

A REVIEW OF MACROECONOMIC IMBALANCES IN THE ETHIOPIAN ECONOMY IN THE 1980s AND RECENT YEARS

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1. INTRODUCTION

Ethiopia is currently experiencing a fundamental economic and political transformation. In the economic sphere, there has been a need for changing the wrong policies of the military regime and replacing them with new policies of recovery, rehabilitation and development. The new economic policy of the Transitional Government of Ethiopia (TGE) emphasizes the role of the private sector thereby reducing and redirecting the role of the state in the economy. The role of the state would be regulatory and one that would create an enabling environment for private enterprises. The enabling environment would reduce market distortions and rigidities and provide incentives as well as economic infrastructure. This would pave the avenues of change from a command economy to a market economy.

In the political sphere, the major tasks during the transition period will be maintenance of peace and stability, and laying the foundation for democracy. TGE has already taken a number of measures in these directions.

Both the economic and political reforms are closely interrelated. Economic transformation is possible only with political stability ensured through democracy; democratization, in turn, rests on economic improvement and higher standards of living of the people.

In a transition period, people look forward with optimism. They hope for a better life. However, realization of this hope is affected by the depth of the political and economic crisis of the past. In the past the economy has been stagnant and ravaged by the civil war. The masses of people have suffered from widespread unemployment and chronic poverty. In the transition period, the process of stabilization and adjustment will have to deal with these problems. The problems of demobilization of ex-soldiers, displaced persons and refugees/returnees and retrenchment are also formidable ones.

To come up with satisfactory solutions and deal with the problems effectively, one has to assess the current state of the economy, a state characterized by macroeconomic imbalances, both internal and external, and identify the major causes of the economic crisis. Such an assessment may help in designing appropriate policy measures, programs and projects.

2. THE CURRENT STATE OF THE ECONOMY

Ethiopia is reputed for her natural and human resources potential. But because of the structural problems, natural disasters and man-made crisis and war, the country has been rendered backward. Economic and social indicators show the lowest performance. The Gross National Product(GNP) per capita of US\$120 per annum is one of the lowest in the world. Infant mortality is 111 per 1000 and life expectancy is 46 years. Health services cover only 45 per cent of the population. Malnutrition is rampant, with a daily per capita calorie supply of 1,620, which is again one of the lowest in Africa. Only about 12 per cent of the rural and 80 per cent of the urban population have access to safe drinking water. Current enrolment rate for primary education is only 31 per cent (MOPED, 1992: 3).

Gross Domestic Product(GDP) growth rates have been negative for four years since 1988. In 1989/90 overall GDP growth was 0.9 per cent below zero(MOPED, 1991/92:3). The economic situation did not improve in the following years. In 1990/91 GDP declined by 0.3 per cent and the situation worsened in 1991/92 when GDP at constant prices declined from Birr 9,175.8 million to Birr 8,254.4 million. The major contributors to this decline have been the poor performance of the agricultural and service sectors, which registered decline of 7.4 per cent and 15.1 per cent respectively.

The growth rate of GDP has been much lower than that of population. Consequently, per capita income declined by 3.7 per cent. Thus, per capita income has been expected to fall from Birr 180 in 1990/91 to Birr 157.6 in 1991/92. The per capita income is much below the urban poverty line of Birr 201 per month for a family of five persons (MOPED, 1992: 20). This poverty line is much higher than the minimum wage of Birr 50 (before October 1, 1992) and Birr 105. In all cases, there is a strong indication of a poverty-trap and declining standard of living of the people.

Agriculture, being the backbone of the Ethiopian economy, contributes about 44 per cent of the GDP and 85 per cent of employment and 90 per cent of export earnings. Its average annual growth rate, though showing sharp oscillations, was 0.7 per cent in the last 17 years. In the last decade, per capita production fell from 178 kg to 164 kg. With population growing at 2.9 per cent per annum, food production has been below demand, generating chronic food deficits. Food aid was a major source to fill the gap between demand and supply. Yet, overall consumption of food grain was below the minimum annual requirement of 180 kg at the rate of 500 gms per day per person.

