AFRICAN DEVELOPMENT BANK
Ethiopia Country Office
P.O. Box 25543 Code 1000
Addis Ababa, Ethiopia,
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Tel: +251 115 177268
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Request for expression of interest to undertake a diagnostic analysis on
Which exchange rate regime should Ethiopia adopt and why?

Introduction

The African Development Bank hereby invites individual consultants to indicate their interest in the following assignment: ‘Which exchange rate regime should Ethiopia adopt and why?’ Over the last 15 years, Ethiopia’s economy has expanded at rates exceeding 10% annually and poverty declined from about 28% in 2011 to 23.5% in 2016. Structural transformation is occurring, albeit at a slow pace. However, inequality is rising, and emerging macroeconomic imbalances including foreign currency scarcity and structural bottlenecks are putting a break on the high rates of growth as well as its inclusivity. Accelerating the process economic transformation necessitates a transition from the government-led growth model to increased private investment and finance as driver of growth. Consequently, addressing the key impediments to private investments, including a conducive exchange rate regime, is a key policy priority for Ethiopia.

1. The services to be provided under the assignment include:

   o Undertaking detailed review of literature on exchange rates in Ethiopia relative to other low-income countries, data gathering and a systematic analysis of the current exchange rate regime and its implications for inclusive and sustained economic growth;
   o Outlining different exchange rate management systems and the associated pros and cons, particularly relative to Ethiopia’s country context;
   o Using relevant data, estimate the extent of exchange rate misalignment in Ethiopia and the implications for economic growth and ongoing reforms;
   o Using relevant macro-econometric models, estimate the potential costs and benefits of transitioning towards a more competitive exchange rate policy for Ethiopia, including the monetary, fiscal, external, and real sector (output, poverty, income distribution etc.) outcomes; and perform different policy scenarios for the period 2020/21-2024/25; and
   o Preparing an analytical report capturing, among others the key issues in exchange rate management, and recommend policy options to inform dialogue with the Government of Ethiopia on the required reforms to transition towards a more favorable exchange rate
policy to reduce distortions, facilitate competition and support the country’s economic transformation objectives. The assignment is expected to be completed within three months, starting on 15th November 2020 and be completed by 31 March 2021. The consultant will need to commit effort equivalent to at least two person months. The consultant may work from any location and no mission is expected.

2. The African Development Bank Ethiopia Country Office invites individual consultants to indicate their interest in providing the above-described services. Interested consultants shall provide information on their qualifications and experience demonstrating their ability to undertake this assignment (current CV; a 3-5 page proposal with indicative cost; reference to and experience on similar assignments; etc.)

3. The eligibility criteria, the establishment of a short list and the selection procedure shall be in conformity with the Bank’s Procurement Policy Framework under projects financed by the Bank Group, October 2015 Edition, available on the Bank Website at http://www.afdb.org. Please, note that interest expressed by a Consultant does not imply any obligation on the part of the Bank to include him/her in the shortlist.

4. The estimated duration of the services is two person months, with expected start date of 15th November 2020.

5. Interested individual consultants may obtain further information at the address below during Bank’s working hours: 8am – 5pm.

6. Expressions of interest must be received at the address below no later than 25th October 2020 at 6am GMT and specifically mentioning Which exchange rate regime should Ethiopia adopt and why?

For the attention of: Ms. Netsanet Hussen
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Email: n.hussen@afdb.org; p.mpuga@afdb.org
Annex 1

Terms of Reference (ToR) -
Which exchange rate regime should Ethiopia adopt and why?

1. Background

The exchange rate – the ratio for exchanging one currency to another - is important in determining the economic performance of a country. The governance of the exchange rate is determined by the exchange rate regime with far-reaching consequences (as it is linked to capital controls and monetary policy framework). The way the country’s monetary authority manages its currency in relation to other currencies and the foreign exchange market has important implications for the real and the financial sectors of the economy. Facilitation of international trade, export competitiveness, investment, inflation, mobility of capital, elasticity of the labour market and the administrative capacity of the authorities all come into play when considering the exchange rate regime to apply. Moreover, policy decisions on the exchange rate regime will determine the policy options that are available in other areas of economic policy.

