

PERFORMANCE OF THE ETHIOPIAN ECONOMY 1991-1998

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1. INTRODUCTION

Ranked at 169th out of a total of 174 countries by the most recent Human Development Report, Ethiopia is, by any measure, one of the poorest countries on earth. The miserable condition of the Ethiopian economy is reflected in every sector and by all standard social and economic indicators one chooses to use. Ethiopia's real per capita GNP calculated in dollar terms for 1997¹ was \$110, which surpasses only Mozambique with a GNP per capita of \$90. The average figure for low-income countries for the same year was \$350 while the average for Sub Saharan Africa was \$500.² If we use purchasing power parity (PPP) which is more indicative of people's buying power in their own countries, Ethiopia's real GDP per capita for 1995 was \$455 which is the second lowest figure only better than the Democratic Republic of Congo with a value of \$355.³ This is a very low figure even compared with other developing countries. The average for LDCs was \$1008 while the average for all developing countries was \$3068. Our close neighbor Kenya has a value over three times more than Ethiopia with a PPP of \$1438.

The level of poverty in the country is rather staggering. Over 46% of the population, roughly about 28 million people currently live under the dollar a day measure of poverty with a 12.4% poverty gap, i.e. with an average of 12.4% below the cut-off figure indicating the depth of poverty. Increasing the poverty line to \$2 a day raises the number of people living under the poverty line to 89% of the population or over 53 million people and 42.6% poverty gap.⁴ The adult literacy rate for Ethiopia stands at 35.5 compared with 49.2 for least developed countries and 77.6 for the rest of the world. Kenya stands over twice that of Ethiopia at 78.1. The gross enrollment ratio for 1st, 2nd and 3rd levels stand at 20 in 1995 compared with 36.4 for LDCs, 52 for Kenya and 61.6 for the rest of the world. Life expectancy at birth stand at 48.7 for

¹For data needing comparison between countries, we used the most recent World Bank World Development report, 1998/99 and the Human Development Report of the United Nations Development Program, 1998. The WB report uses 1997 as the most recent reporting time while UNDP uses 1995. For strictly Ethiopian data, we used local sources, which have data as recent as 1990 Ethiopian calendar (1997/98 Gregorian Calendar).

²World Bank, op.cit., pp.190-191.

³Human Development Report, 1998.

⁴See Table 4, Poverty, World Bank, World Development Report, 1998/99 p.196.

Ethiopia compared to 62.2 for all developing countries and 53.8 for Kenya. Only 27% of the population have access to safe water and 10% have access to sanitation while the infant mortality rate stands at 109 deaths per 1000 live births. These figures stand at 71 for safe water, 30 for sanitation and 80 for infant mortality rate for low-income countries. For Kenya the figures stand at 53 for access to safe water, 77 for sanitation and 57 for infant mortality rate.

The problem is not only about where we are now. It is more daunting when one looks at where we are heading and the degree to which we are able to narrow the development gap between Ethiopia and other countries. As can be seen from Table 1-1 below, for Ethiopia to reach the level of per capita GDP that is currently achieved by the average low income country (350 USD) it will take her about 30 years assuming the other countries register no per capita income growth and Ethiopia grow at an annual rate of growth of PCI of 4% or a real GDP growth of 7% per year. It will take 17 years if we grew by 10%. By the same token it will take us about 37 years to reach the level of the average Sub Saharan African country with a 7% GDP growth and 22 years with a 10% growth. On the other hand, achieving the growth level of middle income countries will take over three generations. But, to be realistic, other countries will not wait for us when we register such a high growth rate. The situation looks even more hopeless when we consider a PCI growth rate of 4% for them while we grow at 7%. In this scenario, it will take about 41 years to achieve average low income level, 53 years to reach the average SSA country, 100 years for the average middle income countries.⁵

To achieve such a fantastic rate of growth of PCI for Ethiopia it requires a historically unprecedented level of savings either from domestic or foreign sources. Ethiopia is required to ensure a saving rate of 16% of GDP to achieve a 10% growth rate of GDP.⁶ The highest level of savings so far achieved in our country was 13% obtained

⁵Let Y_0 and Y_0^* be the levels of the per capita GDP of Ethiopia and other countries' group (low income, middle income and SSA countries), respectively, in year 0. And let Y_t and Y_t^* be levels of per capita GDP of Ethiopia and other countries' group, respectively, at year t . Then, the number of years required to catch up the other countries whose economy grow at an average of g^* , if Ethiopia's economy grows at a rate of $g\%$ per annum in per capita terms, can be calculated as follows.

$$Y_0(1+g)^t = Y_0^*(1+g^*)^t \Rightarrow \left(\frac{Y_0^*}{Y_0}\right) = \left[\frac{(1+g)}{(1+g^*)}\right]^t \Rightarrow t = \frac{\log\left(\frac{Y_0^*}{Y_0}\right)}{\log\left(\frac{1+g}{1+g^*}\right)}$$

⁶With a capital-output ratio of k , the saving rate required to achieve a growth rate of g may be derived using the simple Harrod-Domar model:

$$s = kg.$$

For Ethiopia, there is no reliable investment function made so far. Hence, we used the method used by J. Bognar; that is, we divided the total gross investment (data for depreciation is not available) for the past ten

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in the last years of the imperial regime. During the Derge period the average saving rate for the country was 7.2% which has come down to about 6.3% on average between 1991-97. This figure has recently grown to about 9%.

Table 1-1. The Number of Years Required for Ethiopia to Catch up With Other Countries

Ethiopia with Per Capita GDP of \$110		Low Income Countries (USD 350)		SSA (USD 500)		Middle Income Countries (USD 1890)		To Double PCI
		g = 0%	g = 4%	g = 0%	g = 4%	g = 0%	g = 4%	
No. Of Years Required for Ethiopia to Catch up	g = 4%	29.5	∞	36.6	∞	72.5	∞	17.7
	g = 7%	17.1	40.7	22.4	53.3	42.0	100.0	10.2

Where g = growth rate of per capita GDP

Source: Authors' calculation using the method provided in footnote 5.

It is this dismal economic scene that prompted many Ethiopians to desperately seek a way out of this economic quagmire. In 1974, the educated strata of the Ethiopian population felt that the main factor responsible for the overall backwardness and the poor performance of the Ethiopian economy largely rests on the "feudo-bourgeois" regime of Emperor Haile Selassie and the largely pro-capitalist and pro-feudal policies that he pursued. The preferred policies of these revolutionaries was to redirect the Ethiopian economy along socialist lines which was hoped to release the productive forces of the country for a more rapid economic growth on more egalitarian grounds with significant transformations in the structure of the national economy. After seventeen years of this experiment (although a stunted version) and incalculable human, social, political and psychological cost to the whole society, none of the promised achievements occurred. In fact, the Ethiopian economy was much worse off in 1991 when Mengistu's "socialist" dictatorship was overthrown than when it took power seventeen years earlier.

Seven years have passed since Ethiopia has again charted a new course to address these same economic issues. This time again, as in the past, the main problem with the economy was associated with policies of the previous regime. A new pro-capitalist and market friendly regime that reverses the dirigiste policies of the past was instituted to stabilize the economy and eventually achieve a healthy economic growth. Various policy measures, some of which are homebred while others are standard medicines subscribed by multinational financial institutions, were taken to achieve the intended immediate objective of macroeconomic stability and the long term objective of sustained economic growth. In addition to these broad policy measures, various sector specific social and economic policies and programs were implemented to complement and support the macro policies.

years by the incremental change in GDP for the same period. This estimates the capital - output ratio to an average of 1.6 for the past 10 years. We have used this to calculate the figures that follow in the text.

This paper aims to review and evaluate the performance of the Ethiopian economy in the past seven years. The main intention of the paper is not to provide a definitive assessment of the successes or failures of these policies. Such an endeavor requires a much more detailed and careful analysis of the various sectors of the economy and their interrelationship and the degree to which the policy measures were responsible for the actual performance of the economy. Instead, what is attempted here, in the spirit of an earlier such review,⁷ is to provide a broad indicative assessment of the performance of the Ethiopian economy since the Ethiopian Peoples Revolutionary Democratic Front (EPRDF) took power in 1991 and briefly review the various policies that might have contributed towards this performance. When the situation allows, attempts will be made to suggest some of the policy challenges that are ahead of us if we are to achieve a better performance in the future. The paper proceeds as follows. The next section of the paper will review the "initial conditions" that the new government inherited from its predecessor including a brief assessment of the performance of the Ethiopian economy for the ten years before the new government took over. By way of comparison, the third section will review the various policy measures undertaken by the new government and provide an analysis of the performance of the economy since 1991. The last section of the paper will provide a summary of the findings and raised a number of policy challenges that are ahead of us if we are to have any hope of improving the life of the majority of our population.