The poor performance of the agricultural sector has had an impact on other sectors of the economy. It has not been able to provide raw materials required by the industrial sector. It has not generated enough foreign exchange for the purchase of raw materials and spare parts from abroad. Thus, output in other sectors has been depressed.

If we look at macroeconomic indicators, the performance of the economy has been very poor. In the 1980s the rate of savings declined from 4.8 per cent to 0.2 per cent in 1991.

Investment also declined from 15.8 per cent in 1987 to 9.1 per cent in 1991/92. Both savings and investment ratios were one of the lowest in Africa (MOPED, 1991/92).

Total government expenditure had reached 30.8 per cent of GDP in 1989/90 with a growing overall deficit, reaching 17.1 per cent. Domestic banks financed the deficit to the order of 10.4 per cent of the GDP (MOPED, 1988/89). The overall balance of payments has also shown continuous deficits since 1986. This was due to the sluggish growth of exports and rising level of imports. Export earnings were only 71 per cent of imports in the early years while it fell to 41 per cent in 1989/90 and 27 per cent in 1990/91. The fall in the price of coffee in the international market has reduced the country's import capacity. Other export commodities faced competition from domestic consumption and their export volumes have declined.

The overall balance of payments problems have been compounded by the low level of per capita assistance from donors and by their stringent conditionalities in lending for development projects.

The low performance of the economy and the high growth of population have created a gap between demand and supply of basic goods and services such as food, shelter, clothing, health and education. The constraints to development in Ethiopia have also caused high incidence of poverty, unemployment, inequity, social tensions and economic dislocations.

3. BALANCE OF PAYMENTS CURRENT ACCOUNT

Ethiopia's current account deficit has widened due to the stagnant export earnings and rising merchandise imports, despite positive non-factor service receipts. The causes for such performance are considered here in terms of the magnitude of exports, relating their performance to the policy environment and assessing the effects of low export earnings on the balance of payments and on foreign exchange supply and allocation. Imports are also treated in terms of investment outlays, financed by foreign borrowing which has, in turn, given rise to the debt service problem (World Bank, 1990).

3.1 Trade

The current account deficit has worsened from year to year due to the foreign trade imbalance. Export earnings declined from Birr 918 million in 1988/89 to Birr 389 million in 1991/92, while import expenditure rose from Birr 2,110 to Birr 2,166 million during the same period. Thus, the trade deficit widened from Birr 1,192 million to Birr 1,777 million. The major cause for the decline in export earnings has been the fall in both volume and value of coffee export. Coffee export accounted for 68 per cent of the total export value in 1988/89 and this share declined to 42 per cent in 1991/92 (see Table 1). Coffee export reached a peak in the period 1978-83 when it averaged 87,000 tons per annum and in the

following five years its annual average fell to 75,000 tons, less than Ethiopia's quota under the International Coffee Agreement (ICA). Drought, planting restriction (which is now removed) and farm-gate prices below parallel-market prices have all contributed to the decline in coffee export performance. Other primary exports have also stagnated. Their domestic market prices have been higher than the export-market prices at the official exchange rate so that export volumes have tended to be a function of the success of public procurement agencies (World Bank, 1990: 40). These agencies have been renowned for their inefficiency and mismanagement.

Exports of hides, skins and leather have performed better both in volume and value. Indeed, the value of these exports increased much more than their volume due to high domestic value-added, following the ban on exports of unprocessed skins (*ibid.*). Apart from leather and spices, most manufactured goods were exported at a loss. A system of export subsidies, financed by surcharges on certain imports, has been used to recover losses incurred by public enterprises engaged in export businesses. Exports of livestock, oilseeds and pulses, leather, fruit and vegetables and textiles and clothing have all received export compensation. In 1989 private coffee exporters also began to receive subsidies and the producer price of coffee was fixed at a floor of Birr 2.26/kg.

Despite official inducements, exportable produces have been smuggled across borders by traders ready to reap the benefit of the parallel exchange rate which was much higher than the official rate. Smuggled exports are estimated to have amounted to 30 per cent of the official exports (*ibid.*, p. 41).

The decline in the export earnings and the rise in the dollar price of imports has contributed to a decline in the terms of trade. The terms of trade deteriorated in 1989 when the ICA lifted the quota restrictions on coffee exports which resulted in the plummeting of world coffee prices. The price of coffee fell from US\$3.00/kg to US\$2.00/kg in 1989 alone. As a result, Ethiopia's coffee export earnings were severely affected.

