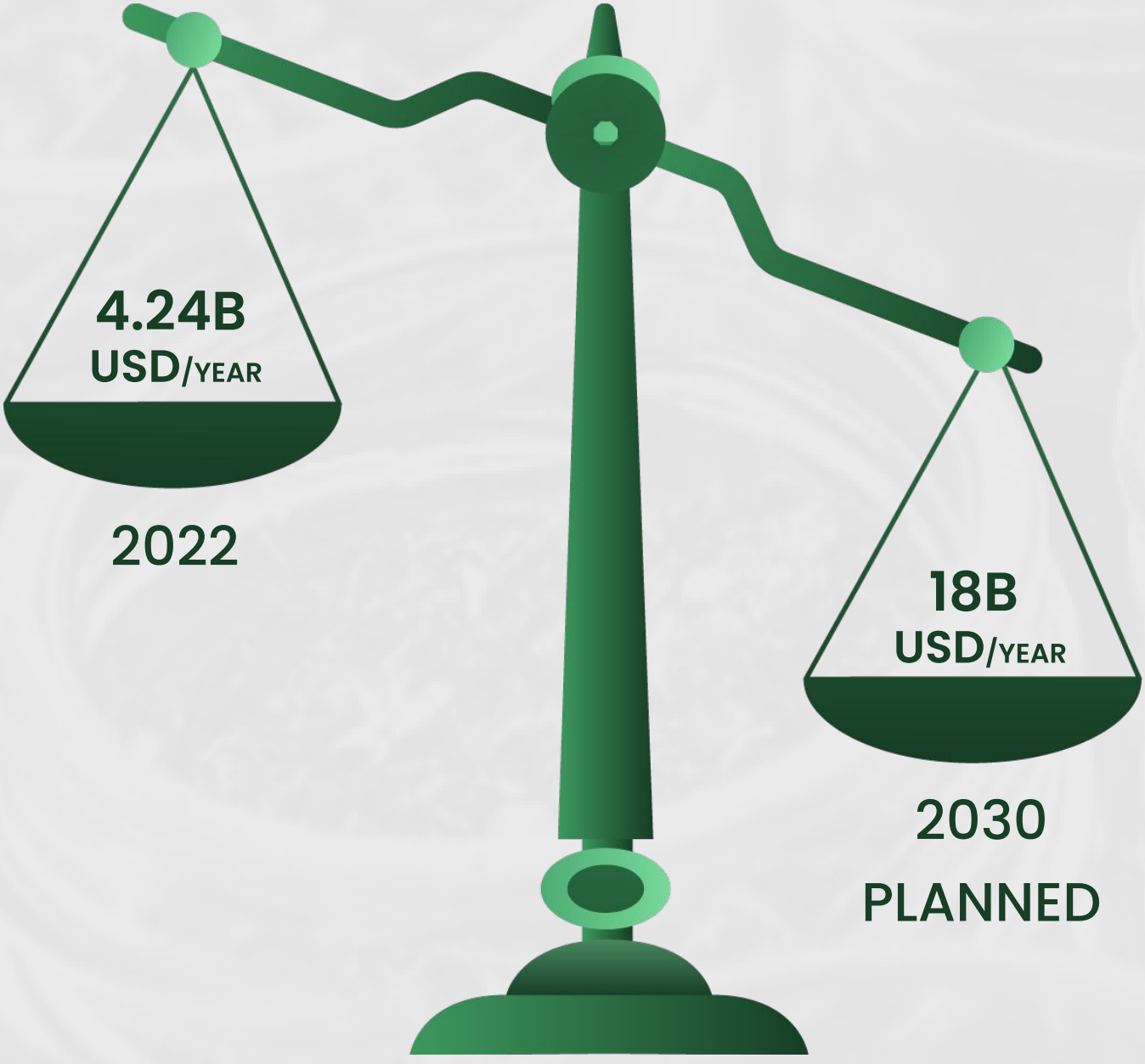
ETHIOPIA'S EXPORT FUTURE

BALANCING REFORM AND REALITY



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ETHIOPIA'S EXPORT FUTURE

In a significant shift towards a market-oriented economy, the National Bank of Ethiopia (NBE) recently enacted major reforms to the foreign exchange regime. Effective on July 29, 2024, Ethiopia transitioned from a fixed exchange rate to a market-based approach, allowing the birr's value to be determined by supply and demand. As of September 13, 2024, the exchange rate surged to ETB 117.17 per USD, driven by the newly liberalized policy framework.

This reform is anticipated to improve Ethiopia's export competitiveness by making its goods cheaper on the global market. However, a critical question arises: Will these reforms drive substantial export growth? Historically, currency devaluation has been utilized to boost export competitiveness by reducing the relative price of domestic goods abroad (Krugman & Obstfeld, 2003). Yet, the impact of devaluation on Ethiopia's export performance may not be straightforward, as other structural challenges remain.

To provide a more comprehensive analysis of the devaluation's impact on Ethiopian exports, it's essential to examine the country's export trends over the past decade. This historical context will help us understand the broader factors influencing Ethiopia's export performance and identify potential areas of strength and weakness.

ETHIOPIA'S EXPORT PERFORMANCE: A HISTORICAL CONTEXT

Ethiopia's exports have consistently represented a small portion of the national economy. In 2022, exports contributed only 3.2% to GDP, a figure dwarfed by that of countries with similar development levels such as Uganda (12%) and Tanzania (15.4%). According to UN Comtrade data, Ethiopia ranked 112th among 145 commodity-exporting nations in terms of export values, underlining the country's limited global trade presence.

Highlight: Peaks in Agricultural and Textile Exports - The Impact of Government Support

Agricultural exports reached a peak of $2.6 billion in 2014, largely attributed to the successful implementation of the Agricultural Growth Program (AGP) and the conclusion of Growth Transformation Plan I (GTP I). These initiatives, with a strong agricultural focus, demonstrated the highest implementation rates in their final years.

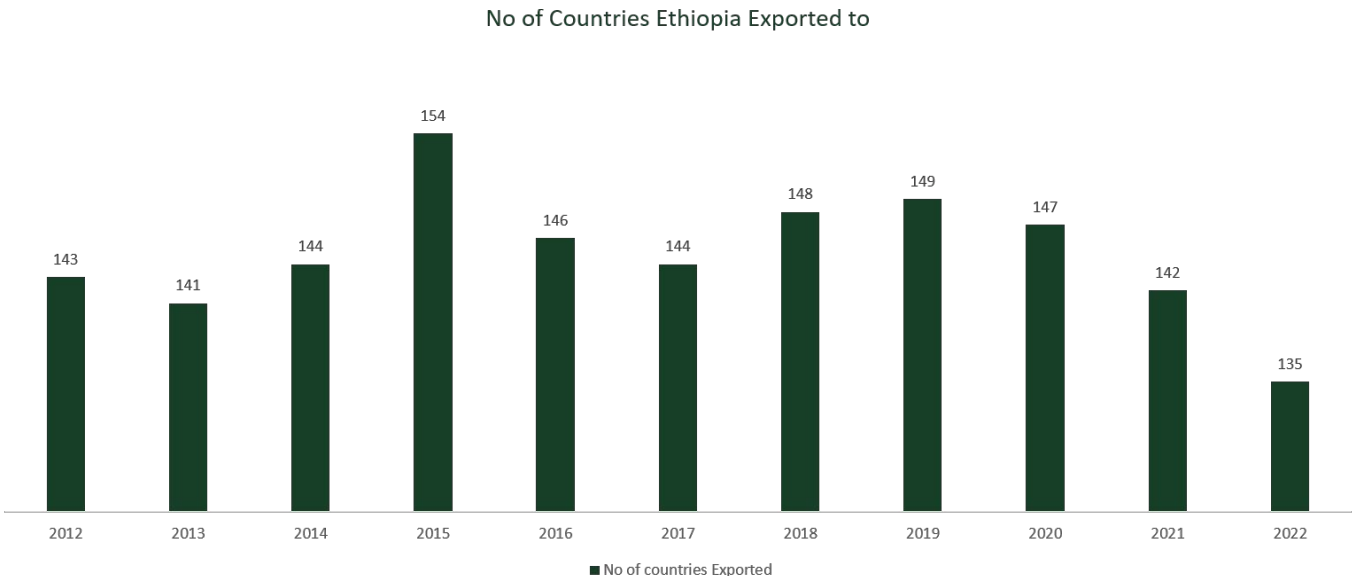
Furthermore, the Agricultural Transformation Agency (ATA) played a pivotal role in addressing challenges related to project monitoring and identifying areas of low agricultural productivity (Africa Renewal, 2015). This highlights the significant impact of government support in driving positive change within the agricultural sector.