2. INITIAL CONDITIONS

2.1. The Structure of the Ethiopian Economy before 1991

The rebels that succeeded in overthrowing the Mengistu regime in 1991 took over an economy that was in shambles, a very unstable political climate and a society that was terribly beaten down by a ruthless dictatorship and a pervasive bureaucracy and little hope for a better future. Probably, the biggest asset of the new government was the good will that it enjoyed from the international donor community.

As mentioned above, by the time the Derge left power, the structure of the Ethiopian economy was not significantly different from the early 70s. As can be seen from Table 2-1 below, agriculture still contributed about 53% of the country's GDP on average between 1980/81 and 1990/91 with a very high values of 58.1% at the beginning of the period and 56.3% in the last year. Industry averaged 12.2% while services averaged some 34.8% of which distributive services account for 14.7%. Industry's contribution to GDP was higher in 1980/81 at 10.9% compared with the last year of the Derge where it stood at 9.4. The only sector that showed improvement was the other services sector, which grew from 17% of GDP to some 22%.

⁷ Eshetu Chole and Mekonnen Manyazewal...(1992).

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Table 2-1. Sectoral Contribution to GDP (1980/81-90/91)

Year	Growth Rate of Real GDP	Agriculture		Industry		Distributive Service		Other Service		Growth Rate of Per Capita GDP
		As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	
1980/81		58.1		10.9		14.0		17.0		
1981/82	0.51	55.7	-3.6	11.8	8.5	14.5	4.3	18.0	6.3	-2.4
1982/83	10.1	57.5	13.6	11.3	5.9	13.5	2.8	17.6	7.8	6.9
1983/84	-6.3	53.7	-12.5	12.8	5.7	14.5	0.3	19.0	1.1	-9.0
1984/85	-9.7	47.0	-20.9	14.8	4.5	16.2	0.9	22.0	4.4	-12.4
1985/86	9.9	49.6	16.0	13.3	-1.2	15.2	3.5	20.8	3.8	6.4
1986/87	14.0	51.7	18.8	13.6	16.5	15.4	16.1	19.3	6.2	10.4
1987/88	-0.1	50.3	-2.8	13.1	-3.8	15.9	3.4	20.7	7.1	-3.0
1988/89	0.3	50.6	1.0	12.2	-6.6	15.0	-5.5	22.2	7.5	-2.7
1989/90	4.1	51.2	5.3	11.2	-4.7	15.0	4.4	22.6	5.8	0.9
1990/91	-4.2	56.3	5.2	9.4	-19.1	12.0	-23.5	22.3	-5.5	-7.2
Average	1.9	52.9	2.0	12.2	0.57	14.7	0.57	20.1	4.5	-1.2

Source: MEDaC, National Income Accounts, Revised Series, 1998.

2.2. Brief Review of Economic Performance under the Derge: 1980/81-1990/91

2.2.1. Trends in GDP and Value Added in the Various Sectors

During the Derge period not only the structure of the economy did not change, but also the overall performance of the economy was poor. Real GDP growth was actually negative in three of the ten years considered. There were three exceptionally good performance years one of which started with a low base of two consecutive negative growth of -6.3% and -9.7% following the drought years of mid 1980s. The highest "normal" rate of growth of GDP registered during this period was the 14% growth rate achieved in 1986/87 following the 9.9% growth rate of the previous year. The average real GDP growth for the last 10 years of the Derge period was 1.9% per year compared with an average population growth of 3% leading to a net decline in per capita income of 1.2% per year. This dismal performance is reflected in all the sectors except for the service sector. Agricultural production grew by a mere 2% per annum during the period while industry and distributive services grew by 0.57% per year on average.

2.2.2. Trends in Savings and Investment

Economic growth is largely related to the rate of investment, which in turn is related to savings. Gross Domestic Saving (GDS) as percent of GDP had reached the highest figure of 13% in the last years of the imperial regime. The socialist state was supposed to increase this by reducing the "conspicuous consumption" of the ruling classes and owing to the sacrifice it anticipates from the lower classes. Rather than

an increase in the saving and investment ratios what we achieved during the Derge was a huge fluctuation ranging as high as 12.5% in 1987/88 and as low as 3.4% in the last year. On average GDS was 7.2% over the last ten years of the regime. Gross fixed capital formation (GFCF) as percent of GDP averaged about 14.2% per annum during the ten years reaching a peak of 20.4 percent in 87/88 and dropping to about half that level in 1990/91. The gap between investment and domestic saving (the resource gap) averaged about 7.1% during this period requiring foreign savings which comes in the form of grants and loans from other countries. This is reflected in the country's debt burden, which is measured by the country's external debt as percent of GDP and the debt service ratio. The former was steadily increasing from 25.6% in 1981/82 to a high of 43.1% in 1990/91 averaging about 35.7% for the ten years. The latter also showed a marked increase from a low 12.9% to a whopping 69.9% averaging 34.4% for the whole duration. As can be seen from Table 2-2 below, the decline in the saving and investment ratios is not a result of the public increasing its consumption from previous levels. In fact private consumption expenditure held relatively steady or even declined a bit during this time. What happened instead was a marked increase in government consumption as a result of the overall expansion of the bureaucracy and the military in particular. Public consumption as percent of GDP increased from a modest 14.2% in 1980/81 to over 19% in the latter part of the 80s averaging 16.7% for the whole duration.

Table 2-2. GDS, GFCF, Resource Gap, Consumption and Total Debt (1980/81-90/91)

Year	(1) GDS as % of GDP	(2) GFCF as % of GDP	(2-1) Resour ce Gap	External Debt as % of GDP	Debt Service Ratio	Public Consu- mption as % of GDP	Private Consu- mption as % of GDP	(3+4) Total Consu- mption Exp.
1980/81	7.6	13.6	-6.0			14.2	78.3	92.6
1981/82	5.9	13.7	-7.8	25.6	12.9	15.3	78.7	94.0
1982/83	5.5	12.2	-6.7	27.6	16.2	16.8	77.8	94.6
1983/84	8.1	16.8	-8.7	31.7	16.1	17.3	74.6	91.9
1984/85	2.8	10.7	-7.9	33.8	24.8	15.3	81.8	97.1
1985/86	8.6	16.4	-7.8	36.1	25.6	15.8	75.6	91.4
1986/87	7.6	15.6	-8.0	37.4	37.2	15.7	76.7	92.4
1987/88	12.5	20.4	-8.0	41.3	43.5	18.1	69.4	87.5
1988/89	8.9	14.4	-5.5	41.2	39.2	19.4	71.7	91.1
1989/90	7.9	12.5	-4.5	43.1	58.9	19.2	72.9	92.1
1990/91	3.4	10.4	-7.0	39.1	69.9	16.5	80.1	96.6
Average	7.2	14.3	-7.1	35.7	34.4	16.7	76.2	92.8

Source: MEDaC op. cit., and National Bank Annual Bulletin, various issues.

2.2.3. The External Sector

The country's foreign trade sector was not immune from this overall trend in the last decade of the Derge. Since 1980/81 exports as percent of GDP were fluctuating

although the overall trend was declining for the whole period. On average, the value of exports were 8.7% of GDP declining from a peak value of 10.6% in 1980/81 to about half that level by 1990/91. Imports also had a declining trend, particularly in the last few years of the regime, although not by as much as exports. The average import to GDP ratio was about 15.8% during this period. The gap between imports and exports (the current account balance) during this time averaged about -7.1% of GDP. The structure of imports and exports showed some change during this period where capital goods imports as percent of total imports increased seemingly at the expense of consumer goods imports. On the other hand except for the unusual final year of the regime, the place of coffee in the total exports seems to have been maintained hovering around 57% for the five years data is available.

2.2.4. Monetary and Fiscal Developments

Attaining rapid economic growth requires raising investment which in turn requires investible resources. One possible source of finance for investment is foreign saving. However, the government's anti-imperialist rhetoric could not ensure such a supply from the more capable western sources forcing the government to largely rely on domestic sources of finance. The preferred method of the Derge was massive domestic borrowing and printing money. Money supply (both broad money and narrow money) had growth rates much higher than the growth rate of both nominal and real GDP. As can be seen in Table 2.4, money supply was increasing by more than twice that of GDP on average during the 9 years under consideration. The increase in money supply had apparently no major effect on inflation partly because of the price controls exercised by the authorities. The increase in the money supply has also helped private savings to rise a bit as the venue for private investment is reduced because of the imposition of capital ceilings.

