members). The nine regional state councils have limited powers, including that of appointing members of the Council of the Federation
National elections	National elections: May 2000 (federal and regional); next elections due in May 2005
Head of state	President, currently Girma Wolde-Giorgis, who has a largely ceremonial role and is appointed by the Council of Peoples' Representatives (appointed October 2001)
National government	The prime minister and his cabinet (council of ministers), appointed in October 2001
Main political parties	The Ethiopian People's Revolutionary Democratic Front (EPRDF) evolved from the coalition of armed groups that seized power in May 1991. It includes the Tigray People's Liberation Front, the Amhara National Democratic Movement and the Oromo People's Democratic Organization. Several small parties exist. Having boycotted the 1995 elections, some stood in the 2000 election, but won only a handful of seats

	Prime minister	Meles Zenawi
	Deputy prime minister	Addisu Legesse
Key ministers	**Agriculture & rural development**	Mulatu Teshome
	Capacity building co-ordination	Tefera Walwa
	Education	Genet Zewde
	Federal affairs	Abbay Tsehaye
	Finance & economic development	Sufian Ahmed
	Foreign affairs	Seyoum Mesfin
	Health	Kebede Tadesse
	Information	Bereket Simon
	Infrastructure development	Kassu Illala
	Labour & social affairs	Hassan Abdella
	Mines	Mohamed Dirir
	Defence	Abadula Gemeda
	Revenue & income	Getachew Belai
	Trade & industry	Girma Birru
	Water resources	Shifera Jarso
	Youth, sports & culture	Teshome Toga
Central Bank governor	Teklewold Atnafu	

Economic structure

Annual indicators

	1999[a]	2000[a]	2001[a]	2002[a]	2003[b]
GDP at current market prices (Birr bn)	48.4	51.9	54.2	51.8	57.0
Real GDP growth (%)[c]	6.2	5.4	7.7	1.2	-3.8[d]
Consumer price inflation (av; %)[e]	4.8	0.0	-8.1	1.5	17.8[d]
Population (m)	61.4	63.4	65.4	67.5[b]	70.0
Exports fob (US$ m)	467	486	456	480	537
Imports fob (US$ m)	1,387	1,131	1,626	1,700[b]	1,903
Current-account balance (US$ m)	-465	16	-454	-382[b]	-473
Reserves excl gold (year-end; US$ m)	459	306	433	882	956[a]
Total external debt (US$ bn)	5.5	5.5	5.6	6.0[b]	6.6
External debt service, paid (% of exports)[c]	16.8	13.9	18.7	7.4[d]	7.4[d]
Coffee production ('000 tonnes)[c]	101	117	96	110[b]	130
Exchange rate Birr:US$ (av)	7.94	8.22	8.46	8.57	8.60[a]

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Fiscal years ending July 7th; Bank of Ethiopia figures. [d] IMF-World Bank estimates. [e] Addis Ababa retail index.

Origins of gross domestic product 2002/03[a]	% of total
Agriculture & allied activities	39.4
Industry	11.9
Services	48.7
GDP at factor cost	**100.0**

Components of gross domestic product 2000/01[a]	% of total
Private consumption	80.2
Government consumption	17.5
Gross domestic fixed investment	18.0
Exports of goods & services	15.4
Imports of goods & services	–31.2
GDP at market prices	**100.0**

Principal exports fob 2000/01[a]	US$ m
Coffee	171
Qat	60
Oilseeds	30
Pulses	8

Principal imports cif 2000/01[a]	US$ m
Consumer goods	459
Capital goods	436
Fuel	403
Semi-finished goods	278

Main destinations of exports 2002[b]	% of total
Djibouti	11.1
Italy	7.3
Japan	6.5
Saudi Arabia	6.5

Main origins of imports 2002[b]	% of total
Saudi Arabia	28.8
Italy	5.9
India	4.8
US	3.8

[a] Fiscal years ending July 7th; Bank of Ethiopia figures. [b] Based on partners' trade returns; subject to a wide margin of error.

Quarterly indicators

	2002				2003			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
Prices								
Consumer prices, Addis Ababa (1995=100)	95.5	96.2	103.9	108.6	123.6	118.6	123.9	119.9
Consumer prices, Addis Ababa (% change, year on year)	-7.6	-3.6	6.8	11.5	29.4	23.3	19.2	10.4
Financial indicators								
Exchange rate Birr:US$ (av)	8.56	8.56	8.57	8.58	8.58	8.59	8.61	8.62
Exchange rate Birr:US$ (end-period)	8.56	8.57	8.57	8.58	8.59	8.60	8.61	8.62
Deposit rate (av; %)	5.83	3.49	3.47	3.64	3.72	3.74	3.75	3.74
Lending rate (av; %)	10.16	8.24	8.18	8.06	8.06	8.06	8.06	8.06
Treasury bill rate (av; %)	1.66	1.36	1.16	1.03	1.20	1.64	1.49	1.14
M1 (end-period; Birr m)	15,117	15,672	15,949	16,558	17,300	17,538	17,235	18,598
M1 (% change, year on year)	8.8	6.6	9.9	19.4	14.4	11.9	8.1	12.3
M2 (end-period; Birr m)	26,883	27,919	28,662	29,534	30,521	31,260	31,482	33,211
M1 (% change, year on year)	11.3	9.4	11.5	15.9	13.5	12.0	9.8	12.4
Sectoral trends (annual totals; '000 tonnes)								
Coffee production[a]	(		220	)	(		220	)
Foreign trade[b] (US$ m)								
Exports fob	110.7	202.2	140.9	121.1	134.4	160.2	151.5	n/a
Imports fob	-425.8	-415.7	-480.3	-487.4	-543.9	-568.7	-586.6	n/a
Trade balance	-315.1	-213.5	-339.4	-366.3	-409.4	-408.6	-435.2	n/a
Balance of payments (US$ m)								
Merchandise trade balance fob-fob	-204.6	-195.1	-277.3	-297.7	n/a	n/a	n/a	n/a
Services balance	17.2	-7.5	-24.0	17.1	n/a	n/a	n/a	n/a
Income balance	-1.9	-6.5	-4.1	-10.1	n/a	n/a	n/a	n/a
Net transfer payments	186.0	153.2	226.0	280.0	n/a	n/a	n/a	n/a
Current-account balance	-3.4	-55.9	-79.4	-10.8	n/a	n/a	n/a	n/a
Reserves excl gold (end-period)	468.4	648.7	724.7	881.7	903.4	905.6	913.4	955.6

[a] Estimate for 2003. [b] *DOTS* estimates.

Sources: Food and Agriculture Organisation; IMF, *International Financial Statistics*.

