

## **DILEMMA OF WORLD BANK ACTION IN BIRR DEVALUATION AND ITS EFFECTS ON ETHIOPIA**

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### **Abstract**

The Ethiopian financial crisis has been ongoing for several years, with various economic challenges such as high inflation, foreign exchange shortages, and a growing public debt burden. However, one of the major events that triggered the crisis was the devaluation of the Ethiopian birr (the country's currency) in October 2017, which led to a rapid increase in inflation and caused significant economic hardship for many Ethiopians. The World Bank has been providing financial and technical assistance to the Ethiopian government to help address the crisis and promote sustainable economic growth. This research paper analyzes the World Bank's role in addressing Ethiopia's financial crisis using a combination of qualitative and quantitative research methods. The study includes in-depth interviews with key stakeholders, secondary data analysis of World Bank reports and other relevant documents, and exploratory data research methods to analyze economic trends in Ethiopia. Writer also highlights the value of using a combination of research methods to examine complex economic issues such as Ethiopia's financial crisis. By drawing on multiple data sources and research methods, the study provides a comprehensive understanding of the World Bank's role in addressing the crisis and the broader economic context in which it operates.

**Keywords:** Ethiopian crisis, World Bank, Devaluation.

## INTRODUCTION

In October 2017, the Ethiopian government announced the devaluation of the Ethiopian birr by 15% against major foreign currencies, including the US dollar. The decision was made in response to a chronic shortage of foreign currency reserves, which had put pressure on the birr and contributed to rising inflation and a trade deficit. The devaluation was seen as a necessary step to boost exports, attract foreign investment, and ease the pressure on the country's foreign currency reserves.<sup>1</sup>

The devaluation of the birr was not a standalone event, but rather a result of a complex set of economic, political, and social factors that reflect the interconnectedness of the global political economy. One factor that contributed to the birr's devaluation was Ethiopia's reliance on exports of primary commodities, which are subject to price volatility in the global market. Another factor was the country's heavy borrowing to finance large-scale infrastructure projects, which led to a significant increase in external debt.

The devaluation of the birr was also facilitated by the World Bank, which provided technical and financial support to Ethiopia's government in the lead-up to the announcement. The World Bank's involvement reflected its mandate to promote global economic development and stability, and its recognition of the importance of Ethiopia's economy to regional and global trade.<sup>2</sup> However, the World Bank's role in the devaluation was not without controversy, with some critics arguing that the Bank's policies and recommendations may have contributed to Ethiopia's debt crisis and economic instability.

This was also a significant event in the country's economic history, with far-reaching implications for Ethiopia's people, government, and international partners. It underscored the complex interplay of economic, political, and social forces in the global political economy, and highlighted the role of international institutions such as the World Bank in shaping economic policy and outcomes.

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<sup>1</sup>Fassil Eshetu. "Birr devaluation and its effect on trade balance of Ethiopia: An empirical analysis." *Journal of Economics and International Finance*, Vol. 9(11), pp. 103-119, December 2017.

<sup>2</sup>Ibid.

## METHODS

This research uses 3 different methods, namely Qualitative method, Secondary Data method, and also Exploratory Research. Qualitative research itself emphasizes data analysis and sharpening of a sentence. The power of word processing is also relied upon in qualitative research method.<sup>3</sup> Processing data by taking existing data without conducting interviews, surveys, observations or techniques that are directly related to either the location or the source is secondary data. We also used exploratory research in this study. Where, Exploratory research is research that aims to explore, explore knowledge, explore or find new ideas, to formulate problems in more detail to make decisions whether new research needs to be carried out. Exploratory research is generally the development of existing hypotheses, not to test other hypotheses but also aims to define and explain the concepts and patterns that will be used in future research.<sup>4</sup>