On the fiscal side the government's expenditure was rising significantly without a comparable rise in revenue. The government's socialist strategy required that most productive activities, particularly industrial activities, had to be under state control. Recurrent expenditure was rising fast partly owing to the government's expenditure on defense rising from 14.1% of GDP in 1973/74 to over 26% in 1987/88 out of which general government outlay accounted for 15%. To finance these investment activities and the recurrent expenditures, it imposed confiscatory tax rates as high as 89% which, except for its disincentive effect on saving and investment, never was able to match the rising expenditure.

Table 2-3: Value of Exports and Imports (as percent of GDP)

Year	Value of Exports	Value of Imports	(1-2) Resource Gap	Share of Value of Imports (%)						Growth Rates of Volume of Exports			Share of Coffee in the Value of Exports
	(1) As % of GDP	(2) As % of GDP		Raw Materials	Semi finished Goods	Fuel	Capital Goods	Consumption Goods	Misellane ous	Coffee	Non- coffee	Total	
1980/81	10.6	16.6	-6.0										
1981/82	9.5	17.2	-7.8										
1992/83	9.0	15.8	-6.7										
1983/84	10.6	19.3	-8.7										
1984/85	8.1	16	-7.9										
1985/86	9.4	17.1	-7.8	3.8	11.7	11.4	33.6	39.3	0.2				
1986/87	8.2	16.3	-8.0	2.2	12	10.1	42.8	32.6	0.3				64.8
1987/88	8.1	16	-8.0	2.4	14.4	9.5	47.1	28.3	0.3	-11.3	11.4	6.4	55.7
1988/89	9.0	14.6	-5.5	2.6	16.9	10.1	39	30.7	0.7	32.1	-17.9	-8.8	68.3
1989/90	7.7	12.3	-4.5	3.1	17.4	13.8	37.9	27.6	0.2	-5.5	-8.2	-7.5	53.6
1990/91	5.5	12.5	-7.0	2.7	11.1	9.9	45.3	30.2	0.9	-34.5	-10.9	-17.2	46.9

Source: MEDaC, National Income Accounts, 1998 and NBE Annual Bulletin.

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Table 2-4: Growth Rates of Money Supply and GDP

Year	Growth Rate of Nominal GDP	Growth Rate of Real GDP	Growth Rate of Narrow Money	Growth Rate of Broad Money	Inflation Rate	
					CPI*	GDP Deflator**
1982/83	10.7	10.1	15.2	15.0	3.8	2.9
1983/84	-6.7	-6.3	9.1	11.3	-0.5	-3.9
1984/85	18.6	-9.7	13.2	13.6	18.4	34
1985/86	4.2	9.9	18.1	15.6	4.6	-5.5
1986/87	6.0	14.0	12.1	8.1	-9.5	-7.1
1987/88	4.0	-0.1	9.7	8.9	2.2	3.6
1988/89	5.1	0.3	6.7	8.9	9.6	5.2
1989/90	6.9	4.1	19.5	17.6	5.2	3.7
1990/91	14.1	-4.2	22.9	18.7	20.9	19.7
Average	6.99	2.01	14.06	13.08	6.08	5.84

* Calculated using the Consumer Price Index of Addis Ababa (1963 =100).

**Inflation rates are calculated using the implicit GDP deflator.

Source: MEDaC, CSA and NBE Annual Bulletin, various issues.

3. PERFORMANCE OF THE ETHIOPIAN ECONOMY 1991-1998

3.1. General

There isn't much disagreement about the nature of the performance of the Ethiopian economy in the past seven years. Although there might be differences in emphasis and even disagreement on the appropriate comparator to use to get a proper picture of the Ethiopian economy, most observers agree that the Ethiopian economy did reasonably well by most standard criteria between 1991-98. While the government emphasizes the correctness of its overall strategy and its specific policies as the reasons behind its presumed success, its detractors argue that the achievements are not to be exaggerated and that its performance, when evaluated in relation to what could have been achieved with a better policy package, is much worse than what the government wants us to believe. Even the little success the opponents grudgingly accept, they attribute it to the incredible generosity of donors which have showered the government with massive amounts of loans that is bound to be a serious burden in the long run. It is by no means an easy task to accurately assess cause and effect in such a case where there are so many factors that have contributed to the performance of the Ethiopian economy in the past seven years. What we will try in the following pages is to briefly discuss the broad policy framework of the government and provide the reader with what the official data shows about the performance of the economy. We will provide our assessment of the factors that contributed to this performance next.

2.2. Economic Policies of the Ethiopian Peoples' Revolutionary Democratic Front (EPRDF)

Unlike the Derge, the overall economic strategy of the EPRDF government defies easy categorization. While it seems to have grudgingly accepted the capitalist system as the only option for Ethiopia in the foreseeable future, it is by no means convinced that pure market allocation of resources without much government intervention is a viable option for countries such as Ethiopia. This reservation is not simply a hang over from its past egalitarian ideology, although there is some of that influence. More fundamentally, it emanates from a conviction that liberal capitalism could not provide the rapid and sustainable economic development that the country desperately needs. The observed weakness of the capitalist class in such societies necessitates the close working relationship between government and various social forces including the national bourgeois. More importantly the economic policy to be pursued need to be able to galvanize the energies of the masses of people whose contributions as a source of labor, investible resource and domestic demand is as important if not more important than the capitalist class. Furthermore, for economic development to be sustainable in the long-run government has a responsibility to ensure that the spatial difference in the pace of economic development is narrowed and all regions of the country are equal beneficiaries from the developmental effort.

This broad thinking is encapsulated in four core policy items of the government. The first one is the government's strategy known as Agriculture Development Led Industrialization (ADLI).⁸ The essence of this strategy rests in the belief that the agricultural sector can serve as the driving force for the rest of the economy. The logic is simple and mostly persuasive. For a country such as Ethiopia to develop rapidly, it needs to make better use of the abundant available resources in its hand, namely agricultural land and a massive peasant population. Currently, this sector is seriously under utilized and backward. Both land and labor productivity is so low in this sector that the 85% of the population ekes out a meager subsistence with very little contribution to the overall development of the country. The strategy hopes to increase the level of productivity in agriculture through the introduction of modern agricultural techniques and supply of agricultural technology ranging from fertilizers and improved seeds to comprehensive extension services. The increase in income of the rural population following the increase in productivity has more than egalitarian benefits. Higher incomes imply higher savings that can then be harnessed for investment in other sectors. Demand for industrial goods, particularly consumer goods and agricultural inputs, will also grow as a result of rising living standard of the rural population. Surplus agricultural output also benefits industry by making relatively cheap raw materials available for industrial processing. The fact that agriculture is at such a low level of development in Ethiopia also meant that small improvements in agricultural techniques, requiring relatively small capital outlay, have a potential to increase output significantly. In other words, the capital output ratio in agriculture is so

⁸ For details on this strategy, see EPRDF's Five-Year Development Program, EPRDF publication, 1995.

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low that it is a much cheaper strategy to increase economic growth compared with other strategies. All these advantages, the EPRDF believes, make this strategy suitable for Ethiopian conditions.

This can only be successful with deliberate and massive government intervention. The second core belief of the current government is simply an affirmation of that. Its definition and understanding of the role of the state in the economy is much broader than what neo-classical economics and its adherents in multilateral financial institutions recommend. For EPRDF, the objective of economic policy is not just to enhance short-term efficiency in the allocation of resources by providing the requisite legal and psychological environment for the private sector to do its job right. The primary objective of economic policy, instead, is to provide rapid economic development even if that comes at the expense of short-term losses in efficiency. Accordingly, the state involvement in the economy can range from actually producing goods and services that the private sector finds unprofitable, protecting local industry when necessary, providing subsidies, or even segregating certain areas of production to the state sector or to the local private sector. This strategy is preferred based on the presumed successful experiences of South Korea and Taiwan.⁹

The third belief sees the urban economy directly benefiting from the main strategy of ADLI. However, it emphasises the key role of the state in the cities to be a supplier of adequate social and physical infrastructure including electricity, water, roads, sewage disposal, schools, hospitals, residential houses and the like. This is expected to encourage the private sector to do productive investment in the cities and generate employment, lack of which is considered the most important problem of the cities.

Finally, EPRDF's core thinking strongly believes in achieving some kind of regional balance as a key objective of its overall policy. To achieve this objective it has implemented several measures that gives preference in budget allocation to relatively undeveloped regions and a number of incentives to investors who wish to invest in such areas. In some form intertwined with all these beliefs is the party's land policy which essentially retained the core policy of the previous regime save for the new land lease system that largely operates in the urban areas. The area of land policy is probably one area where ideological convictions dominate the thinking of the party. In most other areas the party has proven to be much more pragmatic than many has given it credit for.¹⁰

⁹ These and similar views on the role of the state and other core beliefs of the party are provided in an 85 page Amharic publication of the party entitled "Our Revolutionary Democratic Beliefs." EPRDF publication, Nehase 1989 Ethiopian Calendar. South Korea and Taiwan are repeatedly mentioned in this document as the successful implementers of this wisdom.