Outlook for 2004-05

Political outlook

Domestic politics

The dispute over the location of the shared border with Eritrea is deadlocked. The prime minister, Meles Zenawi, faces intense pressure from his own party, the Tigray People's Liberation Front (TPLF), not to yield to international calls for Ethiopia to accept the ruling of the Ethiopia-Eritrea Border Commission (EEBC) that awarded the symbolic town of Badme to Eritrea. At this point it would be political suicide for Mr Meles to enforce the judgement and he has made it clear that he is not willing to accept the loss of territory. The TPLF is the most powerful party in the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF) coalition, which also includes the Amhara National Democratic Movement (ANDM) and the Oromo People's Democratic Organization (OPDO). The government's intransigence over Badme partly reflects the need to fight federal and regional elections in 2005, but also Mr Meles's need to placate the more hardline elements within the TPLF. However, Mr Meles will not hesitate to expel or alienate those within the TPLF attempting to undermine his authority, as evidenced by the recent re-shuffling of the TPLF's central committee. In order to further consolidate his authority, Mr Meles is also likely to work more with the ANDM and OPDO.

Although the opposition is demonstrating greater unity through the formation of the United Ethiopian Democratic Forces (UEDF) coalition, its support base cannot compete with that of the EPRDF. The UEDF and other opposition forces will attempt to capitalise on the ongoing stand-off with Eritrea over the border, but the government will not be taking a softer line on the border issue and the Economist Intelligence Unit expects the EPRDF to win the federal election easily and for Mr Meles to continue as prime minister.

The post- September 11th emphasis on international security will reinforce the government's commitment to quashing domestic insurgency and it will seek, where possible, to link domestic unrest (particularly in Oromo areas), with "international terrorism". Isolated incidents of violence and unrest are likely to occur but will pose little threat to the regime's authority.

International relations

Relations with Eritrea will continue to dominate foreign policy in 2004 and 2005. According to an official document, the Ethiopian government sees no prospect of normalising relations with Eritrea while the regime of Isaias Afewerki retains power in Asmara. Eritrea has called for the imposition of UN sanctions on Ethiopia over its refusal to implement the EEBC's ruling, but the UN Security Council will be reluctant to move down this route. The EEBC can only amend its decision with the agreement of both parties, and Eritrea has refused to countenance any changes. Ethiopia has continued to call for UN intervention, and the UN's special representative, a former Canadian foreign minister, Lloyd Axworthy, will have great difficulty in finding a resolution—thus far Eritrea has refused to even meet Mr Axworthy. Bilateral diplomacy will be the main weapon employed by the international community, but Ethiopia's strategic importance puts it in a strong bargaining position. In particular, the US continues to view Ethiopia as a key ally in the Horn of Africa in the "war against terrorism", and joint operations between Ethiopian forces and US forces based in neighbouring Djibouti will continue. The US has threatened economic and military sanctions for non-compliance with the EEBC, but under the current US administration, strategic concerns may take precedence over the UN peace process. The EU has also threatened to link development aid to border compliance, but Ethiopia will attempt to stall for as long as possible.

The impasse over Badme has increased the risk of a new war with Eritrea, although both sides insist that they will not start another conflict. The UN Mission in Ethiopia and Eritrea (UNMEE), whose mandate has been extended to September 2004, has found no evidence of mobilisation, but tension remains high because of the political deadlock. Three sector military co-ordination committees and the main military co-ordination committee that meets in Nairobi, Kenya, every six weeks will continue to be the only forums for face-to-face consultations.

Ethiopia's relations with its neighbours Yemen and Sudan will continue to strengthen over the forecast period, as the three countries signed a charter formalising their relationship in December 2003. In relation to Somalia, the Ethiopian government will continue to support the process of forming the parliament agreed to in Nairobi by Somali delegates to the January peace talks. However, if progress is made in establishing sustained peace in southern Somalia, the issue of Somaliland's independence is likely to create some tensions between Somalia and Ethiopia, as Somaliland is unlikely to rejoin the south and Ethiopia is likely to support Somaliland, if only behind the scenes.

Economic policy outlook

Policy trends

Economic policy will remain geared towards meeting obligations under the IMF’s poverty reduction and growth facility (PRGF), which runs until July 2004, and the government’s poverty reduction strategy paper (PRSP), also known as the Sustainable Development and Poverty Reduction Programme (SDPRP) in deference to "local ownership" of reforms. Donors have continued to endorse progress in policy reform, despite the difficult macroeconomic environment caused by the worst drought for a generation and poor capacity. We expect the final review of the PRGF—in July 2004—to proceed smoothly, and Ethiopia is likely to comply with the remaining structural benchmarks. The medium-term strategy aims to boost agricultural growth, exports and private-sector investment, within the context of poverty reduction. We expect there to be no problems in the signing of a new PRGF when the current programme expires this year.

Structural reform will continue under the IMF's PRGF and the World Bank's 2003-06 country assistance strategy (CAS), which focuses on capacity building, public-sector management and export promotion. The centrepiece of the reforms will initially be the reform of the financial sector. One key aspect is the scheduled implementation of a final restructuring plan for the Commercial Bank of Ethiopia (CBE), the dominant market player, which aims to slash the level of non-performing loans and restore the institution to profitability.

However, the government's rejection of proposals to split the CBE into parts and open it to foreign capital will hamper the spread of competition in the banking sector. The authorities have nevertheless brought in foreign private managers to run the CBE for an interim period. The government is unlikely to drop its opposition to the privatisation of large state assets, at least until the firms in question have been restored to profitability. But much like the CBE, it may introduce private management at the state electricity company and other enterprises, although no significant sell-offs are expected in 2004-05

Fiscal policy

Ethiopia remains heavily dependent on high levels of donor support, which rose to 8% of GDP in fiscal year 2002/03 (ending July 7th), mainly because of emergency food aid. Donor support is expected to fall to 7.1% of GDP in 2003/04 as agricultural production recovers. As a result of the lingering impact of the drought, the IMF has revised forecasts for domestic revenue in 2003/04 downwards to Birr12.5bn (US$1.38bn), although this is still 12.5% higher than the Birr11.1bn collected in 2002/03. Tax revenue is expected to rise by 20% year-on-year to Birr9.9bn (15.5% of GDP) in 2003/04, owing to the introduction of value added tax (VAT) in January 2003, the ongoing strengthening of the large taxpayers' unit, improved collection of arrears, computerisation and the introduction of tax identification numbers. Tax figures from the Federal Inland Revenue Authority for the first half of 2003/04 show growth of 18% year-on year, suggesting that the revised revenue targets may be exceeded, but this will have little impact on the fiscal deficit, as spending will be adjusted accordingly.