While export earnings stagnated, expenditures on imports rose substantially. Much of the increase in imports has been accounted for by food and capital goods. Expenditure on plant and equipment for industrial, energy and agricultural projects has soared. Merchandise imports declined in 1989/90 with the resultant shortages of spare parts and raw materials which constrained industrial production and transport services. The declining merchandise imports were covered by external financing since export earnings or import capacity contracted from 9.8 per cent of GDP in 1980/81 to 4.3 per cent in 1988/89 (*ibid.*, p. 43).

3.2 Resource Gap and Current Account Deficit

Non-factor services have been highly successful during the last decade. Air and shipping lines earned a substantial amount of foreign exchange. Net non-factor service receipts accounted for about a quarter of gross merchandise export receipts. However, gross interest payments on foreign debt have grown fast, rising from US\$17.5 million in 1980/81 to US\$81.7 million in 1988/89. This and the low export performance has widened the resource

gap from 7.6 per cent of GDP in 1988/89 to 12.3 per cent in 1991/92 (MOPED, 1992/93). The widening resource gap signifies a growing dependence on external financing. The current account deficit has reached 10 per cent of GDP in 1991/92 at the previous exchange rate (US\$1 = Birr 2.07). With the new exchange rate the current account deficit to GDP ratio would be larger (World Bank, 1990).

3.3 Financing the Current Account Deficit

The current account deficit has been financed by grants and loans from bilateral and multilateral sources. Grants have risen sharply in the years when drought and famine relief has been required, particularly after the 1985 drought. Also, there have been the inflow of development grants and loans from donor countries and multilateral financial institutions. According to a World Bank report, 35 per cent of gross loan disbursements during 1982-87 were non-concessional. Credits from socialist countries were 30 per cent of gross loan disbursements and they were classified as concessional.

The foreign exchange reserve had increased tremendously after the drought year of 1985 mainly due to large receipts of relief assistance. But, this was depleted in the later years. In June 1988 the reserve was reduced to three-weeks cover of merchandise imports and it rose to four weeks in June 1989; but a quarter of a year later it reached its lowest import coverage of less than three weeks (ibid, p. 44). In 1990/91 the reserve was negative (see Table 1).

Table 1: Balance of Payments 1988/89-1991/92
(in million birr)

	1988/89	1989/90	1990/91	1991/92
1. Trade Balance	-1,192.7	-1,067.3	-1,558.3	-1,777.3
1.1 Export	918.2	756.9	572.1	388.6
1.1.1 Coffee	626.4	405.4	268.5	164.9
1.2 Import	2,110.4	1,824.2	2,130.4	2,165.9
2. Non-Factor Services (net)	91.0	89.9	-36.3	-101.1
3. Private Transfers	389.1	354.6	413.9	518.5
4. Current Account	-281.1	-287.4	-429.8	-514.0
5. External Grants	433.0	335.4	750.9	814.4
6. External Loans	438.4	231.7	162.1	-194.4
7. Errors & Omissions	-201.5	-486.4	114.9	187.8
8. Balance of Payments	-42.2	-542.1	-152.8	-552.1
9. Foreign Exchange Reserve	23.0	151.3	-324.9	-83.0
10. Arrears	0.0	390.8	456.1	635.1
11. Debt Cancelled	19.2	0.0	21.6	0.0

Source: MOPED (1992/93).

3.4 Debt and Debt Service

The decline in export earnings and the rise in import expenditures have augmented the current account deficit which has been partly financed by loans. Thus, the debt service ratio on cash basis rose from 30.4 per cent in 1989/90 to 35.5 per cent in 1990/91. The ratio did not take into account arrears which have risen from Birr 391 million in 1989/90 to Birr 635 million in 1991/92. If arrears are considered, then the debt service ratio on accrual basis would reach 95.7 per cent (MOPED, 1992/93: 7). This ratio reveals that from every one birr of earning from exports, including non-factor services, 95.7 cents would have been used for debt repayment - a mind boggling debt crisis.