¹⁰ One clear indicator of the flexibility of the government in changing ideologically held positions is reflected in the recent change in the investment proclamation which, among other things, changed the party's long held position against allowing foreign investment in power and telecommunications. The previously mentioned party document expressly held this position which was changed in less than six months by the Jimma Congress of the party in early 1990 E.C.

Around these core belief one finds detailed policy pronouncements on a range of issues. According to the government's policy framework paper for 1996/97–1998/99, in the area of fiscal policy, the government wishes to improve tax administration and broaden the tax base on the revenue side and reduce expenditure growth to less than that of the growth of nominal GDP and improve expenditure efficiency. It also hopes to minimize government financial crowding out of the private sector by minimizing government borrowing from domestic sources. In the area of monetary and credit policy, the government tries to ensure growth of monetary aggregates consistent with targets for inflation and economic growth. It plans to create an environment to establish a modern competitive financial system. It also plans to increase private investment by taking measures to encourage the private sector by speeding up privatization, improving the investment code, institutionalizing a regular dialogue between the private sector, and ensure the adequate supply of urban land for investment purposes.¹¹ Given the above and other policy measures by the government, how did the Ethiopian economy perform in the last seven years? What contributed to this performance? These are the questions we now return.

3.3. Economic Performance under EPRDF

3.3.1. Trends in GDP and Value Added in Various Sectors

The structure of the Ethiopian economy changed very little in the past few years agriculture remaining the dominant sector with over 51.4% contribution to GDP since EPRDF took power. This share was 55.5 percent for the last 18 years reaching the low level of 46.4% in 1997/98 owing to a 7.6% decline in agricultural output rather than a normal increase in the share of the other sectors. The share of industry in GDP, which should have been increasing under a normal growth path remained static over the seven-year period averaging 10.8% of GDP. The sector that showed a steady increasing trend is the services sector particularly the "other services" sector which grew to about 24% of GDP from about 20% during the previous regime while the distributive sector remained stagnant at about 14% of GDP.

The real GDP of Ethiopia has grown on average by 4.7% for the last seven years. Excluding the abnormal year of 1991/92, the average for the past six years showed a healthy growth of 6.1% with a per capita GDP growth rate of over 3% on average. This performance compares favorably with the 1.9% GDP growth of the last ten years of the Derge. The highest GDP growth rate registered since 1991 was in 1992 which registered an 11.6% growth rate though starting from a very low base of a -3.7% growth rate in 1991. The highest "normal" growth rate registered under EPRDF was the 10.7% growth achieved in 1995/96. The GDP growth rate closely follows the

¹¹ The interested reader can find the details of these and other numerous policy objective and measures agreed upon by the government and its donors in this policy framework paper prepared for the consultative group meeting of December 10-12, 1996, Addis Ababa.

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growth rate of value added in agriculture for obvious reasons. Oscillations in the growth rate of agriculture was highly associated with rainfall¹².

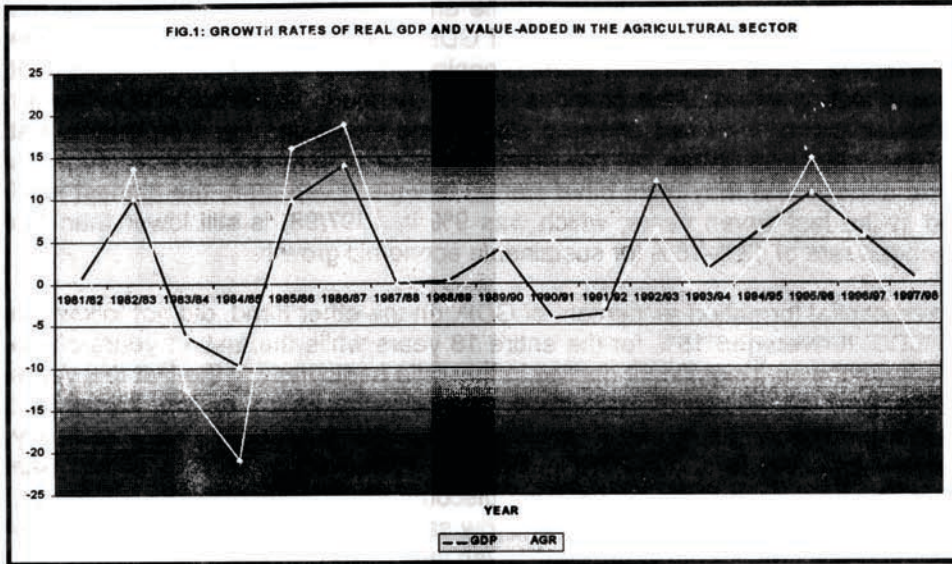


Table 3-1: Growth Rates Of GDP And Value Added In The Various Sectors (1991/92-97/98)

Year	Growth Rate Of Real GDP	Agriculture		Industry		Distributive Service		Other Services		Growth Rate Of Real Per Capita GDP
		As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	
1991/92	-3.7	56.8	-2.7	9.1	-7.1	12.8	-2.5	22.0	-5.1	-6.7
1992/93	12.0	53.8	6.1	10.4	28.4	13.3	22.2	22.5	14.7	9.0
1993/94	1.6	51.0	-3.7	11.0	7.0	13.9	6.2	24.1	8.9	-1.6
1994/95	6.2	49.7	3.4	11.2	8.1	14.0	6.4	25.2	11.0	2.9
1995/96	10.7	51.5	14.7	10.7	5.6	13.7	9.0	24.1	5.9	7.4
1996/97	5.6	50.5	3.4	10.9	7.9	14.2	9.4	24.5	6.9	2.4
1997/98*	0.5	46.4	-7.6	12.0	10.9	15.3	8.3	26.3	7.9	-2.6
Average	4.7**	51.4	1.9	10.8	8.7	13.9	8.4	24.1	7.2	1.6

* estimates

**The average growth rate of real GDP for the years 1992/93-97/98 (i.e. excluding the year 1991/92 which was a year of political distabilization) is 6.1% and the corresponding per capita GDP growth rate is about 3%.

¹² For example, negative growth rates in the years 1983/84, 84/85, 93/94 and 97/98 are characterized by low (below the average) rainfall.

3.3.2. Trends in Savings and Investment

Gross domestic saving by the time of the overthrow of the imperial regime was around 13%. Since that time GDS showed tremendous fluctuation but remained significantly lower than this high figure for the entire post revolution period. For the past 18 years GDS averaged about 6.8% of GDP. The figure was even lower if we take the average for the past seven years dropping down to 6.1% from an average of 7.2% for the last 11 years of the previous regime. Although the average was low for the last seven years, the trend shows a steady and increasing trend indicating that some of the measures taken by the government to encourage savings, such as raising the deposit rate may have started to work. Even then, the highest level achieved in the last seven years, which was 9% in 1997/98, is still lower than the recommended rate of 13%-15% for sustainable economic growth.

Gross fixed capital formation as percent of GDP, on the other hand, did not follow the trend of GDS. It averaged 15% for the entire 18 years while the last 11 years of the Derge period showed a significant decline in this ratio particularly in the last few years when it dropped to 10%. In the last eleven years of the Derge period, investment averaged around 14%. The trend in investment started to show a steady recovery since 1992 increasing to about 20% in 1997/98. The average for this period was 16.2%, which could have been 17.2% if we discount the first year of EPRDF, which, by any account was an abnormal year. The low saving ratio clearly could not finance the investment level registered in the past seven years. Accordingly, the resource gap widened significantly in the past seven years from an average of 8.7% of GDP in the Derge period to an average of about 10% in the last seven years. As a result, the debt burden (measured as debt to GDP ratio) increased from about 39.1% in the last days of the Derge rising to as high as 91% in 1993/94. The saving grace in this area is that for the five years where data is available, it shows a declining trend going down as low as 71% in the last year reported. The debt service ratio also declined sharply during these years dropping from as high as 82% in 91/92 to 34.5% in the last year reported which was almost the same as the average for the eleven years of the Derge. As can be seen from Table 3.2 below, one of the success stories of the new government was its ability to control government expenditure particularly defense expenditure¹³. The level of public consumption as percent of GDP went down to an average of 11.6% from an average of 16.7% during the Derge period.

