THE EFFECT OF EXTERNAL DEBT ON ECONOMIC GROWTH OF ETHIOPIA

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2016/HD06/3198X

A RESEARCH REPORT SUBMITTED IN PARTIAL FULLFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF ECONOMIC POLICY MANAGEMENT OF MAKERERE UNIVERSITY.

NOVEMBER, 2017

ABSTRACT

External debt has been in Ethiopia since the time of the emperor and reached its apex US$10billion towards the end of the Dergue (socialist) period a condition that has turned the country into one of the heavily indebted country where debt servicing (interest payment) reached 1billion birr an equivalent of $250million at the then exiting exchange rate of $1=5Ethiopian birr

To date we can see that Ethiopia has been and is still facing a serious financial crisis in form of heavy debt burden from external debts. Ethiopia's external debt is not simply unsustainable; even the most generous debt relief would not bring the country within reach of meeting its responsibility within the context of global poverty-reduction goals. In line with this, according to the World Bank classification of Highly Indebted Economies, the country is one of the severely indebted low-income countries. Ethiopia being a developing country has not been out of danger, an implication that the country is incapable of servicing its debt and attaining a reasonable level of economic growth. Therefore, the issue is what kind of effect the accumulated external debt stock and the repayment of debt will has on the economic growth of Ethiopia in the long run and what is the optimal level that Ethiopia can borrow from outside so that it can helps in fostering economic growth.

This study investigated the effects of external debt on economic growth in Ethiopia for the period 1985-2016 using annual time series. To achieve the study major objective the study used tests like Augmented Dickey- Fuller (ADF) for stationary, Johansen for co-integration, Vector Error Correction Model (VECM) for checking the existence of long run relationship between the variables. External debt was found to have a positive effect on the economy of Ethiopia in the long run with the optimal level of external debt to GDP ratio of 123%.The main policy implications of the study findings is that government should reduce over reliance on External debt and increase on investment that will bridge that savings gap that leads the country to borrow.

Key words; External debt and Economic Growth