## RESULT AND DISCUSSION

### History of The World Bank

A multinational financial organization called the World Bank was established in 1944. It seeks to advance economic development and lessen poverty by offering financial and technical support to developing nations all around the world.<sup>5</sup> In order to accomplish this, the organization offers loans to such nations, both short- and long-term loans, with funds designated for economic growth, poverty reduction, boosting education, and reducing social inequities.<sup>6</sup> The World Bank receives funding from member state contributions, bond issuance, gains from financial market investments, and interest income from loan portfolios.<sup>7</sup> The International Development Association (IDA), a division of the World Bank, is one of the programs the organization uses to achieve this. IDA offers loans to low-income nations and nations hit by natural disasters at reduced

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<sup>3</sup>Yoni Ardianto, "Memahami Metode Penelitian Kuantitatif", <https://www.djkn.kemenkeu.go.id/artikel/baca/12773/Memahami-Metode-Penelitian-Kualitatif.html> , diakses pada 27 Oktober 2022.

<sup>4</sup>"Penelitian Eksploratif: Arti, Ciri, dan Contohnya", <https://www.sampoernauniversity.ac.id/id/penelitian-eksploratif-arti-ciri-dan-contohnya/> , di akses pada 27 Oktober 2022.

<sup>5</sup> Michelle Miller Adams, *The World Bank: New Agendas in a Changing World*, (New York: Routledge, 1999), <https://www.routledge.com/The-World-Bank-New-Agendas-in-a-Changing-World/Miller-Adams/p/book/9780415193535>

<sup>6</sup> "What We Do," World Bank, Accessed on 13 May 2023, <https://www.worldbank.org/en/what-we-do>

<sup>7</sup> "Debt," The World Bank, Accessed on 13 May 2023, <https://www.worldbank.org/en/topic/debt/overview>

interest rates or even without interest.<sup>8</sup>

### **The Ethiopian Crisis**

The stability of Ethiopia's economy was impacted by a significant currency crisis that occurred in 2017. High trade deficits and a lack of foreign direct investment were the main causes of the crisis, which led to a fall in foreign exchange reserves and required governments to turn to alternative sources in order to satisfy the nation's import requirements. The Ethiopian Birr initially had a value of one US dollar. Tuesday marked the first time in seven years that the central bank of Ethiopia depreciated the birr by 15% in an effort to increase overdue exports. The devaluation was implemented in order to boost exports, which had been stagnant for the last five years as a result of the strong birr relative to major currencies.<sup>9</sup>

The value of the Birr has decreased to 130% over time as a result of periodic currency exchange rate cuts intended to improve the global competitiveness of nations that rely on imports. None of this has yet materialized, despite the fact that it is intended to boost export income while lowering import costs for the nation. Over the past ten years, the nation has shipped \$3 billion worth of goods annually on average, while only \$15 billion worth of goods have been imported.

The issue has also gotten worse as a result of the government's policy of controlling currency exchange rates. The central bank of Ethiopia controls a system of set exchange rates, although these values are viewed as unrealistic because they do not correspond to the actual market rate. As a result, a large number of importers purchase dollars at a premium on the black market, which raises inflation and depresses the birr exchange rate. Because of this, the government of Ethiopia forces importers to ask NBE for foreign currency based on their imports' international prices.<sup>10</sup> Other factors affecting the Ethiopian currency crisis are political uncertainty and inconsistent shifts in government economic policies. Several economic reforms announced by the government have been delayed or cancelled, creating uncertainty and reducing investor confidence.

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<sup>8</sup> IDA Financing," IDA, Accessed on 13 May 2023, <https://ida.worldbank.org/en/financing>

<sup>9</sup> Aaron Maasho, "UPDATE 1-Ethiopia devalues currency by 15 percent to boost exports," Reuters, October 10, 2017, <https://www.reuters.com/article/ethiopia-rates-idUSL8N1ML40J>

<sup>10</sup> Abdur Rahman Alfa Shaban, "Ethiopia moves to combat forex trading on black market," Africa News, last updated on December 19, 2017, <https://www.africanews.com/2017/12/19/ethiopia-moves-to-combat-forex-trading-on-black-market/>

### **Assistance provided by the World Bank**

Assistance provided by the World Bank through Enhancing Shared Prosperity through Equitable Services (ESPES) and related projects has helped Ethiopia over the past seven years to dramatically reduce infant mortality, improve access to prenatal health services, and increase public school enrollment rates, according to Victoria Monchuk of the World Bank Project Task Team Leader. "In the last two years alone, ESPES has enabled more than 8,600 health-related students to receive instruction, allowing 11 million homes to have access to agricultural extension services.