It is very difficult to make a sensible comparison of the performance of private investment between the two periods since the former regime has an expressed interest in discouraging private investment particularly foreign direct investment. On the other hand, the new government has made numerous pronouncements indicating its interest to attract private investment particularly foreign direct investment. In the last six years alone it has revised its investment code to make it more attractive for foreign investors to invest in Ethiopia. The degree to which this policy has achieved its intended objective is not easy to determine. The main problem, of course, is to find

¹³ The onset of the Ethio-Eritrea war has definitely changed this trend.

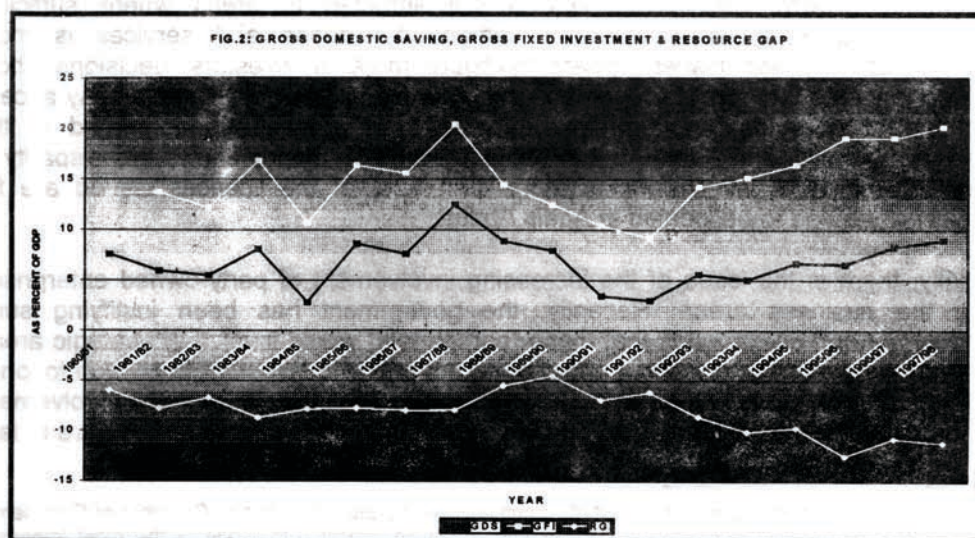
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an appropriate basis for comparison. There is no detailed comparable data for the pre-EPRDF period to make a meaningful comparison. It is also analytically meaningless to compare it with the past since the policies pursued by the Derge have no intention of increasing foreign investment. The only data we can obtain comparing the two periods was from the recent World Bank World Development Report, which compares the value of FDI in 1980 with that of 1996. According to these figures, FDI in 1980 was 12 million USD compared with 5 million USD for 1996¹². We have problem in taking these values seriously as the data from the investment authority provides a much different picture as can be seen from Table 3.2.1 below. In the absence of the counterfactual, we can not compare the current performance with what would have happened with an alternative policy package.

Table 3-2: GDS, GFCF, Resource Gap and External Debt (as percent of GDP)/1991/92-97/98

Year	(1) GDS/ GDP	(2) GFCF/ GDP	(1-2) Resource Gap	Public Consumption	Private Consumption	Total Consumption	External Debt	Debt Service Ratio
1991/92	3.0	9.2	-6.2	10.5	86.9	97.4	31.5	82.5
1992/93	5.6	14.2	-8.6	11.2	83.8	95	70.4	53
1993/94	5.0	15.2	-10.1	11.7	83.8	95.5	90.8	56.9
1994/95	6.7	16.4	-9.7	11.6	82.5	94.1	81.8	36.7
1995/96	6.6	19.1	-12.5	11.7	82.5	94.2	71.4	34.5
1996/97	8.3	19.1	-10.8	12.1	80.7	92.8		
1997/98*	9.0	20.2	-11.2	12.4	79.7	92.1		
Average	6.3	16.2	-9.9	11.6	82.8	94.4		

Source: MEDaC and NBE Annual Bulletin



¹² World Bank World Development Report, 1998/99, Table 21, p. 230.

For the purpose of this paper we have collected the data for the number of investment licenses issued by the investment authority for various sectors of the economy and compared those with the projects that are under implementation and that started production so as to get a sense of the gap between early intention and implementation as an indicator of business confidence. As can be seen from Table 3.2.1 below, between 1994-97 some 26 billion birr worth of projects were licensed by the authority for 3530 projects. Of this total capital intended for investment, only 13.4% were in the implementation phase and 18.2% started production for a total conversion of 31.5%. This proportion roughly remained the same for the next year although the value of the total capital licensed increased by over 30% to 35 billion birr. Some critics of the government suggest that this low ratio of implementation is a result of bureaucratic red tape, which discourages investors in the process of implementing their projects. Particular mention is usually made about the slow process of land allocation and the monopoly price charged by the municipality government in Addis Ababa as the key constraint to private investment in Ethiopia in the past seven years.¹³ Another interesting observation about private investment in Ethiopia is the low level of foreign investment in the country despite the numerous attempts by the government to encourage foreign investors. In the 1996/97 fiscal year, the proportion of foreign investment compared with total investment licensed was 15.4%, which grew to 22.7% in 1997/98. If we take out the investment activities of the MIDROC group, which every one accepts to be a special case, the amount of foreign investment that came to Ethiopia is in deed miniscule.¹⁴

Despite the clearly stated objective of the government to undo regional imbalance in economic growth, new investment is still attracted to areas where sufficient infrastructure is available and the demand for goods and services is more concentrated. These issues apparently figure more in investors' decisions about where to locate their projects than tax and other incentives (for example easy access to land) that regional governments provide to new investors compared to the incentives provided to Addis Ababa. Table 3-2-2 below clearly shows this disparity in spatial location of investment as more than 52% of the licenses issued are for projects intended to be located in Addis Ababa.

Finally, there is the issue of the increasing involvement of party-owned enterprises into the business arena. Recently, the government has been justifying such involvement on the grounds that these "parapartals" would involve in strategic areas where the private sector cannot afford or do not prefer to invest probably due to long-run returns from such enterprises. The logic seems sensible although the involvement of these businesses is clearly beyond what can be labelled strategic. They are in fact

¹³ So much is clearly stated in a recent study commissioned by the Addis Ababa Chamber of Commerce. The overwhelming majority of the business people surveyed indicated that one of the most important constraints for business development is the land allocation system in the country in general and in Addis Ababa in particular.

¹⁴ For details on the nature of foreign investment in Ethiopia, see Seid Nuru's article on *Economic Focus*, vol. 1, no.3.

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involved in all areas of business ranging from wholesale and retail trade to construction and real estate. Certainly areas that domestic businesses are able and willing to invest in. Looking at this reality, there is some legitimacy to the apprehension of the local business community that these institutions are actually crowding-out private investment. The fear that the prevalence of these institutions will spoil the business environment by providing them undue privileges is a serious concern of the local business community that the government need to squarely address.

Berhanu Nega and Seid Nuru

Table 3-2-1: Private Investment

SECTOR	1992/93- June,1996/97						1992/93-March,1997/98						1992/93- June,1996/97			1992/93- March,1997/98				
	Approved		% to the total	Implementation Phase		Started Production		Approved		% to the total	Implementation Phase		Started Production		Implementation Rate					
	No.	Capital '000Birr		No.	Capital '000Birr	No.	Capital '000Birr	No.	Capital '000Birr		No.	Capital '000Birr	No.	Capital '000Birr	I/A	P/A	[P+]/A	I/A	P/A	[P+]/A
Agriculture	100	4718164	18	114	527060.7	378	1442369	1124	5506409	15.6	122	1032401	404	2518147	11.2	30.6	41.7	18.8	45.7	64.5
Fishing	4	4854.8	0.02	1	1478.9	1	1276.5	4	4854.8	0.01	1	1478.9	2	2957.3	30.5	26.3	56.8	30.5	60.9	91.4
Mining & Quarrying	21	384566.9	1.5	7	128806.5	5	190412.5	27	448169.6	1.3	7	128806.5	5	190412.5	33.5	49.5	63	28.7	42.5	71.2
Manufacturing	145	9801519	37.3	241	1449190	201	822033.7	1798	13376803	38	303	1936774	357	1212692	14.8	8.4	23.2	14.5	9.1	23.5
Construction	97	3719275	14.2	17	867644.7	19	1060103	137	4552536	12.9	18	848410.5	27	1269389	23.9	28.5	52.4	18.6	27.9	46.5
Real Estate	310	3153480	12	21	79391.5	7	19997.3	350	5603538	15.9	20	79323.6	8	19465.8	2.5	0.6	3.2	1.4	0.4	1.8
Trade	122	392896.5	1.5	12	54006.6	12	33178	140	434354.6	1.2	20	99892.5	16	62883.5	13.8	8.4	22.2	23	14.5	37.5
Hotel & Tourism	300	1563666	6	70	337242.5	21	32009.5	320	1693748	4.8	78	423143	41	199427.7	21.6	2.1	23.6	25	11.8	36.8
Transport	32	1230982	4.7	1	6000	6	903275.9	35	1237169	3.5	0	0	9	945786.1	0.5	73.4	73.9	0	76.4	76.5
Education	61	283260.8	1.2	1	3983.2	9	233580	108	808020.5	2.3	3	10034.5	3	6269.2	1.4	82.5	83.9	1.2	0.8	2.0
Banking	11	312330	1.2	0	0	4	15240.6	11	312330	0.9	0	0	9	233580	0	4.9	4.9	0	74.8	74.8
Health	55	441389.3	1.7	5	35335.7	1	397	94	847745	2.4	8	75025.3	6	26152.7	8	0.1	8.1	8.9	3.1	11.9
Other Service	65	249491.2	0.95	2	6317.5	5	10270.6	89	374617.5	1.1	8	29459.5	6	10951.5	2.5	4.1	6.7	7.9	2.9	10.8
Total	3530	26255885	100.27	492	3516458	669	4764143	4237	35200294	99.9	588	4664748	893	6698113.8	13.4	18.2	31.5	13.3	19	32.3

