On 1 September 2010, the Central Bank of Ethiopia announced a devaluation of the birr by 20 per cent. With this devaluation measure, the value of the birr has declined by at least 45 per cent since 2008. It is to be recalled that the birr was devalued by at least 10 per cent in October 2008, by 9.9 per cent in July 2009, and by at least 5 per cent in early May/late April 2010. Numerous sources indicate that all devaluation measures are conducted after the macro-economic team chaired by Prime Minister Meles Zenawi makes the decisions to do so.

Devaluation is associated with fixed or pegged exchange rates systems whose value is not being determined by the normal (free) mechanics of supply and demand. In general, devaluation reflects the existence of serious macroeconomic problems (imbalances or weak economic fundamentals) and also reflects weaknesses of the government that is devaluing its currency.

When it comes to Ethiopia, the economic weakness is reflected by several of the resource gaps: The savings-investment gap, the balance of payments (BoP) gap which in 2009 escalated, with total exports and imports amounting to US$1.657 billion and US$7.093 billion respectively, according to the CIA World Factbook. Ethiopia is also afflicted by other gaps such as a continuous budgetary gap, a skilled human resource gap, a significant agricultural (food security) gap, a dire foreign exchange gap, technology gap and most importantly, a good governance gap.

By just looking at the solvency issue, that is, the balance of payments and budgetary balance gaps and the alarming foreign exchange shortages, one is also led to believe that the birr is overvalued and some measure of devaluation is necessary. When I wrote the popular article The Causes of the Soaring Ethiopian Inflation Rate a few years ago, and suggested that the birr was overvalued, some of my readers were perplexed by such an expression, informing me that I was wrong. They did so partly because they thought I agreed with the government that devaluing the birr would serve as a panacea for the structural problems that the Ethiopian economy was facing, and partly because they thought all the theoretical possibilities were applicable to Ethiopia, and devaluation would solve the country’s structural problems. All that I was saying was this: Using standard economic reasoning and rationales of devaluation, the fact that the country has been engulfed with high inflation rates means that the purchasing power of the birr has been decreasing.

The fact that the government has been facing foreign exchange shortages and is unable to meet the lowest required foreign exchange reserves (which is supposed to be not less than a 3-month import coverage, but with actual coverage at times being less than six weeks of import coverage) and the fact that such shortages have led the Central Bank of Ethiopia to ration foreign exchange to both importers (and foreign investors who are unable to repatriate some of their profits back home as a
result of the foreign exchange shortages) also indicates a non-market clearing foreign exchange market. The fact that the IMF has been warning the government that it would face financial difficulties implies that the birr could collapse, sooner or later. Moreover, the fact that even some domestic firms were suspending their operations and were unable to import the necessary intermediate inputs from overseas due to the lack of foreign exchange also indicate a disequilibrium in the exchange rate market (that is, the exchange rate between the birr and other currencies has become untenable).

It also means that, with disequilibrium in the exchange rate in existence, the government will be unable to carry on its new 5-year ‘Growth and Transformation Plan’. It is for these already existing and new realities and inherent weaknesses why I argued the birr was overvalued long ago. I also believed that were it not for the continuous influx of donor assets (estimated to be US$3 billion in 2009) and remittances (the National Bank of Ethiopia reporting total remittances just for the first two quarters of 2009 being US$1,798.8 million), the value of the birr would have been much lower than what it was then and what it is now as well.

Regarding the political aspect of the weakness, in general, devaluation comes as a result of the realities of economic mismanagement and the push (many people like to call it coercion) by the International Monetary Fund (IMF). In general, a greater portion of a country’s citizens consider their government to be a weak one whenever they observe it bowing to the IMF’s pressure. Second, since those firms who are engaged in the production of exportables tend to benefit the most from the devaluation of the birr, it indicates the increasing lobbying power of those firms (groups) that are able to turn policy decisions in their favour.

In the Ethiopian case, given that several of the Tigrayan People's Liberation Front (TPLF)-controlled conglomerates organised under the Endowment Fund For The Rehabilitation of Tigrai (EFFORT) and the Relief Society of Tigrai (REST) (in collaboration with Sheikh Mohammed Al-Amoudi’s MIDROC Ethiopia [4]) have seized the state, it is only them who stand to benefit from the devaluation. The fact that powerful elements are able to gear government policies towards their favour in turn reflects the weakness of the government, which is supposed to look after the interests of the country and the general populace.[3]

Political observers I talked to speculated that the largely unexpected massive devaluation of the birr may also indicate an acknowledgement of weak economic fundamentals by the authorities themselves. For example, they say, when questioned about the merits of the devaluation measure by the local business leaders and party members, Prime Minister Zenawi was quoted as saying that it was ‘a sour medicine that the economy has to swallow.’ In a normal setting, both the harsh economic realities on the ground and the ‘bitter pill to swallow’ statements made by the authorities would create serious political problems for the regime in power.