Another notable example of government support's positive impact on Ethiopian exports is the surge in textile exports to $161 million in 2021. This growth can be attributed to several factors, including Ethiopia's participation in the African Growth and Opportunity Act (AGOA), which granted duty- and quota-free access to the U.S. market, boosting trade and investment between sub-Saharan Africa and the United States (World Economic Forum, 2023). Additionally, the development of industrial parks, such as the Hawassa Industrial Park, Kilinto Industrial Park, and Addis Ababa Industrial Park, played a crucial role. These parks, established in recent years, provided essential infrastructure and facilities for textile and garment manufacturers. To further support these industries, the government implemented various fiscal and non-fiscal incentives for companies operating within the industrial parks.

ETHIOPIA'S EXPORT DESTINATIONS: A REGIONAL FOCUS

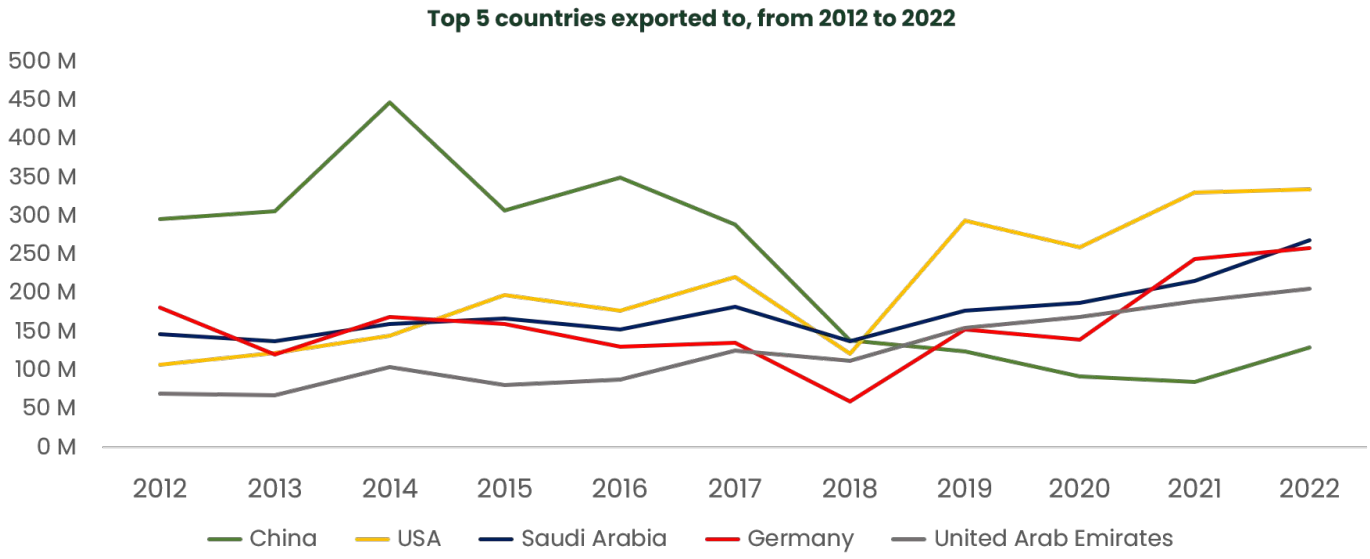


Source: The United Nations Comtrade Database



Source: The United Nations Comtrade Database

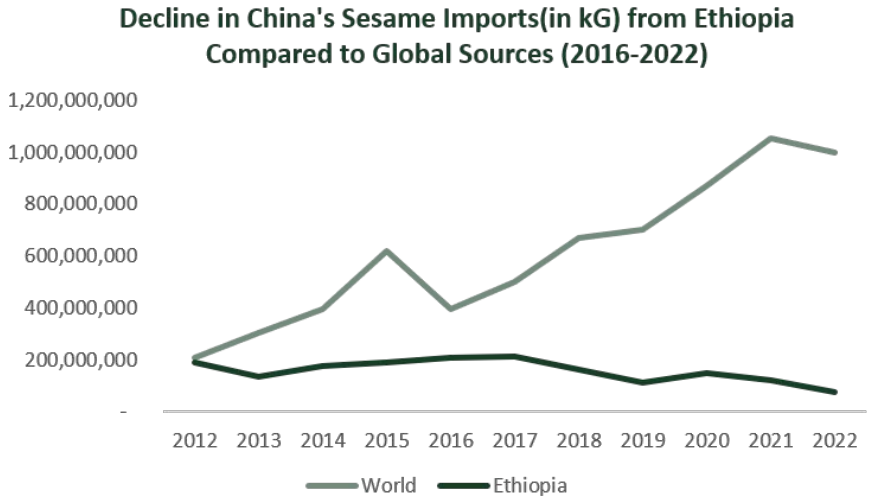
While the number of countries importing Ethiopian goods decreased from 143 in 2012 to 135 in 2022, export sales experienced a significant surge, reaching $3.08 billion in 2022.



Source: The United Nations Comtrade Database

China was the top market for much of the early 2010s, exports to China declined sharply to as low as $129 million in 2022 from its peak of $447 million in 2014. Conversely, US imports from Ethiopia surged over 300% during this period, making the United States the largest single-country market.

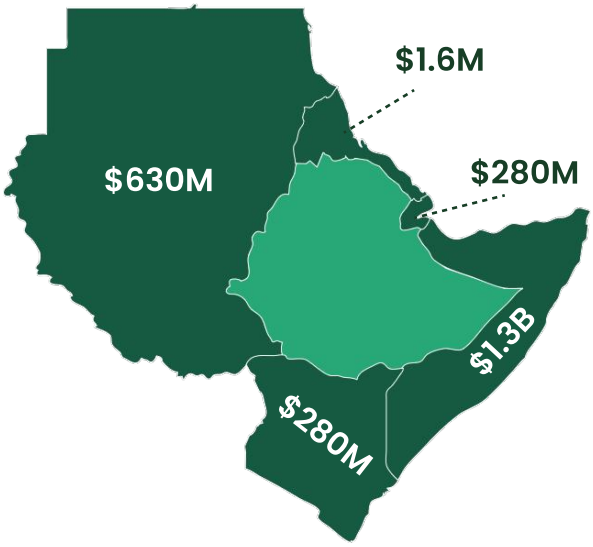
China has historically been the major destination for Ethiopian exports. Coffee and oilseeds(especially sesame) are the main products exported to China. However, this changed in 2016. According to the Observatory of Economic Complexity, Over the past years, Ethiopia's exports to China have decreased at an annualized rate of 11.4%, from $321M in 2017 to $175M in 2022. This can be attributed to the stringent regulations of the Ethiopian government and China's diversification of import sources. “The Ethiopian government has mandated that **all exports to China must go through commercial bank,** a policy established eight years ago when loans owed to the World Bank and the International Monetary Fund (IMF) were exclusively handled by these banks. As a result of this policy, many exporters, who have been engaged in foreign trade for years, find themselves unable to sell their agricultural products directly to Chinese buyers. Instead, they are compelled to sell through third parties, which diminishes their profits and market presence. The challenges are compounded by the fact that **many traders prefer to work with private banks,** which they claim better meet their needs for loans and foreign exchange. However, this creates a dilemma, as payments must still be routed through commercial banks, forcing exporters to sell their products to intermediaries rather than directly to Chinese buyers. In addition, China began diversifying its import sources and turned to other African markets”.(Capital)



According to Edao, president of the (EPOSPEA), China was importing **half** of Ethiopia’s sesame four to five years ago. “However, countries like Burkina Faso, Guinea, Chad, Nigeria, and Sudan are replacing Ethiopian products in the market,”.

This, along with other factors such as war and the resulting decline in productivity, has caused Ethiopian sesame's market share in China to plummet from 50% to just 5% today. This sharp decline in Ethiopian sesame exports to China is believed to be the main factor that has led to a noticeable drop in China's position as a key export destination for Ethiopian goods.