* Adjustments are made for the overestimated report of EIA for the Amahara region in 1996/97.

I=Capital of projects under implementation; P= Capital of projects that started production; A= Total capital of projects approved (=I+P+Pre-implementation phase)

Source: Ethiopian Investment Authority

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Table 3-2-2: Regional Distribution of Capital of Investment Approved

Regions	Up to Jan 9, 1996				Up to July 1998			
	Capital of Investment Projects Approved		Capital of Investment Projects Approved Divided by Population		Capital of Investment projects Approved		Capital of Investment Projects Approved Divided by Population	
	Million Birr	Share	Birr	Share	Million Birr	Share	Birr	Share
Tigray	3040.21	20.42	926.90	13.07	3859.89	10.55	1122.10	5.85
Afar	995.70	6.69	897.00	12.65	1513.83	4.14	1305.00	6.80
Amhara	554.70	3.73	38.50	0.54	2760.75	7.55	182.50	0.95
Oromiya	1985.91	13.34	101.70	1.43	5310.73	14.52	258.90	1.35
Somalie	102.00	0.69	30.50	0.43	141.90	0.39	40.40	0.21
Benishangul-G.	159.50	1.07	332.30	4.70	306.26	0.84	606.50	3.16
SENNP	690.54	4.64	63.90	0.90	1803.36	4.93	159.20	0.83
Gambella	21.33	0.14	112.30	1.58	56.19	0.15	282.40	1.47
Harari	182.96	1.23	1306.90	18.43	418.2	1.14	2806.70	14.63
Addis Ababa	7124.04	47.84	3152.20	44.46	19093.75	52.21	7857.50	40.95
Dire Dawa	34.66	0.23	128.40	1.81	1310.63	3.58	4566.70	23.8
Total	14891.55	100.02	266.90	100.00	36575.49	100.00	623.60	100.00

Source: Ethiopian Investment Authority and own computations.

3.3.3. The Foreign Sector

The structure of Ethiopia's foreign trade did not show any marked change in the past few decades. Coffee still dominated the country's export hovering around the high 50-60 percent of total exports. However, there was significant improvement in the foreign sector of the Ethiopian economy over the past seven years. Exports as percent of GDP increased from an average of 8.7% in the last eleven years of the former regime to 12% between 1990/91 and 1997/98. This increase in exports was paralleled by the equally high increase in imports, which increased from an average of 15.8% in the earlier period to close to 22%, which also increased the resource gap.

Table 3-3: Value of Exports and Imports (as percent of GDP)

Year	Value of Exports	Value of Imports	(1-2) Resource Gap	Share of Value of Imports (%)						Growth Rates of Volume of Exports			Share of Coffee in the Value of Exports
	(1) As % of GDP	(2) As % of GDP		Raw Materials	Semi-finished Goods	Fuel	Capital Goods	Consumption Goods	Misell-aneous	Coffee	Non-coffee	Total	
1991/92	4.5	10.7	-6.2	2.9	12.8	13.6	36.2	34.2	0.3	-44.6	-55.3	-63.9	52.9
1992/93	8.3	17.0	-8.7	2.0	9.0	22.7	35.0	31.3	0.1	108.9	47.1	62.6	56.6
1993/94	11.4	21.5	-10.1	1.8	16.3	15.3	29.2	35.1	2.2	2.65	93.8	64.4	50.6
1994/95	14.3	24.1	-9.8	2.0	17.0	15.2	31.9	32.5	1.5	18.9	-15.0	-8.2	63.5
1995/96	13.1	25.6	-12.5							18.7	-21.1	-10.7	66.1
1996/97	15.5	26.3	-10.8										
1997/98	17.2	28.4	-11.2										

Source: MEDaC & NBE Annual Bulletin.

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3.3.4. Monetary and Fiscal Developments

On the expenditure side the new Ethiopian government did not find it difficult to follow the fiscal conservatism of previous regimes. In fact fiscal prudence was exercised from the beginning and continued all the way through.

Table 3-4-1. Total Revenue and Grants (as percent of GDP)

Revenue Type	1986/87-1990/91	1991/92-94/95	1992/93	1993/94	1994/95	1995/96	1996/97 (pre. Act.)	1997/98 (pre. Est.)
Total Revenue & Grants	21.8	19.2	13.7	17.4	19.0	19.5	21.4	20.6
Revenue	18.8	14.2	12.0	13.9	15.9	16.8	18.0	17.2
Tax Revenue			8.3	10.9	10.4	11.4	12.1	11.5
Non-tax Revenue			3.7	3.0	5.5	5.4	5.9	5.7
Grants	3.0	5.0	1.7	3.5	3.0	2.7	3.4	3.5
Expenditure	28.8	26.0	19.6	25.0	22.5	24.6	22.6	21.9
Current Expenditure	20.1	16.9	12.9	15.5	14.0	13.5	12.9	11.9
Capital Expenditure	8.7	9.1	6.7	9.5	8.5	8.6	9.7	9.4
Government Saving			-0.9	-1.6	1.9	3.3	5.1	5.3
Overall Balance (incl. grant)	-7.0	-6.8	-5.9	-7.7	-3.6	-5.2	-1.2	-1.3
Overall Balance (excl. Grant)	-10.1	-11.8	-7.6	-11.1	-6.6	-7.8	-4.6	-4.8
Financing			5.9	7.7	3.6	5.2	1.2	1.3
External			2.7	6.0	3.4	3.4	1.6	1.8
Domestic			3.2	1.7	0.2	1.8	-0.4	-0.6
Banking System			4.2	3.3	0.8	-0.03	-1.9	-0.2

Source: MEDaC.

When it comes to the various components of expenditure, there is a significant decline in defense expenditure over the last six years. This, of course, is bound to change with the ongoing conflict with Eritrea and irrespective of how the conflict is resolved in the short run. In other items, what we observe is essentially a constant or very small change over the years since EPRDF came to power.

The other developments since 1991 are increasing government savings and a narrowing budget deficit. As a result, domestic and banking system of financing have declined and even abandoned.

When one compares the average expenditures for the past six years with that of the Derge period, the share of the general service has declined from an average of 54.1% during the Derg period to an average of 29.7% since 1991. The respective share of defense in the two periods were 43.8% and 15.9%. The share of economic

and social services in the past six years has shown an increasing trend.

Table 3-4-2. Components of Recurrent Expenditure (as percent of GDP)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
General Service	4.4	4.8	4.5	4.7	4.2	4.2
Defense	2.6	2.3	2.0	1.9	1.9	1.7
Economic Services	1.3	1.6	1.5	1.5	1.5	1.3
Social Services	3.6	4.3	3.8	3.4	3.4	3.4
Education & Public Health	3.0	3.6	3.2	3.1	3.1	3.1
Pension Payments	0.9	1.0	0.7	0.7	0.7	0.7
Interest & Charges	2.0	3.4	2.3	2.2	2.1	1.9
Miscellaneous	0.3	0.4	0.5	0.5	0.5	0.3
External Assistance	0.5	0.2	0.6	0.3	0.6	0.0
Total Expenditure	12.9	15.5	14.0	13.5	12.9	11.9

Source: MEDaC.