Forecast total spending in 2003/04 has also been revised downwards, by Birr1.4bn to Birr21bn (33.6% of GDP), to reflect lower receipts, although this is still 6.3% higher than in 2002/03. Recurrent spending is projected to decline by 5.7% year on year to Birr12.8bn, owing to cuts in defence and wages, but capital expenditure is forecast to rise by 32% year on year to Birr8.3bn. Poverty-related outlays are expected to climb from 15% of GDP in 2002/03 to 17.5% of GDP in 2003/04, largely because of higher capital spending on social projects. As a result of the above trends, the budget deficit (including grants) is forecast to narrow to 7.1% of GDP in 2003/04 from 8.4% of GDP in 2002/03. The shortfall will be financed through a combination of external and domestic borrowing. In 2004/05 total revenue is projected to slip slightly to 26.1% of GDP (owing mainly to lower external grants), but a tighter fiscal policy will lower total expenditure, resulting in a budget deficit of 5.6% of GDP.

The government's fiscal policy will remain geared towards revenue enhancement and expenditure restraint, but with spending redirected towards poverty reduction and away from defence and wages. The decentralisation of financial powers to the regions warrants concern because of possible problems in the timely collation of accurate data, as well as capacity issues at lower levels of government.

Monetary policy

Improved monetary management has been one of the key components of the PRGF. During the outlook period monetary policy will remain geared towards ensuring prudent growth in money supply (which will include maintaining ceilings on domestic government borrowing), and meeting inflation and foreign-exchange reserve targets. The authorities are likely to achieve these objectives and, while headline inflation will move in line with food prices, core inflation is forecast to remain at about 3%. Interest rates will continue to be market determined (except for the minimum savings deposit rate, which is set at 3%) and will fall slightly in 2004-05, owing to increased competition in the banking sector.

Economic forecast

International assumptions

International assumptions summary
(% unless otherwise indicated)

	2002	2003	2004	2005
Real GDP growth				
World	2.9	3.8	4.7	4.1
OECD	1.6	2.1	3.2	2.5
EU	1.0	0.7	1.8	2.0
Exchange rates				
¥:US$	125.3	115.9	105.5	106.5
US$:€	0.945	1.132	1.270	1.357
US$: SDR	1.30	1.40	1.50	1.55
Financial indicators				
¥ 2-month private bill rate	0.10	0.03	0.03	0.10
US$ 3-month commercial paper rate	1.7	1.1	1.1	2.7
Commodity prices				
Oil (Brent; US$/b)	25.0	28.8	27.0	22.1
Gold (US$/troy oz)	310.3	362.8	421.3	375.0
Coffee (Arabica; US cents/lb)	61.5	64.2	71.0	74.0
Food, feedstuffs & beverages (% change in US$ terms)	12.7	6.6	6.4	2.5

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

The global economy is accelerating. We forecast that world GDP growth (on a purchasing power parity basis) will average 4.7% in 2004, slowing fractionally, to 4.1%, in 2005. However, as many of the world's largest economies are still nursing considerable debt or other economic imbalances left over from the boom years of the late 1990s, the recovery carries some significant risks with it. The prospects for Ethiopia's main commodity exports over the outlook period are relatively favourable. International coffee prices are expected to strengthen slightly as global demand picks up, averaging 71 US cents/lb in 2004 and 74 US cents/lb in 2005. Prices for hides and skins should also rise as growth in developed economies improves and demand for leather goods increases.

Economic growth

The economy is forecast to grow by 6.7% in fiscal year 2003/04 (ending July 7th), after contracting by 3.8% in 2002/03, as the country recovers from a severe drought that cut output in the agricultural sector (which accounts for 40% of GDP). Good rains pushed the 2003/04 cereals harvest to 11.7m tonnes, 60% higher than the previous season and well above the five-year average of 10.5m tonnes. Better rainfall will also improve hydroelectric power supply, while ongoing structural reform will encourage some increased private investment in the sector. The economy will also receive substantial donor support over the forecast period, with a significant amount being spent on infrastructure projects. This will benefit the construction sector and help to boost activity in the services sector (transport, financial and communications). As a result, we expect real GDP growth to rebound to 6.7% in 2003/04, as the country recovers from drought, before easing slightly to 6.4% in 2004/05.

Inflation

Average annual inflation surged to nearly 18% in 2003 as drought caused a steep rise in cereal prices. Inflation is forecast to decline sharply in 2004, although by less than earlier thought owing to unfavourable trends in food and oil prices. Despite the bumper harvest in 2003/04, cereal prices have not fallen as quickly as expected because of strong demand from donors (for food aid programmes), traders and the government. The government also raised domestic fuel prices by 15-30% in April 2004 because of the strength of world oil prices. As a result, we forecast average inflation of 5.5% in 2004 and 3.5% in 2005, provided the 2004/05 harvest is at least average. Core inflation, which excludes cereal and pulse prices, has remained steady, at 3%, and is forecast to stay at this level in 2004 and 2005.

Exchange rates

The birr depreciated by a gentle 0.4% against the US dollar in 2003 to average Birr8.60:US$1. The birr declined faster against the euro, as the dollar weakened on world markets. The local currency's official exchange rate has continued to weaken slightly in 2004, in line with the market-determined exchange rate policy of the National Bank of Ethiopia (NBE; the central bank), but the birr seldom trades on local markets for less than Birr9.0:US$1, which suggests that a rate of Birr10.0:US$1 would more closely mirror economic fundamentals. However, the birr is underpinned by strong foreign-exchange inflows from international donors and remittances from Ethiopians living abroad, which should prevent any drastic fall in the currency. We expect the birr to weaken to an official average of Birr8.9:US$1 in 2004 and Birr9.3:US$1 in 2005.

