The Ethiopian Peace Dividend: Counterfactual Growth Scenarios

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Summary

Up to 2020, Ethiopia benefited from a 'growth premium' of between 3.9 to 6.9 percentage points relative to other sub-Saharan African countries that are not rich in natural resources. Forecasts from the International Monetary Fund (IMF) World Economic Outlook (WEO) for the period 2022–2027 suggest that this premium is now on average only 1.5 percentage points per year. We argue that this is linked to the direct – and especially indirect – costs of the conflict the country has experienced in recent years, such as the inability to access international public and private resources to support speedy macroeconomic stabilisation and economic reform, public investment for growth, and FDI. Without sustained peace, and a positive response from international partners, it is unlikely that any improvement is possible on the IMF forecasts; some might even argue that the situation could be worse than the forecasts. If the growth premium cannot be restored, it will be equivalent to a loss to the Ethiopian economy of about 125 billion current US dollars (range: US$ 79 to 171 billion), and will lead to an economy that will be 19 percent (range: 13 to 26 percent) smaller than what could have been obtained by 2027.

Method

We consider a simplistic but transparent scenario as a counterfactual to the current situation. Before the conflict and the war, Ethiopia's economy grew significantly faster than other non-resource-rich countries in sub-Saharan Africa. Our hypothetical scenario assumes that, after recovering from the COVID-19 pandemic, Ethiopia's economy maintained this pre-crisis 'growth premium' relative to the rest of the continent.

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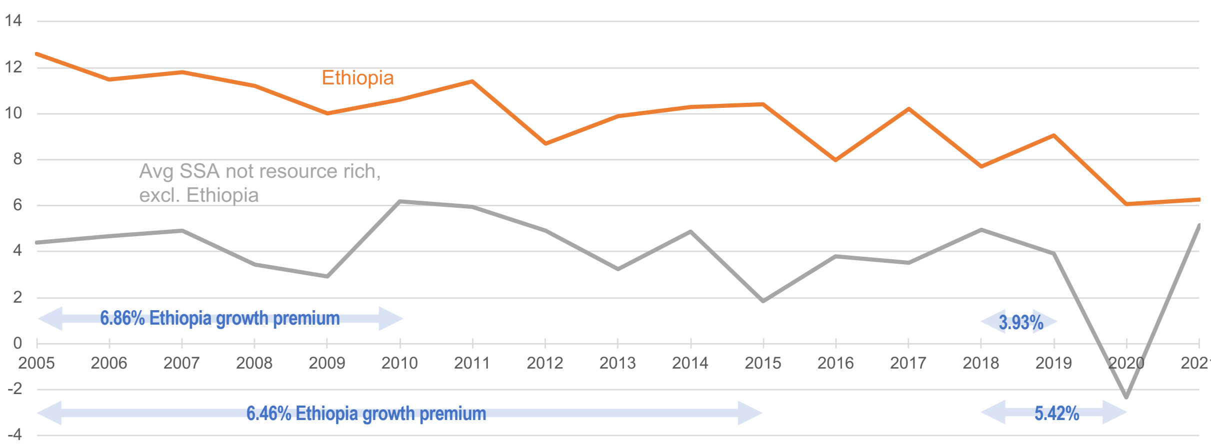
To calculate the growth premium, we first calculate the average annual rate of real GDP growth of 29 countries in sub-Saharan Africa that the IMF categorises as not rich in natural resources,[2] excluding Ethiopia, over different growth spells (Table 1 and Figure 1). We compare the group's average growth to Ethiopia's growth in the same period. We define the average difference between the group of countries and Ethiopia as the Ethiopia growth premium.

Table 1: Actual GDP growth rate (% per year, real) in sub-Saharan Africa and Ethiopia, by period

	2005 to 2010	2005 to 2015	2018 to 2019	2018 to 2020
Average sub-Saharan Africa	5.83	5.26	3.26	1.62
Average sub-Saharan Africa (not resource-rich, excl. Ethiopia)	4.42	4.31	4.44	2.18
Ethiopia	11.28	10.76	8.37	7.60
Ethiopia growth premium (row 3 minus row 2)	6.86	6.46	3.93	5.42

Source: IMF World Economic Outlook (October 2022)

Figure 1: Actual GDP growth rate (% per year, real) in sub-Saharan Africa and Ethiopia



Source: IMF World Economic Outlook (October 2022).

Our counterfactual growth scenario for the next five years assumes that Ethiopia maintains this same growth premium over the rest of sub-Saharan Africa from 2022 to 2027, based on the IMF forecast for the region. In other words, the recovery after the COVID-19 pandemic is in line with that in other countries in the region. We compare this counterfactual against the growth that the IMF currently forecasts for Ethiopia's economy in the five years from 2022 to 2027, given the current situation. We define this as the loss in economic growth due to the conflict.