Highlight: The Untapped Potential of Intra-African Trade



Source: The United Nations Comtrade Database

Neighbouring countries account for **81%** of Ethiopia's export to Africa. Despite the logistical advantages of trading within Africa, Ethiopia's overall intra-African trade only accounts for **12%** of its exports. This contrasts significantly with South Africa, where intra-African exports constitute **24.3%**, demonstrating the country's reduced reliance on traditional markets and increased resilience to economic shocks.

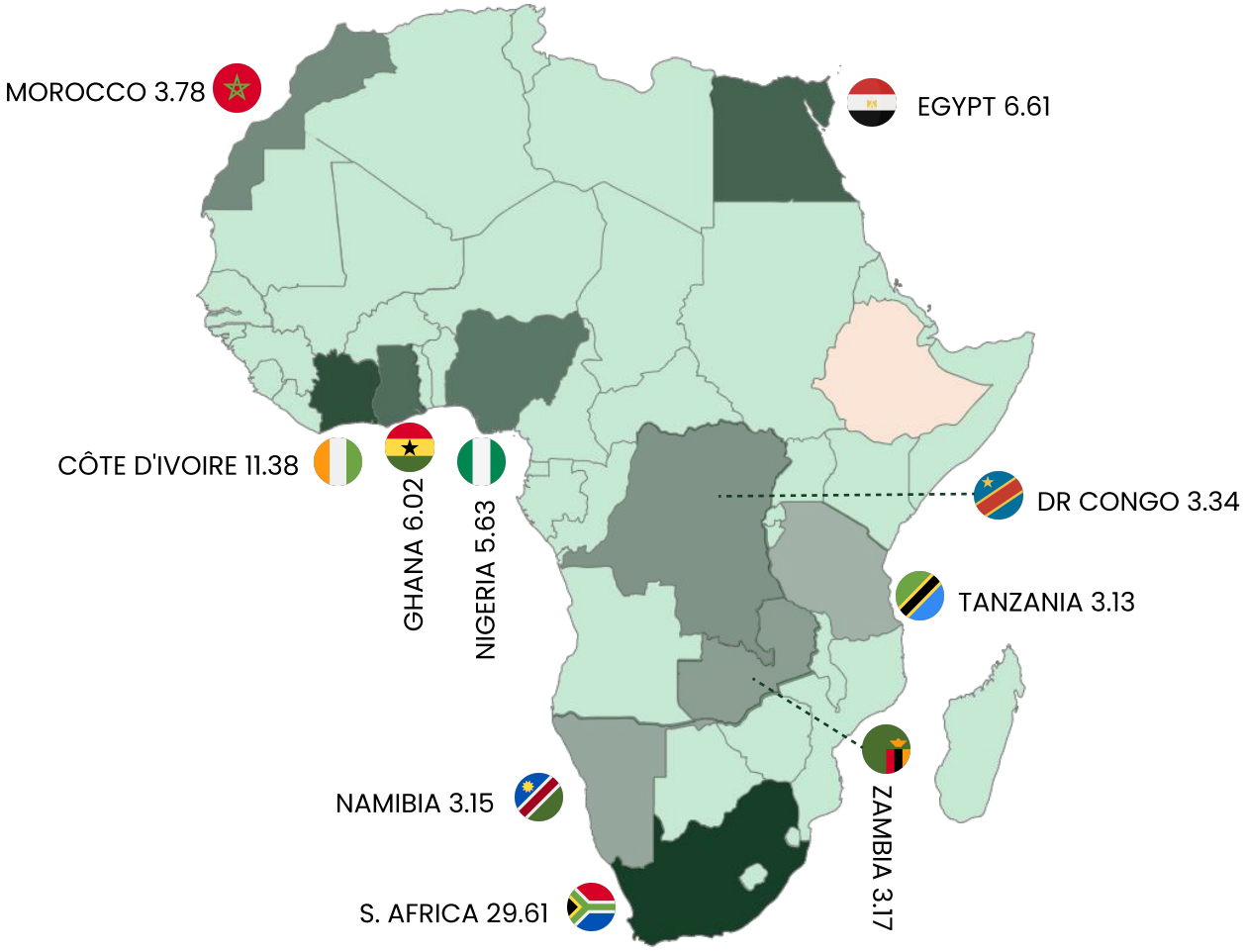
Political tensions have had a further detrimental impact on Ethiopia's exports to Africa. While traditional export destinations have included the United States, Saudi Arabia, Egypt, and Sudan, the filling of the Grand Ethiopian Renaissance Dam (GERD) in 2020 has led to decreased earnings for several export items as a political move (Ebaidalla.M, 2023).

The recent strategic agreement between Ethiopia and Somaliland poses a significant threat to Ethiopia's relationship with Somalia and could have severe consequences for Ethiopian exports. Somalia has been a crucial market for Ethiopian vegetable and root exports, with a total export value of 1.185 billion USD over the past decade. The deterioration of bilateral relations due to the agreement could jeopardize this market access.

To mitigate these risks, Ethiopia should proactively explore alternative export destinations for its agricultural products. China, the United States, and Germany, identified as major importers by the Observatory of Economic Complexity, represent potential markets. However, Ethiopia must meet the specific phytosanitary and volume requirements of these countries to successfully penetrate them.

The African Continental Free Trade Area (AfCFTA) presents a significant opportunity for Ethiopia to diversify its trade and reduce its dependence on traditional partners (UNECA, 2021). However, realizing this potential will require substantial improvements in infrastructure and addressing various barriers, including non-tariff measures.

Countries with highest exports to other African countries (In Billion USD)



Source: 2024 African Trade Report by Afrexim Bank

According to UNCTAD (2019), three major obstacles hinder intra-African trade. First, weak productive capacities and limited economic diversification constrain the range of goods that can be traded, hindering the region's full development. Ethiopia's export data reveals a heavy reliance on agricultural products, accounting for 85.6% of its total exports. To excel in intra-African trade, Ethiopia must diversify its export base beyond agriculture.

Second, tariff-related trade costs are linked to the slow implementation of tariff liberalization schedules. Ethiopia's recent economic reforms, including the NBE's liberalization measures, are crucial steps toward addressing this challenge. These reforms align with the country's 10-year development plan, which aims to rank Ethiopia among the top 50 nations with the least trade barriers.

Third, high non-tariff-related trade costs are primarily due to deficiencies in physical and soft infrastructure. These deficiencies impact transportation and transit costs, both at borders and within countries. Developing intelligent trade facilitation policies can help address these non-tariff barriers and boost regional agricultural value chains and economic integration.

ETHIOPIA'S EXPORT COMMODITIES: A LIMITED DIVERSITY

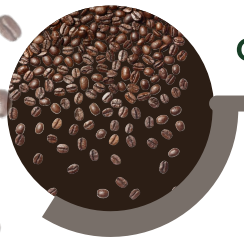
Ethiopia's export commodities exhibit even less diversity than its export destinations. Over the past decade, agricultural goods, including crops and livestock, have constituted more than 90% of Ethiopia's total exports, valued at 25 billion USD.

Highlight: Coffee, Oilseeds and the pitfalls of commodity overdependence

2012

25 Billion Dollar

2022



Coffee, tea, mate and spices

34% *export share*

8.7 Billion USD exported value



Oilseed and oleaginous fruits

19% *export share*

4.8 Billion USD exported value



Vegetables and certain roots

16% *export share*

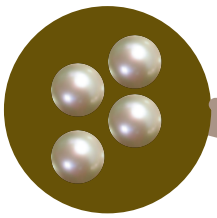
3.9 Billion USD exported value



Trees and other plants

4% *export share*

1.04 billion USD exported value



Natural cultured pearls

4% *export share*

992 Million USD exported value

Other

Other

23% *export share*

5.87 Billion USD exported value

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Source: The United Nations Comtrade Database

Limited Manufacturing Exports

Commodities other than agricultural products (finished and semi-finished products) have generated less than 4% of Ethiopia's total exports. This reflects the increasingly negligible productivity of Ethiopia's manufacturing sector in recent years (Milkias, 2024). The manufacturing sector's low productivity is hindered by several challenges, including a shortage of foreign exchange for essential inputs and raw materials, frequent power outages, high fuel costs, limited access to credit, and inadequate infrastructure. These factors collectively contribute to the sector's suboptimal performance. The limited development of the manufacturing sector is a significant constraint on Ethiopia's economic diversification and its ability to generate higher-value exports. (Milkias, 2024)

Impact of war and turmoil on exports and foreign direct investment (FDI)

Although Ethiopia's government tried to propose several reforms for increased earnings of exports, the Russio-Ukraine war and the internal conflict significantly hindered the effectiveness of those reforms. The Russio-Ukraine war caused the rise in the price of fuel which in turn affected the logistics and the general economy of Ethiopia. Not only the rise in the price of fuel, but the Russio-Ukraine war has also caused the rise of the price of imports which are used as the constituents of the export items (Yalew.A 2023/06). However, the Russio- Ukraine war wasn't the only reason for the logistics problem. The internal conflict of Ethiopia and the cross-border conflict with Sudan has also been one of the causes(Geja.Y and Tolesa. S 2024). The internal war of Ethiopia has caused several economical as well as social insecurities. But most of the impacts that highly affected the exports were supply chain disruptions, the damage of infrastructure for the manufacturing of export items particularly the textile sector, sanctions - withdrawals of trade privileges like the AGOA act - and increased flow of forex to the war which in turn affected the foreign exchange inflow.