On the one hand, the bitter pill to swallow statement contradicts the rosy economic scenario that the Ethiopian People's Revolutionary Democratic Front (EPRDF) has been painting during the run-up to the May 2010 parliamentary elections. On the other hand, such statements and measures indicate that the regime was dishonest to the public about the economic conditions of the country. The measure and reasoning given for devaluing the birr also reflect that, in addition to the currently existing foreign exchange shortages, the authorities might have come to their realisation that they would face crunches in exchange inflows such as remittances, grants, foreign investment, and loans down the road.

With such pronouncements, the authorities are admitting to the well-known fact that the government has become increasing dependent on the remittances, in the same way of many impoverished Ethiopian families. Both the timing and relatively massive devaluation measure also reveal one important empirical fact that both political scientists and economists have known: Devaluations are delayed and the real economic conditions are intentionally distorted during the run-up to elections, in order to increase the electoral chances of the party in office.[4]

Such political opportunistic behaviours contribute to increasing uncertainties both about the competence of the ruling party and the future of the national economy. One is led to think, therefore, that both the measure and the contradictory statements by the authorities would politically backfire
on them if the losers, who will be unable to handle the inflationary ramification of the devaluation measure, are forced to become better organised and more articulate.

CONVENTIONAL PARADIGM OF AND JUSTIFICATION FOR DEVALUATION

The economic reasoning behind the devaluation of the birr as a means of improving a country’s trade balance is that a decline in the birr would cause exportables to be cheaper relative to other countries. This would then lead to an increase in the volume of exports, other things equal. With the cheapened birr, imported goods become more expensive, thereby leading to an improvement in the country’s trade balance. The expected reduction in the trade balance depends, of course, on the exact amounts of imports and exports, their respected price elasticities and a number of other factors some of which I’ll illustrate below.

Despite being contradictory at times, the many statements given by the authorities are in line with such prescriptions. For example, Tamrat G. Giorgis of ‘Addis Fortune’[5] reports that when business leaders questioned both the timing and manner of the devaluation, Prime Minister Meles Zenawi and state minister for Works and Urban Development, Arkebe Oqubay, gave three rationales for devaluing the birr:

a) To meet the $10 billion export revenue target of the ‘Growth and Transformation Plan’
b) To make imported consumer goods more expensive ‘in a bid to promote import substitution industries’
c) To provide more incentives to Ethiopians abroad who send remittances.’

Such reasoning may seem to make the devaluation measure a good idea under different circumstances but given the structural defects in the state/economic functioning, the measure will not have the effects that Mr Zenawi and the IMF desire for several reasons that I discuss below.

NEGATIVE EFFECTS OF DEVALUING THE BIRR

1) The devaluation of the birr is likely to aggravate inflation and it could spark a snowball effect of higher inflation as it can build into a cascade of expectations for further devaluation by private citizens.[6] When devaluation is done overnight in secretive and surprising manner as is done to the birr[7], the action has the potential to irritate the business sector and speculators. As a result, the devaluation measure could be self-defeating and self-fulfilling. Moreover, for those who control the commanding heights of the Ethiopian economy and the party-controlled conglomerates and their ‘owners’, the action will tempt them to convert their assets into dollars/pounds/euros and expatriate their assets before their values are eroded.

There is also a possibility for potential and future birr holders to shun the currency since holding the birr will be very expensive to them. Regarding the issue of expectations, one may convincingly argue that the birr will not be attacked by speculators since the economy is agrarian in nature and the banking sector is largely ‘decoupled’ from the speculators and the international banking system as Prime Minister Meles himself suggested a few years back.[8] If the birr collapses, therefore, it will not be due to those unscrupulous speculators, but due to structural problems and bad policies and their implementation by the government in power. But again, given what took place in Zimbabwe, a combination of existing shortages and the expectation of further devaluation could lead to the collapse of the birr.[9]

2) Increased volatility and uncertainty: Since devaluation affects expectations, it could increase the volatility in the exchange rate as well. Fluctuating prices of domestic goods (caused by devaluing the birr and which will be accompanied by increased price of demand) will increase uncertainty, with their potential to decrease production. The measure will adversely affect the business sector for it does not allow it to plan its operations in advance, price its products properly and forge ahead with future contracts.