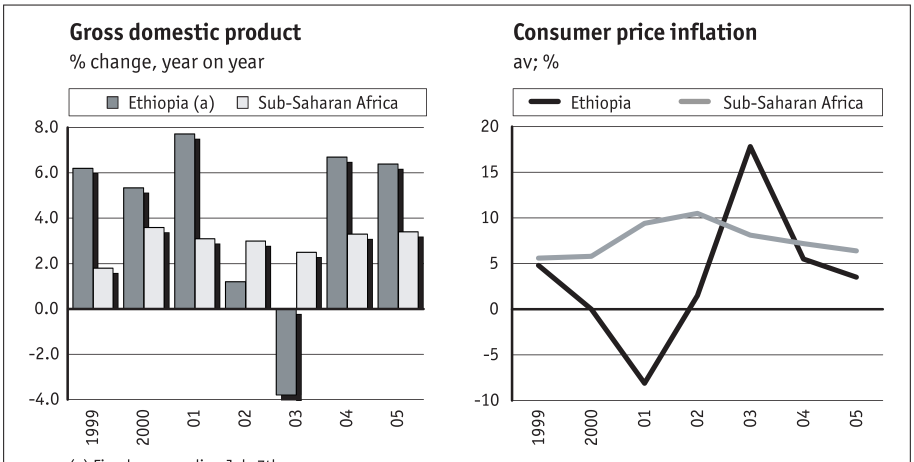
External sector

The size of Ethiopia’s trade deficit will be partly determined by the price of coffee—the single largest export earner—although coffee’s share in total exports fell to 34% in fiscal year 2002/03 (ending July 7th) as commodities such as gold, chat, and hides and skins are becoming ever more important. Coffee prices are expected to rise slightly over the forecast period, but global supply will remain vulnerable to overproduction. Total exports are forecast to rise steadily to US$563m in 2004 and US$605m in 2005, but imports are expected to rise at a faster rate, to US$2.05bn in 2004 and US$2.17bn in 2005, owing to equipment purchases for donor-funded projects and higher consumer demand. As a result of these trends, the merchandise trade deficit is forecast to widen. This will be offset to some extent by a further rise in net services earnings, reflecting Ethiopia’s role in regional trade, and a reduction in interest payments on external debt under the heavily indebted poor countries (HIPC) initiative, which will lower net outflows on the income account. Inflows of donor aid and private remittances will ensure a healthy surplus on the current transfers account. Overall, the current-account deficit is expected to widen from an estimated 4.7% of GDP in 2003 to 7.9% of GDP in 2004 as imports increase, before narrowing to 6.5% of GDP in 2005 as rising exports and strong donor inflows offset higher imports.

Forecast summary
(% unless otherwise indicated)

	2002[a]	2003[b]	2004[c]	2005[c]
Real GDP growth[d]	1.2	–3.8[e]	6.7	6.4
Consumer price inflation (%; av)	1.5	17.8[e]	5.5	3.5
Exports fob (US$ m)	480.0	537.0	563.0	605.0
Imports fob (US$ m)	1,700.0[b]	1,902.7	2,050.0	2,170.0
Current-account balance (US$ m)	-382[b]	-473	-550	-530
Current-account balance (% of GDP)	-6.0[b]	-4.7[e]	-7.9[e]	-6.5
Exchange rate (av; Birr:US$)	8.6	8.6[a]	8.9	9.3

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] Fiscal years ending July 7th. [e] IMF-World Bank estimate.



(a) Fiscal years ending July 7th.

The political scene

The prime minister moves to stifle his critics

The prime minister, Meles Zenawi, has been forced to reassert his authority over the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF) coalition, and particularly over his own party, the Tigray People's Liberation Front (TPLF), in the face of mounting criticism. The other key members of the EPRDF are the Amhara National Democratic Movement (ANDM) and the Oromo People's Democratic Organization (OPDO). At a council of ministers meeting in February, Mr Meles accused several cabinet ministers and EPRDF leaders—including the deputy prime minister, Addisu Legesse, capacity building minister, Tefera Walwa, and the mayor of Addis Ababa, Arkebe Oqubay—of being incompetent, much to their embarrassment. The criticism of Mr Oqubay may reflect his perceived popularity and relatively independent stance. The prime minister also reshuffled his government in mid-March, although he did not make any sweeping changes. Birhanu Adelo was appointed minister of cabinet affairs, while responsibility for rural development was transferred from the deputy prime minister's office to the Ministry of Agriculture. The move makes sense in policy terms, but also perhaps reflects the waning of Mr Adissu's star.

Meles Zenawi reorganises the TPLF's central committee

In a further attempt to bolster his position, Mr Meles reshuffled the TPLF leadership in January 2004. Mr Meles has demonstrated in the past that he will not hesitate to remove members of the TPLF whom he views as overly critical of him (September 2001, The political scene). In a show of strength, Mr Meles had the duties of three members of the TPLF central committee—Kiros Bitew, Tewolde Agame and Zeray Asghedom—modified, while a fourth—Aklilu Demberkay—resigned. At the same time, the ambassador to China—Addisalem Balema—was recalled to head the Endowment Fund for the Rehabilitation of Tigray (a politically important position).

Tigrayan leaders continue to be inflexible

In 2001, when Mr Meles's leadership was being challenged by members within the TPLF, he regained control of the TPLF by expelling and arresting dissidents (on corruption charges) including their leader, Tewolde Mariam, who was formerly the number two figure in the party. However, a new wave of critics appear to have emerged over the past year or so. Many Tigrayans have not forgiven Mr Meles for agreeing to a ceasefire with Eritrea in 2000. His credibility was further eroded by his apparent initial acceptance of the border ruling by the independent Ethiopia-Eritrea Border Commission (EEBC), which awarded the symbolic town of Badme to Eritrea. Although Mr Meles subsequently hardened his position and rejected the EEBC's verdict, he has remained vulnerable to charges of betraying Tigrayan and Ethiopian interests.

The claim that Mr Meles is being too soft on issues relating to Eritrea surfaced again in early 2004 following parliament's decision to grant Ethiopian citizenship to tens of thousands of long-term resident Eritrean nationals. Members of the security forces in particular expressed disquiet about "rewarding" their former enemies in this way, although the security chief, Mekonen Gebre Mariam, claimed it would be easier to monitor the movements of Eritreans who were made official citizens. In addition, many civilians are opposed to giving voting rights to the resident Eritrean community. A peaceful protest in Aby Adi in early March alarmed the government, as although it was not overtly political in tone, instead focusing on demands for water, power and roads, the authorities fear that such incidents could spark wider dissent. The head of Tigray's regional parliament, Tsegai Berhe, appealed for the community to be patient, while federal agents were sent to the town to monitor developments. Requests to hold similar protests in two other towns were turned down by the government. In a further sign of rising opposition to Mr Meles, in March 2004 several TPLF dissidents announced plans to launch a weekly newspaper, *Hizibawi*. They hope to fill the vacuum left by the closure, two years ago, of the dissident mouthpiece *Waghaita*.

Dissent within the Oromo community is on the increase

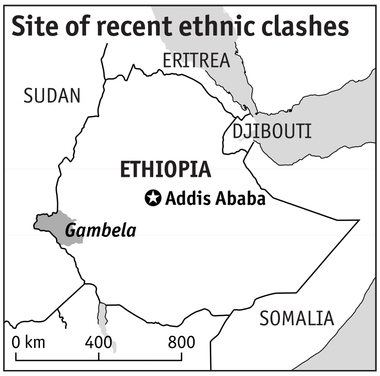
As hardliners within the TPLF continue to disrupt the unity of the party, Mr Meles has sought to build stronger links with the Oromo, Ethiopia's largest ethnic group, represented by the Oromo People's Democratic Organization (OPDO). However, the strategy has been hampered by the moving of the state capital of Oromiya regional state to Nazareth from its traditional base in Addis Ababa in late 2003. Although the switch was backed by the OPDO leadership, it has alienated many Oromo. In January 2004 the Oromo National Congress, a member of the opposition coalition, the United Ethiopian Democratic Forces (UEDF), organised one of the biggest Oromo protest meetings for many years.

Apart from the dispute over the location of the state capital, OPDO's chairman, the defence minister, ex-general Abadula Gemeda, was criticised at a meeting in March 2004 by local party officials, who complained of federal interference in the Oromiya regional parliament and judiciary, in defiance of the constitution. Some also protested about heavy-handed police action in suppressing protests by Oromo students (see box). During the meeting, Mr Abadula responded angrily to the complaints, prompting a walk-out by several delegates including the former party chairman, Kuma Demeksa.