The internal conflict has also caused reputational damage, tarnishing the country's political and legal image. Since FDI is drawn by innovation, technology, and favorable incentives, Ethiopia needed to offer higher incentives or manage risks more effectively to attract investors, but it has been unable to do so.

Additionally, the economic, social, and political insecurities aggregately affected the reliability and confidence of foreign investors. The conflict significantly damaged investor confidence, both domestically and internationally. Foreign direct investment (FDI) in Ethiopia's industrial parks and export sectors slowed down, as investors became worried about the political and security instability. Ethiopia had positioned itself as a hub for garment and textile exports through its industrial parks, but many investors scaled back operations or withdrew. This decline in investment also led to reduced production capacity, especially in the textile, leather, and flower sectors, which are heavily export-oriented.

Given Ethiopia's export history, characterized by a limited diversity of commodities, primarily agricultural products, and a concentration of trade with a few key markets, the country's exports have been particularly vulnerable to internal and external shocks. **Can the recent liberalization of the foreign exchange market significantly improve this situation?**

THE DYNAMICS OF DEVALUATION AND COMPETITIVENESS

Currency devaluation is often seen as a tool to enhance price competitiveness by making exports cheaper and imports more expensive (Dornbusch, 1980). The theory posits that a more competitive exchange rate could increase foreign demand for Ethiopian products, thus boosting export volumes. However, the efficacy of this policy depends on the degree of exchange rate pass-through (ERPT) and how price elastic Ethiopia's exports are (Goldberg & Knetter, 1997).

ERPT is defined as the change in prices caused by the change in nominal exchange rate. In particular, the percentage by which import, export or domestic prices change when the home currency changes by one percent is called the degree of ERPT. (Berga, 2012).As ERPT reflects the transmission of the exchange rate to domestic prices, there are two levels of this transmission: complete and incomplete pass through. ERPT is complete if there is a one-to-one relationship between the change of the exchange rate and that of the relevant domestic price. It is incomplete, or partial, if domestic prices change less than the change of exchange rate., incomplete ERPT indicates that exporters have market power to apply price discrimination by adjusting their markups across destinations when confronted with exchange rate fluctuations (Krugman, 1986).

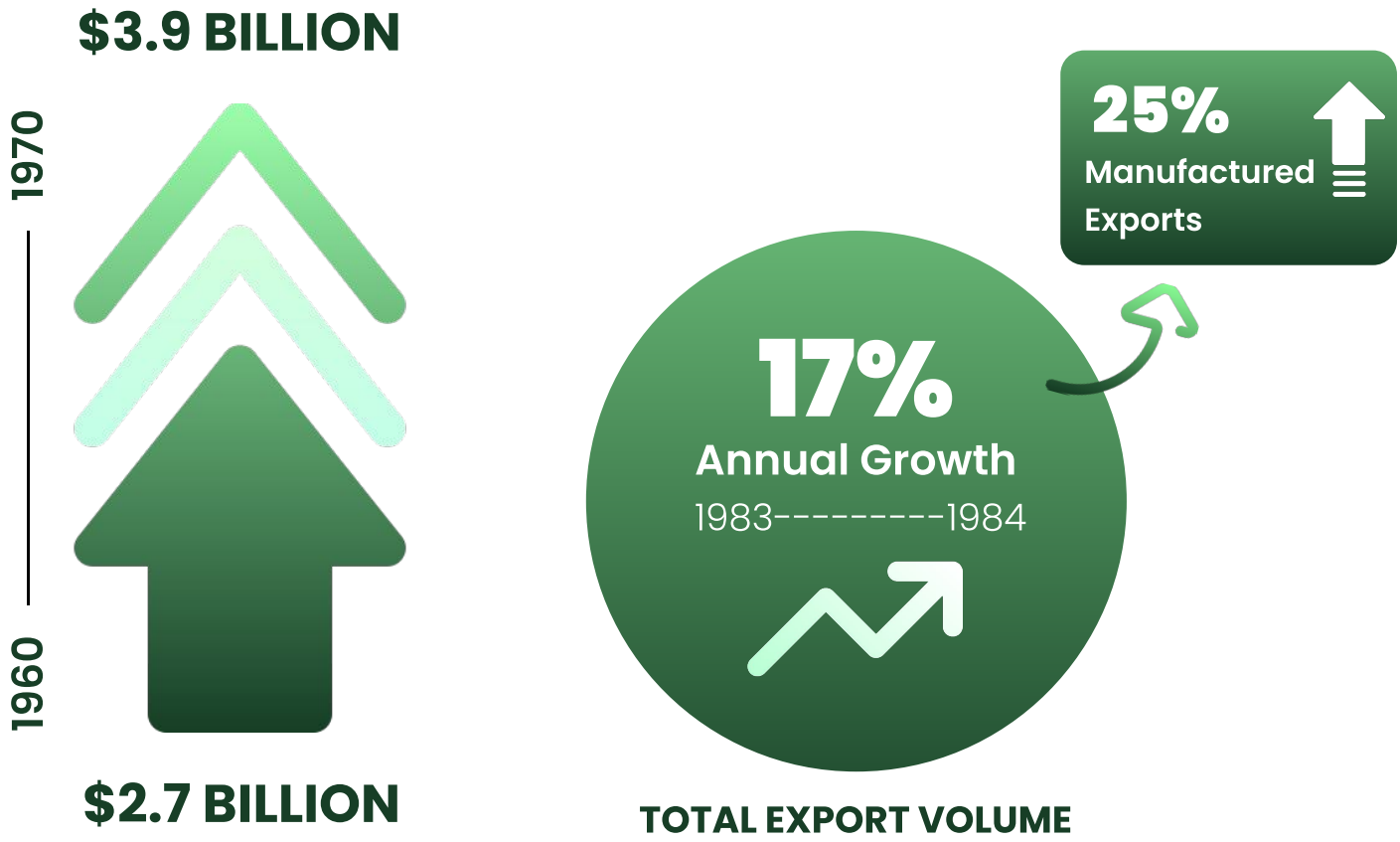
This can be achieved by the combination of supply and demand factors. From the supply dimension, higher quality makes a variety of goods more attractive than others, considering their prices; thus, export quality plays a vital role in determining global trade patterns (Hallak and Schott, 2011). This clearly shows that diversification and value addition should be taken into consideration if currency depreciation is intended to increase exports by making commodities more competitive in the global market.

If Ethiopian goods have a low price elasticity of demand—meaning foreign buyers are not highly responsive to price changes—devaluation might have a limited effect on export volumes. Ethiopia's primary exports, such as coffee and oilseeds, are relatively homogeneous commodities with inelastic demand (Haddad et al., 2012). Thus, the devaluation might not significantly increase demand in major markets like the U.S., Saudi Arabia, and China, unless accompanied by broader improvements in productivity and quality.

BRAZIL AND MORE: LESSONS IN DEVALUATION AND EXPORT GROWTH

Historical examples can provide valuable insights. In the 1960s, Brazil faced a balance of payments crisis, sluggish exports, and an overvalued currency—much like Ethiopia today. In response, Brazil implemented a series of devaluations and fiscal incentives to promote exports (Baer, 2001). These reforms were successful in increasing exports from $2.7 billion in 1960 to $3.9 billion by 1970, primarily by diversifying away from traditional commodities into manufactured goods.