The extent to which the exchange rate should be determined by market forces or how much authorities should aim to influence the exchange rate have remained a point of discussion in the international literature (Hoffmann 2006; Tornell & Velasco 1995). Exchange rate regimes are differentiated on the continuum of fixed and flexible/floating exchange rate regimes, with pros and cons for each regime along the spectrum of exchange rate chosen by a country. Generally, countries in the transition phase in their economic development are faced with the significant challenge of effectively managing their exchange rate system to best suit their context. The task of effectively handling the choice of the exchange rate regime is challenging “as is witnessed by the frequent alterations of regime observed in many countries over time”(Staehr 2015). Moreover, the factors that determine the choice of the exchange rate regime do change across countries and over time.

Ethiopia has achieved strong real GDP growth during the past 15 years, driven by large public investments, especially in physical and social infrastructure, and foreign direct investment. Structural transformation is also underway, albeit at a slow pace. Accelerating the process economic transformation necessitates a transition from the government-led growth model to increased private investment and finance as driver of growth. Consequently, addressing the key impediments to private investments, including a conducive exchange rate regime, is a key policy priority for Ethiopia.

2. Purpose and objectives of the assignment

The purpose of this assignment is to generate analyse the current exchange rate regime in Ethiopia and recommend policy options to inform dialogue with the Government of Ethiopia on the required reforms to transition towards a more favorable exchange rate policy to reduce distortions, facilitate competition and support the country’s economic transformation objectives.
2.1 The proposed work is excepted to:

i. Highlight Ethiopia’s current exchange rate regime over the past 20 years, and its implications on economic growth and transformation.

ii. Outline different exchange rate management systems and the associated pros and cons, particularly relative to Ethiopia’s country context;

iii. Using relevant data, estimate the extent of exchange rate misalignment in Ethiopia and the implications for economic growth and ongoing reforms;

iv. Using relevant macro-econometric models, estimate the potential costs and benefits of transitioning towards a more competitive exchange rate policy for Ethiopia, including the monetary, fiscal, external, and real sector (output, poverty, income distribution etc.) outcomes; and perform different policy scenarios for the period 2020/21-2024/25;

v. Provide policy recommendations and options to mitigate foreign exchange distortions in the short- to medium-term and to inform Ethiopia’s transition to a more conducive exchange rate policy over the medium to longer-term; and

vi. Identify steps towards an exchange rate regime that is consistent with Ethiopia’s development objectives;

3. Methodology

Theoretical review: In order to achieve the above objective, it will be important to present a quick non-technical summary of the existing theoretical discussions for an objective assessment of the different systems. The theoretical review will include a description of the various exchange rate regimes, the interaction of the exchange rate regime with other policies (including capital flow and monetary policy frameworks, for example, the impossible trinity or the Mundell-Fleming trilemma, among others). This will generate knowledge on the various policy considerations necessary in establishing a conducive exchange rate regime.

Review of country experiences: The experience of other countries in exchange rate management is a critical part of the assignment. The assignment aims to sieve through relevant experiences of countries focusing on countries with conditions similar to those existing in Ethiopia, that have transitioned from exchange rate and/or monetary regimes to different systems. This will help to distill best practice in transition and provide a clear description of key milestones during the transition process. The review will examine diverse country groups, including countries in Africa, Eastern Europe, Latin America and Asia.

Estimating the misalignment of the real exchange rate: The ultimate impact of exchange rate management can be quantified through the effect of exchange rate fluctuations on prices, output, interest rates and the current account, among others. There are views that a misalignment of the real exchange rate can be used to improve the profitability of the tradable sector and address market and institutional failures – via undervaluation (Rodrik 2008). Economists argue that persistent misalignment of the real exchange rate (overvaluation) will eventually lead to devaluations with undesirable impact on economic growth. The consultant will therefore use the latest available methods to analyse the extent and drivers of exchange rate misalignment in Ethiopia. The implication of different exchange rate regimes on Ethiopia’s macroeconomic policy ambitions -- rapid and sustained GDP growth and structural transformation -- will also be examined.