3) The devaluation will cause the prices of imported consumer goods (which is one of the purposes of the devaluation) to rise. Since Ethiopia largely relies on imported goods and services, particularly food items, the population at large will suffer from the rise in prices caused by the devalued birr.
4) By making domestic assets – including land – cheaper, devaluation facilitates the transfer of Ethiopian assets to those who hold (or have access to) hard currency (mostly the global enterprises). This will intensify the so-called ‘Land Grab’ process and the acquisition of weakened domestic enterprises by global enterprises.

5) The lack of transparency in the devaluation process coupled with the rise in the cost of living erodes trust in the government, assuming that such a trust already exists, which may complicate the governing abilities of the regime in power. In particular, rational business persons will be hard pressed to trust the government from here on, given the unexpected massive devaluation measure of the birr.

6) This measure is also filled with many contradictions. For one thing, the government has been reigning in the money supply by arresting credit and putting pressure on the banking sector just to fight the inflationary pressure that has engulfed the nation. The devaluation of the birr effectively reverses that policy via exchange rate depreciation. Moreover, given that a substantial portion of the Ethiopian inflation was caused by government spending and free access credit given to party-owned businesses, and given that the government is the biggest consumer of foreign exchange, the depreciation of the birr could only magnify its cash and debt service requirements.

7) No discernible change in the country’s balance of payments (BoP) positions: This is because for devaluation to be successful, domestic supply of output must be responsive to meet the existing and surging demand, which is caused by the depreciation of the birr. If demand surges for Ethiopian exportable products, an excess or spare capacity must have existed ready to meet the demand for domestic products.

Given that the country’s imports are three to four times than the value of its exports, thereby indicating already-existing shortages, the measure will largely be ineffective at best. In fact, the measure will exacerbate the shortages as there are no sufficiently locally produced goods ready to meet both the expenditure switching local demand for domestic goods and foreign demand for domestic products.

Since shortages exist within the Ethiopian economy, supply is inelastic (that is, quantity supplied fails to respond to a change in price caused by the devaluation.) Even if the spare capacity exists (that is, the Marshal-Lerner condition is met), the country will be unable to increase its supply in the short term. In this case, the country’s balance of payments could worsen before it gets better, if at all. This is the well-known J-curve scenario.

Let’s ask these questions: Are there enough domestically (Ethiopian) produced goods which both domestic and foreign consumers wish to buy? As I argued elsewhere, one of the major causes of the 2008 (and thereafter) rampant inflation is shortages of goods, particularly food items. Second, one of the claims made by the government and its agencies is that the devaluation is also an import-substitution strategy. Are the domestically produced goods really good substitutes for foreign made goods? I am sure the reader knows the answer to this question.

Third, assuming that there are (domestically produced) import-substituting goods, how long will it take for both domestic and foreign consumers to adjust their preferences and switch towards Ethiopian-made goods? If they take time to change their preference from imported goods to domestically produced goods, the devaluation measure will be largely ineffective. If I am allowed to use economics jargon, all of these clearly indicate that the impact of the price change on the quantity of exports demanded and the quantity of foreign exchange earned will be determined by the price elasticity of demand for domestic goods.

8) Devaluing the birr could also have a negative effect on trade. In particular, weakening the birr means that products in countries with stronger currencies become more expensive. If Ethiopia, now with a weakened birr, fails to curb imports, it will need more money to pay for the same amount of foreign goods. In this case, the measure will fail to improve Ethiopia’s serious trade imbalance.

As we all know, Ethiopia’s exports are mainly in the forms of commodities, too. Commodity prices
are notoriously known to fluctuate depending on world economic situations and demand. Given that Ethiopia must export whatever it can and given the fact the government is already exporting every exportable product, it is not clear whether the devaluation will help.

As indicated above, devaluation also adversely affects intermediate and capital goods that are imported from overseas thereby affecting domestic production in a negative way. For state-owned, private and even party-owned enterprises, which heavily depend on imported intermediate/capital goods (inputs), the devaluation measure will raise their cost of production thereby adversely affecting their capacity utilisation capabilities. The net effect of the devaluation in this case depends whether the rise in the cost of production (negatives effects) of the devaluation on the intermediate goods outweighs the potential benefit from exporting more primary products. And it is not clear if the policymakers calculated these potential costs and benefits of devaluing the birr.