Regarding the capital expenditure, the average expenditure for economic development has shown a decline compared to the average in the past regime. But, the share of capital expenditure on roads has significantly increased. The average share of expenditure on economic development for the period 1986/87-90/91 was 86.3% while for 1991/92-94/95 it was 67.8%. The respective share of road in these periods was 5.9% and 16.7%. As opposed to the share of economic development, the share of social development has increased from an average of 10.8% in 1986/87-90/91 to 16.6% in 1991/92-94/95 period. This trend seems to justify the fact that the Ethiopian government has given priorities to infrastructures such as road, education and public health.

Table 3-4-3. Share of the Various Sectors on the Total Recurrent Expenditure (as percent of the total)

	1986/87-90/91 (average)	1991/92-1994/95 (average)	1995/96
General Services	54.1	29.7	29.1
Of which Defense	43.8	15.9	13.1
Economic Services	5.9	8.9	10.7
Of which Agric. & Nat. Res.	3.2	5.1	6.1
Roads	1.3	1.2	na
Social Services	18	23.5	23.3
Of which Educ. & Training	12.2	14.7	15.4
Public Health	3.6	5.1	5.4
Pension Payments	4.0	5.3	4.8
Interest & Charges	7.0	14.6	15.1
Others	11.1	28.1	16.9

Source: World Bank Public Expenditure Review

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Table 3-4-4. Capital Expenditure (Shares)

	1986/87-90/91	1991/92-1994/95	1995/96 (est.)
Economic Development	86.3	67.8	68.1
Of which Agr. & Nat. Resource	33.5	24.8	21.4
Roads	5.9	16.7	20.5
Social Development	10.8	16.6	22.2
Of which Edu. & Training	3.0	6.3	13.4
Public Health	2.6	3.5	4.3
General Services	2.2	3.1	2.9
Compensation Payments	0.7	0.4	0.4
External Assistance & Grants		12.2	-6.4

Source: World Bank Public Expenditure Review.

One of the policy targets of the government on the monetary side was to maintain the money supply in harmony with the nominal GDP so as to control inflation. It was believed that there had been monetary deepening in the Derge regime and the task ahead was seen as exercising contractionary monetary policy to fight inflation. Accordingly, since 1991/92 money supply has grown in harmony with nominal GDP.

Table 3-4-5. Growth Rates of Money and Real GDP and Inflation Rates

Year	Growth Rates of				Inflation	
	M1	M2	Nominal GDP	Real GDP	From CPI	From GDP Deflator
1991/92	11.6	13.2	8.3	-3.7	21.0	14.9
1992/93	12.7	16.8	28.3	12.0	10.0	13.1
1993/94	8.6	10.2	6.2	1.6	1.2	2.5
1994/95	18.3	20.7	19.6	6.2	13.4	0.6
1995/96	0.10	11.8	12.0	10.7	0.9	-0.3
1996/97	0.63	5.5	9.3	5.6	-6.4	2.9
1997/98	na	10.2	9.0	0.5	na	na
Average	8.7	12.6	13.2	4.7	6.7	5.6

Source: MEDaC and NBE Annual Bulletin.

3.3.5. Price Developments

Partly because of the monetary policy and partly because of the improved performance of the agricultural sector, inflation has been reasonably controlled in the past seven years particularly compared with other countries in the region. However, it has been markedly higher compared with the last ten years average of the Derge. The average rate of inflation between 1980-90 was 3.6% compared with the 6.7% rate averaged in the 1990s.¹⁵ As can be expected and can be seen from Table 3-4-5,

¹⁵ This is very close to the 8.9% rate given by the World Bank for the latter period. See World Development Report, op. cit., Table 11, p. 210.

the inflation rate calculated from the Addis Ababa retail price index is slightly higher than the rate calculated nationally.

In addition to showing a higher rate of inflation compared with the inflation calculated from the GNP deflator above, the Table below shows where the inflationary pressure is coming from in terms of the various components of the consumption basket. Prices of medical care show a declining trend since 1992/93 when it reached a peak increase of 60.6%. The overall inflation rate seems to follow the trends of prices in food and household items most likely because of the higher weight assigned to them.

Table 3-5-1. Price Rates (Calculated from the Addis Ababa Retail Price Index)

Year	Inflation	Food	Household Item	Clothing	Transport	Medical Care	Personal Care	Readings & Recreation	Others
1991/92	21.0	24.9	15.9	14.0	-0.9	5.9	21.9	12.2	5.6
1992/93	10.0	9.2	-2.5	55.7	24.8	60.6	87.8	-2.9	13.9
1993/94	1.2	0.2	1.9	-8.3	17.8	35.0	8.2	7.8	4.4
1994/95	13.4	18.3	0	-9.2	2.1	33.0	-0.7	2.7	3.2
1995/96	0.9	-0.3	6.6	12.2	6.6	-17.3	9.1	15.4	4.9
1996/97	-6.4	-6.6	-3.9	4.8	0.9	-19	10.6	17.4	3.9
Average	6.7	7.6	3.0	11.5	8.6	16.4	22.8	8.8	6.0

Source: CSA, Statistical Abstract.

4. FACTORS THAT EXPLAIN THE ABOVE PERFORMANCE

Looking at all the above data, what we can say about the overall performance of the Ethiopian economy in the past seven years is that Ethiopian policy makers by and large followed the standard recommended medicine to stabilize the economy and largely succeeded in achieving that objective. The fiscal and monetary policies implemented succeeded in controlling expenditure within a certain limit and restriction in the growth of the money supply partially helped in controlling inflation. The much talked about "macro economic environment" conducive for long-term sustainable growth and structural transformation seem to be achieved. If the story is right, we are now ready to reap the benefits. However, a closer look at the macro economic performance of the last seven years does not render itself for such optimism as, at the structural level, the economy is as susceptible today to those traditional factors that undermine long term growth as ever before.

What one feels in looking at this data is the degree to which very little is achieved by way of structural change in the economy. The same old problems seem to affect the performance of the economy in more or less the same degree if we see the data over a long period. It is as though nothing is really changing on the ground although

"revolutionary" changes seem to take place at the policy making level. One could always argue, we think legitimately to a certain degree, that the time frame is too short to move the pendulum to the side of pessimism so quickly. Be that as it may, we think it is important to encourage policy makers to look at the long term prospects and implement policies that have a potential to effect structural transformation.

In our view, the key constraint to the Ethiopian economy is the extremely high dependency of the economy on agriculture with one of the lowest levels of land and labor productivity on earth. The contribution of the other sectors toward the national economy has remained stagnant over a long period of time. This means that the degree to which the Ethiopian economy grows largely depends on the performance of the agricultural sector. The latter in turn entirely depends on the vagaries of nature and other man made uncertainties such as war. If this is empirically true, the suggestion that comes out of this paper is that at least some portion of our policy making apparatus should devote its time in thinking strategically and come up with a policy framework that would quicken the pace of structural transformation of the economy. Before we get to what we think this strategic thinking should involve at the end of this paper, we did a little empirical exercise to check the empirical validity of this claim.

THE MODEL

In this section a simple model that attempts to capture determinants of agricultural output is made. The model is estimated using an ECM approach so that it is free of the spurious regression problem. The ECM also shows both long-run coefficients and the short-run dynamics. Though, in the literature, there are debates on the use of such ECM procedures developed by Engle and Granger, as other methods like Johanson method are developed, the first method is used with its possible limitations for this paper. In the estimation procedure, Ordinary Least Square (OLS) techniques are used.

The analysis is carried using the following general models.

$$Y_t = \alpha + \beta_1 N + \beta_2 LAND + \beta_3 \mu + \beta_4 DWAR + \beta_5 t + \varepsilon \quad [4]$$

Where

- Y_t = yield of major crops,
- α = intercept,
- N = labor force in the rural area,
- Land = land under major crops,
- μ = mean annual rainfall
- DWAR = dummy for war
- t = time
- ε = error term

Moreover, Equation [1] can be modified by changing mean annual rainfall, μ , by deviation from mean annual rainfall.

$$Y_t = \alpha + \beta_1 N + \beta_2 LAND + \beta_3 (\mu - \sigma) + \beta_4 DWAR + \varepsilon \quad [2]$$

Where $\mu - \sigma$ = deviations from the mean annual rainfall.

