For many businesses scanning Africa for the next opportunity, Ethiopia is the continent’s great enigma. It is a country that has experienced near double-digit growth for the best part of a decade, is rich in land and resources, and has a growing population of over 100 million people; second only to Nigeria on the continent. Yet for all of these positive indices, it is also a market characterised by complexity and constraints, which have historically limited the role played by foreign direct investment in driving its development and growth. In this Africa InDepth note, we assess Ethiopia’s political and economic trajectory, exploring some of the key risks and opportunities this presents for business.

A political system in transition

Ethiopia’s political system and government mindset is strongly defined by its recent past. Having witnessed the military overthrow of Emperor Haile Selassie’s regime in 1974, the country was governed by a communist administration referred to as ‘the Derg’ until its eventual overthrow in 1991. The Derg government indoctrinated the state at the heart of society, using brutally repressive tactics to silence or marshal its dissenters. Its demise was spurred on by a weakened economy as drought and famine ravished the country, a long-running war of independence with Eritrea drained resources, and the Soviet Union’s decline withdrew key support. But the communist regime’s overthrow was ultimately achieved by an armed revolutionary movement.

This revolutionary movement was spearheaded by the Tigrayan Peoples’ Liberation Front (TPLF), which successfully brokered a strategic alliance with other armed ethnic factions to form the Ethiopian Peoples’ Revolutionary Democratic Front (EPRDF). The EPRDF continues to rule the country today, presiding over an ‘ethnic federalist’ system, which sees political power balanced between a central federal government and regional authorities representing the country’s principal ethnic groupings. The EPRDF itself is a reflection of this system, with the coalition consisting of four constituent parties which represent the country’s principal ethnic groupings; namely the TPLF, the Oromo Peoples’ Democratic Organisation (OPDO), the Amhara National Democratic Movement (ANDM) and the Southern Ethiopian People’s Democratic Movement (SEPDM).
While the EPRDF brought an end to communist rule, it has been influenced by the state models which preceded it. Most notably, the state continues to play a dominant role in society and the economy, albeit facing internal resistance from marginalised interest groups on its peripheries. The party seeks both to dominate and control the political space, providing limited room for opposition – a dynamic which has been central to recent internal wrangling in the EPRDF and waves of popular unrest witnessed since last year involving citizens venting frustrations at the perceived lack of effective political participation and broad-based opportunity.

As such, although the EPRDF has witnessed uninterrupted power for 26 years, it faces unprecedented challenges in maintaining unity and stability. For the first 23 years of its existence, the party was steered by the authoritative figure of Meles Zenawi, who had led the Tigrayan revolutionary movement before becoming Prime Minister in 1995, standing until his death in 2012. Meles was an extremely able political operator who was a master in forging consensus, overcoming adversity and outmanoeuvring opposition – even if this sometimes involved resorting to repressive tactics. Drawing on the ethos of the Derg era, he kept the party and state at the centre of all things.

Regional prominence

As host to the African Union headquarters and several international agencies, Ethiopia has significant regional political importance. It is also viewed by the international community as a relative bastion of stability in the volatile Horn of Africa region. Nevertheless, periodic conflicts with Eritrea, restive militancy in the Somali and Ogaden regions of the country, and cross-border vulnerabilities presented by the country’s long shared borders with Somalia, Eritrea and South Sudan underline some of the security complexities faced by the country, particularly in more remote regions.
He also used the notion of ethnic federalism both to provide a veneer of ethnic representation, and to play off the country’s main ethnic blocs against each other. This was critical since the Tigrayans who surrounded him in many positions of high-office come from a minority that accounts for less than 7% of the population, compared to the much larger Oromo (34%) and Amhara (27%) blocs.

Meles’s death in 2012 has unsettled Ethiopian politics, exposing some of the shortcomings of the ruling system that he left in place. Without his consolidating presence at the heart of the ruling apparatus, it has become harder to broker consensus across EPRDF structures. Meanwhile, at the grass-roots there is restiveness, driven both by socio-economic and political factors. Underpinning both elite and grass-roots malaise is a perception that Tigrayan dominance of political, economic and commercial activities has come at the expense of other interest groups. These dynamics are central to the waves of popular unrest that have been particularly prevalent in towns and rural areas in the Oromo and Amhara regions of the country – and some of the political responses to them. Against the backdrop of a changing social fabric brought about predominantly by demographics and communications technology, the EPRDF has been reluctant to open the political space to fair competition for fear of losing its hegemonic status. It has therefore clamped down on opposition voices using the considerable state machinery, and has sought to find internal solutions to alleviate popular grievances. Yet it has faced its own internal struggle in this respect, with its constituent parties competing for influence and a younger generation of leaders also pushing into the ascendancy.