9) Devaluation also leads to a reduction of the country’s real wealth as inflation eats up their assets and raises the cost of living. For those individuals and firms who might have borrowed assets denominated in hard currency, the devaluation measure may force them to go bankrupt as their debt values increase with the appreciation of the foreign currency. As is well-known, some of the contributing factors for the 1994 Mexican and the 1997 Thai financial crises were lax banking regulations which allowed local banks to borrow in hard currency (dollars- most of the borrowing being in short-term loans). The local banks loaned these assets to individuals and businesses that did not have the ability to earn dollar profits. The devaluation of the Mexican peso and the Thai bhat caused a sharp increase in the peso and bhat-equivalent value of the debt of the companies, leading to bankruptcies of firms (as the mortgages held in dollars forced a massive blow-up of bad debt and mortgage defaults). Since, in general, banks borrow short and lend long, a substantial portion of the Mexican and Thai banks were unable to service their debt once the peso and baht got devalued. Moreover, those banks which were affected the most were the once which were heavily involved in the booming real estate market. Ethiopia may not have many private and public banks which have heavily borrowed in hard currency, but those banks that immersed themselves in the real estate market will now be hard pressed since the payments they receive are less in value, thanks to the devaluation.

10) In particular, the devaluation of the birr will have deleterious effects on local savers who were being robbed because of the already-existing negative real interest rates. The measure will intensify the robbing phenomena and will negatively affect the net wealth position of the country and exacerbate the resource gaps. Thanks to the devaluation measure, the real assets of the current savers are now nearly 20 per cent lower than what they were the day before the devaluation! Just think about if you were one of these ‘savers’ and you waking up in the morning finding out that someone has taken 20 per cent of your saved assets you had yesterday - in this case the devaluation! Think also about the alternative, particularly if the devaluation was gradual and transparent. In the later case, you could have found mechanisms which would have minimised the damage (the robbing). Parallel to the government’s robbing of the ‘savers’, the measure is less likely to negatively affect those who have the information that devaluation was about to happen. This fact has been observed in many countries where devaluation had taken place.[10]

11) Devaluation entails income distributional effects, favouring exporters (whose marginal propensity to consume is low) and depressing the wages of workers (whose marginal propensity to consume is relatively high). The devaluation will exacerbate the alarming income discrepancy that is afflicting the country’s population, with the pro-EPRDF forces getting the biggest of the pie. Some of the other distinct groups who are likely to benefit from the devaluation are those who are involved in grain-exporting activities – including those foreign firms who benefit from the notorious ‘land grab’ scheme.

12) The Ethiopian economy is not flexible enough to adjust or respond to devaluation schemes. Given the fact that the commanding heights of the Ethiopian economy are controlled by regional party-owned conglomerates and Sheikh Mohammed Hussein Ali Al-Arouri’s MIDROC Ethiopia, and with a lot of corruption and opaqueness of doing business involved (with a suffocating oligarchy controlling both the political apparatus and the major and productive sectors of the economy), the devaluation of the birr will be largely ineffective on a national level, even if the government’s policy and the multilateral agencies’ intentions who are advising the government are sincere.
13) In the unlikely event that other trading partners follow suit (that is, devalue their currency so that Ethiopia would not take advantage of them), or take other retaliatory measures, the devaluation scheme could unravel as it could potentially trigger the notorious ‘competitive devaluation’ (zero-sum game activity) scheme that devastated the world’s economies before the Second World War. The measure may also trigger a potentially damaging mini trade war involving Ethiopia, its neighbours and her major trading partners.[11]

14) The devaluation measure would likely benefit exporters of products in the extractive industries and those who are engaged in exporting every bit of exportable grain and commodities that the country produces. As transpired elsewhere in the world, the devaluation ought to have already benefited those who knew or suspected devaluation was coming and had converted their birr-denominated assets into dollars/euros a day or so before the devaluation.

15) The devaluation measure is unlikely to spur production of domestic industries as Ethiopia does not have much of a manufacturing sector that is competitive enough to exploit the devaluation measure. Moreover, since devaluation is effectively a protectionist policy, it is unlikely that the devaluation measure will make domestic firms to be more competitive and more efficient than their global counterparts.

16) Devaluation reduces real income, thereby decreasing aggregate demand which will ultimately reduce GDP and the government’s ability to garner more tax revenue. When this happens, the government would be unable to fund its projects and expenditures as a result of lower tax revenues. Such constraints and the promises that the ruling party made to the voters as well as its purportedly five million party cadres will tempt the government to print more money to buy what it needs. This, of course, has the potential to intensify the inflation problems. Let’s also not forget that devaluation will raise the repayments due on existing foreign loans, thereby increasing the country’s indebtedness.

This increased indebtedness and perceived economic weakness has the potential to erode investor confidence, which in turn may hamper the flow of foreign direct investment into the country and its ability to secure loans.

It is for these reasons that some economists call devaluation a slippery slope and a fool’s game.

