THE ECONOMIC REFORM PROGRAMME OF ETHIOPIA

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1. INTRODUCTION

Ethiopia has a population of around 51 million, an estimated total agricultural land of 84 million hectares, the largest livestock population in Africa, an immense hydro- and geothermal energy resources. Yet with a per capita GDP of only 120 US dollars in 1989, Ethiopia is one of the least developed of the developing nations.

Economic development has been beset with continuing problems of recurrent drought, accelerating degradation of natural resources, internal conflicts, budgetary and balance of payment deficits, growing population pressure, etc.

These and other problems of backwardness have prevented the economy from following a path of self-sustained growth and necessitated a reconsideration of previous economic policy.

The Economic Reform Programme (ERP) announced by the past regime provided the basis for working out a series of policy measures. However, the process of implementing ERP was overtaken by the change in government, which has brought with it changes in policies, including economic policy.

This paper is concerned with reviewing the new policy orientation towards a mixed economy type of economic and social development. It is devided into sections dealing with Ethiopia's economic crisis, attempts to deal with the crisis, development issues and objectives and prospects of policy changes.

2. ETHIOPIA'S ECONOMIC CRISIS

In the past thirteen years, efforts have been made to increase the productive capacity of the economy and to upgrade social services through annual development campaigns (1971-76 Ethiopian Fiscal Year (EFY)) and the Ten-Year Perspective Plan. The plan, though not fully implemented, had embarked upon the difficult task of pushing the country from economic backwardness by clearly defining appropriate development objectives and by creating favourable conditions for their realization.

However, the 1980s were difficult years for Ethiopia, as most of the macroeconomic indicators point to a worsening situation. The hope for recovery is becoming more and more faint.

Because of the war and related problems, the country's productive and infrastructural sectors (both economic and social) have deteriorated significantly.

Problems of poverty, food shortage, low productivity, weak productive base and backward technology, which emanate in part from the rigidities within the structures of production, consumption, employment and socio-political organization, have contributed to deepen the economic crisis. These structural characteristics, which manifest themselves in (i) predominance of subsistence activities; (ii) narrow production base; (iii) neglected informal sector; (iv) environmental degradation; (v) lop-sided development; and (vi) weak institutional capacity, constitute the most fundamental causes of the country's underdevelopment.

Other factors have also contributed to the economic malaise. The severe world recession, which was sparked off by the escalation of oil prices in 1979-80 has resulted in very appreciable decline in the overall economic performance of the country. In addition, recurrent drought and particularly the great drought of 1983-85, which claimed very many lives, has stifled the performance of the agricultural sector.

At the same time international financial flows to Ethiopia declined substantially. At US$14.2 per capita in 1989 [IBRD 1991], official development assistance to Ethiopia was amongst the lowest in sub-Saharan Africa, while the flow of private capital is virtually non-existent. Famine relief accounts for the bulk of external assistance. Paradoxically, the burden of external debt has become increasingly heavy; the ratio of debt repayment to earnings from export of goods and services rose from about 31 per cent in 1978 to 57 per cent in 1982 EFY.

Thus, although the country is predominantly agricultural and pastoral, it has become dependent on relief food imports to supplement the meager national output. With current population growth rates, an annual increase of 3 per cent in food production is needed just to maintain the deficit at its current level.

In short, the performance of the economy has been deplorable -- stagnation and, at times, decline. Per capita income has fallen, aggregate output stagnated, savings and investment rates declined, food supply shortages worsened, severe balance of payments problem and high debt service obligations emerged, overt and covert unemployment problems aggravated. Table 1, clearly illustrates the changes and trends of aggregate output and per capita income over the last ten years.

3. ATTEMPTS TO DEAL WITH THE CRISIS

In view of the problems mentioned above, the past regime took far-reaching measures in order to change the institutional and policy framework within which the economy has been operating. The measures were designed to mitigate the growing economic problems and place the economy on the path of recovery and sustained growth.

3.1 The Economic Reform Programme (ERP)

Concerted efforts directed towards solving the country's economic and social problems date back to the 1980 EFY with the process of policy analysis, review, and formulation. Since then a series of economic liberalization measures were taken, including an increase in agricultural procurement prices, liberalization of grain movements on private account in surplus-producing areas, investment policy in areas such as hotels and tourism, small-scale industry and joint ventures, and the drastic reduction of surtax on exports to provide incentives to coffee-growers.