The total arrears and the increasing import expenditure would have led to unmanageable balance of payments crisis had it not been for the postponement of debts in the last three years. As a result of the postponement, total arrears reached Birr 1,482 million. Also, the trade deficit of Birr 1,777.3 million and the expenditure on non-factor services of Birr 101.1 million have resulted in a current account deficit of Birr 514 million in 1991/92. This indicates that the sum of export earnings, external loans, grants and private transfers could not cover the import expenditure of the country.

4. FISCAL AND MONETARY BALANCES

In the last decade, aggregate domestic resources have increased, but absorption of resources has grown more rapidly. The country experienced mounting public expenditure on security and defence, public investment, social and economic services. The rising level of public expenditure has been matched by high and buoyant fiscal receipts and by rising external finance. When budget deficits increased they were offset by higher external financing; drought relief has also been used to reduce budgetary costs. As a result, the fiscal deficit has been contained below 10 per cent of GDP (World Bank, 1990: 55).

4.1 Revenue and Expenditure

In recent years, government revenue and expenditure have declined. Total domestic revenue has declined because of a fall in tax revenue; collection of tax arrears has been difficult in regions affected by war and ethnic strife. The contribution of public enterprises to revenue in the form of business profits and "residual surplus" has also declined due to constrained production capacity caused by shortage of raw materials and spare parts. The decline in volume and value of coffee export has also affected revenue negatively. Consequently, government revenue declined from Birr 3,811 million in 1988/89 to Birr 2,015 million in 1991/92, while recurrent expenditure declined from Birr 3,589 million to Birr 2,815 million (see Table 2).

Domestic revenue has declined faster than recurrent budget, resulting in recurrent budget deficit. In 1991/92, the recurrent budget deficit was around Birr 740 million. In the same year, the capital budget declined to Birr 900 million from Birr 1,743 million in 1988/89. Both the recurrent deficit and the capital budget have created a total budgetary deficit of Birr 1,640 million in 1991/92, which is 12.3 per cent of GDP. The size of the budgetary deficit reveals the enormity of the financial crisis.

Table 2: Central Government Budget and Source of Finance
(in million birr)

	1988/89	1989/90	1990/91	1991/92
1. Revenue	3,810.6	3,108.5	2,666.4	2,015.1
2. Recurrent Expenditure	3,589.3	3,831.4	3,454.6	2,814.8
3. Current Surplus	221.3	-722.9	-788.2	-799.7
4. Capital Expenditure	1,743.4	1,394.9	1,217.1	900.2
5. Overall Deficit	1,522.1	2,117.8	2,005.3	1,699.9
5.1 Share in GDP	12.3	17.0	14.7	12.3
6. Financing of Deficit				
6.1 External Grants	246.9	250.0	200.0	130.0
6.2 External Loans	702.8	461.0	400.0	350.0
6.3 Domestic Bank Financing	476.0	1,295.0	1,230.5	1,100.0
6.4 Others	96.4	111.3	174.8	59.9

Source: MOPED 1992/93.

4.2 Financing of Deficit

The overall budgetary deficit was covered by domestic financing and external loans and grants. The bulk of domestic financing has been from the banking system and the rest coming from non-bank sources of domestic finance such as the pension fund. Domestic bank financing has risen from 31 per cent of the total deficit in 1988/89 to 67 per cent in 1991/92, and in the same period external financing has declined drastically (see Table 2). Because the domestic bank financing was not backed by production, it became inflationary and resulted in the distortion of the exchange rate. It encouraged illegal trade and smuggling of goods, which reduced the foreign exchange earning capacity of the economy.

4.3 Money Supply and Price Movement

Bank financing of the deficit has increased the volume of reserve money tremendously. The deficit-induced money supply growth, against a slow real GDP growth, has pushed prices upward. Reserve money increased from Birr 5,688 million in 1988/89 to Birr 7,982 million in 1990/91 reflecting an average growth rate of 18.5 per cent (MOPED, 1992/93: 11). The major cause of growth in reserve money was domestic bank loan that was used to finance the government budgetary deficit; government borrowing rose by 19.8 per cent in 1990/91 alone. The impact of such deficit financing is obviously an upward movement of prices.