ARGUMENTS IN FAVOUR OF DEVALUATION AND ITS POTENTIAL BENEFITS

1) Some individuals and even consultant groups such as Access Capital [5] – believe the economy needed the devaluation, indicating that there are potential benefits from the measure. Using the devaluation paradigm as their guide, they argue that devaluation increases the goods and services that Ethiopia exports, resulting in increased export volumes, all other things being equal. In so doing, the devaluation of the birr could promote domestic output as well as employment in the exporting sector of the economy and allow the country to earn more foreign exchange. Other things equal, they say, there could be a minor reprieve in the balance of payments (insolvency) problems. The devaluation of the birr and the potential to earn more dollars is also consistent with the government’s new ‘Growth and Transformation Plan,’ according to Access Capital and others. Other economists, such as a friend who briefly looked at my first draft of this article, strongly argue that devaluation benefiting Ethiopia, emanating from the theoretical possibility, is inapplicable to the Ethiopian case. He argues: ‘More will not be exported because of devaluation, [as”]> there is nothing more there to export.’[12]

2) Some who observe the skilful tactics of the ruling party say that, even if the measure is impractical when it comes to Ethiopia, it serves the purpose of fulfilling the ‘pipe-dream’ (as some already called it) manifested in the absurdly too ambitious five-year ‘Growth and Transformation Plan,’ and in partially deflecting the question that people have already begun asking: ‘Where does the money come from to implement these gigantic projects and the entire big five-year plan?’ In theory – and other things equal – a major portion of the multitude of (laundry) projects listed in the ‘Plan’ can only be financed by doing a lot of exporting – and the devaluation can help, they say. In fact, this is exactly how Prime Minister Meles stated it to the two gatherings – one involving business
leaders and the other one involving educators and members of the civil service community. Again, a
cynic may argue that, since Ethiopia is a commodity exporting country, its exports are mainly
determined by world commodity prices rather than a devalued birr. In other words, Ethiopia’s
exports would remain more or less the same, whether the birr is devalued or not.[13]

3) Again, some supporters of the government’s ‘Growth and Transformation Plan’ say that
devaluation could benefit farmers who are producing cash crops. This is what the government has in
mind, as Zenawi also implied it several times during the aforementioned gatherings. Unfortunately,
however, devaluation has the effect of raising the cost of production and decreasing productivity as
the price of imported seeds, machinery, fertilisers and their costs of transportation rise.

Other economists are also not convinced that the devaluation measure will bring extra gains in farm
output. For example, the same economist that I quoted above emphatically states: ‘Farmers are not
earning more in real terms as a result of devaluation because it remains to be money illusion if you
are considering the inflationary prices they are charging for the same amount or quantity of crops
(coffee for example) they are currently selling.’

4) Others bring the traditional theory of the J-curve in play, suggesting that, even though the
depreciation of the birr may worsen the country’s current balance of payments position in the short-
run, the devaluation measure could lead to improved trade balances in the long run. Other
economists disagree with this contention, arguing that given the dire past and current balance of
payments of the country (both the current and capital account being too much in the read for too
long), it is not clear for them if the J-curve theory is applicable to Ethiopia.

A prominent professor of accountancy who has published numerous professional articles on sub-
Saharan Africa stated: ‘The J curve has not been observed in many African countries; hence there is
little reason to expect it [to be effective] in Ethiopia.’ Another economist from back home stated
this about the J-curve: ‘Theoretically, the J-curve effect holds true only if a country has a balanced
BOP position at the time of devaluation, which is not the case in Ethiopia. So, for Ethiopia, the J-curve
effect cannot be expected to hold true.’

5) One may also contend that the devaluation measure will have the effect of reducing workers’
wages since the birr that they are being paid becomes less valuable, thereby making labour
relatively less expensive and allowing (attracting) businesses to hire more labour. Again, the same
economist responded by saying: ‘[Since] wages are already the lowest in the world, how is it going
to be a new incentive for investors? All investors could hire as many workers as they want at the
going wage rate before devaluation.’ He also thinks that workers will demand higher wages as their
real wages substantially decline as a result of the devaluation.

6) Some may argue that the massive devaluation, which exceeded the parallel (black) market
exchange rate, would punish those who hoarded foreign exchange. In fact, this is exactly the
response that a government economic advisor gave when I complained about the government’s raid
on businesses that were engaged in the parallel exchange rate market in 2008. He told us that those
people needed to be punished and the government did the right thing by seizing their assets
(millions of dollars) and putting them in jail. Such a zero-sum game mentality has been the hallmark
of those who have been in power for nearly two decades. But, as was the case with other countries,
the devaluation actually destroys the savings of the poor and the middle class, while leaving the
wealthy and the well-connected unaffected.[14]

7) Good will from the IMF: As I argue below, one could expect an inflow of loans from the IMF as a
result of this ‘bold move.’

