Private Sector Development in Ethiopia: Current Status, Challenges, and Prospects

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1. Introduction

Investments are money of the present in anticipation of future returns. They are important for the economic growth and development of a country. Private investment is considered the main driver of growth and the proposed solution for economic growth in sub-Saharan Africa. In Ethiopia, it is mainly the public sector rather than the private sector that is the main driver of growth and development. The private investment ecosystem in Ethiopia has different faces under the different Ethiopian regimes. During the imperial period, private investment in Ethiopia was almost nonexistent. The Derge regime followed a socialist ideology and the private sector was not encouraged as much. Under the EPRDF and Prime Minister Abiy Ahmed, the private investment ecosystem has shown its unique characteristics (Anemut, 2020). This manuscript aims to shed light on the status, challenges, and prospects of private investment since Prime Minister Abiy Ahmed took office in April 2018 until today.

2. Privet Investment Ecosystem since 2018 in Ethiopia

Private investment in Ethiopia faces several challenges. The business environment is considered unfavorable, and the country ranks 161st out of 190 countries in terms of ease of doing business. The recent war in northern Ethiopia has led to an imbalance in GDP, imports, and exports, and a negative trade balance, making it difficult for investors to buy machinery in foreign currency. To improve the foreign trade position, economists suggest improving the trade balance, replacing imports, and promoting exports. Ethiopia's main exports currently include coffee, gold, oilseeds, and horticulture, while the country imports significant amounts of food, textiles, oils and fats, manufactured goods, minerals, fuels, and lubricants, which affects the country's hard currency reserves (Tilahun, 2021).

3. Current Status of Private Investment Development in Ethiopia

In Ethiopia today, private investment needs an acceptable philosophy, capital to finance it, and competent labor to carry it out. However, the realities regarding these three aspects seem unclear. For large investors, the Ethiopian Investment Commission (EIC) is solely responsible for promoting the country's investment opportunities and conditions to foreign and domestic investors. The Commission seeks to create a politically conducive environment in which domestic and foreign capital can be properly invested. The government also promotes external sources of finance that also fill domestic savings and technological gaps (Oqubay & Lin, 2020).

Ethiopia's real gross domestic product (GDP) growth has slowed due to the pandemic COVID - 19, with the industrial and service sectors experiencing single-digit growth declines. However, agriculture, which accounts for more than 70% of the country's population, was not significantly affected and even contributed slightly to growth FY 2020/21 Agriculture is critical to the growth of other sectors such as food, textiles, construction, and others. The Ethiopian economy has been among the fastest growing in the world over the past 15 years, thanks to capital accumulation, especially in public infrastructure investment.

The World Bank (2022) pointed out that Ethiopia has a young private sector whose growth and ability to create jobs are hampered by constraints on the business climate and competitiveness. Public investment, GDP growth, public spending, population growth rate, unemployment rate, trade openness, tax rate, exchange rates, and real interest rates have both short- and long-term effects on private investment. Microeconomic determinants of private investment in Ethiopia include access to finance, investment areas, access to credit, infrastructure facilities, the judicial system, corruption, investment incentives, and bureaucratic hurdles that affect the private investment landscape. Most micro and small investors struggle to access finance because they lack the collateral to obtain loans (Singh, 2019).

4. Challenges

Ethiopia's current financial sector consists mainly of state-owned banks, which makes it difficult for private companies to access credit. Bureaucratic procedures for starting a business and obtaining permits are complex and lengthy, especially at the regional and individual business levels. Inadequate infrastructure, including transportation systems and electricity supply, poses a major challenge to private investment, and the limited supply of skilled labor in the country hinders innovation and technological development. In addition, Ethiopia's small domestic market and limited access to international markets pose further obstacles for businesses. In recent years, Ethiopia has experienced political unrest, which has contributed to a difficult business environment and uncertainty for investors (EIC, 2017). Ethiopia also faces challenges in self-sustaining economic development due to low savings, an inadequate education system, and foreign debt. The country often relies on external assistance to find skilled labor, and private investment is held back as export revenues are eaten up by debt. Investors may not fully understand the government's interests and abuse privileges granted by the government, which can lead to conflicts with the local population.