Table 1: Changes in Aggregate Output and Per Capita Income

No.	Year (EFY)	GDP growth rate (%)	Per capita growth rate (%)
1	1974	0.74	-2.06
2	1975	8.06	5.06
3	1976	-4.94	-7.58
4	1977	-5.84	-8.41
5	1978	9.94	3.94
6	1979	9.53	6.38
7	1980	1.85	-1.04
8	1981	1.62	-1.28
9	1982	-0.92	-3.76
10	1983	-5.63	-8.34
Average		1.41	-1.71

Source: ONCCP, Macro Planning Department.

The adoption of the ERP is, therefore, the outcome of the worsening crisis Ethiopia has been facing and detailed evaluation of the economic situation since the early 1970s.

ERP moves in the direction of a mixed economy with greater private sector participation in all sectors of the economy. Ethiopia has always been a mixed economy in terms of dominant peasant agriculture and strong private sector participation in small- scale manufacturing and domestic trade. Therefore, ERP is nothing but a change in the overall development philosophy from one which attempted to direct the economy gradually towards a socialist structure of production relations to a 'mixed economy' type of development using a combination of both plan and market.

ERP was announced by the 11th Plenum of the ex-Central Committee of the then Workers' Party of Ethiopia held in March 1990. The 11th Plenum brought together earlier thoughts and new perspectives on the problems and prospects of the Ethiopian economy and transformed them into a fundamentally new overall development strategy, policies and institutional framework within a mixed economic model.

3.1.1 Key Elements of the ERP

The key elements of the ERP are:

a) Promotion of mixed economy where all forms of ownership -- state, private and co-operative -- operate side by side on the basis of competitiveness and profitability. Private economic activity is to be actively promoted;
b) Greater use of the market mechanism to guide economic decisions;
c) Elimination of state controls (investment ceilings, areas of operation, grain quotas and movements, pricing, etc.) on the operation of private enterprises and active promotion of private economic activity;
d) Restructuring and divesting public enterprises. This comprises introducing management autonomy, i.e., in labour hire and fire, input supply and marketing, guiding the operations of public enterprises on profit basis, enforcing a bankruptcy law, offering for sale those enterprises not amenable to state management;
e) Formation of co-operatives on strictly voluntary basis and the full exercise of democratic practices; and
f) Encouragement of foreign investment both direct and joint ventures with the government and Ethiopian nationals.

ERP, indeed, marked a basic change in the overall orientation and path followed by the Ethiopian economy since the mid-1970s. It accepts market mechanisms, competitiveness and profitability as basic guiding principles for economic decision-making. It envisages, *inter alia*, the expansion of private sector participation (domestic and foreign), improved efficiency of public enterprises and increased flow of foreign investment.

3.2 The Draft Economic Policy of the Transitional Government

As indicated earlier, the process of implementing ERP was overtaken by the change in government which has brought with it changes in the political, institutional and economic environment. In view of these circumstances, therefore, it would be imperative to sketch out the salient features of the Draft Economic Policy.

The major elements of the Draft Economic Policy can be summarized as follows:

i) promotion of a mixed economy;
ii) privatization of most of the state farms, public industrial enterprises and trade;
iii) security of land tenure;
iv) the right of free use of production;
v) active encouragement of investment, mainly domestic, through incentives;
vi) reorienting public sector management towards efficiency through competitiveness and profitability;
vii) providing adequate guarantee for investment; and
viii) introducing appropriate macroeconomic polices for economic growth, including budgetary, credit, monetary, balance of payments and exchange rate policies.

These overall aspects, by and large, suggest that the Draft Economic Policy is not dramatically different from ERP. Since ERP has not been fully implemented and since the New Economic Policy is still in its draft form, however, subsequent discussion is confined to ERP. Hence, the likely impact of the programme on the overall economic development will be assessed in the light of development issues such as investment, agricultural, fiscal and monetary policies and others.

4. DEVELOPMENT ISSUES

4.1 Investment Policy

Following the adoption of ERP, the past regime issued a series of proclamations and regulations that created the legal framework for the participation of local (public and private) and foreign capital in the acceleration of the country's development. The new proclamations and regulations removed investment ceilings on private capital, eliminated control on area of operation, provided security of land tenure and property, ownership through land allocation for commercial farm and granting of private property rights on urban property including the right to transfer, sell, rent, etc. and eliminated labor hiring restrictions in agriculture.

In May 1990, the then State Council issued a Special Decree (No. 17/1990) on investment. The new Investment Decree defines the areas of investment open to investors and the incentives to which they are entitled. Private and foreign investment was to be actively encouraged without restriction on size, in all sectors, except in a very few cases such as public utilities, banking and insurance for which prior authorization is required.

The new Investment Decree also provided wide-ranging incentives. Investors are exempted from payment of custom duties and of income tax for two up to five years, depending on the nature and volume of capital invested. Furthermore, the Decree provided an additional year or two exemption from income tax to serve as an incentive for investments made in areas designated as priority.

