

# The Devaluation of the Birr- a Layman's Guide

Seid Hassan – Murray State University, September 7, 2010

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) and also reflects weaknesses of the government which 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 gap which in 2009 escalated, total exports and imports amounting \$1.657 billion and \$7.093 billion, respectively, according to the *CIA World Fact book*. 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<sup>1</sup>. 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 led to believe that the birr is overvalued and devaluation is necessary. When I wrote the popular article titled as the “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 was agreeing 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 the theoretical possibilities were applicable to Ethiopia. All that I was saying was this: using standard economic reasoning and rationales of devaluation, the fact that there is a parallel market (black market) with the birr buying less dollars/euros means that the birr was overvalued. 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 the actual coverage at times being less than six weeks of import coverage) and 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 unable to import the necessary intermediate inputs from overseas due to the lack of foreign exchange also indicate a balance of payments disequilibrium (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 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 \$3 billion in 2009) and remittances (the National Bank of Ethiopia reporting total remittances just for the first two quarters of 2009 being \$1798.8 million), the value of the birr would have been much lower than what it was then and what it is now as well.

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<sup>1</sup> At a recent gathering of the local business leaders, Prime Minister Meles Zenawi admitted that corruption is an inherent problem within the civil service sector. In actuality, my investigation shows that the rampant corruption is not limited to the civil service section of the government sector. Many foreign firms, including those of the United States have been complaining about repeated and abrupt cancellation of tenders, favoritism towards party-owned companies organized under EFFORT and REST and towards Chinese vendors, a lack of transparency in the procurement system, etc. See, for example, this report: [http://ustraderep.gov/assets/Document\\_Library/Reports\\_Publications/2009/2009\\_National\\_Trade\\_Estimate\\_Report\\_on\\_Foreign\\_Trade\\_Barriers/asset\\_upload\\_file405\\_15451.pdf](http://ustraderep.gov/assets/Document_Library/Reports_Publications/2009/2009_National_Trade_Estimate_Report_on_Foreign_Trade_Barriers/asset_upload_file405_15451.pdf).

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 whose government bows to IMF's pressure is considered to be a weak one. 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) which are able to turn policy decisions towards their favor. In the Ethiopian case, given that several of the TPLF- controlled conglomerates organized under EFFORT and REST (in collaboration with Sheikh Mohammed Al-Amoudi's MIDROC Ethiopia) 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 favor in turn reflects the weakness of the government which is supposed to look after for the interests of the country and the general populace.

### **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 which I illustrate some of them below.

### **Negative Effects of Devaluing the Birr**

1. The devaluation of the birr is likely to *aggravate inflation* and it could start a snowball effect of higher inflation as it can build into a cascade of expectations for further devaluation by private citizens. When devaluation is done overnight in secretive and surprising manner as is done to the birr, 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.<sup>2</sup> 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

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<sup>2</sup> 80% of the Ethiopian population is known to have no access to banking and financial services. In addition, Ethiopia has no stock market and no foreign financial sector investors, making the economy one of the least monetized in the world. While this somewhat insulated the economy from the contagion effects of the 2007-2009 crisis, the poor integration of the economy has its own drawbacks. See also the January 2010 British Overseas Development Institute (Getnet Alemu)'s report at <http://www.odi.org.uk/resources/download/4718.pdf>.

- took place in Zimbabwe, a combination of existing shortages and the expectation of further devaluation could lead to the collapse of the birr.<sup>3</sup>
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 goods (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, to be 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 weakened domestic enterprises being acquired by global enterprises.
  5. The lack of transparency in the devaluation process coupled with the rise in the cost of living erodes the trust for the government, assuming that such a trust already exists, which may complicate the governing abilities of the regime in power.
  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 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 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 goods. 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 Marshall-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

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<sup>3</sup> One may be tempted to say that the government could raise interest rates in order to forestall the potential inflation created by devaluing the birr. There are two problems with raising interest rates: for one thing, interest rates are unresponsive to monetary policy since the Ethiopian economy is one of the least monetized one on earth. Second, raising interest rates will slow the economy down.

- 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 balance. 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 got, 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.
  9. Devaluation also leads to a **reduction of the country's real wealth** as inflation eats up 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. 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% lower than what it was the day before the devaluation! Let's also not forget that devaluation will make already existing foreign loans to rise, thereby increasing the country's indebtedness.<sup>4</sup>
  10. Devaluation entails income distributional effects, favoring 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 already 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 grain-exporting activities- including those foreign firms who benefit from the notorious "land grab" scheme.
  11. 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

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<sup>4</sup> On the devastating effects of devaluation on savers, the gap between the haves and the have-nots and the general economy as applied to Sub-Saharan Africa, Ethiopian readers could benefit from reading a brief and non-technical analysis written by Selahaddin Nur-Hussein in the weekly *Ethiopian Reporter* magazine, which was posted on March 27, 2010 - [http://en.ethiopianreporter.com/index.php?option=com\\_content&task=view&id=2434&Itemid=1](http://en.ethiopianreporter.com/index.php?option=com_content&task=view&id=2434&Itemid=1).

