Unlocking Forex for the Off-Grid Solar Sector

Ethiopia

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Africa Clean Energy
Catalysing Africa's Solar Markets

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INTRODUCTION

Ethiopia has set a target of creating access to electricity for 9 million households through the stand-alone solar (SAS) systems by 2025. It is an ambitious but achievable target if existing constraints can be tackled. The main challenge affecting private businesses and households' access to Off-Grid Solar (OGS) is lack of access to forex for the import of solar products. The World Bank/Development Bank of Ethiopia (DBE) credit facility has to some extent alleviated this problem by extending working capital loans to Private Sector Enterprises (PSEs) for the importation of solar products until the fund was depleted in 2019. With the universal electrification target date fast approaching, a policy shift is required to address the forex challenge.

Forex is a chronic problem to the country and the prospective policy measure to support off-grid solar should not affect the amount of forex available to other priority sectors like pharmaceutical, fuel and inputs for agriculture. It should also be a timebound measure targeted at alleviating the forex constraint in the off-grid solar sub-sector.

Statement of the Problem

OGS import is not designated as an essential commodity by National Bank of Ethiopia (NBE) for priority access to forex. Forex availability for import in general is also affected by the decrease in remittance flow, due to the impact of COVID-19 and the country's commitment to service its growing foreign debt. The new NBE directive, 'retention and utilization of export earnings and inward remittances directive no. FXD/70/2021', requires all beneficiaries to surrender 30% of their foreign currency earning to the commercial banks and further requires the beneficiaries to sell 55% (of the remaining 70%) of their foreign currency earning to the bank on the day of receipt at the prevailing buying exchange rate. This will likely reduce the forex access of many solar product distributors (who are mainly diaspora returnees).

Market Forecast

If the National Electrification Plan (NEP) 2.0 plan is to be met, annual supplies of OGS products will have to rise significantly over the next few years - annual supply must increase by an average of 12% from 1.7 million units in 2021 to 2.7 million units in 2025. Close to two-thirds of the supply or 6.8 million units must be solar lanterns and the rest solar home systems (SHS) and pico systems as shown in figure 1.

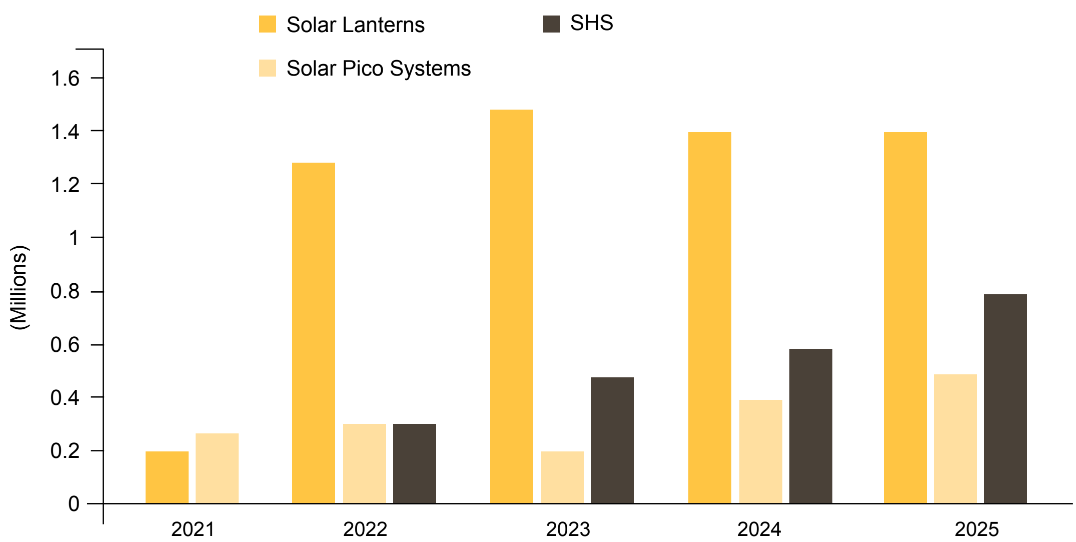

Figure 1: Off-grid electrification demand, 2021-2025

The estimated supply value (excluding distribution costs) for the home system component of the off-grid plan is estimated at USD 72 million in 2021 and set to rise to USD 171 million in 2025. Cumulative investment in solar home systems between 2021 and 2025 will be USD 587 million total (or about USD 117 million annually), with SHS accounting for close to two-thirds of the total cost, as shown in Figure 2. If we add solar pumps, the total estimated supply cost reaches over USD 1 billion.