There have been many positive developments stemming from this process. Leadership changes within the OPDO and ANDM have seen the old guard of political leaders make way for fresher faces. A similar process has also played out in the cabinet, with the EPRDF removing some of its more controversial or underperforming figures from front office, and generally replacing with more competent technocratic figures. Meanwhile, in settling some of the grievances of the Oromo and Amhara, more power and decision-making is being devolved to regional administration. The government’s decision to appoint populist OPDO figure Lemma Megersa as Speaker of the House of Peoples’ Representatives has also been seen as a good tactical move, especially since he is foremost a nationalist rather than an ethnic partisan, so can foster a unity narrative at a time when ethnic voices are singing loud. However, more far-reaching political reform to strengthen the mechanisms for political participation and representation will likely be needed if Ethiopia is to maintain stability and manage the expectations of a burgeoning youth population in the long-term.

As a sign of the current internal turmoil playing-out in the heart of the EPRDF, the party took the unprecedented step of postponing its party congress by six months until March 2018 while it resolves internal debate and determines its future direction. With the OPDO and ANDM appearing increasingly aligned in handling the grievances of their constituents, all eyes are fixed on the TPLF which remains the most powerful party within the ruling coalition, despite weakening since the loss of Meles. The TPLF is undergoing its own internal struggle and amid heated internal debate, it has yet to come up with a coherent response to the growing challenges to its central authority.

The EPRDF congress will likely give a signpost for the country’s future trajectory, setting the political and development priorities of the ruling party for the coming years. Radical reforms seem unlikely in the current context. But at least there is a mature debate ongoing and clear efforts to respond to the outspoken grievances voiced by parts of the electorate. As always, the EPRDF will seek to manage this as an internal issue rather than opening up the political landscape for greater opposition – a decision that will perpetuate certain structural risks. However, the responsiveness of the government to date bodes well, and the state and party likely remain strong enough to overcome the existential threats they have faced of late. Crucially from a stability perspective, the military and political elite remain relatively intertwined and have a range of interdependent political and commercial interests which would be threatened by instability, reducing the incentives to disrupt the status quo. Meanwhile, the political opposition – even from within the party – is likely to be too weak to mobilise an organised movement that can fundamentally alter the current order. Change is inevitable, but the party may just have enough political tricks up its sleeve to shape the pace of it.
Ethiopia’s economic miracle or mirage?

The EPRDF’s political legitimacy has in large part derived from its ability to drive development and promote opportunity for the growing population. To date, it can claim considerable success in this respect. Its state-led development model with a focus on industrialisation, infrastructure development and commercialisation of agriculture has brought consistent annual growth rates of 8-12% since 2004, at times making Ethiopia the fastest growing economy in the world. This growth has also brought socio-economic dividends with incremental improvements on human development indicators. However, the scale of the challenge is enormous given the low base from which the country has come from, and the demographic bulge that it is facing. Many citizens have not felt the benefits of Ethiopia’s rise, while parts of the rural economy in particular remain extremely poor.

The government’s state-led approach, enshrined in the Growth and Transformation Plan II, also carries consequences for businesses, some of which constrict growth potential. Foremost among these is the centrality of the state in economic activities, which is preserved through distorting protectionist measures and state monopolies. Significant parts of the economy such as the banking, telecoms, services and import sectors are largely closed to direct foreign investment. This has restricted avenues for foreign capital and created inefficiencies in the economy, albeit preserving lucrative industries for the government and a select business elite. Meanwhile, the government’s ambitious infrastructure spending plans have resulted in a drain on the country’s foreign exchange, which is inadequately supplied due to an uneven balance of trade. Strategic projects such as the $5bn 6,000MW Grand Renaissance Dam have priority access to forex, which is in increasingly short supply.

Nevertheless, despite forex shortages many businesses with an established presence in the market remain extremely bullish about their prospects. This speaks to the sheer force of numbers in Ethiopia, with robust growth and investment propelling the economy forward. On a recent visit, africapractice engaged with a number of consumer-oriented businesses which continue to experience strong year-on-year growth and robust profitability, even with the impact of the recent unrest witnessed in the country. By and large, these firms held ambitious expansion plans for the coming years, providing a ringing endorsement of the potential they see in the market.

However, for new companies entering the market it can be a slightly different state of affairs – particularly if they lack the scale and resources to carry commercial clout. The country benefits from one of the best-staffed and most competent investment agencies on the continent, the Ethiopia Investment Commission. However, the agency has limited political power to help companies overcome some of the challenges and resistance they can face in penetrating the market. Notably, established local competition – including from the state or state-aligned interests – in many sectors can create vested interests and barriers to investment, while the bureaucratic and hierarchical mindset which pervades in public office means that license and permitting procedures tends to be glacial. This dynamic is reflected in the country’s dragging position in the World Bank’s 2018 Doing Business Report rankings. For this reason, having a strong and trusted in-country partner or representative is even more critical in Ethiopia than in many other African markets or you simply won’t progress.
For those companies requiring land for their business – notably agricultural, mining, geothermal and other non-strategic power projects – the process can be extremely thorny and meet local resistance, further adding to the risks and challenges of market-entry under this model. It is notable that in the recent waves of unrest across the country, several businesses were targeted and vandalised, either because they were seen to be strongly associated with (or owned by) government, or because they were seen to have mishandled local community dynamics around land acquisition or labour engagement. Firms that managed such issues better were conspicuously spared in several instances.