To address the global debt crisis developing countries were facing in the 1980s, Brazil again employed significant currency devaluation. These devaluations aimed to boost exports by making them more competitive internationally, significantly increasing exports. The total export volume grew by an average of 17% annually in 1983-84, with manufactured exports increasing sharply by over 25% per year. However, mere devaluation alone was insufficient to spur this export growth.



Brazilian authorities took a proactive approach by combining exchange rate policies with export subsidies. This strategic intervention effectively stimulated rapid export expansion. Brazil's experience illustrates the importance of using devaluation alongside other structural reforms to stimulate export growth, particularly in non-traditional sectors.

Even though policies set out by the government were successful in growing exports, some policies inadvertently hindered export growth. For example, import substitution policies were initially designed to nurture local industries, but they ultimately created a protective environment that suppressed competitiveness. This shift negatively impacted manufactured exports, erasing earlier gains and limiting Brazil's ability to compete effectively in international markets. Another policy was during the early 1990s when significant trade liberalization efforts came into place, including drastic reductions in tariff barriers. This was intended to increase competition and attract foreign investment but resulted in imports outpacing exports. Imports surged from $14.6 billion in 1988 to $49.2 billion by 1999. This proves that a well-thought-out policy is important to nurture the growth of exports.

Similarly, Taiwan devalued its currency in the 1960s to support export growth. Taiwan's success lay in its focus on manufacturing, investment in infrastructure, and the establishment of export processing zones (Balassa, 1978). These broader reforms complemented the devaluation, leading to a sixfold increase in exports over the decade. Ethiopia, by comparison, has yet to establish a strong manufacturing sector, and without such complementary measures, the gains from devaluation may be limited.

***CASE STUDY:** Argentina in the '90s - A Rollercoaster of Reform and Resilience*

In the heart of Argentina, where the passion of tango fills the air and the Andes watch over the landscape, the economy in the 1990s was a wild ride, marked by bold reforms and deep struggles that shaped the nation's future. The country is richly endowed in natural resources, where agriculture and agro-industries have traditionally been important. Argentina was self-sufficient in petroleum up to the 1980s, and investment following privatization in the early 1990s turned the country into a net exporter of oil and natural gas.

Following Carlos Menem's election as president in 1989, Argentina launched an economic liberalization program in the middle of the year with two key components to rebuild its economy along the lines of the Washington Consensus. The first was the 'big bang' strategy, which utterly ignored the order in which changes were implemented in several areas, including trade, public sector, and budgetary reforms. The second was the legal implementation of a convertibility system, which mandates that the Central Bank (CB) use foreign exchange reserves to support the whole monetary base. Despite continuing economic reforms and experiencing prosperity for the most of the 1990s, Argentina was unable to reduce government spending, which resulted in a persistent rise in budgetary deficits and an increasing amount of public debt. Overall, Argentina performed very well during the 1990s before the onset of the crisis in late 1990s. Before we examine the interrelated problems that progressively exacerbated the financial crisis, let's first review the nation's employment, export, and import data to have a better understanding of the economy.

In 1990, an Economist Intelligence Unit assessment stated that the export of minerals and oils accounted for a significant portion of Argentina's total export revenue. Apart from that, the nation's main exports have been a few finished goods like vegetable oils and agricultural items like cereals. The same data source indicates that there was a sizable import market, with electrical machinery, cars, and other expensive commodities that distorted the nation's balance of payments being the main imports. And during that time, Brazil, the United States, and Chile were the main export markets for Argentinean goods, with Brazil receiving the majority of these exports. Brazil was a major export destination, which contributed to the export rigidity that we shall discuss in the paragraph on economic reforms.

The job environment is one of the other main effects of a nation's economic health. The prominent unpleasant aspect of the Argentine economy was the increase in the unemployment rate. While the number of jobs increased in parallel with the population between 1989 and 1999, the number of persons seeking employment increased at an even quicker rate. The current combination of high taxes on formal work and rigid labor rules has caused the above-ground economy to create jobs at a slower rate than the number of job searchers. Some job searchers turned to the larger but more unstable underground economy, which offers greater flexibility. (Saxton,2003)

In 1991, Argentina pegged its peso to the U.S. dollar, initially inflation plummeted from 2,314 percent a year in 1990 to 4 percent by 1994. However, it led to overvaluation of the peso and loss of competitiveness in international trade. Argentina's competitiveness worsened as the dollar strengthened relative to most of the other currencies pulling the peso up with it. The dollar rose sharply against the Japanese yen after 1995 against the currencies of south-east Asian after their crises of 1997 and 1998, and against the European currencies in 1999 and 2000. The terms of trade also moved against Argentina, with world prices for its exports declining relative to the prices of its imports. But the biggest blow to Argentine competitiveness came when Brazil's currency, the Real, fell sharply in 1999. This being the major reason behind After years of gains, Argentine-Brazilian trade was flat in 1998 and shrank in 1999. As we attempted to highlight abovxe, Brazil served as Argentina's main export destination, which limited its growth by reducing trade profitability and compounding the impact of the export market's rigid elasticity brought on by its diminished influence on the global stage. As a result, the country's export sector suffered greatly and was unable to further its development.

Despite attempts at reform, the Argentine government continued running fiscal deficits, spending more than it earned. The fixed exchange rate in Argentina could have succeeded if the peso became competitive enough to create a trade surplus, allowing the country to pay off international debt. While the one-to-one exchange rate made Argentine products expensive, higher productivity could have offset this by lowering production costs. However, rigid labor laws and strong union pressures prevented further gains in competitiveness.

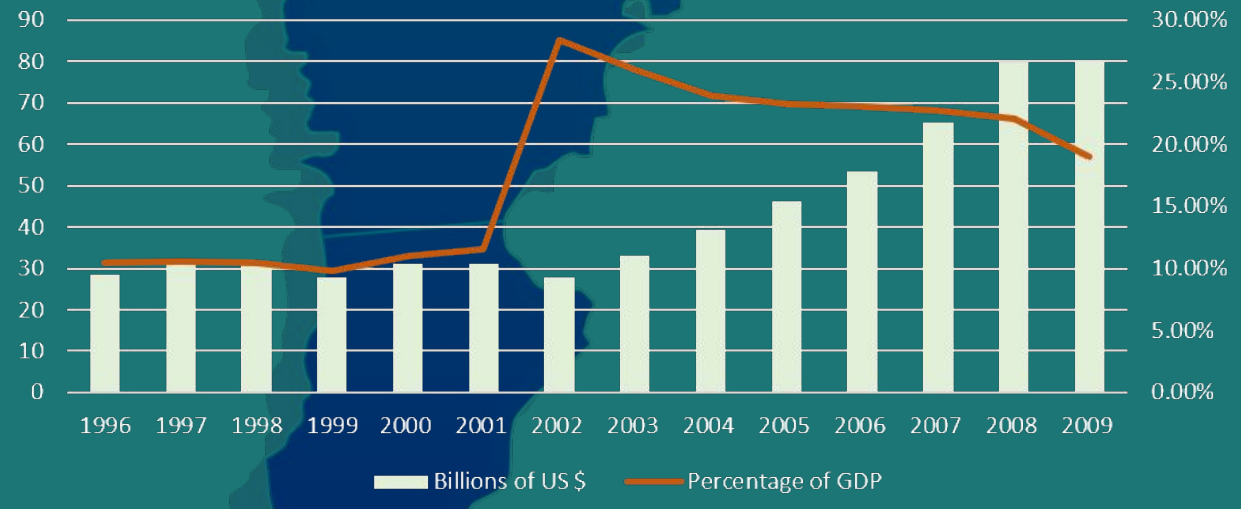
As Argentina's debt grew, fears of a currency crisis emerged. Investors might convert pesos into dollars, draining reserves. Although the central bank could raise interest rates to stabilize the peso, the government hesitated to push them high enough due to concerns about the economy.(Nataraj & Sahoo, 2003)

Concerns about a deposit freeze arose from the government's inability to successfully refinance its debt, and on December 1, 2001, this was confirmed. The economy went from a recession to a severe depression as a result of the widespread suspension of private sector activities; violent riots resulted from the public outcry and the worsening economic conditions, forcing Minister Cavallo and President De la Rúa to resign on December 20, 2001. On January 1, 2002, Eduardo Duhalde was elected president, and he was a staunch opponent of the economic policies of the 1990s.The president's first action was devaluation of the Argentinian peso relative to the foreign currencies. From 1 Argentina Peso = 1 US Dollar By 2002, the currency fell to 4 Peso to 1 Dollar. Inflation was running at 80% This led to imported inflation and a large reduction in living standards.