The poor performance of the economy is reflected in the movement of prices. The slow growth of GDP in 1990/91, with its attendant excess demand over supply, widened the

budgetary deficit. Deficit-induced growth of reserve money has been greater than the growth of GDP. Due to the growth in reserve money and the rise in import prices and problems of distribution, including transport services, retail prices have been soaring. The Addis Ababa Retail Price Index reflects a rise in the inflation rate from 5.2 per cent in 1989/90 to 20 per cent in 1990/91. On the contrary, there was little or no growth in income; and consequently, the purchasing power of the people was eroded and the standard of living plummeted. The inflationary situation with its impact on the cost of living and the rampant overt unemployment fuelled the stagflationary situation in the economy.

5. INVESTMENT AND SAVINGS

In the preceding sections of this paper, we have glanced at the nature of fiscal deficits, rising public expenditure, deficit-induced growth in reserve money and inflation, and their negative impacts on the living standard of the people. With these crises in the background, we will, in this section, attempt to analyze the generation of savings to finance investment.

5.1 Investment

The poor economic performance and the low GDP growth has had a negative impact on investment. The investment ratio declined from 15.8 per cent of GDP in 1986/87 to 9.1 per cent in 1991/92 (see Table 3). Records of national accounts reveal that this ratio is the lowest in recent decades. Some of the major causes of this low investment ratio have been: shortage of foreign exchange, shortage of construction materials and low construction capacity, wrong economic policies, difficulty in the implementation of projects without feasibility studies, shrinking savings ratio, shortage or misuse of highly skilled manpower and low absorptive capacity. The declining investment ratio, combined with population explosion and unemployment, has been heraldic of the deepening economic crisis.

5.2 Domestic Savings

The savings ratio, along with the investment ratio, has been plummeting throughout the last decade. It reached 0.2 per cent of GDP in 1990/91 and it was negative in the following year, when GDP could not cover total domestic consumption. As a result, gross fixed investment was totally financed by external sources (MOPED, 1992/93).

The economy was so incapacitated that the domestic savings could not cover even a small amount of investment. In the five years up to 1991/92, the resource gap has been about 10 per cent of the GDP, and last year it was 12.3 per cent, indicating the level of external dependence and the consequent debt burden.

Table 3: Domestic Expenditure, Savings and Investment as Percentages of GDP
(at current market prices)

	1987/88	1988/89	1989/90	1990/91	1991/92
1. Gross Domestic Expenditure	110.0	107.6	106.6	110.2	112.3
2. Fixed Investment	15.8	13.4	12.3	10.4	9.1
3. Domestic Savings	4.9	5.8	5.7	0.2	-3.2
4. Resource Gap	-10.9	-7.6	-6.6	-10.2	-12.3
5. GDP (in million birr)	-	-	12,430.2	13,669.8	13,348.7

Source: MOPED.

6. OTHER MACROECONOMIC IMBALANCES

In this short paper it has been attempted to have a glimpse of the major constraints on and resources for growth and development in the country and the consequent macroeconomic imbalances. This section is intended to highlight some of the major problems such as population explosion, food and food insecurity, unemployment, poor infrastructure and unfavorable external economic relations.

6.1 Population and Food Security

The agricultural sector has suffered most from the causes of Ethiopia's economic stagnation. In the last decade grain output has been declining, while population has been growing rapidly. The consequences of these developments have been the country's failure to meet the needs of the people and a mounting food crisis which has persisted long after the catastrophic drought of 1985. Despite increases in grain imports, per capita food availability and nutritional standards have fallen (World Bank, 1990: 71). The flow of food between surplus and deficit areas was hampered by institutional factors and shortage of transport equipment, worsening food shortage in deficit areas.

With a larger population (55 million in 1992, growing at 2.9 per cent) and shortage of food, per capita food availability has declined. After allowing for seed and post-harvest losses, per capita consumption in the early 1980s was 178.8 kg - equivalent to 1,728 calories per day, while in 1988/89 it declined to 163.9 kg.- equivalent to 158 calories per day, or 75 per cent of the recommended calorie intake (*ibid.*, p. 72). Per capita food availability fell to 124.9 kg in 1991/92 during which total food deficit was 39.8 million quintals (MOPED, 1992/93: 3). The causes of the food deficit were population explosion and low agricultural productivity. Indeed, Ethiopian agriculture is mainly rain-fed and the technology used is primitive, as a result of which grain production could not satisfy the rising need of the

population. Also, government agricultural policies, including pricing and marketing policies, had negative impacts on the productivity of peasant agriculture. As agriculture has been growing at less than one per cent per year in the last decade, it could not support the rapidly growing population. This gap between the growth of food grain production and population resulted in food deficit and created dependency on imported food.