Since the last 12 years, with assistance from the World Bank Ethiopia has reported encouraging results with respect to the implementation of a common monetary policy. This has helped the country achieve several Millennium Development Goals (MDGs), particularly in the areas of access and equity for women in primary education, infant mortality, HIV/AIDS, and malaria.

While these are positive results, the Government of Ethiopia recognizes that more needs to be done. Therefore, the Government of Ethiopia has identified the most critical areas for equitable services in its ongoing strategic planning with the aim of bridging the development gap and has committed to enacting the necessary changes to ensure the achievement of these goals. At the same time, the World Bank states that the quality and capacity of institutional mechanisms that support service delivery are also important factors going forward. In order to ensure that issues like community engagement, public financial management, environmental and social safeguards, fraud and corruption control, as well as systems of monitoring and evaluation, are addressed, capacity building has thus become the World Bank's primary area of focus.

Through block grants that encourage the exchange of information, resources, and accountability across various levels of government, service providers, and citizens, ESPES has supported Ethiopia's decentralized governance system since 2015 in the country. With a focus on the needs of the most vulnerable Ethiopians and less developed areas, ESPES' support for the system has proven to be very successful in enhancing equal access to essential services in nearly

a thousand districts around the nation.<sup>11</sup>

These extra resources will aid in funding grants for the provision of fundamental social services like healthcare, education, agricultural services, rural roads, and water and sewage. The monies will support adequate nutrition, community involvement, social and environmental protection, and fiduciary management in addition to scaling up current initiatives. According to Carolyn Turk, World Bank Country Director for Ethiopia, Sudan, and South Sudan, "the project will build on the successes achieved in service delivery and apply significant lessons learned during previous phases to improve efficiency." "By refocusing on outcomes and equity, we seek to help the most marginalized and underprivileged groups, assisting Ethiopia in its efforts to broaden the scope of its transition to Middle Income Country status.

ESPES will keep using Ethiopia's own institutions and procedures and will continue to tie payments to the accomplishment of particular goals. As a result, the nation's capability will be boosted, effectiveness and efficiency will be improved, and more concrete and long-lasting achievements will be attained. Even while the European Union, the African Development Bank, the governments of Italy and Austria, as well as the European Union, are the primary funders for the provision of basic services, they also make contributions. The Ministry of Finance and Economic Cooperation will still be in charge of ESPES implementation.

## CONCLUSION

It is difficult to make a definitive judgment on whether the World Bank's actions helped or hindered Ethiopia's devaluation in 2017. On one hand, the World Bank provided technical and financial support to Ethiopia's government, which likely helped to smooth the transition and implementation of the devaluation. Additionally, the World Bank's assistance may have helped to build confidence among foreign investors and other international partners. On the other hand, the World Bank's policies and recommendations may have contributed to Ethiopia's debt crisis and economic instability in the first place. For example, the Bank has been criticized for encouraging Ethiopia to pursue large-scale infrastructure projects without sufficient attention to the country's

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<sup>11</sup> World Bank Group Reaffirms its Commitment to Advance Equitable Access to Basic Services for Millions of Ethiopians. 2017. The World Bank. <https://www.worldbank.org/en/news/press-release/2017/09/14/world-bank-group-reaffirms-its-commitment-to-advance-equitable-access-to-basic-services-for-millions-of-ethiopians>

debt sustainability or the potential risks of such investments.

For conclusion, we as a writer accept that the World Bank's role in Ethiopia's devaluation is complex and multifaceted, and it is difficult to say with certainty whether its actions helped or hindered the process. However, it is clear that the devaluation had significant implications for Ethiopia's economic future, and that the country's relationship with international institutions like the World Bank will continue to be a critical factor in its development.

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