Did this devaluation bring the desired result to the economy?

Following the significant devaluation, the Argentine economy expanded in a number of areas, some of which can be visualized by data indicators of macrotrades. After four difficult years of economic turmoil, Argentina began to stabilize its situation. Three months after Argentina's $100 billion debt default, the country's economy started to grow quickly. The nation's economy grew at the quickest rate in the West with a GDP rise of more than 50%. Reversing the Peso's fixed exchange rate policy with the dollar was one of the main moves made by the administration to put an end to the crisis (Weisbrot et al., 2007).

Argentine export from 1996 to 2009



Source: macrotrends-global metrics

Bank of international settlement report revealed the early years of the century (2003–07) saw fiscal and current account surpluses (primary fiscal surplus of 3%, total fiscal surplus of 1.4% and current account surplus of 3.18% of GDP on average), together with strong growth (8.7% on average). This went hand in hand with burgeoning terms of trade (+30% from 2002 to 2007), international reserve accumulation and lower public indebtedness (the latter following debt restructuring in 2005).(Pesce et al,2023)

Investment showed an amazing dynamism, growing at a 42.7% annual rate along this second phase and contributing 57% to GDP growth (see Table 2.1). This behavior is in part a result of the gradual normalization of the financial environment. However, it should be stressed that such a recovery took place in a context of accentuated credit rationing, both external and internal. (Frenkel &Rapetti,2007).

Although an attempt has been made to draw attention to the export growth patterns mentioned above, the transition was skewed toward certain commodities. Depending on how elastic the exported good is, there are differences in the realized impact on export. Estimates derived from IMF data indicate that export elasticity to relative prices is low in some sectors (cereals, soybean) and strong in others (particularly, automobile, machinery, and equipment). A 10 percent real devaluation of the Argentine peso would, according to the product-level elasticities added together, increase overall export growth by less than one percentage point. In terms of demand elasticity, we discover that an increase of 1% in trading partners' growth would result in an approximate 2% rise in overall export growth. (Lusinyan.et al, 2017)

However, did the currency devaluation alone play a major influence in the expansion of the export industry?

many data sources indicated that Argentina had to undergo many macroeconomic reforms and adjustments in order to attain the results shown in the aforementioned data, But while some helped achieve the desired result, others became a bottleneck as a result of implementation problems. Implementing policies to promote trade, such as lowering export taxes and expanding market access, Privatization reforms was some of the many economical reforms the government's took. In addition to these actions, multi-exchange rates were employed as a strategy to improve the exporting environment (Saxton, 2003).

Privatizations were one of the main economic changes implemented in Argentina. The privatization of public services in Argentina aimed to replace state management with market-oriented enterprises, aiming to improve population well-being and competitiveness in monopolistic environments. However, the government's focus on fiscal relief and the private sector's dependence on the state for survival led to some privatized utilities being highly profitable, while others depended entirely on the state.

Some of the original objectives of privatization were achieved, such as increased productivity and adoption of new technologies. However, after the 2002 devaluation, privatized firms discontinued investment plans and provided services only to established clients, leading to public discontent. The government started a renegotiation process to achieve the original objectives of increasing efficiency and consumer gains.

In some sectors, privatization goals were not attainable, such as water and sewerage, where the state financed infrastructure investments, and the quality of services depended on state subsidies. Additionally, the state's institutional capture contributed to a weak regulatory framework, with the extraordinary profits obtained due to lack of experience and involvement of newly created enterprises.

The Argentinean privatization reform experience highlights the importance of a strong, independent regulatory authority for successful privatization of public utilities, as concessionaires become powerful lobbyists with little incentive to improve efficiency, resulting in a reasonable long-term return.(Baer & Montes-Rojas, 2008)

Overall, a variety of political, macroeconomic, and debt management factors contributed to Argentina's economic disaster. The cessation of currency pegs and significant devaluations occurred when exceeding 50% of GDP in debt. A variety of macroeconomic measures, including tax reduction and privatization, were implemented in concert to lessen the nation's debt service and get the intended results in foreign commerce. It took a while to get the intended results due to the per-evaluation climate and the export commodities' in-elasticity, which also prevented the anticipated results on some industries. As an unintended consequence, the economic reform also decreases the nation's standard of living for several years. The main barrier keeping Argentina from benefiting from these macroeconomic reforms for more than a decade was the ineffectiveness of the regulatory system and the way policies were implemented, even though the nation was able to witness brief spikes in various sectors.

MEXICO

In the 1970s, Mexico's economy was heavily reliant on oil exports, which provided substantial revenue and facilitated borrowing from international banks. However, this dependency became problematic as global oil prices fluctuated. The Iranian Revolution of 1979 led to a spike in oil prices, prompting the Mexican government to increase its borrowing. By the early 1980s, Mexico faced a severe debt crisis, exacerbated by high interest rates in the United States. To address these challenges, Mexico initiated a series of structural reforms in the 1980s and 1990s. These reforms included privatization of state-owned enterprises, trade liberalization, financial deregulation, and shifting from import substitution to export promotion strategy. The goal was to make Mexico's economy more competitive and attractive to foreign investors.

A significant turning point in Mexico's economic history was the North American Free Trade Agreement (NAFTA), which came into effect in 1994. NAFTA provided duty-free access to the U.S. and Canadian markets for Mexican goods, boosting exports and attracting foreign investment in export-oriented manufacturing industries. However, the Tequila Crisis of 1994, triggered by the devaluation of the Mexican peso, exposed the country's vulnerability to external shocks. Despite the challenges posed by the Tequila Crisis, Mexico's economy rebounded more quickly than expected. The growth of export revenue observed during and after the tequila crisis was not only due to the real depreciation of the Peso but also driven by an increase in the volume of non-oil exports, which was, in turn, stimulated by Mexico's low-cost labor and proximity to the U.S. market and a transitory improvement (or correction) in the international competitiveness of Mexico's industrial sector.

POLICY RECOMMENDATIONS: BEYOND DEVALUATION

For Ethiopia to maximize the benefits of its foreign exchange reform, several key strategies must be adopted. First, the government should focus on diversifying its export base, particularly in light manufacturing and value-added sectors (Hausmann & Hidalgo, 2011). Increasing production capacity and improving infrastructure—especially in transport and logistics—are also essential for enhancing export competitiveness. Finally, Ethiopia should leverage regional trade agreements such as AfCFTA to expand into new markets.

To achieve sustained export growth, Ethiopia should consider the following strategies:

DIVERSIFYING EXPORTS

Ethiopia's exports have been traditionally dominated by agricultural commodities. Diversifying into more complex products can enhance economic growth. Strategic new products should be selected based on their proximity to existing capabilities, complexity, and potential for diversification. Leather footwear, insulated electric wire, preserved vegetables, garment knits with impregnated fabric, and plastic tubes are promising sectors in this regard. Ethiopia’s export performance in the recent 5 years has shown a great increase due to the diversification of export products(Balami. K, Ketema.M, and Goshu, 2023)