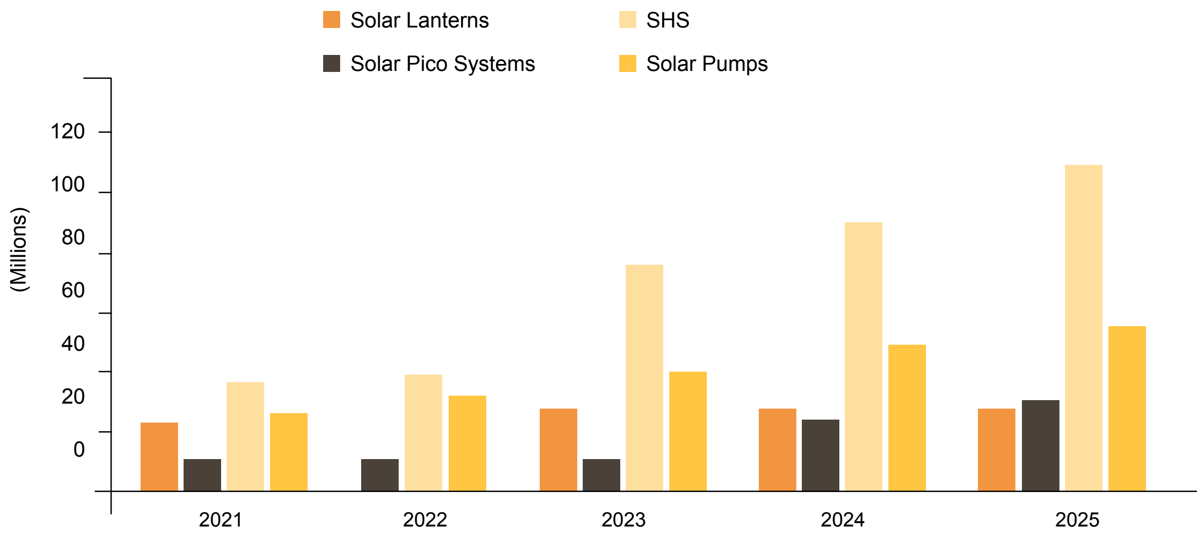

Figure 2: Off-grid electrification investment, 2021-2025

Comparing the quality certified GOGLA off-grid solar sales trend, without considering non-quality certified imports, the estimated potential demand for the next 5 years shows a significant deficit in supply. To illustrate the point, the highest quality certified OGS import was registered in the second half of 2019 with a total import of 718,000 units. For Ethiopia to meet the 1.7 million units of imports forecasted for 2021, it needs to bring in an additional 1 million units above and beyond the figure recorded in 2019; to satisfy the market demand. This is unlikely without a commensurate increase in the amount of forex available to private sector OGS product importers.

Local manufacturing is extremely limited; mainly assembly processes for pre-made components but has high growth potential given the Government of Ethiopia's (GoE) prioritization of manufacturing activities. However, the current capacity of solar manufacturers is exceedingly small for any significant difference in the supply of solar products to the local market.

What are the Potential Solutions for the Forex Constraint?

Donor financed credit facilities are one of the potential solutions. In this regard, there is already good experience with the WB/DBE credit facility. This credit facility had financed the import of over 800,000 SAS products until the fund was depleted in 2019. The World Bank and African Development Bank have also jointly set aside a sum of USD 500 million to support the OGS sector. The loan component for private sector enterprises, towards the import of SAS products for household and productive use, is not more than a fifth of the total. As we may see above, this is not sufficient enough to meet the potential demand for forex to import solar products for the next five years.

If donor financed credit facilities are not adequate in satisfying the potential demand for forex, are there any other potential solutions? The government may allow foreign solar manufacturers, that have the necessary forex resources, to import and engage in the retail business in Ethiopia. The modalities of their engagement in the local market may take one of the following forms.

Option 1

The government may allow foreign private businesses to set up distribution avenues in Ethiopia if they agree to sign an undertaking to establish a manufacturing operation in the country after a 3 year trial period. Domestic manufacturing of solar products creates employment opportunities for the growing unemployed youth, saves scarce forex for other essential imports and helps in the dissemination of critical knowhow and key technology in the local economy, for emulation by local entrepreneurs.

Option 2

Foreign companies may be allowed to setup a distribution operation for a specified period, say until 2025. This will help the country achieve a critical milestone i.e., universal electrification access by 2025. Moreover, it will provide widely available solar appliances that will power water lifting for safe drinking water, expand solar pump irrigation, replace diesel pumps, and enable non-farm enterprises to process agricultural raw materials.

Option 3

The government may alternatively allow foreign companies that have established joint venture partnerships with local distributors to enter the market for a specified number of years, preferably until 2025. This arrangement allows foreign partners to tap into their local partners' knowledge of the legal and institutional landscape of the domestic business environment. On the other hand, local partners in this arrangement will benefit from new capital injection and technology transfer that can upscale their operations and help implement new consumer financing solutions such as Pay-As-You-Go (PAYG).

Next Steps

To allow foreign solar businesses to operate in the retail space in Ethiopia, donors and other stakeholders can engage the government on Investment Regulation No. 474/2020, which prohibits foreign-owned companies from retail trade.

A first step would be to hold consultations with Ministry of Water, Irrigation and Electricity (MoWIE), the industry association and other relevant government stakeholders aimed at garnering their support for the proposal.

The second step would be to seek authorization from the Ministry of Finance (MoF) for temporary derogation for solar retail businesses for a specified period of time (preferably until 2025). The case can be made for significantly decreased end-user prices if businesses can oversee their own importation, distribution, and sale of solar products.

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