Apart from the food crisis and insecurity, population explosion has severe impacts on sources of energy, land, social and economic infrastructure. It has created social crises in the form of unemployment and displacement. If we take only the unemployment problem, among others, it has become a serious national challenge of development. The rate of unemployment, excluding displaced persons and demobilized soldiers, has now reached 32 per cent. There are 700 thousand unemployed job-seekers who could not be absorbed by the economy. This situation would get worse when workers are retrenched due to the new economic reform program.

6.2 Economic Infrastructure

Economic and social infrastructure contribute immensely to the growth and development of a country. However, in Ethiopia economic services have been poor and deteriorating. Transport and communications have been seriously affected by wear and tear of vehicles, shortage of spare parts and services. The size of transport fleet has been insufficient for the growing population, and the transport and communications network has been severely damaged by the civil war. Thus, the transport sector needs total rehabilitation to give proper services for the major sectors of the economy.

Social services have also been deteriorating from time to time due to civil strife and lack of proper attention. Schools have been destroyed or closed; students and teachers have been dislocated. As a result, participation rate in the literacy program, primary and secondary education has declined drastically since 1988/89. Quality of education has also declined. The health sector has also suffered from the economic crisis and the civil war which reduced health services to ashes in some parts of the country. The import of basic medical equipment and medicine has been very much reduced because of the shortage of foreign exchange.

The housing condition is also a good indicator of the deteriorating standard of social services. Shortage of investment in construction and the virtual absence of construction materials has hampered housing services and supplies. The low construction capacity and high growth of the urban population have created immense problems of housing and general services in the urban areas.

6.3 External Economic Situations

In the preceding parts of this paper, it has been pointed out that most of the country's investment has been covered by external loans and grants and that the share of tradeables in the GDP has been quite substantial. Thus, international commodity prices, loans and interest

rates have had strong impacts on the economic performance of the country. In the 1980s, primary export prices have been adversely affected, reducing the import capacity of the country.

Being a part of the international economic framework, Ethiopia, like any other developing country, has suffered from international economic crises and external shocks. Decline in export prices, increase in interest rates and the outflow of capital from the developing to the developed countries, have all constrained the development efforts of the least developed countries, including Ethiopia.

7. MAJOR CAUSES OF THE ETHIOPIAN ECONOMIC CRISIS AND MEASURES TAKEN

7.1 The Major Causes of Economic Crisis

The causes of the economic crisis in Ethiopia are complex and interlocked. Structural problems, natural and man-made calamities and civil strife have stifled economic growth. Recurrent droughts have had a devastating impact on the natural and human resources of the country.

The civil war which ravaged many parts of the country has been a major cause of economic decline. It had claimed a bulk of the national budget, a large amount of output and thousands of productive manpower. In short, the country suffered from all the evils of a war economy.

The misguided and wrong policies of the military regime had greatly contributed to the devastation of the economy. These policies were inconsistent with the objective reality of the country. The command economy, with overstretched state control, deprived the private sector the right to participate fully in the economic development of the country. The policies ushered in a period of mismanagement, corruption, embezzlement of public funds by high officials, nepotism, bribery, etc. that contributed enormously to work indiscipline and low morale. Of course, inefficient management, bureaucratic red-tape and the absence of intersectoral coordination hampered economic growth (TGE, 1991: 12).

The external economic dependence had, and still has, a negative impact on the growth of the economy. Investment was mostly or totally financed by external loans that were non-concessionary; and terms of trade were unfavorable. Thus, the economy, the structure of which is backward and externally dependant, had suffered from external shocks.