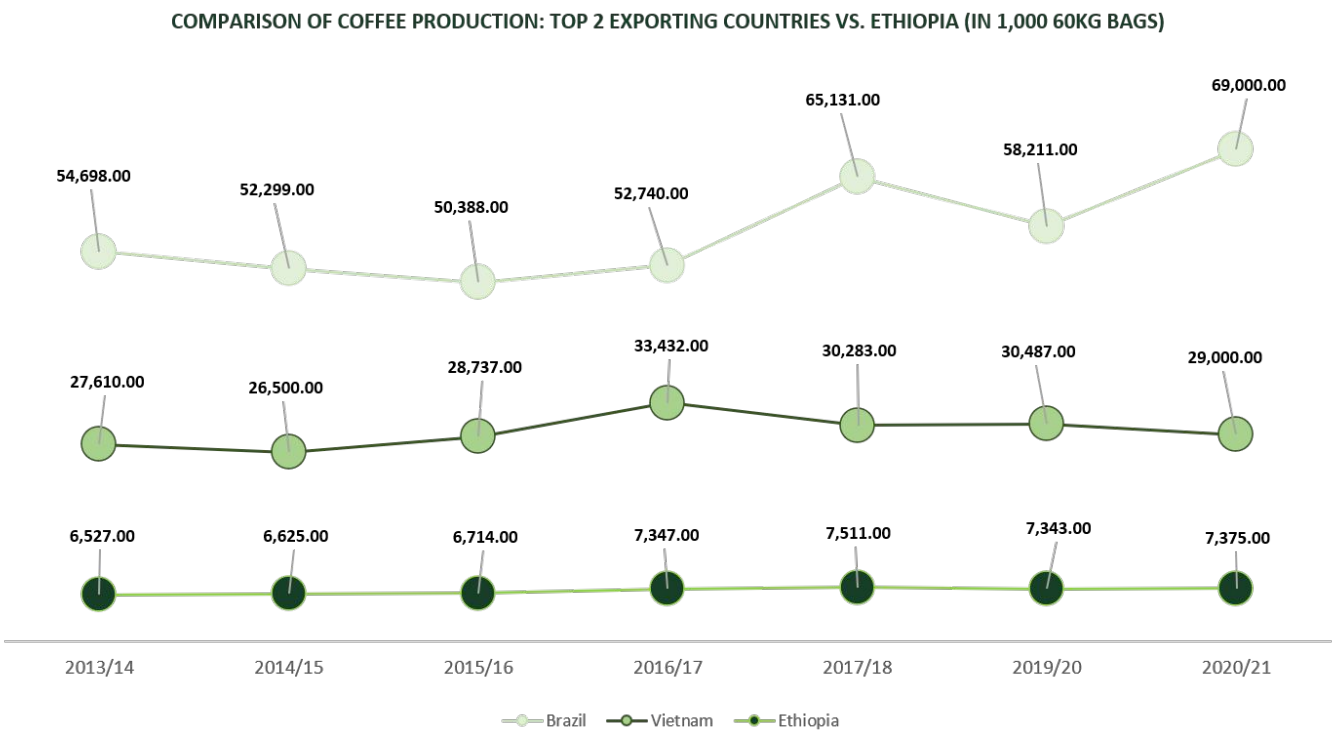
The Coffee and Agricultural sector manipulated Ethiopia’s export system and the forex before 2013G.C. As a result, by 2012 G.C Ethiopia didn't have any exports in the chemical, machinery, metal, mineral, stone, textile, and vehicle sectors. But by 2013 GC, Ethiopia started exporting some items in small amounts (Hard rubber - chemical sector, Musical instruments - machinery sector, Copper waste and scrap and Tantalum - Metal sector, Zirconium ore, Marble and precious metal ores - Mineral Sector, Parts of other aircraft - Vehicle sector). After the introduction of GTP II in 2015 GC high growth in export earnings was noticed with The total export earnings of 2020 increasing by USD 340 million from 2012. This was due to the part of its priority of GTP II in the economic cluster which was the development of the sectors above.

INCREASING PRODUCTION

The Ethiopian export sector is constrained not only by its reliance on a limited range of agricultural products but also by the relatively small volume of these exports compared to other leading exporting countries. Ethiopian farming is largely characterized by peasant holders who grow food mainly for family consumption thus leaving little for commercial purposes. This inadequate volume of production is mainly due to the tardy progress in farming methods and scattered pieces of land holdings, poor infrastructure, and limited access to finance and technology restricting farmers' ability to invest in higher-yielding crops and modern agricultural practices. To address these challenges and improve agricultural production volume, it is essential to invest in infrastructure development, agricultural research, capacity building for farmers, utilizing underdeveloped lands, and promoting large-scale commercial agriculture.

Many producers and manufacturers in Ethiopia operate close to 20 or 30 percent capacity due to infrastructure constraints and capital shortages. The World Bank's Logistics Performance Index (LPI), a composite score based on infrastructure, timeliness, customs, and logistics quality, places Ethiopia last among its peers, nearly 30 percent below the LPI leader Kenya. Much of this outcome owes to Ethiopia's poor road quality and connectivity, for which the African Development Bank and the World Bank both report low scores. Meanwhile, Ethiopia's rail network also lags far behind its comparators, with the average rail density of its comparators exceeding Ethiopia's by more than twelve times. That said, the percentage of Ethiopian firms reporting transportation as a major constraint to doing business, around 8 percent, falls well below the average rate of 25 percent reported among its comparator countries.

In the World Bank's Ease of Doing Business rankings, Ethiopia is about average for Sub-Saharan Africa on the Trading Across Borders score, which includes assessments of both internal transport costs plus the costs of documentary and border compliance (Deren, Motamed, 2020). Efforts to address these infrastructural barriers are crucial for maximizing production and increasing exports.



Source: International Coffee Organization

VALUE ADDITION

Ethiopia's traditional exports of primary goods, such as coffee, oilseed, and cut flowers, are susceptible to price fluctuations in the international market. Value addition, through the export of roasted and ground coffee, processed meat, textiles, leather products, and other value-added goods, can enhance export earnings, reduce vulnerability to price swings, and achieve greater economic stability.

Ethiopia's heavy reliance on agricultural commodities—specifically coffee, oilseeds, and cut flowers—renders its export sector vulnerable to price volatility in global markets. While devaluation may temporarily boost competitiveness, sustained growth will depend on diversifying into higher-value-added sectors. Studies show that economies that transition from primary commodity exports to manufactured goods are better able to withstand external shocks and achieve sustained economic growth (Rodrik, 2006).

It is also worth mentioning that while the currency devaluation has diminished incentives for exporters to sell foreign earnings on unofficial markets by making the official exchange rate more competitive, it has also reduced a major financial benefit that previously motivated their business activities. To sustain export growth, the government could implement policies encouraging exporters to reinvest foreign currency proceeds into value-adding processes within Ethiopia's export industries. This two-pronged approach addresses the lack of motivation now facing exporters due to diminished windfall gains, as well as the need to boost domestic value capturefrom exported commodities through more processing and upgrading. Providing the right incentives such as income tax and duty incentives for reinvestment could help compensate exporters while stimulating greater economic linkage and productivity gains within exporting sectors.

The government has already taken steps to develop these incentives through the amendment of the Export Trade Duty Incentive Schemes Proclamation. This amendment allows for more goods to be cleared through Franco Valuta transactions, a system that allows traders to pay import costs directly in foreign currency, rather than relying solely on letters of credit. By expanding the use of Franco Valuta, the government aims to encourage exporters to bring in more critical goods and use these goods for the production of export commodities.

CAPACITY BUILDING

A critical often-overlooked factor in successful export performance is the exporters' themselves possessing sufficient and up-to-date knowledge of foreign trade practices. As highlighted by the Ethiopian Pulses, Oilseeds and Spices Processors Exporters Association (EPOSPEA), many exporters lack awareness of international trade procedures, struggle with identifying destination addresses, and face general challenges related to trade facilitation (Zekarias, 2024). Addressing these deficiencies requires focused efforts to train exporters on trade facilitation and maintain existing trade connections while actively seeking to establish new ones.

Despite the devaluation, if Ethiopia does not improve productivity and scale its manufacturing capabilities, it risks remaining trapped in low-growth, low-value-added sectors. The elasticity of demand for its agricultural exports is not sufficient to drive transformative growth without these complementary reforms (Hausmann et al., 2007).

***CASE STUDY**: Strategies to improve the quantity and quality of export coffee in Ethiopia, a look at multiple opportunities*

As the birthplace of Arabica coffee, Ethiopia boasts exceptional coffee quality. This prized commodity serves as Ethiopia's primary export, contributing significantly to the country's economy. To further enhance coffee production, expanding cultivation beyond traditional regions is essential.

Despite its favorable agroclimatic conditions, Ethiopia has not fully embraced commercial coffee cultivation. The five primary coffee-producing regions, Yirgachefe, Teppi/Bebeka, Limu/Djimmah, Sidama, and Harar, located in Oromia and the Southern Nations and Nationalities People (SNNP) areas, account for over 95% of Ethiopia's coffee production (Muhie, 2022; Wolde et al., 2017; Elis et al., 2020). However, regions like Amhara, Gambella, Benishangul Gumuz, and Tigrai also possess suitable agroclimatic conditions for coffee cultivation. These regions offer the added advantage of readily available and affordable labor, particularly among young people seeking employment (Muhie, 2022).