Over and above custom duty privileges and tax holidays, the incentive package included the reduction of the marginal tax rate on business incomes from 89 per cent to 59 per cent.

In order to facilitate the implementation of the Investment Decree, regulations were issued on procedures, licensing, charges and fees. These included Regulation Nos. 7, 8 and 9 of 1990, which were for agricultural, industrial, hotel and tourism activities, and Regulation No. 10 stipulates the conditions for foreign capital participation.

The expansion of private sector investment would result in the expansion of employment and improvement of income. This is, however, dependent on how fast the private sector regains its confidence and moves into productive investment. Past policies have "spoiled" -- so to say -- the private sector by forcing it to increasingly move into speculative merchandise trade and rent-seeking activities. From the magnitude of conspicuous consumption by the "merchant class", one gets a good indication of the huge profits amassed through arbitrage. It is important, therefore, to remove the distortions that make such activities attractive and thereby give correct economic signals to redirect capital towards productive investment.

In the area of foreign investment, the new economic policy seeks to encourage the flow of foreign capital through direct investment and joint ventures with public capital and Ethiopian private capital. If foreign investment comes on a large scale and is sustained, it can contribute a lot for the expansion of employment and transfer of technology. The problem with foreign investment, however, is the question of whether Ethiopia can succeed in attracting foreign investors on a significant scale, given fierce competition among countries of the region and those in Europe and South-east Asia.

4.2 Agricultural Policies

The ERP introduced a number of measures that are designed to improve the institutional, incentive structure and investment opportunities in agriculture. It allows for the establishment of private commercial farms (both local and foreign) for the first time since the 1976 Land Reform Proclamation. In order to protect small farm-holders from undue competition by commercial farms, the programme stipulated minimum investment levels and land holdings differentiated by type of crops.

The removal of restrictions on hiring labor in rural areas helps to accelerate the development of commercial farms by alleviating the labour shortage problem particularly in cash crop -- coffee, cotton, etc. -- producing areas.

Other measures of the ERP also included the guaranteeing of security of land tenure and the formation of co-operatives on a purely voluntary basis.

a) Security of land tenure. The insecurity of land tenure that emerged as a consequence of the reallocation of land by peasant associations in order to accommodate new members has been considered as a major source of disincentive to raise productivity and invest in perennial crops. The new policy grants security of tenure thus removing the source of friction among members of peasant associations and motivating them to invest in the planting of trees and afforestation, soil and water conservation, expanding rural energy sources and raising agricultural productivity.

But there is also a likely adverse impact that could result from land tenure security, i.e., rural landlessness, partly as a direct result of crowdedness. This will presumably provoke migration of heads of the households or whole families.

Problems of income and food insecurity, as a result of rural landlessness could partly be mitigated by the ERP as it allows the hiring of labor which was prohibited since the rural land reform of 1976.

b) Co-operatives. As explained earlier, co-operatives are to be formed on voluntary basis and shall be governed by democratic principles under ERP. It is up to the members to keep their co-operatives a going concern or to dissolve them if they find them not beneficial.

Immediately after this policy declaration, a number of producers' co-operatives were dissolved a *prima facie* evidence of the failure of producers' co-operatives to meet the objective and perceived interest of their members. The dissolution of producers' co-operatives can have beneficial effects since it can save members energy which was wasted on losing and unproductive co-operative establishments.

Service co-operatives, on the other hand, are generally unaffected by the breakup phenomena. Service co-operatives provide agricultural services such as credit and inputs, goods for sale, and market farmers' produce. They operate flour mills and grain storage facilities and other social facilities. These functions, perhaps, explain the reason behind their continued existence in the post-reform period.

4.3 Reform of Public Enterprises

ERP envisaged basic changes in the operation and management of public enterprises. A Public Enterprise Law, which would enable them to operate on a profit basis and would provide power to management to hire and fire labour, fix prices, establish sales outlets, declare bankruptcy when the magnitude and nature of losses require such an action, was about to be promulgated. The past regime had already declared its intention to restructure public enterprises, and those that cannot be made viable even after restructuring will be sold or liquidated. The ultimate objective was to have a relatively small but efficient and vibrant public enterprise sector.

The rationalization measures will, in the short-run, aggravate the unemployment problem as public enterprises shed off labour. These measures could also mean higher prices for goods and services, as they strive to reflect market conditions, given existing shortages. The strength of the inflationary effect and its persistence, however, are dependent on the overall supply response to ERP.