STRUCTURAL PROBLEMS

The government has been either ineffective in collecting taxes or the economy is unable to generate
taxable incomes. The economy’s inability to generate tax revenues is strongly tied with the many
constraints that the government has imposed on the people of Ethiopia, the most important of them
being state seizure and corruption manifested by the transfer of Ethiopian assets to party-owned
conglomerates (the so-called ‘endowments’ who now control the most productive sector and
commanding heights of the Ethiopian economy) and the reprieve given to them from paying taxes. As long as such an opaque system stays, the government will continue to be starved of potential and real tax revenues.

Moreover, the Ethiopian economy has been beset by power outages. Local firms are unable to find sufficient skilled manpower, largely due to the government’s political decision-making process. For one thing, the nepotistic policies of the ruling party have forced out able-bodied people away from their civil service activities and the productive sectors of the economy. A great many of them have chosen to either be self-employed or work for the highly fragmented private sector, forcing many of them to be underemployed. The regional party owned conglomerates (endowments), on the other hand, are filled with inept political cadres and are run by powerful rent-seeking party leaders as their board of directors (who effectively own them).

A great many of the educated personnel have already left the country. A recent survey which indicated that 46 per cent of Ethiopians would like to migrate reveals that not only Ethiopia’s brain will continue to bleed when those who are holding their skills in their own pockets and who can sell these same skills elsewhere in the world leave the country, but also when those who are able to run away from the repression leave their beloved homeland and families behind. I mentioned just these to show that the system is largely inefficient and the problem is structural and macroeconomic, not financial. As a result, the structural imbalances will not be solved by monetary (devaluation) means.

Secondly, the imbalances are caused by past government policies and activities. The ruling party’s policies were designed to make the relatively small industrial sector fizzle out and/or be unable to get off the ground. The government’s policies enticed both party-owned parastatals and individual entrepreneurs, particularly those who have a close working (and blood) relationship with the governing party to be involved in the economic sectors that could garner them quick profits. Consequently, the aforementioned economic players found investing in banking, wholesale and retail trade, construction, real estate and renting, transport and communications, hotels and restaurants and education to be highly profitable.

The shunning of the industry sector by both ‘private’ players and the government’s spending preference towards the service sector has not only made the country less competitive, but it also has created huge structural imbalances and misallocations of resources. The so-called ‘Growth and Transformation Plan’ will exacerbate such imbalances, negatively affecting the national economy and the standard of living of the people of Ethiopia.

Despite the claims made in the new five-year ‘plan,’ all the indications are that the misallocation of resources, government interference in the economy and increased activities in the service sector will continue unabated. This new plan envisages a doubling of agricultural output, drastic improvements in social services, continuous infrastructure building, and etc – all culminating in a doubling of the country’s economy within the five-year plan.

Leaving the agricultural sector aside (which involves serious and multitude structural problems of its own, thanks mainly to EPRDF’s land tenure policies)[15], the government’s pronouncements of the ‘Growth and Transformation Plan’ being predicated by the last five-year plan attests to my contention that the ‘feel good’ words uttered by the economic planners now will not materialise, as was the case in the past.

Since the five-year plan is also based on the so-called ‘Developmental State’ policy, we are bound to see an intense ‘hands on’ activity on the economy by the government, which, according to many observers, is a byproduct of the communist style ‘Revolutionary Democracy’ philosophy of the EPRDF.

WHAT WOULD LIKELY TO FOLLOW

The devaluation measure is taken as amelioration to the chronic problems which already exist in the system. To tackle the problems, deep structural economic adjustment is inevitable. That is one of the reasons for my contention that there have been ‘negotiations’ between the Meles government and the IMF, which take place largely behind the scenes. The fact that we heard the IMF has welcomed
the measure clearly indicates that there is the common ‘Letters of Intent’ and/or a ‘Memorandum of Understanding’ to devalue the birr and for funds to flow from the IMF coffers to support the government.

Now that the Meles government has devalued the birr to the IMF’s liking, we should expect more loans from the IMF to be announced soon. The government possibly agreed to devalue the birr first and take other strong policy measures next in order to secure loans from the IMF. Since, normally, devaluation is insufficient to resolve the problems caused by structural issues, currency devaluations are usually followed by other measures, such as reducing public spending, raising taxes, and, in general, by doing both.

The introduction and implementation of the VAT system and its likely increase is one indicator for this claim. Even though devaluation effectively reduces wage rates, the measure could also be followed by formal wage reductions as well. These structural adjustments, if implemented, will decimate domestic demand, which is the main driver of the economic activity. It is for this and other reasons why critics duped the so-called ‘Growth and Transformation Plan’ as a pipedream originating from the Menelik Palace.