Beyond these ongoing challenges, it remains clear that the principal driver of growth in the country will remain the state – and there are rising sovereign debt levels to show for it. The state-led model is successful to a point, but questions will increasingly arise around its sustainability, and around the inefficiencies it engenders. As a principal source of wealth for government and associated businesses, radical reform to liberalise the economy remains a distant prospect. But if Ethiopia is to maintain the robust double-digit growth required to meet rising popular expectations, then incremental reform will need to become a more prominent feature of the business landscape.

Industrial parks – a new model for investment

One notable advance in the government’s development strategy has been the creation of industrial parks, which strongly incentivise foreign investment. The motivation for the parks is primarily to address two pressing government priorities; creating jobs and generating forex. With this in mind, the industrial parks have been established to encourage export-oriented manufacturing businesses to invest in Ethiopia. They have strong political backing and their development is being overseen by the influential Arkebe Oqubay.

Amongst other incentives, the parks offer corporate tax income exemptions for 10-15 years, 0% export tax, 5-7 year exemptions on expatriate staff income tax, and access to shared infrastructure and worker training support. The government is rapidly rolling out the industrial park strategy with $1bn already invested and plans for $1bn in annual investment going forward. There are currently four operational parks, namely Bole Lemi, Hawassa, Mekelle and Kombolcha, with up to 15 others in various stages of development. In this respect, some parks are not necessarily located in the most convenient locations, noting a political drive to ensure that each administrative region hosts a park for local benefit. Each park is established around a cluster-system of industries, ranging from textiles and garments, food processing and heavy industry.

The strategy has already drawn notable successes with the likes of US clothing giant PVH and European counterpart H&M setting up within the parks, alongside a growing number of suppliers. Low labour and energy costs are also a motivating factor as Ethiopia seeks to position itself as the next low-cost global manufacturing hub, seizing on the opportunity presented by China shedding jobs from its manufacturing base.
However, in this respect it is notable that the industrial parks currently witness a high level of labour churn, suggesting that the price-point of labour wages and the accompanying benefits may be inadequately set at this stage to ensure a robust business model given comparatively high costs of living in the industrial park areas, and broader inflationary pressures. Companies seeking to invest in this space will likely therefore need to look beyond the bottom line to consider what sort of social investments can be made in housing and other allowances to ensure a more stable workforce model. This is in any case likely to carry significant social and political capital for long-term reputation and sustainability, even if it moderately reduces margins, particularly in the short-term.

The industrial park strategy is still a work in progress. Some of the highest costs remain transport-related – though a $3.4bn 750km Chinese-built railway linking several of the parks to the main port in Djibouti will likely cut time and costs in this respect. Bureaucracy has also been significantly reduced by having customs inspections occur on-site at the parks, and by having banks and key state agencies also represented within the parks. Nevertheless, the parks are not entirely insulated from some of the challenges faced in the market, including in managing paperwork and processes around import-and-export. In this regard, the need to source many inputs from outside the market (and have the adequate forex supply to maintain an inventory) also presents some challenges. But these are largely surmountable, and Ethiopia’s manufacturing sector will likely grow apace. In particular, it offers an opportunity for companies wanting to establish their own ecosystem from scratch to achieve this without the established parameters and legacy issues of other major manufacturing hubs like India and China.

Conclusion

Ethiopia is a beast of an African market, abounding with opportunity but also unique in its complexities. Those companies who are already present in the market have generally invested the time and resources to make this all worthwhile, and they are now armed with the footprint and know-how that will provide scope for further robust growth. But this will not come without its considerable challenges – not least the forex issue.

Meanwhile, the industrial parks in particular will likely attract a new breed of investment, and brave first-movers will likely pioneer a promising success story. From the government side, it remains unclear to what extent the industrial parks strategy represents a coherent pillar of a well-organised development strategy, as opposed to a hastened response to the immediate demand for jobs and forex, which could become distorted down the line in response to future political and economic developments. However, the signs to date have been very promising and the trajectory of development in the parks has been impressive, reflecting genuine government commitment to this initiative. Ultimately, the country’s economic future remains heavily intertwined with its political prospects. The country’s political leadership has certainly woken up to the fact that they cannot continue with the status quo. But they have yet to determine and articulate a new direction that will preserve the status of the state as the central organ of development, while allowing greater reform both on the political front to improve mechanisms of participation, and on the commercial front to ease the business environment and reduce some of the distortions, monopolies and inefficiencies of the system.

These are lofty ambitions that will take years to achieve, with slow progress at times. But change – and indeed the pace of change – will be critical to ensuring the country’s stable and prosperous future, such are the demands and expectations of its growing population, which has undoubtedly found its voice. Africa is becoming increasingly accountable to itself as better networked and more urbanised societies look to government to act as an agent for development and change. Ethiopia is no exception to this rule. And the government’s handling of these pressures, as well as its performance in delivering on expectations, will shape the future of politics, the economy and business in the years to come.