The police break up protests by Oromo students

Oromo students at Addis Ababa University protested in January about a pro-Oromo People's Democratic Organization (OPDO) meeting on campus, provoking a strong reaction from the authorities. Under pressure from the government, the university president, Endrias Eshete, called in the police: scores of students were arrested (and many allegedly tortured), while a dozen alleged ringleaders were hauled before the courts. Moreover, several hundred students have been excluded and may not be allowed to return, in a move that has split the university's ruling hierarchy. Student protests have historically served as an outlet for popular discontent for many groups and are likely to continue to do so. Many of those currently in government, including the leadership, protested against the *Derg* government when they were students at Addis Ababa University—a fact that appears to have been forgotten during some of the bloodier crackdowns on student protests carried out by the security forces in recent years.

Calls arise for an inquiry into Gambella massacres



Inter-ethnic clashes in December 2003 and January 2004 in Gambella, south-west Ethiopia, led to the deaths of about 500 people, when indigenous Anuaks fought against Ethiopians from the highlands, who have gradually taken over political power in the region (March 2004, The political scene). Several thousand Anuaks, half of them children, have been obliged to seek refuge in Sudan. Most worrying are allegations that army units sent to quell the tension directly participated in attacks on Anuak civilians, and both the EU and the US have called on the Ethiopian government to carry out an inquiry into the killings and the role of the army.

In February 2004, under pressure from donors as well as Gambella MPs, a parliamentary committee called for the establishment of an independent inquiry into the massacres, although the decision was opposed by some in the EPRDF (partly because the opposition UEDF had backed such an inquiry). However, MPs remain in dispute about what exactly constitutes a "neutral" investigation and it is unlikely that the authorities will be prepared to tolerate excessive criticism of the military. The government has issued an apology to the people of Gambella for failing to intervene more effectively and has also arrested nearly 80 alleged perpetrators of the violence. However, sporadic violence continued into April 2004, despite government claims that the situation is now calm, with reports of fighting between troops and Anuak farmers, although it is hard to verify this, as the area is remote with poor communications.

The government holds first-ever talks with the opposition

Mr Meles held his first ever meeting with the opposition since coming to power in 1991. The opposition coalition, the UEDF, had requested talks on the conduct of the 2005 election. Mr Meles's decision was surprising, and several EPRDF colleagues were opposed, but the prime minister favours opposition participation in the poll, if only to assuage donor concerns that the contest will be free and fair. Mr Meles conceded nothing of substance during two hours of talks with a four-person UEDF team in mid-February. The UEDF delegation included chairman, Beyene Petros (of the Council of Alternative Forces for Peace and Democracy); vice-chair, Merera Gudina (of the Oromo National Congress); and secretary-general, Admassu Gebreyehu (of the Ethiopian Democratic Unity Party). Hailu Shawel of the All Ethiopian Unity Party did not attend because of recent disagreements with fellow UEDF members.

The prime minister rejected UEDF calls for a new national electoral commission (NEC), claiming that the current body is sufficiently independent. He said that the president of the Supreme Court would be assigned responsibility for overseeing the NEC, although this will do nothing to loosen the government's control over the institution. Mr Meles also rejected proposals for inviting international observers, but said that diplomats and local civic and religious bodies would be allowed to monitor the poll. He also dismissed a call to legalise all opposition groups, saying that those who have chosen the path of violence must first renounce their cause and request security clearance. Despite the seeming impasse, the UEDF clearly got enough out of the meeting to request further dialogue, and in his sole concession the prime minister agreed to appoint government officials to handle future negotiations.

The Ethiopia-Eritrea border dispute remains deadlocked

Little headway has been made in resolving the impasse over the Ethiopia-Eritrea border, and the vital process of physical demarcation remains a distant prospect. Ethiopia refuses to accept the ruling by the independent EEBC awarding certain territories to Eritrea, including the symbolic town of Badme, despite earlier agreeing that the verdict would be binding. There is widespread opposition in Ethiopia to the loss of Badme and Mr Meles would be risking political suicide to force the issue, despite constant pressure from donors to commit to an "act of statesmanship".

Ethiopia is relying on further foreign mediation, but Eritrea has so far refused to meet the UN secretary-general's special envoy, Lloyd Axworthy (a former Canadian foreign minister), who was appointed in January 2004, charged with finding a way forward. Eritrea claims that the border issue has been settled and all that remains is to secure Ethiopia's compliance through UN sanctions if necessary—such a scenario is unlikely. US and EU sanctions have been threatened, but the government will benefit from its role as a valuable ally in the war against terrorism, at least in the eyes of the current US administration.

At the same time, Asmara is facing intense diplomatic pressure to at least meet Mr Axworthy, and we expect a face-to-face meeting to take place before mid-year, although finding common ground between the two protagonists will prove immensely difficult. The EEBC can only amend the border with agreement from both sides, but Eritrea is unwilling to give up what it sees as the moral high ground. Even the UN concedes that whoever holds Badme will somehow be seen as the moral victor. While Eritrea refuses to talk, Ethiopia refuses to move ahead with border demarcation, and vice versa.

Tension eases as local commanders hold meetings

Despite the political deadlock, the military situation on the ground remains stable, if tense, according to the UN Mission in Ethiopia and Eritrea (UNMEE). UNMEE has complained about restrictions on the movement of its forces, especially the closure of important supply roads by Eritrea, but says that both sides are largely in compliance with their obligations and that no signs of mobilisation are evident. The UN Security Council has extended UNMEE's mandate for a further six months, until mid-September 2004, and further extensions are expected.

Recognising that a localised incident could provide the spark for a wider conflagration, UNMEE has successfully persuaded both sides to establish three sector military co-ordination committees (SMCCs), which will serve as the point of contact between the two sides in their respective areas. The SMCC's will complement the main Military Co-ordination Committee (MCC) (March 2004, The political scene). The MCC brings Ethiopia's and Eritrea's military chiefs together every six weeks in Nairobi, Kenya, and, until the recent advent of the SMCCs, was the only forum for bilateral contact. In March 2004 local commanders in the western and central sectors met on neutral bridges—their first meeting since the war ended. They agreed on local mechanisms to deal with incidents such as cattle rustling and army exercises, and also named dates for their next meetings.