The structural characteristics of the economy are the fundamental causes of the country's underdevelopment (ibid., p. 20). The agricultural sector which engages the majority of the Ethiopian people, is backward and employs primitive technology. The sector has been vulnerable to drought and natural disaster. The industrial sector is dependent on imported

machinery, raw materials and spare parts, and the sector suffers from built-in obsolescence and primitive technology. Social and economic services are poor and inadequate. The linkage between these economic sectors is weak and uncoordinated.

Having recognized the structural deficiencies of the economy and the major causes for its decline, the TGE has issued a new economic policy and has taken decisive measures for the recovery and development of the economy.

7.2 Economic Recovery Measures

In this short paper, it would be difficult to enumerate all the measures taken by the TGE and discuss their merits. However, a brief review of the major steps taken is in order. Given the Ethiopian situation, the economic reform program is sequenced and to be implemented phase by phase. The Emergency Recovery and Reconstruction Program (ERRP) is put in place to facilitate the utilization of existing capacity of production. The program helps to improve social services by rehabilitating health and educational facilities. Transport and communications would be improved, and spare parts would be made available. The ERRP prepares the ground for starting the next phase of the Structural Adjustment Program. In this phase a regulatory framework is laid down. The investment law was issued; trade liberalization measures were undertaken; prices, marketing and transportation were deregulated. These measures provide the necessary foundation for macroeconomic stabilization. Fiscal and monetary policies were designed to reduce budgetary and balance of payments deficits. New exchange and interest rates were introduced. Safety-net measures to combat the impact of the reform program were designed along with macroeconomic stabilization policies. Finally, public enterprise restructuring and privatization were incorporated as complementary aspects of the economic reform program.

Some of the elements of the reform program such as investment autonomy, currency devaluation, cost of living adjustment are briefly presented below:

- i) **Investment Promotion:** The TGE has promulgated *Proclamation No. 15/1992* to create an enabling policy environment that would encourage private capital participation. Both domestic and foreign private capital will participate in various economic activities without any ceiling to investment. It is stipulated that all bureaucratic hurdles and red-tape would be removed. The state would provide a comprehensive package of incentives to encourage private capital participation. The response of private capital to the investment policy of the state may be positive, but it is too early to judge. However, institutional factors, ethnic strife, cultural barriers, national/regional administrative and power structures may impair the movement of factors of production during the transition period. Thus, policy measures alone may not be fruitful unless a favorable working environment is created.

- ii) **Public Enterprise Management Autonomy:** It has been necessary to restructure the public enterprises to promote efficiency, productivity, profitability and competitiveness. Public enterprises now enjoy management autonomy that would enhance their capacity to operate in a market economy. These enterprises, though under state control, would be guided by board of directors, in which labor participates with a third of the vote. This arrangement assumes that the board members act as owners. The board may be a crucible in which management and/or labor representatives would be in full cry.

- iii) **Currency Devaluation:** In an effort to reduce the deficit in the balance of payments and government budget, the TGE has undertaken an economic reform program based on its new economic policy. The reform program is a package that embraces supply management measures such as public enterprise restructuring and divestiture, including privatization and liquidation of both moveable and immovable properties. However, demand management, including the suppression of aggregate demand and export promotion, is given priority. Thus, devaluation of the birr is instrumental in the reduction of demand; both investment and consumption would be curtailed; import-intensive investments, and government expenditure public and private consumption would be reduced. Conversely, management of supply, including factors of production, has been lagging behind. Thus, the economy would be trapped in a series of disequilibria, limping from one crisis to another.

- iv) **Cost of Living Adjustment:** With measures that would artificially suppress demand, the natural growth in demand, derived from high population growth, would cause an inflationary situation. Lag in supply response would worsen the situation leading to high cost of living and the consequent immiserization of the fixed income group. To reverse this trend, the TGE has taken fiscal and salary adjustment measures. It is now too early to gauge the impacts of these measures. However, the full realization of demand and supply problems is in place.

- v) **A New Labor Law:** There is a draft labor law that is believed to be consistent with the new economic policy. It is expected to promote productivity and efficiency and at the same time protect the rights of workers. Workers, employers and new investors would have vested interests, usually conflicting ones, in the contents of the law, and in its implementation. Thus, the promptitude of the state to promulgate the draft law is of essence.

