



Leveraging Enhanced SDR Allocations to Finance Resilient Economic Recovery in Ethiopia

Abdurohman Ali, Gebrehiwot Ageba and Ali Issa

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Key messages

1. Revising the current SDR allocation formula to incorporate liquidity needs and underlying structural vulnerabilities of countries is critical to meaningfully address short term liquidity needs and long term development financing needs of LICs such as Ethiopia.
2. Enhanced SDR allocation cannot substitute the need to make concerted effort to address political economy challenges that lead to sub-optimal economic decision-making, macro-economic imbalances, public sector inefficiency, corruption and illicit financial flow.

3. Development partners' support to LICs in building resilience against climate change is an investment in global public good.

Background

Ethiopia's economy has been hit by a series of internal and external shocks over the last few years. The combined effect of the Covid-19 pandemic, the Russia-Ukraine war, domestic conflict and drought have put the country on a lower growth trajectory. Capital investment has plummeted. Budget deficit and Balance of Payment(BoP) deficit have widened and its external debt position has been on high risk of distress. The country has put austerity measures to meet its international debt obligations. Debt servicing is taking a toll on important social and economic sectors. This can be seen by the crowding out effect of debt servicing over other sectors. Ethiopia's budget for servicing public debt in 2022/23 exceeds the combined budget for health, education, water and energy, agricultural development, trade and industry. The budget for servicing public debt in 2022/23 is three times larger than the previous year. As a result, the country is sliding backwards from the important economic and social gains of the previous two decades. Poverty rates are rising. Moreover, Ethiopia's performance towards achieving the SDGs has been poor and ranked 144th among 166 countries.

Given a multitude of external and domestic shocks Ethiopia has been going through, it would benefit from a new special drawing rights (SDR) allocation or rechanneling of excess SDR. However, given the sheer size of the current liquidity crunch and financing needs for its long term recovery, a new allocation based on the current IMF quota would only be a small fraction of the country's needs.

Potential role for SDR and need for reform

Out of a historically high SDR allocation of USD 650 billion in 2021 to respond to a global pandemic, Africa received just USD 33 billion, of which Ethiopia's allocation was USD 414 million. This amount was just a fifth of Ethiopia's annual debt servicing expense.

Ethiopia's humanitarian response plan for 2023 alone requires a little below USD 4 billion of funding. As indicated earlier, the country needs an estimated USD 4 billion debt re-profiling over the next three years to improve its debt status from 'high risk' of debt distress to 'moderate risk' level. To finance resilient recovery and reconstruction following the conflict in northern Ethiopia, an estimated USD 20 billion is required over the next five years, with as much as USD 5 billion needed in the first year, according to Ethiopia's Ministry of Finance.

If IMF were to make a new allocation based on the current IMF quota, Ethiopia's allocation would be a small fraction of its short term liquidity needs, not to mention its financing needs for medium to long term recovery. This is true for many other African countries going through severe liquidity shortfall and difficulty to finance resilient recovery.

The story of Ethiopia is a case in point to amplify the call for revision in SDR allocation formula as part of the broader call for SDR reform. A new SDR allocation formula shall incorporate parameters indicating liquidity shortage and structural vulnerability of countries in addition to the existing parameters. The time taken for new SDR allocation after need is triggered by a shock is also too long, evident from the slow reaction in response to the Covid-19 pandemic. Regarding instruments to re-channel SDR, the PRGT and RST provide concessional lending to African countries. However, the stringent IMF requirement means that many countries in need, such as Ethiopia, would not be able to fully utilize these concessional lending facilities.

Policy options

Enhanced SDR allocation or rechanneling of SDR from countries with excess reserve would benefit Ethiopia. This would require revising the current SDR allocation formula to incorporate liquidity needs and underlying structural vulnerabilities of countries in addition to the IMF quota.

Rechanneling SDR via multilateral development banks such as the AfDB is more preferred than through augmenting the existing IMF lending facilities. AfDB has country specific expertise and less stringent policy conditionality for lending to its members.

It's important to realize that SDR reform takes time and enhanced SDR allocation should only be complimentary to individual countries' effort to improve their own domestic resource mobilization. Enhanced SDR allocation cannot substitute the need for countries to address structural challenges and the need to build resilience to shocks.

As Ethiopia's risk of debt distress largely depends on its export performance, there needs to be concerted effort to address bottlenecks hindering the growth of export. Studies have shown that continual adjustment of the exchange rate to the inflation differential between Ethiopia and its trading partners is critical to maintain its export competitiveness.

Ethiopia lags behind many African countries in domestic resource mobilization (DRM), particularly in tax revenue collection. Improving the operational strength of tax administration agencies can go a long way in improving tax revenue collection.

Development partners have an important role in supporting low income countries like Ethiopia to ease the effect of global shocks on debt burden and strengthen resilient recovery. The DSSI in 2020/21 helped postpone debt payments for low income countries including Ethiopia for a year. Given the severity of the pandemic, however, the relief period should have been longer. More broadly, the international debt resolution mechanism needs a new set of principles and discussion forums designed to find consensus among indebted countries and creditors including private bond holders.

Developed countries should look at the consequences of global shocks such as the pandemic and climate change on developing countries as common global challenges.

Many developing countries are home to vast biodiversity and need to be supported to preserve this global public good. Ethiopia, having vast arable land and water resources, would benefit from supporting sustainable land use and water preservation programmes, which in turn would contribute to sustainable global food supply.

What should policy makers and development partners do?

Policy makers in Ethiopia or at the AU level should use the evidence to strengthen the collective voice for reform in SDR allocation.

Ethiopia needs to address political economy challenges that lead to sub-optimal economic decision-making, public sector inefficiency, corruption, and illicit financial flow.

Ethiopia's policy makers need to make concerted effort to address the macro-economic imbalances plaguing the country's export competitiveness and causing a growing indebtedness.

Ethiopia should enhance its domestic resource mobilization by improving the operational capacity of tax administration agencies.

Climate change induced political instability and displacement in the global south would pose challenges to countries in the north. Hence, addressing global challenges such as climate change is a global public good. In this regard, the G-20 need to keep their pledge to support 30% of the earth's land and water resources by 2030.

Development partners need to be more willing to provide medium term debt relief to countries in high risk of debt distress including Ethiopia.



Mission

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African Economic Research Consortium
Consortium pour la Recherche Economique en Afrique
Middle East Bank Towers,
3rd Floor, Jakaya Kikwete Road
Nairobi 00200, Kenya
Tel: +254 (0) 20 273 4150
communications@ercafrica.org