Estimating impacts of different exchange rate regimes on macroeconomic outcomes:
Once the level of misalignment and a path to competitive exchange rate has been defined, this section will present the impact of variations in exchange rate policy on macroeconomic variables such as real output, exports, imports and balance of payments. Analysis will be undertaken using a macro-econometric model that simultaneously captures the major relationships between prices, balance of payments and output, and helps to identify the impact of policy shocks on the county’s external debt sustainability.

Policy recommendations.
This section will tie together the findings and analysis and findings into a set of policy recommendations on how Ethiopia can transition from the fixed exchange rate regime to a market determined one.

4. **Scope of Work and Deliverables**

The primary deliverables to be undertaken by the consultant during the period November 2020 – March 2021 will include:

i. Inception Report capturing: (a) review of relevant literature and country experiences, (b) the methodology to be used in responding to the study questions, data to be gathered, their periodicity and potential sources (c) and the proposed outline of the report;

ii. Draft and revised study reports incorporating stakeholder comments and suggestions;

iii. Presentation of draft study reports at the Macroeconomic Forum for review and inputs; and

iv. A final study report underscoring key policy options, with the how and who to implement them.

5. **Deliverables and Timelines**

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<th>Activity</th>
<th>Indicative Timeline</th>
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<tr>
<td><strong>Deliverable 1 (D1):</strong></td>
<td>November 15, 2020</td>
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<tr>
<td>- Inception report capturing:</td>
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<tr>
<td>(a) review of relevant</td>
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<td>literature and country</td>
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<td>experiences, (b) description of the methodology to be used in responding to the study questions, and why, (c) outline the sources of data, periodicity and how the data will be gathered, and (d) outline of the study report</td>
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<td><strong>Deliverable 2 (D2):</strong></td>
<td>January 2021</td>
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<td>- Draft study report underscoring the key findings in line with methods applied</td>
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<td>- Outline of implications for policy recommendations</td>
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<td><strong>Deliverable 3 (D3):</strong></td>
<td>January 2021</td>
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<td>- Presentation of the draft study reports at Macroeconomic Forum for review and inputs</td>
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<td><strong>Deliverable 4 (D4):</strong></td>
<td>February 2021</td>
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<td>- Revised draft report incorporating the comments of the Macroeconomic Forum and other reviewers.</td>
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- The revised draft report will underscore the key policy recommendations, to be reviewed by the Ministry of Finance and the National Bank of Ethiopia for consistency with ongoing reforms, and within the Bank for their viability.

**Deliverable 5 (D5):**
- Final report incorporating the comments of the Ministry of Finance and the National Bank of Ethiopia as well as the Bank’s internal review.
- The final report will underscore the key recommendations with how and who will implement them

| March 2021 |

6. **Desired qualifications and competencies**

The national individual consultant should be able to demonstrate professional, operational and academic competence in the field of macroeconomics and economic policy, with specific experience working with governments in developing countries. Individual candidates should be able to demonstrate the following academic qualifications and professional experience, at a minimum:

**Academic qualification:** At least a master's degree or equivalent in development economics, economics, macroeconomic policy analysis, public sector economics, and related disciplines.

**Experience:**
- At least fifteen (15) years, of progressive experience in the field of economic policy analysis, working with governments, and/or international organizations;
- Specific experience in relevant areas that include macroeconomics, exchange rate, inflation analyses or monetary and fiscal policy management;
- Experience of working with the public sector, particularly in macroeconomic management and policy analysis.
- Experience in economic research and macroeconomic modelling as well as preparing policy analysis and policy briefs.
- Demonstrable experience in the relevant areas of research and policy work in developing countries is desirable. Previous experience on such work in Ethiopia will be a bonus;
- Excellent communication skills and ability to meet tight deadlines and under pressure.