Ali Al-Amoudi'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.

12. 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 WW II and a potential mini trade war.

13. 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 that the country produces. But 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 will make domestic firms to be more competitive and more efficient than their global counterparts. 14. 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 it 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.

It is for these reasons why some economists call devaluation being a slippery slope and full's game/exercise.

#### **Arguments in Favor of Devaluation and its Potential Benefits**

1. Some individuals and even consultant groups such as *Access Capital* - <http://www.accesscapitalsc.com/downloads/Exchange%20Rate%20Review--September%202010.pdf> – 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 strongly argue that benefiting from the devaluation, 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."<sup>5</sup>

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<sup>5</sup> After looking into more sources, such as this one, <http://www.odi.org.uk/resources/download/4718.pdf>, the professor might have point. Getnet Alemu shows that, among other things, the degree of integration of the Ethiopian economy with the rest of the world and trade flows have been declining recently (largely due to the global economic/financial crisis). He writes: "... Values of exports declined from

2. Some who observe the skillful 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 (laundry) projects listed in the "Plan" can only be financed by doing a lot of exporting and the devaluation can help. 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-wide 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.<sup>6</sup>
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 the Prime Minister also implied it several times during the aforementioned gathering. Unfortunately, however, devaluation has the effect of raising the cost of production and decreasing productivity as the price of imported seeds, machinery, fertilizers and their costs of transportation rise. Other economists are 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 red 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 [be effective] in Ethiopia."
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 labor relatively less expensive and allowing (attracting) businesses to hire more labor. 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

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23.7% in 2007/08 to -1.2% in 2008/09, whereas those of imports declined from 32.8% to 12.8% for the same period."

<sup>6</sup> To show that they have a point, the cynics cite the trumpeting as if the devaluation by the government as if the devaluation measure a good thing and one which will assist the projected 14.9% average economic growth rate spelled out in the "Plan." Nothing could be further from the truth, they say. Devaluation is a desperate act and designed to manage a crisis, caused by economic mismanagement, which is exacerbated by the global economic shock on the case in hand.

- 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 respond that a government economic advisor gave when I complained about the government's raid on those businesses who are 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.
  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 has 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 directors (who effectively own them.) A great many of the educated personnel have already left the country. A recent survey which indicated that 46% 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, no 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 already relatively small industry sector to increasingly fizzle 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 which 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 being highly profitable. The shunning of the industry sector by both "private" players and the

government's spending preference towards the service sector not only has 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 to 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)<sup>7</sup>, 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 materialize 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" on the economy by the government, which 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 has been "negotiations" between the Meles government and the IMF, which is largely done 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 BoP imbalance and the budget shortages (which, according to some, more than 40% 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

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<sup>7</sup> For a snapshot of some of the problems afflicting the agricultural sector, please see Dr. Zemedu Worku's article (an agricultural specialist)

[http://www.ethiopians.com/foodsecurity/zemedeworku\\_foodsecurity.htm](http://www.ethiopians.com/foodsecurity/zemedeworku_foodsecurity.htm).

business leaders (a customary of 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) were they fail 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 BoP 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 could suggest a devaluation of the birr in such a massive scale, particularly for a currency which 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 only the massive devaluation as the only measure to ameliorate the problem. Again, all the information available indicates that taxes will be raised.

The other perplexing aspect of the IMF's decision is that, until recently, it was demanding the government to fight the rampant inflation which was close to 65% 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 which caused the structural imbalances?<sup>8</sup> It sure knows that the government will not be able to fight inflation while devaluating 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 to 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 and devaluation will not be a panacea for the structural (political and economic) ills of the country and the continuous manipulation of the birr will unlikely correct the general economic malaise. Instead, the policy changes 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 incentivizing the system, which includes the privatization of land, and a total restructuring the oligarchy which has enriched itself through illegal means.<sup>9</sup> 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,

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<sup>8</sup> In fact, one can safely say that the IMF knows that the Ethiopian economy faced serious problems. In 2009, for example, the IMF had projected the global recession to "have taken its toll on the country's earnings from export, remittance and foreign [direct investment](#) in the coming year..." and for official development assistance to decline. <http://www.ezega.com/news/NewsDetails.aspx?Page=news&NewsID=1766>.

<sup>9</sup> Critics claim that the two Britton Woods Institutions have assisted, knowingly or otherwise, for the transfer of Ethiopian resources to mostly TPLF-owned companies (now a fearsome oligarchy). The writer has found a mounting circumstantial for this, and God willing, more will be forthcoming.

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 favors. 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.<sup>10</sup>

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.

The writer can be reached at: [seid.hassan@murraystate.edu](mailto:seid.hassan@murraystate.edu)

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<sup>10</sup> For more on corporate governance problems in Ethiopia, see Negash (2008) [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1264697](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1264697) and <http://www.ethiomeia.com/absolute/3110.html>.