We present counterfactual growth scenarios based on different growth spells below (Table 2 and Figure 2).

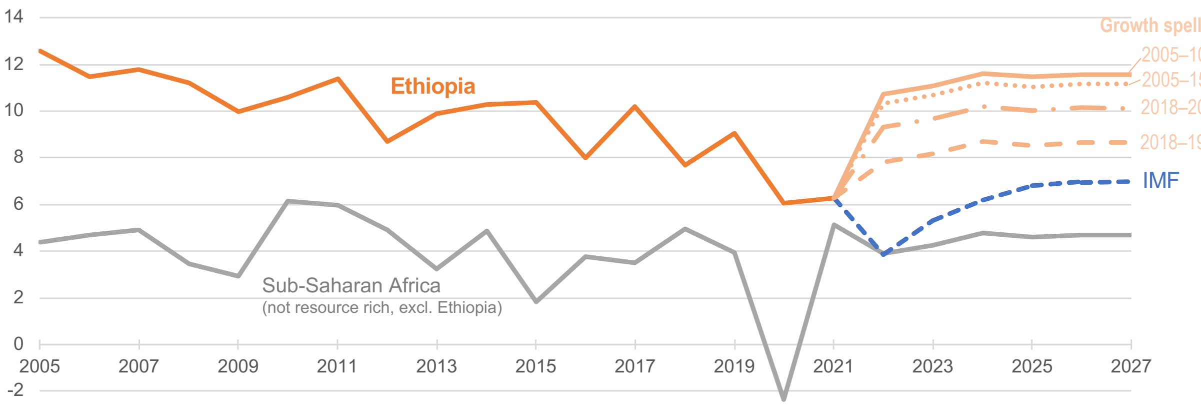
[2] IMF Macroeconomic Policy Frameworks for Resource-Rich Developing Countries, available at https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Macroeconomic-Policy-Frameworks-for-Resource-Rich-Developing-Countries-PP4698

Table 2: Forecast GDP growth rate (% per year, real) and counterfactual growth scenarios

	2022	2023	2024	2025	2026	2027	*Average*
IMF WEO: Average sub-Saharan Africa	3.89	4.25	4.77	4.60	4.72	4.71	*4.49*
IMF WEO: Ethiopia	3.84	5.29	6.20	6.79	6.98	6.99	*6.01*
Counterfactual growth scenario							
Ethiopia growth spell 2005–2010	10.75	11.10	11.62	11.46	11.57	11.57	*11.35*
Ethiopia growth spell 2005–2015	10.35	10.70	11.22	11.06	11.17	11.16	*10.94*
Ethiopia growth spell 2018–2019	7.83	8.18	8.70	8.54	8.65	8.64	*8.42*
Ethiopia growth spell 2018–2020	9.32	9.67	10.19	10.03	10.14	10.13	*9.91*

Source: Authors' calculations, based on IMF World Economic Outlook (October 2022).

Figure 2: Forecast GDP growth rate (% per year, real) and counterfactual growth scenarios



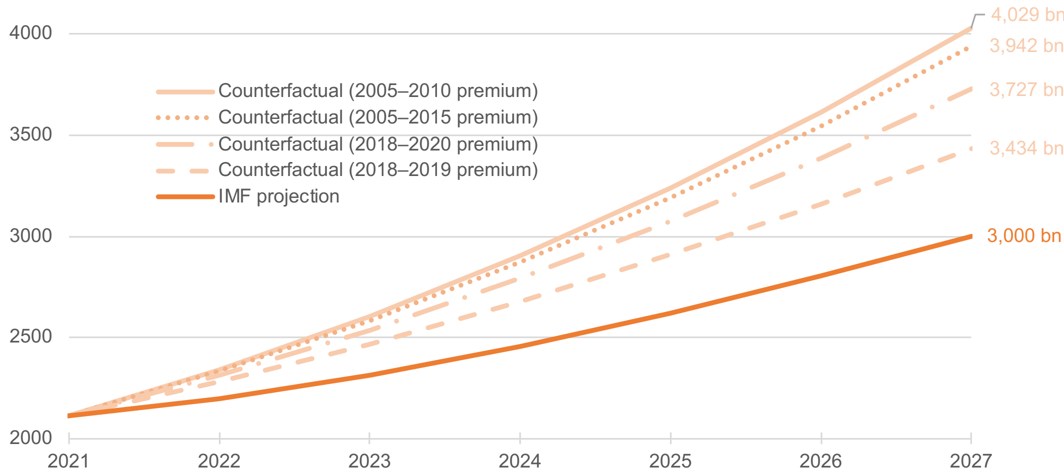
Source: Authors' calculations, based on IMF World Economic Outlook (October 2022).