Economic policy

The IMF endorses Ethiopia's reform efforts

The IMF has endorsed Ethiopia's performance in its fifth review of the country's poverty reduction and growth facility (PRGF), covering the period 2001-03. As a result, it released the penultimate tranche of SDR10.43m (US$15m) due under the PRGF in February 2004, taking the total disbursed so far to SDR89.9m. Two further reviews of the three-year PRGF will be undertaken before the completion of the programme at the end of July 2004. The IMF's deputy managing director and acting chairman, Takatoshi Kato, noted that the economy is recovering after the 2002/03 drought and that the country is making good progress in implementing a comprehensive and participatory poverty reduction strategy. According to the IMF, Ethiopia needs to maintain monetary and fiscal policies consistent with macroeconomic stability, while pursuing structural reforms and improving the climate for foreign direct investment (FDI), in order to bring about rapid, sustained growth.

The budget deficit is expected to decline in 2003/04

The IMF made substantial revisions to the 2002/03 budget estimates and the 2003/04 projections at the time of the fifth PRGF review in November 2003. Revenue was 8% less than expected in fiscal year 2002/03 (ending July 7th), at Birr15.7bn (US$1.7bn, 27.6% of GDP), as the drought-induced recession cut domestic receipts, while external grants failed to reach the hoped for level. Spending was trimmed accordingly, to Birr20.5bn, and the final deficit of Birr4.8bn (8.4% of GDP) was close to initial forecasts.

Revenue projections for 2003/04 were lowered by 7.5% to Birr17.1bn, including a 4.6% cut in domestic receipts to Birr12.5bn, because of the lingering impact of the drought on taxpayer accounts, and a 14.9% reduction in external grants as food aid needs decline. Once again, spending will be adjusted to reflect trends in taxes and aid, and total outlays in 2003/04 are forecast to be 6.8% down from earlier projections at Birr21.6bn (33.8% of GDP). As a result of these trends, the forecast budget deficit in 2003/04 was trimmed from 7.5% to 7.1% of GDP. This is also a significant improvement on the 2002/2003 figure. The shortfall will largely be financed by foreign funds, as domestic borrowing is capped at Birr1bn by the IMF.

Government finances

(Birr m unless otherwise indicated)

	2002/03 [a]	2003/04 [b]	% change
Revenue & grants	15,702	17,084	8.8
Domestic revenue	11,149	12,542	12.5
Tax revenue	8,244	9,932	20.5
Non-tax revenue	3,010	2,610	-13.3
External grants	4,553	4,542	-0.2
Total expenditure & net lending (incl special programmes)	-20,495	-21,628	5.5
Recurrent spending	-13,527	-12,752	-5.7
Development spending	-6,313	-8,341	32.1
Balance	**-4,793**	**-4,544**	**-5.2**
% of GDP	-8.4	-7.1	

[a] Latest revision. [b] Forecast made in November 2003.

Source: IMF *Country Report* March 2004.

Tax revenue collected in the first half of 2003/04 (to January 7th 2004) amounted to Birr5.3bn, 18% higher than a year earlier, which suggests that IMF projections made earlier may be too conservative—expenditure will be increased if this is the case. The improvement in tax collection stems from the restructuring of the Federal Inland Revenue Authority (FIRA) and the Ethiopia Customs Authority, a wider tax base, the computerisation of value added tax, the introduction of tax identity (ID) numbers, and the pick-up in economic growth. However, the modernisation programme has experienced delays and FIRA remains short of staff. FIRA also noted in March that state firms had accumulated tax arrears of Birr130m.

FIRA reduces fines for tax arrears

In an attempt to extract arrears from both public and private firms, the Federal Inland Revenue Authority (FIRA) has slashed penalties attached to unpaid taxes, which in some cases are greater than the original tax obligation and represent a major disincentive to settlement. The exact cut in penalties will be determined by a sliding scale, with relatively large fines benefiting from the greatest discount. Fines in excess of taxes owed, for example, will be cut by 80%, while FIRA also has the prerogative to cancel the entire penalty. This programme is likely to recover a respectable amount of outstanding debts owed to FIRA, as it offers individuals and firms an affordable way to get on a legitimate footing with the authorities.

Government policies continue to hamper the private sector

The environment facing Ethiopia's small, non-peasant private sector remains very difficult, according to Eyesuswork Zafu, acting president of the Addis Ababa Chamber of Commerce. He told a joint government-business seminar in April that government policy was not conducive to business development, blaming in particular a range of burdensome controls including bureaucratic red tape. Furthermore, the cost of starting up and running a business is high—especially because of the high price of land—and despite government promises to bring about improvements, little has been done. The main requirements of the private sector are a stable financial system, modern communications and secure property rights. The state minister for trade and industry, Tadesse Haile, defended the government's record, citing the liberalisation of trade and investment, and the maintenance of macroeconomic stability. The seminar ended in stalemate, although the deepening of public-private dialogue is a positive development. Although the government has made efforts to boost the private sector, it could and should do more. Moreover, it continues to face allegations of unfairly favouring private firms linked to the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF) and of pursuing vendettas against those who oppose current policies.

The World Bank highlights the difficult business climate

Problems faced by the Ethiopian private sector were also highlighted in a joint report by the World Bank and International Finance Corporation (IFC) entitled "*Doing Business in 2004*". Ethiopia is one of the most costly places to start a business in East Africa, with outlays equivalent to more than 400% of GDP per head. The bulk of this comprises the cost of publishing an official notice in the press, although charges for this service were reduced by 30% in June 2003. The minimum capital outlay is also high, at over US$1,750, compared to zero in the three members of the East African Community (EAC)—Kenya, Uganda and Tanzania. Furthermore, it is difficult for businesses to secure bank loans owing to the lack of public or private credit information agencies, while current laws prevent the use of accounts receivable as collateral. Creditors have limited legal powers and Ethiopia is the fifth slowest place in the world to enforce a contract through the courts—the process takes an average of 895 days.

Costs of starting a business and contract enforcement

	Starting a business			Enforcing a contract	
	Time (days)	Cost (US$)	Minimum capital (US$)	Time (days)	Cost (US$)
Ethiopia	44	422	1,756	895	35
East Africa Community (average)	44	363	0	160	71

Source: World Bank, *Doing Business in 2004*.

The authorities charge several top businessmen with tax evasion

Berhane Mewa, president of both the Addis Ababa and Ethiopian Chambers of Commerce, and owner of Poly Industrial Chemicals, was arrested along with four other prominent businessmen in late February and charged with evading value added tax (VAT). He was released on bail in mid-March, after the courts ordered his release pending a full hearing—he then left Ethiopia for the US. VAT evasion, if proven, cannot be condoned, but the actions of the Federal Inland Revenue Authority (FIRA) appear excessive, suggesting an underlying political agenda to stifle criticism of government policy. Mr Berhane was one of the government's most prominent critics and had earlier complained that the introduction of VAT in January 2003 (an IMF condition) was premature, although he denies avoiding payment. He spent time in government jails several years ago when he was head of the magazine *Alef*, which backed the opposition Ethiopian People's Revolutionary Party. As part of the government's campaign against its detractors, the Addis Chamber's twice weekly, half-hour radio programme, which was useful for the local business community, was suspended after a broadcast in support of the arrested businessmen.