4.4 Development Strategies and Policies

In the area of development policies, ERP was expected to have serious effects on society, since its main thrust was to provide a conducive economic policy environment for recovery, structural transformation and growth of the economy. Output, employment and income were bound to rise in the long-term. In the long-term, therefore, ERP was likely to have a positive economic and social impact on vulnerable (e.g., low-income) groups, given sufficient sensitivity in the development planning exercise and if the essentials of ERP are implemented and sustained.

It is also believed that the various strategies, i.e., the National Food and Nutrition Strategy (NFNS), the Disaster Preparedness and Prevention Strategy (DPPS), the National Population Policy (NPP), the National Conservation Strategy (NCS) and the Investment Policy (IP) that constitute important components of ERP are designed to alleviate structural constraints. These will go a long way in putting the economic benefits on firmer foundation.

ERP may be expected to inflict adverse effects on vulnerable groups in the short- to medium-term. This is more so because of the prevailing economic crisis and the move towards a market-oriented economic management. Key macroeconomic indicators clearly show that Ethiopia is moving into deeper economic crisis, the crisis of the 1980s that led to ERP getting aggravated.

Apart from the war, the various factors that reinforced each other to generate the economic crisis are still operative: foreign capital inflow is extremely low; the external economic shocks have continued to be punishing; and shortage of foreign exchange has become the most critical bottleneck threatening the economy to a halt. Given the continued economic crisis,therefore, poverty in Ethiopia is bound to get worse.

4.5 Development Planning

The shift towards a mixed economy type of development entails a change in the role of planning. It is worth noting that Ethiopia did not have a fully operative central planning in its classical form as that practiced so far in the Soviet Union and Eastern Europe. Although the drive of the government was towards establishing central planning, it was difficult to do so in a predominantly peasant economy.

Ethiopia's planning has been, therefore, more indicative than mandatory despite attempts made to set targets and allocate skilled manpower, investment and foreign exchange resources for the public enterprise sector.

Under a mixed economy, planning has to be reoriented and focused on macroeconomic management. Generally, its major functions are:

i) set priorities and formulate medium- and long-term development strategies;
ii) regulate and encourage the private sector through various economic levers--taxes, exchange rates, interest rates, etc.;
iii) formulate short-, medium- and long-term comprehensive national plans and prepare economic forecasts;
iv) formulate regional development strategies, polices and plans; and
v) formulate public investment programmes (capital budgets) on the basis of the short-/ medium term plans.

Overall, the system of economic management under the new economic policy will have utilized both plan and market in a complementary way. Decisions regarding what and how to produce would have been largely governed by market signals.

By allowing public enterprises to operate through the market mechanism, the government will be in a position to reallocate the resources that used to be spent on subsidizing inefficient and losing enterprises. If these resources are invested, for example, to enhance human capital development such as education and training, health, etc., they will contribute to a betterment of economic opportunities.

4.6 Fiscal and Monetary Policies

Macroeconomic stability is essential for the attainment of improved growth, employment and income on a sustained basis. ERP envisaged changes in the monetary, fiscal, trade and exchange rate policies.

Currently, adjustment in the fiscal area necessitates two complementary actions -- raising revenue and the reducing budget deficit. The tax effort (tax/GDP ratio) is one of the highest among developing countries. Recently, the government introduced a new sales tax by consolidating the transaction, turnover and excise taxes and by upward adjustment. Such taxes are likely to fall heavily on vulnerable groups, for non-progressive taxes have more impact on lower-income groups.

Reducing the budget deficit, albeit difficult in the short-term because of declining revenues, is inevitable in the medium-term. It can be achieved mainly through cuts in defence budget but also entails substantial cut or elimination of subsidies, restructuring of the civil service and perhaps leading to the shedding off central government employees, and reduction of recurrent and capital expenditures for economic and social development eventually.

Although ERP does not explicitly state its position as far as foreign exchange adjustment or devaluation is concerned, recognizing the fact that the Birr is a highly overvalued currency and given also the negotiations between the former regime and the Bretton Woods Institutions, which is likely to be resumed by the Transitional Government, for a possible structural adjustment programme, some kind of devaluation is inevitable.

The broad aims of a structural adjustment programme (SAP) include:

i) revival of economic growth;
ii) reducing macroeconomic imbalances;
iii) improving economic efficiency and resource allocation; and
iv) expanding the productive capacity of the economy.

While specific elements of SAP packages vary from country to country, the following polices seem to feature in most of them:

i) restriction of demand;
ii) devaluation of currency;
iii) liberalization of trade;
iv) reduction and targeting of subsidies;
v) reduction of government budget deficit by putting ceilings on expenditure and attempting to raise revenue; and
vi) price decontrol.