Given the massive balance of payments imbalance and the budget shortages (some say over 40 per cent of it has been financed by donor countries), the government would have to adopt contractionary fiscal policy (raising taxes and cutting spending) sooner or later, particularly if the donor funds tend to dry up. Here, one may be tempted to argue that, by devaluing the country’s currency and by not raising taxes or cutting spending, the government has opted to ‘defend the economy.’

However, after forcefully gathering the local business leaders (parading the general populace for propaganda purposes is common among dictatorial/communist leaders), Prime Minister Meles was heard several times (arrogantly) threatening them, and telling them that his government will cut their hands – as he already had cut the hands of some businessmen, he told them – if they failed to pay the newly introduced value added taxes (VAT). In fact, the prime minister told the business leaders that the government is in full swing to collect more taxes. But, even if the government does not raise taxes or cut spending to alleviate the budgetary and balance of payment shortfalls, devaluation works the same way by effectively reducing workers’ wages when the birr they are being paid becomes less valuable.

Speaking about the IMF, it is quite puzzling that the IMF would suggest a devaluation of the birr on such a massive scale, particularly for a currency that has not faced a currency collapse. Devaluation of this magnitude is generally necessitated by a currency collapse, which is not the case with the birr. One may also argue that this relatively massive devaluation may indicate the government’s willingness to forgo the necessary structural adjustment measures, using the massive devaluation as the only measure to ameliorate the problem. Again, all the information available indicates that taxes will be raised.

The second perplexing stand of the IMF is that, on the one hand, in its ‘Article IMF Report on Ethiopia, Assessment of the Level of the Birr’, it stated that only a 7-10 per cent – or perhaps even lower percentage adjustment in the exchange rate – was sufficient (even indicating the exchange rate could be where it was supposed to be), suggesting a marginally overvalued birr. The welcoming of the current massive devaluation by the IMF contradicts its own assessments, projections and prescriptions for devaluation. It also may indicate that either the IMF does not know what it is talking about when it comes to the Ethiopian economy, or there is a strong collusion between the IMF and the Ethiopian policymakers. Or, could it be that, by welcoming and accepting such massive devaluation of the birr, the IMF has come to realise the dire situation that the Ethiopian economy is in?

Another perplexing aspect of the IMF’s decision is that, until recently, it was demanding that the government fight the rampant inflation, which was close to 65 per cent in 2008. The fact that the institution has been advising the government to devalue the birr – which is known to lead to higher inflation rates – contradicts its own policies. It also indicates that the institution has either bought the government’s claim that the Ethiopian economy has been vibrantly growing. Or, does it reflect its
willful negligence about the real issues that caused the structural imbalances?[16] I certainly know that the government will not be able to fight inflation while devaluing the currency. Even though the ruling party cannot legitimately corroborate the growth figure that is manufactured, institutions such as the IMF and the World Bank continue to accept the manufactured numbers, irrespective of their implications for the Ethiopian people and their own reputations.

In short, unless sound economic policies are designed and implemented with the full participation of the Ethiopian people, Ethiopia will never be competitive. Devaluation will not be a panacea for the structural (political and economic) ills of the country, and the continuous manipulation of the birr is unlikely to correct the general economic malaise.

Instead, policies should be geared towards unleashing the resources from government control, eradicating the rampant corruption and the enforcement of the rule of law, diversifying the economy to reduce dependence, and incentivising the system, which includes the privatisation of land, and a total restructuring the oligarchy which has enriched itself through illegal means.[17] The patronage networks and de facto preferences given to party-owned parastatals in the form of preferential access to bank credits, foreign exchange, land and physical infrastructure, administrative services, tax breaks, procurement contracts, and import duties has been a stumbling block for those independent and foreign firms who want to do business the normal way in the country.

After discussing the peculiar nature of corruption and EPRDF-owned businesses with numerous concerned individuals, particularly with those whose profession is economics and accountancy, we came to the conclusion that party-owned and operated businesses are unique creatures in the Ethiopian economy. The TPLF has used them as vehicles for amassing wealth to the region that it favours. It is a well-known fact that political party controlled companies are outlawed in countries where governments are accountable to the electorate. In countries where international corporate governance and ownership standards are at work, the managers of these companies would have gone to jail for fraud, corruption and violating the country’s Company Law.[18] This is not the case for Ethiopia, for, alas, it is pretty normal for the EPRDF to break its own constitution.