Allegations are made of unfair competition

One of Ethiopia's longest-running private firms—Ethiopian Amalgamated (EAL), which imported fertiliser—was foreclosed by the authorities in early April 2004, and its head offices and factories put up for auction, after the company failed to accept conditions imposed by the Commercial Bank of Ethiopia (CBE) on the repayment of debts worth Birr140m (US$16.4m). CBE demanded Birr10m immediately, but EAL's chief, Gebreyes Begna, (who left for the US years ago) refused, claiming discrimination by the government in favour of EPRDF-backed importers, including the unilateral cancellation of contracts, harassment of company agents and excessive bank charges. EAL claims that such tactics have cost the firm Birr200m. The dispute between EAL and the government over the latter's unilateral cancellation of a 75,000-tonne fertiliser contract is the subject of ongoing international arbitration.

The domestic economy

Food shortages fuelled rapid inflation in 2003

Average inflation jumped to 17.8% in 2003, compared to 1.5% in 2002, according to the April 2004 edition of the IMF's *International Financial Statistics*, as a result of the sharp spike in food prices during the 2002/03 drought and the slower than expected rate of decline in prices as the harvest came in during the fourth quarter. Core inflation, excluding cereal and pulse prices, remained at around 3%. Headline inflation is expected to fall sharply in 2004, although not by as much as earlier thought, because of unfavourable trends in food and oil prices. Despite the bumper crop, cereal prices have remained above average and were rising throughout the country in early April according to the Famine Early Warning Systems Network (FEWS-NET). This partly reflects purchases by the government, donors and traders. Furthermore, the government raised petroleum prices in April, with gasoline climbing by 29% to Birr4.69/litre (52 US cents/litre), diesel up by 30% to Birr3.02/litre and kerosene up by 15% to Birr2.15/litre, because of the strength of world oil prices. Domestic fuel prices are revised every six months in line with global trends. The Economist Intelligence Unit forecasts average inflation of 5.5% in 2004.

Agriculture

Food import requirements will fall sharply in 2004

It is too early to speculate on the size of the 2004/05 harvest, as the main *kiremt* rains are not due to start until June 2004, but the short *belg* rains (March-May) have so far been satisfactory. Food security improved significantly following the bumper *Meher* harvest in 2003/04 (September-December), which amounted to 11.7m tonnes according to the Central Statistics Agency (CSA), compared to an average of 10.5m tonnes over the previous five years. However, an estimated 7.2m people still require food aid in 2004 (down from 13.2m in 2003), although much of this will be sourced from within Ethiopia, where some 350,000 tonnes of cereals are available for purchase. As a result, the cereal import requirement in the 2004 marketing year (January-December) is expected to fall sharply to just 232,000 tonnes (from nearly 2m tonnes in 2003), of which 182,000 tonnes constitutes food aid, according to the most recent forecast from the UN Food and Agriculture Organisation.

Food supply, 2004 marketing year (Jan-Dec)
('000 tonnes)

	Wheat	Rice	Coarse grains	Total
Domestic availability	2,400	0	8,060	10,460
Production 2003	1,900	0	8,060	9,960
Stock drawdown	500	0	0	500
Utilisation	2,595	15	8,082	10,692
Domestic consumption	2,595	15	7,982	10,592
Exports or re-exports	0	0	20	20
Build-up of stocks	0	0	80	80
Import requirement	**195**	**15**	**22**	**232**
Commercial	35	15	0	50
Aid	160	0	22	182
Five years' average production	1,322	0	7,152	8,474
Five years' average imports	1,014	13	74	1,101

Source: UN Food and Agriculture Organisation, Global Information and Early Warning System, *Food Supply Situation and Crop Prospects in Sub-Saharan Africa*.

Infrastructure

Electricity generating capacity rises by one-third

Ethiopia's largest electricity plant, the 184-mw Gilgel Gibe I hydropower facility, was opened in February 2004 after a five-year construction period. The dam cost US$300m and was jointly financed by the World Bank (68%), the European Investment Bank (EIB, 16%) and the state-owned Ethiopian Electric Power Corporation (EEPCo, 16%). Gilgel Gibe 1 added almost one-third to national generating capacity, taking the total to approximately 750 mw. EEPCo plans to electrify a further 114 towns by the end of 2005 (to add to the 140 towns that already have electricity) and to raise consumption by head threefold by 2010. Central to this ambition is the construction of several more dams, including Tekeze, Gojeb, Gilgel Gobe II, Geba (Baro-Akobo) and Blue Nile, with a total capacity of more than 900 mw. Feasibility studies have been completed for most of the dams, including the 300-mw, US$350m Tekeze dam in northern Ethiopia, which will be the largest single facility.

However, donors have requested that EEPCo re-tender the contract for the 150-mw Gojeb dam, awarded to the MIDROC group, because the feasibility study was not sufficiently thorough. Donors including the African Development Bank and the EIB have signalled their intention to back the project, although the expected start date has moved forward to late 2004. EEPCo has also signed memoranda of understanding with several private investors for independent power plants, although detailed financial or technical plans have still to be submitted. To facilitate private involvement and clarify the risks, EEPCo has prepared a model power purchase agreement, but electricity prices have yet to be settled. Reliance on hydroelectricity has its drawbacks, as output is vulnerable to drought. Ethiopia has been obliged to ration power every summer since 1992, to the detriment of business, but the connection of several new plants to the national grid will help to spread the load.

Financial and other services

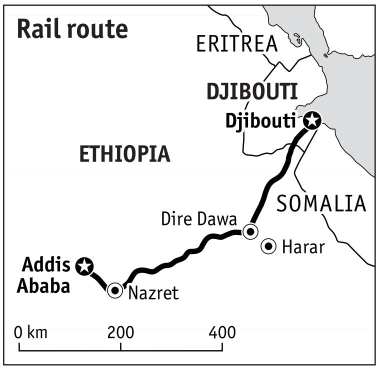
The government complies with IMF conditions

To date Ethiopia has fulfilled all of the IMF's performance criteria and structural benchmarks under the poverty reduction and growth facility (PRGF). The authorities finalised and started to implement comprehensive restructuring plans for both the Commercial Bank of Ethiopia (CBE), by the end of November, and the National Bank of Ethiopia (NBE, the central bank), a month later. According to the plan, the CBE is required to:

- achieve full compliance with central bank provisioning directives from January 2004 (as are all commercial banks);
- put in place a timed programme to cut non-performing loans to 20% of total loans, from 54% in June 2003;
- keep the capital adequacy ratio above 8% and raise it to 10% by mid-2004.

The government continues to reject a break-up of the CBE, which held 79% of bank deposits and 63% of loans in mid-2003, or to allow foreign capital into the sector. However, private managers have taken over at the CBE and the local private banking sector is expanding.