8. CONCLUSION AND RECOMMENDATIONS

The structural characteristics of the Ethiopian economy, like any other developing economy, constitute the most fundamental causes of macroeconomic imbalances and retrogression. The most important manifestations of these are: the predominance of subsistence agriculture, the narrow production base with primitive and ill-adapted technology, the neglect of the informal sector, drought and environmental degradation, disintegration of markets and fragmentation of the economy, weak institutional capabilities and excessive dependence of the economy on external factor inputs (UNECA, n.d.: 2).

The dependent economy was also constrained by unfavorable external factors. The preconditions for balance of payments support and debt relief from external sources were tight. Internally, the economy suffered from lack of appropriate institutions, wrong policies, poor accountability, and mismanagement.

The following constraints resulting from the structural problems and poor management of the economy have been recognized and identified as the major bottlenecks to balanced economic growth:

- poor agricultural productivity and food insecurity;
- low capacity and declining productivity in the manufacturing sector;
- low savings and investment ratios;
- inability to earn or save foreign exchange;
- disproportionate growth in population and in GDP;
- poor economic and social infrastructure;
- long and painful recovery of the economy; and
- unfavorable external factors.

In view of the serious macroeconomic imbalances in the economy discussed above, the following recommendations may be useful:

- 1) **Food Self-sufficiency:** Food policy should be designed to achieve food self-sufficiency through various strategies. One such strategy would be to keep a proper balance between food production and the production of agricultural primary exports. Another strategy would be to expand the production base through the use of appropriate technology for the transformation of agriculture to increase food supply as well as agricultural produce for export. A population policy would have to be designed to reduce the pressure of domestic demand on food and primary products. Such measures would lessen the problem of food shortage and food insecurity. A credit policy that would favor food production and the manufacture of essential goods is critical for the satisfaction of our food requirement.

- 2) **Manageable Debt and Debt Servicing:** It is a precondition to establish strong debt-management system if the scarce and badly needed foreign exchange is to be fruitfully used. Debt management would involve a continuous assessment of debt repayment capacity. Debt accumulation should be rationalized by allocating future loans to productive projects that result in quick and high returns.
- 3) **Satisfaction of Critical Needs:** The satisfaction of basic needs, other than food, should be carefully considered. Enhancing the production of basic goods and services calls for the allocation of an increasing share of foreign exchange for imports of vital inputs for agriculture and manufacturing sectors. This would result in the expansion of agricultural and industrial employment. It also encourages the production of domestic output and avoids import restriction. The allocation of foreign exchange should be designed in such a way that strengthens interlinkages between agriculture and industry.
- 4) **Mobilization of Domestic Savings:** Measures that encourage mobilization of resources are indispensable if we are to reduce the huge resource gap we are facing. This requires systematic reduction of speculative activities and the shifting of resources to productive engagements. Selective interest rates that encourage productive activities may be instrumental for resource mobilization. Also the mobilization of rural savings requires administrative arrangements that create and strengthen rural financial institutions.
- 5) **Capacity Utilization:** The rehabilitation and utilization of unused productive and infrastructural capacities is a sine qua non for faster economic growth. The rehabilitation exercise saves foreign exchange embodied in the installed productive capacities. Encouragement of greater productive capacity is also a parallel measure to be taken through the creation of a special fund for loans. These loans may be availed to entrepreneurs at subsidized interest rates.
- 6) **Balance of Payments:** Strategies should be worked out to encourage capital inflows, especially by nationals working abroad. These measures should, however, discourage capital flight through adoption of attractive investment codes and procedures tailored to the promotion and development of small-scale industries. Improvement in the balance of payments also requires the promotion of export through appropriate fiscal and monetary policies. A package of economic reform programs may be used to reduce deficits in the balance of payments, provided that supply management is given due attention.
- 7) **Budgetary Balance:** Measures that reduce government expenditure and increase its revenue should be devised in order to reduce budgetary deficits. Through

enlarging the tax base and improving the efficiency of the tax collection machinery, revenue might be raised. The enlargement of the tax base requires the provision of a package of incentives for investors and entrepreneurs. On the expenditure side, the government should reduce expenses on non-productive activities and release the resources for investment. This calls for efficient resource management. Reduction in budgetary deficit would be reflected in the improvement in the balance of payments.

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