It is public knowledge that the TPLF companies enriched themselves, almost overnight, by diverting Ethiopian resources. It is also public knowledge that the TPLF companies have not published their audited financial statements in a transparent and legitimate manner for more than a decade. Moreover, the amount of tax liabilities and the debts owed to the state by the commercial and development banks are unknown. The companies which are managed by the TPLF leaders and their supporters are also being repeatedly accused of providing sheltered employment to the politically connected on a regular basis. Notwithstanding these, the IMF, the World Bank and the donor community have continued to be silent. To make matters worse, a number of foreign firms (mainly Chinese firms) have collaborated with TPLF companies, hence endangering not only their own reputation and their own ethical standards but also subjecting their firms to potential lawsuits.

To summarise the main points, the Meles government and the multilateral organisations who are advising the regime in power seem to fail to recognise or fully weigh in the following issues:

1) The negative impact of the sharp rise on imported consumer and intermediate goods of the devaluation.
2) The potential for the devaluation measure to create uncertainties and its macroeconomic ramifications; and for the massive devaluation measure to spark a downward pressure on the value of the birr; the impact of the eroded birr in widening the trade and budget deficits.
3) The potential sharp decline in economic activity when companies and individuals whose dollar denominated asset liabilities rise and go bankrupt (since the devaluation would force them to spend more birr per dollar to cover their liabilities) and the potential wave of insolvencies and foreclosures if the birr continues to slide.
4) The fact that devaluation measures will have little impact on the overall GDP in part because the negative effects of devaluation could outweigh the potential gains from exporting more goods, and in part because the share of exports to GDP is relatively small. Moreover, even though the devaluation measure may give the government a short-term breathing space regarding the foreign exchange bottlenecks, the measure will have little impact in alleviating the country’s trade deficits.
5) The political ramifications of the contradictory signals that the authorities send: On the one hand
informing the general public that devaluing the birr was a bitter pill to take, and on the other
claiming that all is well, even though the relative massive and sudden devaluation indicate
otherwise. The negative ramifications will be much higher if the sought-after foreign exchange
earnings are not realised and the measure fails to resolve the balance of payments crisis.
6) The inability of the measure to attract sufficient flow of foreign direct investment and the
manufacturing sector’s inability to pick up the slack of weak foreign exchange liquidity, and the
neglect of the structural fundamental problems of the economic policies of the government.
7) Most importantly, they failed to realise that the country’s insolvency problems are not caused by
an overvalued birr; instead, the imbalances are caused by the structural problems and the solution
lies in addressing those problems.

NOTES AFTER REVISION

1) While exploring the impact of the devaluation of the birr within the last two weeks, my reading
indicates that the massive devaluation has forced many merchants, particularly importers, to adjust
their prices upwards, by 20 per cent or more. According to Afrik-News.com [6], price hikes of 20
percent or more are observed the construction sector of the economy, particularly in steel, cement
and paints. As expected, even government owned enterprises such as Mugher Cement Factory and
Ethiopian airlines have immediately raised their prices and fares following the devaluation measure.
Even though I am happy not to see chaos and extremely high prices of both imported and
domestically produced goods, the immediate increase in prices by 20 per cent or more is as
predicted in the earlier version of the write-up.

2) My reading also indicates that other economists also more or less agree with my assessments. For
example, Tesfaye Kidan, in his article posted on Addis Fortune [7], makes more or less the same
points that I did in my original write-up.

I also discovered that Addis Fortune, using the 2008 devaluation of the birr, had posted an article
which questioned the validity devaluation and raising its many pitfalls. The reader can refer to the
same article here [8].

An astute journalist also led me to the full version of the analysis provided by Access Capital [9]. I
had only looked their summary when I wrote the first draft. I encourage the reader to visit this
Access Capital’s web page link, read their analysis carefully and try to decipher what the analysts
are trying to say.

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* Seid Hassan [10] is professor of Economics at Murray State University [11]. The author thanks the
many web masters, concerned individuals and friends who asked him to write about this issue and is
grateful to those who communicated with him while he was writing this article.
* Please send comments to editor@pambazuka.org [12] or comment online at Pambazuka News
[13].

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(function(d, s, id) { var js, fjs = d.getElementsByTagName(s)[0]; if (d.getElementById(id)) return; js =
d.createElement(s); js.id = id; js.src =
"//connect.facebook.net/en_US/sdk.js#xfbml=1&appId=1465091963738031&version=v2.0";
fjs.parentNode.insertBefore(js, fjs); })(document, 'script', 'facebook-jssdk');

Article-Summary:
Ethiopia’s central bank announced a devaluation of national currency the birr by a fifth on 1
September, reportedly on the instructions of a macro-economic team chaired by President Zenawi.
Placing the devaluation within in a wider political context, Seid Hassan outlines what the move
means for the country’s economy and why it might please the IMF.