A foreign concessionaire is sought for railway



In April 2004 Ethiopia and Djibouti invited expressions of interest from potential strategic partners to invest in and manage their 780-km joint railway, *Chemin de Fer Djibouto-Ethiopien* (CDE). On offer is a 25-year contract, renewable for further 3-year terms. The deadline for pre-qualification is May 31st 2004, and a final agreement is scheduled to be signed in June 2005, before the winner takes over in September 2005. The concessionaire will be obliged to run freight and passenger services, maintain and renew the track, and procure more rolling stock. In common with other African state railways, CDE has serious financial problems and has appealed to the government for a capital injection pending the award of the concession. CDE is short of spare parts and has failed to pay staff on time, while the line was closed for nine days in January 2004 following a bomb attack by rebels fighting the Ethiopian government. More recently, sections of track were washed away in April 2004 when heavy floods struck Djibouti.

Despite the problems, CDE is likely to attract foreign interest given a planned US$52m EU-funded rehabilitation of the line, Ethiopia's rising dependence on the port of Djibouti (which has been managed by Dubai Ports International since 2001), and planned investment of US$15m in container handling facilities at the port during 2004. Tonnage carried by CDE in 2003 amounted to 240,000 tonnes, compared to a target of 300,000 tonnes, although volumes are expected to rise in 2004 following the signing of a new contract with the Metehara sugar factory in March to transport 7,000 tonnes of molasses per week. Furthermore, revenue will be boosted by the 18% rise in freight charges to Birr189/tonne introduced in December 2003. In the medium term, CDE aims to capture more bulk business, including fertilisers, fuel and food aid, most of which are currently transported by road. Much will also depend on the terms of the purchase, as in many African countries railways often come with a large workforce, pension plans and involvement in ventures not directly related to the transport business–making them less attractive to foreign buyers.

Ethiopian Airlines reports rising profits

The national airline, Ethiopian Airlines (EAL), announced net profits of Birr276m (US$31m) in the first six months of fiscal year 2003/04 (ending July 7th), 35% higher than a year earlier. The figure includes Birr160m from the sale and lease of aircraft and Birr106m from passenger and freight services. However, EAL faces increasing competition, particularly on African and Arabian Gulf routes, from carriers such as Kenya Airways and Emirates (Dubai). To help it fight back, EAL has commissioned consultants to devise a restructuring programme. Proposals are likely to include lay-offs, departmental mergers, establishing a West African hub and forming partnerships with foreign carriers. EAL has also been criticised by exporters of perishables, such as flowers and meat, who complain about costly delays, and the airline was obliged to charter planes to meet demand, which yields minimal profits and is not viable in the medium term. EAL is currently engaged in an expensive, US$350m upgrade of its passenger fleet, due to end in mid-2005, and the acquisition of urgently needed cargo planes is unlikely before then.

New x-ray machines will speed passage through Bole airport

Ethiopian Airlines installed five new x-ray machines (costing Birr2.3m) at Bole International airport in March 2004 to improve security, limit smuggling and cut long queues at check-ins caused by manual baggage inspections. Two machines will be employed for inbound luggage, two for outbound luggage and one for the passengers themselves. Bole is one of the few African airports considered secure enough to have been granted Category 1 status by the US Federal Aviation Authority, which allows for direct non-stop flights to the US.

Foreign trade and payments

Ethiopia nears HIPC completion point

It was announced in late April that Ethiopia has reached completion point under the IMF-World Bank's heavily indebted poor countries (HIPC) initiative, boosting both available resources and confidence in the future. Ethiopia is now the thirteenth country to reach completion point under the programme, out of the 37 countries eligible for HIPC debt relief. Following earlier concerns over the impact of HIPC debt relief, the IMF and World Bank also pledged "topping-up" funds to bring debt back down to sustainable levels. In Ethiopia's case, the level of debt relief envisaged at HIPC decision point in 2001 is no longer sufficient to bring the net present value of Ethiopia's debt/exports ratio down to an acceptable level of 150-175%. This reflects the decline in world coffee prices, which has reduced projected Ethiopian exports, as well as the fall in world commercial interest rates, which has reduced the relative benefit of fixed rate concessional loans for all HIPC countries by inflating the debt/exports ratio in net present value terms. Donors have used Ethiopia as a test case in deciding whether to revisit the HIPC initiative in light of developments in world financial and commodity markets. The country will benefit from the following debt relief:

- US$1.3bn in net present value terms (including "topping up" relief) from multilaterals;
- US$700m in net present value terms from bilateral and commercial creditors;
- and US$300m in net present value terms from Paris Club creditors.

The IMF estimates that total external debt amounted to US$6.6bn in nominal terms in mid-2003. The lowering of the debt/exports ratio resulting from the HIPC write-off should also unblock substantial World Bank funding—of up to US$430m in 2004 alone—as disbursement has been restricted to grants since Ethiopia's debt indicators deteriorated in 2003. However, some countries, such as Uganda, have borrowed heavily after receiving debt relief and their debt indicators have worsened again quickly as a result. Although HIPC write-offs provide immediate relief in terms of debt servicing and an improvement in debt ratios, many countries still cannot fund development projects without external help after receiving debt write-offs, which potentially negates the benefits of the write-offs within a short

Current account, 2002/03-2003/04
(US$ m unless otherwise indicated)

	2002/03[a]	2003/04[a]	% change
Trade balance	-1,458	-1,602	-9.9
Exports	483	518	7.2
Coffee	165	167	1.2
Imports	-1,940	-2,120	9.3
Non-factor services balance	167	169	1.2
Non-factor services exports	657	650	-1.1
Non-factor services imports	-490	-481	-1.8
Income balance	-55	-51	-7.3
Transfers balance	1,035	905	-12.6
Private transfers	495	456	-7.9
Official transfers	540	449	-16.9
Current-account balance	**-310**	**-579**	**-86.8**
Current-account balance (% of GDP)	-4.7	–7.9	–

[a] Financial year ending July 7th.

Source: IMF, *Fifth review under the poverty reduction and growth facility*, February 2004.

The current-account deficit will widen in 2003/04

The current-account deficit is forecast to jump sharply in financial year 2003/04 (ending July 7th) to 7.9% of GDP—14% of GDP excluding official grants—according to the latest IMF country report. However, the deficit in 2002/03 was revised downwards from 6.1% of GDP to 4.7% of GDP. Exports of goods and non-factor services, as well as private transfers, were higher than earlier expected, while imports were lower. In 2003/04, imports are projected to rise faster than exports, partly because of a US$117m outlay on new aircraft, resulting in a near 10% widening of the merchandise trade deficit to US$1.6bn. At the same time, the invisibles surplus is expected to fall by 10.8% year-on-year to US$1bn, owing to the decline in official and private transfers following the end of the 2002/03 drought. The current-account deficit in 2003/04 will be fully covered by balance-of-payments support from donors. Foreign-exchange reserves are forecast to rise to around 6.5 months of imports at the end of 2003/04.