The difference between our scenarios and the IMF forecast suggests that by 2027 the cumulative losses to the Ethiopian economy since the start of the conflict will reach between 1.54 trillion birr (using the 2018–19 Ethiopia growth premium) and 3.34 trillion birr (using the 2005–2010 premium) in constant 2015/16 birr (Figure 3). This implies that the economy will be 13 percent to 26 percent smaller by 2027 than it would have been without the conflict.

We consider the 2018–20 growth premium to be the most appropriate middle-ground counterfactual (highlighted above), implying a total loss in GDP of 2.4 trillion constant 2015/16 birr, and an economy that is about 19 percent smaller by 2027 (Figure 4).[3]

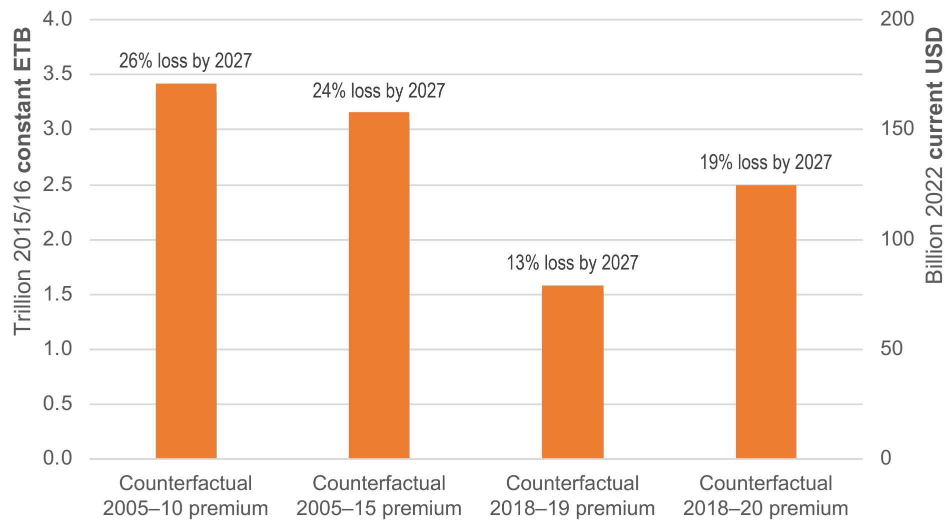
[3] Using the 2018–20 growth premium, we estimate that total GDP could have reached 3,727 billion constant 2015/16 birr by 2027. In comparison, the IMF currently forecasts total GDP reaching 3,000 billion constant 2015/16 birr by 2027 – 19 percent smaller than the counterfactual.

Figure 3: Total projected GDP (billion constant 2015/16 birr), by counterfactual growth scenario



Source: Authors' calculations, based on IMF World Economic Outlook (October 2022).

Figure 4: Total lost potential GDP (constant 2015/16 birr on left axis, current USD on right axis)



Source: Authors' calculations, based on IMF World Economic Outlook (October 2022).

To put this into context, this is equivalent to a setback in real growth of about five and a half years.[4] If the total economic loss in this counterfactual scenario were invested in a hypothetical cash transfer, it could immediately lift all urban poor out of poverty for the next four years.[5]

[4] Looking at the same growth spell from 2018 to 2020, the Ethiopian economy grew by, on average, 130.7 billion 2015/16 birr per year. To make up for 727 billion lost GDP, it would take about 5.56 years of growth at that rate.

[5] The total money required to lift the poor above the poverty line using a hypothetical, perfectly-targeted transfer can be calculated based on the 'depth of poverty' or 'poverty gap' – a measure of how far the consumption of the poor is from the official poverty line. As the basis for our calculation, we use the poverty estimates for 2015/16, available in the 2020 World Bank Ethiopia Poverty Assessment (available at https://documents.worldbank.org/en/publication/documents-reports/documentdetail/992661585805283077/ethiopia-poverty-assessment-harnessing-continued-growth-for-accelerated-poverty-reduction). We use separate estimates of

To convert 2015/16 birr into current USD, we first use the GDP deflator reported by the IMF World Economic Outlook to obtain 2022 current birr (index of 269.9). We then use the current ETB:USD market exchange rates of 0.019 to convert 2022 birr to current USD. In current USD amounts, total losses to the Ethiopian economy would amount to 79 billion to 171 billion USD. Our preferred estimate based on the 2018–20 growth premium would imply a total loss in GDP of 125 billion current USD.

the poverty gap for rural and urban areas and combine them with population figures from the World Bank's World Development Indicators database. We calculate the total required transfer per year to be 4.41 trillion birr in rural areas and 0.55 trillion birr in urban areas (both in 2015/16 prices). Our counterfactual scenario described above finds that by 2027 the total loss of GDP amounts to 2.43 trillion birr in 2015/16 prices. This could pay for more than four annual transfers to lift the urban poor out of poverty (a total of 2.19 trillion birr).