An assessment of SAPs undertaken by African countries gives a discouraging picture. A number of issues have been raised with regard to the efficacy of SAPs. It has been argued, for example, that SAPs tend to entrench the traditional few export commodities and undermine the needed shifts to food production. It has been pointed out that curtailing public expenditure, as recommended by SAPs, reduces public investment and hence overall economic growth. In addition, it is argued that polices like the removal of subsidies on inputs such as fertilizers and pesticides can have direct negative effects on agricultural output. It is true that one major reason why many African governments adopt IMF and World Bank sponsored SAPs is to enable them mobilize the much needed financial resources. Experience has shown, though, that donors, demanding assurances that policy changes these governments intend to adopt have the support of the IMF and the World Bank, have not always provided all the funds required to guarantee the success of the reform programmes.

It has become clear that there have been many social and economic costs associated with structural adjustment programmes, including increased unemployment levels, declining income per capita, paucity of essential goods and services, declining real wages, increasing prices, and serious deterioration in health and nutrition standards. Concern for these adverse socio-economic costs of SAPs have led to a re-examination of the design of SAPs with what is now referred to as "adjustment with a human face".

If the Transitional Government decides to undertake SAP, Ethiopia's experience is not likely to be any different. The problems associated with SAPs would have happened even without the adjustment programme, so an orderly adjustment is better than a disorderly one leading nowhere.

5. CONCLUSION: OBJECTIVES OF THE POLICY CHANGES AND PROSPECTS

Development in Ethiopia faces a number of entrenched, long-term constraints: poor infrastructure, a low level of technological development and know-how, growing population pressure on available land, degradation of land and water resources. Moreover, in recent years, the country's capacity to respond to these constraints has been limited by a number of other factors such as deteriorating terms of trade, internal conflict and recurrent drought.

The balance of payments situation is critical, and foreign currency resources have dropped to precarious levels. Production, development programmes and maintenance of infrastructure are all hampered by the resulting shortages of essential goods, raw materials, space parts and fuel.

As outlined earlier, ERP moves in the direction of a mixed economy, with greater private sector participation. The mixed economic policy, if accompanied by related measures, provides a viable programme framework.

5.1 Objectives

The Ethiopian government country presentation for the Second UN Conference on LDCs [PDRE 1990] sets out broad national development objectives constituting:

a) National food self-sufficiency and food security through enhanced domestic production and distribution...;

b) Reversing the growing balance of payments deficit by initiating an integrated export development programme composed of an expansion of existing export volume and diversification into new agricultural, mining and industrial exports;

c) Diversification of the overall production base by promoting small- and medium-scale industries;

d) ... extend the availability of education and basic health care to a larger proportion of the population; and

e) ... specially focused programmes to stem the decline in the natural resources base including... a National Population Policy and a National Conservation Strategy.

As mentioned earlier, these objectives are also complemented by a National Disaster Prevention and Preparedness Strategy, National Food and Nutrition Strategy, and programmes in such areas as forestry and irrigation and science and technology already prepared or under preparation.

5.2 Prospects

The liberalization policy embodied in ERP and the Draft Economic Policy would create the general conditions for a renewed growth effort upon implementation. With the prospects of solutions to the hitherto intractable problem of civil strife, a "peace dividend" could provide additional impetus to faster economic development.

ERP and the Draft Economic Policy need to be articulated into guidelines and directives in order to enhance their application in the various spheres of development. Carefully planned interventions can help inject useful experiences in order to minimize mistakes that could be encountered with an inward-looking strategy strongly indicated in the Draft Economic Policy.

Although Ethiopia faces a number of problems associated with backwardness, it is endowed with a wealth of varied renewable and non-renewable natural resources. Given the presence of appropriate policies and investment climate, these resources could generate significant employment, foreign exchange and balanced development.

A well-designed programme to utilize these resources in a rational manner should include sound policy, legislative and investment promotion actions, introduction and adaptation of technology as well as development of the necessary managerial and technical skills in the public and private sectors.

With all the necessary guidelines and directives in place, there are immense opportunities for development. The liberalization policy initiated by the past regime, together with the Draft Economic Policy, will help establish an environment that would allow investors to be attracted to engage themselves in productive investment. Local investors should be allowed to take the lead, as their example would be a vote of confidence and would encourage foreign investors.

The liberalization process is, therefore, one of a series of policy reforms that would make Ethiopia a more liberal and competitive place in which to do business. However, if conditions for a profitable investment in Ethiopia are non-existent and, if the necessary investment climate and confidence are lacking, there would be no point in attracting investment. Investors, especially foreign investors, would be looking for investment opportunities globally and not just Africa, let alone Ethiopia.

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