Most banks in Ethiopia are privately owned, only a few banks are state-owned, and foreign banks do not yet exist in the country; they are not scheduled to join until 2023. The local Commercial Bank of Ethiopia, which dates back to 1905, has a major problem with hard currency to lend investors dollars. The Development Bank of Ethiopia, established in 1951, lends to local and international investors, but its capacity in hard currency reserves and buying and importing machinery for micro and small investors is still weak. Bank growth in the country has not kept pace with population growth and private investment. Insurance law and business activity in the country are low, and there is no stock market or stock exchange in the country. In addition, the exchange rate for various hard currencies in Ethiopia appears to be unstable for domestic investors. Most private companies do not make efforts to promote their products at home or abroad, although the country has numerous diplomatic missions around the world.

There is also a regional imbalance in the development of private investment in Ethiopia. Most industries are located in the hinterland of Addis Ababa and in the Oromia region. Only a few industries are located in other regions of the country. The rapid growth of the working-age population has limited employment opportunities. The population is growing rapidly by 3.02% per year and is estimated to exceed 144 million people in 2030 (ILOSTAT, 2019). In addition, the labor force is growing much faster than the total population due to a demographic profile dominated by young people. An estimated 45 percent of the population is under age 15 and 71 percent is under age 30 (2018). The government estimates that about two million people enter the labor force in Ethiopia each year (Ethiopian Job Creation Commission, 2019) (ILO STAT, 2019).

The labor market in Ethiopia has a mismatch between supply and demand, with inadequate labor market information and weak labor market institutions. Unemployment and underemployment are a major problem, especially among youth. For example, the youth population (15-35 years old) accounted for about 33% of the total population in 2000 and has increased to 37.38% in

2019. In 2018, the youth unemployment rate in urban areas was 25.3%, of which 30% NEET (Marielle, 2020). The country is the second most populous and produces more than 150,000 college graduates each year. An even greater challenge to the labor market in Ethiopia than the unemployment problem is the low quality of employment.

5. Prospects

Ethiopia has significant untapped resources and untapped potential for industrial and commercial development. The country's government is also committed to supporting private investment. Ethiopia also ranks 34th out of 138 economies when it comes to impartial public decision-making. The country offers wide-ranging incentive packages for priority sectors and export-oriented investments and has developed state-of-the-art industrial parks and an electrified railroad system linking the capital to the port of Djibouti. The country has experienced impressive economic growth over the past 14 years, with an annual GDP growth rate of around 11%. During this period, the country was among the fastest-growing economies in the world (The Ethiopian Embassy in the United States, 2022).

The country has a large active labor force (54 million) that can be trained and is available at competitive wages. The country benefits from duty-free and quota-free access to some of the world's largest markets, including China, the EU, Japan, Canada, Turkey, Australia, and New Zealand. Ethiopia also has preferential market access to India and is a member of COMESA, which provides preferential market access to a regional market of 400 million people. The country's strategic location near the Middle East, Europe, and Asia may present a good opportunity. Highlights include the recently constructed electrified rail link between Addis Ababa and Djibouti, the world-class airline with over 100 international and 20 domestic destinations, and the investment potential in renewable energy such as hydropower, wind power, and geothermal energy. The Grand Ethiopian Renaissance Dam (GERD) is expected to generate an additional 6,000 megawatts of electricity. There are also numerous investment opportunities in Ethiopia in manufacturing, industrial park development, agriculture, tourism, energy and mining.

6. Recommendations

Remember, every investor at every level, micro, small, medium, or large, seeks profit. The bottom line is that both the government and the investor must work in a win-win situation. Most investors prefer to get finance, land, government support, and cheap labor as there is no minimum wage in Ethiopia, but they need to do a situation analysis for their specific sector, e.g. electricity, type of investment, commodities, transportation, energy, water, security, etc. The current high inflation rate in Ethiopia will also make labor costs very expensive in the coming days (Anemut, 2020). The USD Birr exchange rate is hurting the Ethiopian currency and domestic production is decreasing due to conflict-related problems. Any private investor, local or foreign, must conduct a detailed situation analysis, including risk analysis and a critical PESTL analysis. For a sustainable investment, it is recommended to sell some products in the local market to create a sense of ownership in the community. Investors should also review the country's investment, agricultural, trade, banking, and industrial policies before starting private investment.

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