In estimating long run, static models, results may be spurious depending on whether the variables involved are stationary or non-stationary. The latter assumes either Trend Stationary Process (TSP) or Difference Stationary Process (DSP) which we are not going to discuss in detail here. If time-series data are TSP type, estimations require regressing with time; while if they are DSP type, it require the introduction of differences of variables. But most time-series data are DSP type. In estimating with differences, however, valuable long-run information may be lost. One solution recommended is testing for a case called co-integration of dependent and independent variables (i.e. whether there is a long-run relationship between the explanatory and explained variables). Existence of co-integration, which would be tested by unit-root tests, implies the possibility of fitting an error Correction Models - ECM to the data. In fact the existence of co-integration justifies the estimation of both longrun and short-run models. ECM procedure introduces lagged residuals to account for the adjustment to long-run equilibrium. The coefficient of the lagged residual shows the adjustment term. In such case, the ECM counter part of the models specified above can be written as follows:

$$\Delta Y = \gamma_1 \Delta N + \gamma_2 \Delta(LAND) + \gamma_3 \Delta \mu + \gamma_4 (DWAR) + \gamma_5 \varepsilon_{t-1} + \varepsilon_t \quad [3]$$

Where

$$\varepsilon_{t-1} = Y_{t-1} - (\beta_1 N_{t-1} + \beta_2 (LAND)_{t-1} + \beta_3 \mu_{t-1} + \beta_4 (DWAR)_{t-1})$$

$$\Delta Y = \gamma_1 \Delta N + \gamma_2 \Delta(LAND) + \gamma_3 \Delta(\mu - \sigma) + \gamma_4 (DWAR) + \gamma_5 \varepsilon_{t-1} + \varepsilon_t \quad [4]$$

Where

$$\varepsilon_{t-1} = Y_{t-1} - (\beta_1 N_{t-1} + \beta_2 (LAND)_{t-1} + \beta_3 (\mu - \sigma)_{t-1} + \beta_4 (DWAR)_{t-1})$$

Each of the above equations is estimated using data for the years 1960/1961 to 1994/1995. The results of estimation for Equations [1] to [4] are summarized as follows.

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Table 4-1. Results of the Ordinary Least Squares Estimation.

Eqn.	Dependent Variable	Regressor	Coefficient	T-ratio	R ²	\bar{R}^2	DW	F-stat.
1	Y	α	-120092	-2.85	0.91	0.89	2.04	F(5,29) 55.28
		N	4.68	3.20				
		LAND	6.60	8.12				
		μ	62.39	3.18				
		DWAR	-8473.6	-1.95				
2	Y	t	-770.1	-0.51	0.89	0.88	1.74	F(3,31) 85.85
		α	-38607.3	-5.22				
		N	2.71	8.79				
		LAND	7.35	13.02				
3	ΔY	$(\mu-\sigma)$	46.27	2.53	0.76	0.73	1.77	F(4,26) 23.23
		ΔN	2.44	0.91				
		$\Delta LAND$	7.75	7.21				
		$\Delta \mu$	60.66	3.93				
		DWAR	-4326.3	-1.10				
4	ΔY	ϵ_{t-1}	-0.99	-5.35	0.73	0.70	1.92	F(3,30) 27.1
		ΔN	2.13	0.76				
		$\Delta LAND$	8.23	7.22				
		$\Delta(\mu-\sigma)$	55.27	3.44				
		ϵ_{t-1}	-0.88	-4.77				

Table 4-2. Diagnostic Tests

Eqn..	Serial Correlation		Functional Form		Normality	Heteroscedasticity	
	LM-Version	F-VERSION	LM-VERSION	F-VERSION	LM-Version	LM-Version	F-Version
1	$\chi^2(1) = 0.02$	F(1,28) = 0.015	$\chi^2(1) = 1.37$	F(1,28) = 1.14	$\chi^2(2) = 2.5$	$\chi^2(1) = 0.68$	F(1,33) = 0.65
2	$\chi^2(1) = 0.64$	F(1,30) = 0.56	$\chi^2(1) = 2.63$	F(1,30) = 2.44	$\chi^2(2) = 2.3$	$\chi^2(1) = 1.18$	F(1,33) = 1.16
3	$\chi^2(1)^* = 8.1$	F(1,28) = 8.7	$\chi^2(1)^* = 5.6$	F(1,28) = 5.5	$\chi^2(2) = 0.78$	$\chi^2(1)^* = 5.8$	F(1,32) = 6.6
4	$\chi^2(1) = 1.6$	F(1,29) = 1.21	$\chi^2(1)^* = 6.3$	F(1,29) = 6.6	$\chi^2(2) = 2.08$	$\chi^2(1)^* = 5.97$	F(1,32) = 6.8

*The null hypothesis is rejected at 5% level of significance.

Before applying the ECM procedure, tests for co-integration using unit root tests of Dicky-Fuller (DF) and Augmented Dicky - Fuller (ADF) tests were applied. In the case of the DF test, a case of co-integration is unequivocally supported both with and without trend while in the case of the ADF tests, the case of co-integration is not unequivocally supported with trends. With such a background, the following interpretations may be inferred from the estimation results.

Equation [1] fulfills all statistical requirements and is more or less dependable for analysis. Coefficients of labor, land, rainfall and dummy for war¹⁶ are significant. The sign of the coefficient of the dummy for war is negative implying that war has negatively affected agricultural production. The significance of rainfall proves the high dependency of Ethiopian agriculture on rainfall. The coefficient for time, t, which is a proxy for technical improvement, is not significantly different from zero, most

¹⁶ A value of one (1) is given for the years 1976/77, 1977/78, 1987/88, 1988/89, 1989/90 and 1990/91 when war is said to reach climax and a value of zero (0) otherwise.

probably, implying that farmers operate on obsolete technology; that is, no technological improvement has occurred.

On the other hand, though land and rainfall retain their significance in the dynamic counterpart of Equation [1], i.e. Equation [3], most of the higher order statistics are not as desired which impair further analysis.

In estimating Equation [2], deviation from the mean annual rainfall is positive and significant. In the dynamic counterpart of the model, all variables retained their sign and significance except labor though it has some higher-order statistical problems.

Regardless of some weakness of the technique of the estimation procedure (Johanson method might have been applied, for example), it may be possible to conclude that Ethiopian agriculture is highly dependent on rainfall, which is an exogenous factor, and land. Labor has insignificant coefficient in the short - run dynamic model witnessing that there is redundancy of labor in the rural sector in relation to other factors, particularly land. This is sensible for that a peasant household may have economically active family members beyond the optimal size required for the size of the land the household possesses. Moreover, uncertainties such as war have negative impact on agricultural activities. Finally, the static technique of production in the agricultural sector is justified by the insignificant coefficient of time in the model.

CONCLUSION

There are a number of conclusions that emerge from the forgoing discussion. First, by standard criteria of macroeconomic performance the Ethiopian economy has performed reasonably well since EPRDF took power seven years ago. It is also true that what largely fueled this performance is a result of unprecedented generous financial contributions from donor countries and agencies. Furthermore, the fluctuations in the performance of the macro economy is largely explained by the fluctuations in the agricultural sector which in turn is directly related to the availability of adequate rainfall and man made uncertainties.

Clearly with this kind of causality, we can not hope to go very far in achieving sustainable and rapid economic growth and structural transformation. To achieve these strategic objectives we need, in addition to pursuing the short-term objectives, devise a long-term strategy with clear objectives. Key elements of this strategy, we believe, should include first and foremost, significant transformation of the agricultural sector. While the government's five-year program in increasing agricultural production and productivity is a step in the right direction, its inability to address the key issues of institutional transformation, we believe, will in the long run stunt the process. We are particularly concerned with what Desalegn Rahmeto some fifteen years ago labeled

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the process of agrarian involution that has been taking place in rural Ethiopia for a long time and still continuing at a rapid pace.¹⁷

A second element of such a strategy must seriously think about reducing the role of agriculture in the economy by significantly increasing the growth in the other sectors particularly in industry. In this area the government, in addition to supplying the necessary infrastructure, must carefully identify strategic industries in which Ethiopia can develop a dynamic comparative advantage in the long run and vigorously promote such industries either from local or international investors. We believe the government's role in this area is crucial particularly in strengthening and supporting the local private sector.

Finally, the relationship between political stability and economic development is something that is confirmed by a wide body of research. As our exercise above indicates, one of the constraints to the growth of the agricultural sector in Ethiopia has been the uncertainty caused by political conflict. As we have shown in the introduction to this essay, the level of development we currently have is so miserable even compared with other "poor countries," we need generations of concentrated hard work to achieve the level of income others have reached. The degree to which differing policies can affect the future direction of the country is not worth the cost of engaging in potentially destabilizing conflict. So what should be included in this strategic thinking is developing a tolerant political atmosphere that freely allow constructive engagement, the underlying premise of which is a shared destiny.

¹⁷ See Desalegn Rahmeto, *Agrarian Reform in Ethiopia*, 1984.

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