To significantly increase coffee production, Ethiopia should focus on intensifying its production systems and transitioning from traditional to commercial farming practices, while maintaining hand-picking for premium quality coffee. Additionally, diversifying coffee production beyond Arabica coffee by cultivating Robusta/ Canephora coffee at lower altitudes is crucial. Ethiopia's diverse agroecologies, resulting from varying altitudes, provide ideal conditions for both Arabica and Robusta coffee cultivation (J. Moat, 2017).

Implementing strategies like intercropping coffee with other tree crops and high-value spice crops can enhance profitability and reduce reliance on a single commodity (Muhie, 2022).

The Comprehensive Ethiopian Coffee Strategy (2019-2033) outlines four key areas for enhancing Ethiopia's coffee export value chain and achieving $4.35 billion in coffee export revenue by 2033: marketing, value addition, processing, and overall sector strengthening.





Processing:

To improve quality and management practices, the strategy recommends encouraging exporters and international market actors to provide financial and advisory services to primary processors. Given the volatile nature of global coffee prices, establishing a national training program on price risk and financial management, as well as developing hedging mechanisms, can enhance the value chain's resilience to economic shocks.



Value Addition:

Creating training programs for value addition and encouraging international stakeholders and roasters to offer advisory services can boost value-added exports. Investing in high-quality packaging and international marketing can also strengthen Ethiopia's position in the global coffee market. Additionally, targeted investment programs and land allocation plans for coffee cluster manufacturing plants and industry zones can support roasters and promote local value addition.



Marketing:

Despite producing some of the world's finest coffees, Ethiopia has not fully capitalized on branding, promotion, and marketing. While recent reforms have expanded marketing channels, further efforts are needed to ensure strong enforcement and clear communication of regulations. Improving the efficiency and accessibility of the Ethiopia Commodity Exchange (ECX), which handles over 90% of coffee sales, can enhance the ease of doing business. Expanding access to marketing centers and services can also increase farmer coverage.



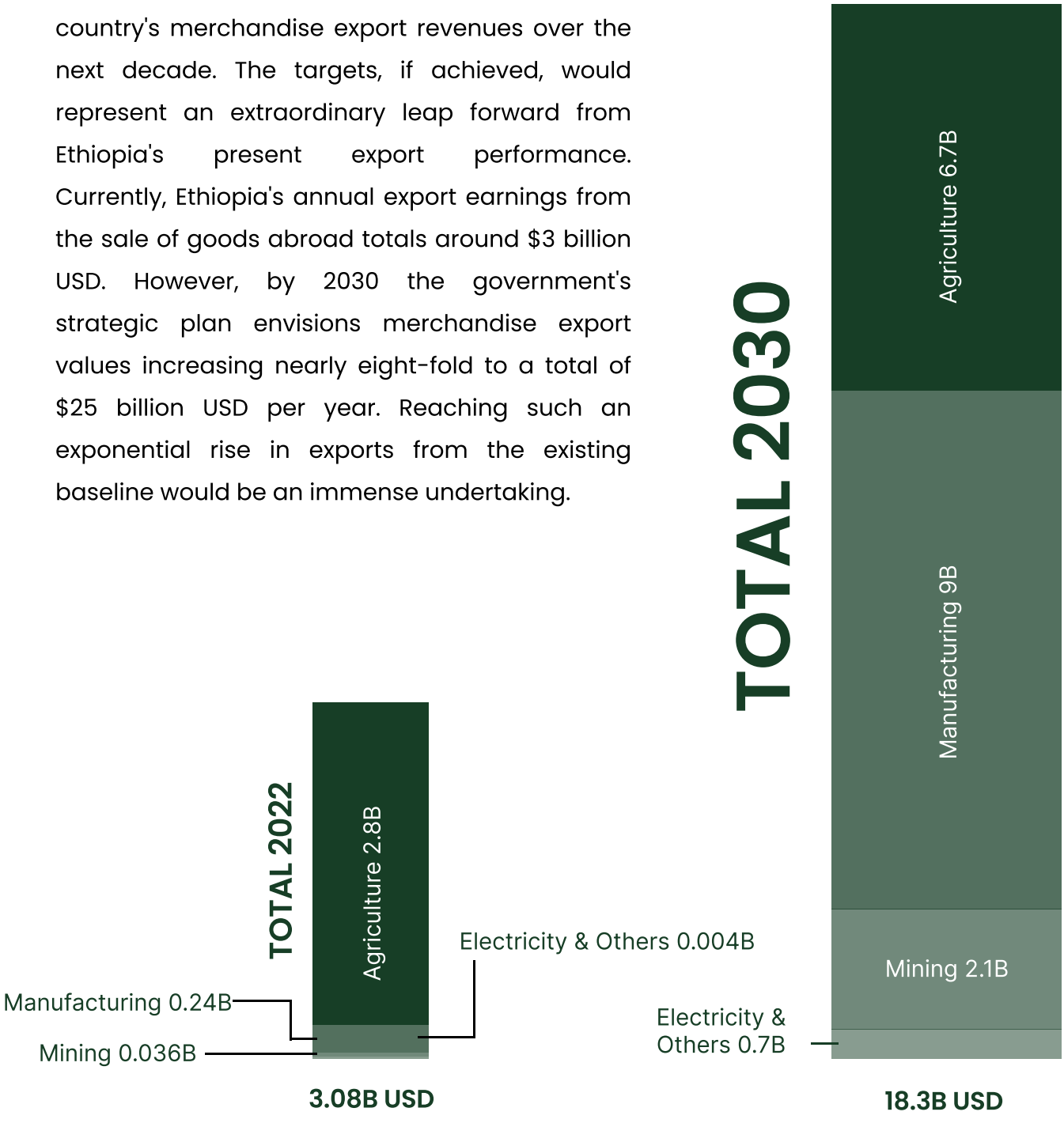
Strengthening the Coffee Sector:

Building effective institutional linkages, collecting accurate sector data, and establishing a coffee fund to invest in various activities can have a lasting impact on the entire coffee sector.

Having proposed several suggestions based on our analysis, we now ask: What are the government's plans for Ethiopia's export sector?

ETHIOPIA'S TEN-YEAR DEVELOPMENT PLAN: EXPORT GOALS

The Ethiopian government has unveiled ambitious plans to substantially increase the country's merchandise export revenues over the next decade. The targets, if achieved, would represent an extraordinary leap forward from Ethiopia's present export performance. Currently, Ethiopia's annual export earnings from the sale of goods abroad totals around $3 billion USD. However, by 2030 the government's strategic plan envisions merchandise export values increasing nearly eight-fold to a total of $25 billion USD per year. Reaching such an exponential rise in exports from the existing baseline would be an immense undertaking.



Source: Ten Year Development Plan a Pathway to Prosperity 2021 - 2030

CONCLUSION

In summary, Ethiopia faces both opportunities and challenges in realizing substantial export-led growth through its recent foreign exchange reforms. While devaluation makes Ethiopian goods cheaper abroad and aims to boost export competitiveness, the country's historical export performance demonstrates that sustained increases in export volumes and revenues will depend on addressing deeper structural issues. Ethiopia remains heavily reliant on a limited range of agricultural commodities for 90% of its exports, lacks manufacturing and industrial capabilities, has underdeveloped infrastructure, and persistent political instability hindering production and trade. Simply devaluing the currency is unlikely to drive transformational change without complementary reforms that enhance productivity, diversify production into higher-value goods, improve infrastructure, and make the business environment more conducive to trade and investment. As examples like Brazil, Taiwan, Mexico and Argentina show, simultaneous development of manufacturing capacities and strengthening of associated industry clusters are needed. If the government utilizes this opportunity to implement its industrialization strategy and development plan through focused sectoral support, capacity building, and continued reforms, Ethiopia has potential to capitalize on the gains from its foreign exchange transition and improve economic resilience through more diversified, complex exports. Achieving its ambitious export targets of increasing total exports six-fold to $18.3 billion by 2030 will require effectively combining currency competitiveness with broader measures that empower Ethiopian producers and businesses to withstand global economic shocks.

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