TRADE LIBERALIZATION POLICY AND THE PROSPECTS OF THE PRIVATE SECTOR IN EXPORT PROMOTION: THE CASE OF ETHIOPIA

Yohannes Ayalew

1. INTRODUCTION

A growing and unsustainable debt burden has become the typical characteristic of LDCs for the last two decades or so. Economists argue that this imbalance in the external sector is to some extent explained by the wrong policy measures taken so far in these countries.

Some of the policy measures which were ill-devised include: over-valued exchange rate as a means of arresting domestic inflation, import taxes as a means of protecting the domestic production of importables, and export duties, as a means of encouraging non-traditional exports. Far from attaining what they were meant for, these policy measures resulted in the proliferation of unproductive activities which are dubbed in the literature as 'rent-seeking' - the rising involvement of the private sector into uproductive venture in an attempt to extract the premium, or rent seeking, induced by the wide disparity between controlled official and 'market clearing' prices.

Ethiopia was not exception to the perverse impact of policies mentioned above. As of 1987/88 the amount of foreign reserve available could only finance 3.4 months of imports, a level which was 11.8 months in 1974/75(ONCCP, p.53). Private sector exports declined from 68 percent of total exports in 1979 to 30 percent in 1982, which further decreased to 15 percent of the total in 1985. This is not due to the increased volume of exports by para-statal organizations but a result of increasingly declining number of exporters and/or their volume of exports. Furthermore, almost all industrial exports of the country needed subsidy by the 1980s so much so that according to a study(Ministry of Trade, 1989), in the years between 1983 and 1986, a one birr equivalent foreign exchange earning required a subsidy ranging between 0.11 birr to leather and shoe exports, and 1.46 birr to that of salt. As such, aside the far-fetched excessive control on the private sector, there was hardly any economic environment to the state sector so to speak. As a result of maldesigned policies and other factors, the external imbalance of the country has widened from -195.8 in 1974/75 to -1,492.7 in 1991/92, which shows a compounded rate of annual growth of 12.7 percent. The indebtedness of the country has also increased tremendously, and as such, that portion of fixed investment financed through foreign borrowing increased from mere 2 percent in the early 1970s to more than 80 percent in 1989/90(ONCCP, p.53).

Cognizant of these problems, the transition to a market-oriented economy was initiated in 1989/90 when the military government, as a last-ditch attempt, declared the "Mixed Economic Policy". But a more comprehensive policy reform has only been started with the launching of

imports, such as personal effect, and goods used to carry out an importer's licensed activities.

- In a move to liberalize the exchange market, the Government introduced on may 1, 1993 a foreign exchange auction. The auction is managed by the NBE and is envisaged to take place on a bi-weekly basis. In the system, each successful bidder pays the price of which he bid, until the supply of foreign exchange is exhausted. The marginal rate (the lowest rate) established at the auction is deemed the secondary rate and is applied to all current and capital account transactions until the next auction, with the exception of a limited number of payments for which foreign exchange is made available at the official rate.

- The new Investment Code redefined the position of foreign investors. The Proclamation guarantees the right of foreign investors to remit their profits and dividends and to pay related fees, royalties, and other foreign exchange costs. However, the Code reserves certain sectors, including most of the financial, energy, and rail/air transportation sector, for investment by the government.

- A harmonized system of import tariff rescheduling means to narrow the gap between tariff rates applicable to different commodities, and to reduce the level of import tariff rates applicable to durable consumer items has been placed in force on August 16, 1993.

- An export trade duty incentives scheme which encourages domestic production of exports through duty draw-backs and duty free importation scheme for raw material imports, exclusively used for that purpose, has been effected as of August 18, 1993.

In implementing these measures the government's goal is to improve the economic condition through market forces. In other words, it is intended to bring about a market structure in the country's economy and thereby promote economic development.

Obviously, the next question would be "Is the ongoing trade liberalization leading to success or failure?". The answer to this question demands a full-fledged analysis of empirical data, which is lacking at the moment. A brief glimpse into some of the basic economic indicators like prices, exchange rates, interest rates and so on is however, in order to indicate the wholesome trend.

Before going through these variables, however, it is worth having a brief look into the theoretical debate on the timing and sequencing of liberalization, which would possibly lay the ground for identifying to what line of thinking the country's reform measures belong and what the next steps should be for the success of the reform programme.

3.3 The Real Interest Rates

The real rate of interest[2] had been increasingly negative for a couple of years, preceding the adjustment program as a result of mounting inflation. It is only in the years 1986/87 and 1987/88 that the rate was positive and this was because inflation went down to the level of -9.5 and 2.2 percent respectively (see Table 1 again). This means that Ethiopia turned from a strongly positive to severely negative real interest rate, as a result of which the country was classified among the highly repressed economies[3].

Table 3

The Real Interest Rates Before the October, 1992 Adjustment
(in percent)

Year	Nominal Rates*	Inflation Rates	Real Interest Rate
1986/87	6.35	-9.5	17.7
1987/88	6.70	2.2	4.5
1988/89	6.70	9.6	-2.6
1989/90	2.43	5.2	-2.6
1990/91	1.00	20.9	-16.4
1991/92	3.63	21.0	-14.3

* According to IMF definition of deposit rates. This is the rate offered by Commercial Bank of Ethiopia on twelve-month time deposits.

Nominal interest rates have been raised since October, 1992, in line with the on-going structural adjustment program. The lower deposit rate of 3.63 percent was raised to 10 percent. Consequently, the real rate became positive for the last two quarters of 1992/93 fiscal year (see Table 3). As could be seen from the table below, the real rate of interest[4] registered a meagre negative of -0.5 percent in the second quarter of 1992/93, only to go up to 0.5 percent in the third quarter as inflation dropped to 9.4 percent. In the fourth quarter, however, as inflation went up slightly to 10 percent, the real rate declined to zero (break-even point). As a result, the real rate of interest for long-term deposits were kept positive all through the quarters.

Thus, the stability in the general prices recorded through the quarters would imply that the likely threat of over-liquidity problem that could arise from poor response of private investors to a further increase in bank lending rates is moderated. Furthermore, the prospect seems encouraging for private investment to expand in the face of excess demand for goods and services in the market. The real financial assets also grew tremendously in 1993 compared to their level in the previous years, indicating an improvement in the country's financial situation

3. IMPACT OF THE REFORM: INFLATION, THE REAL EXCHANGE RATE AND REAL RATE OF INTEREST

The basic macro-economic indicators like prices, the real exchange rate and the real interest rate have shown tremendous improvements in the period between October, 1992 and June, 1993.

3.1 Inflation

Inflation which started to mount to a higher level in 1990/91 and 1991/92 declined tremendously in 1992/93 despite the decline in real GDP. It is not, however, true to attribute such a decline solely to the reform. There were also external factors which contributed to this decline. Below, the important factors which affected the level of prices are discussed in brief.

To begin with, the 1990/91 civil war pushed up prices to unexpected level due to the disruption of agricultural production in cereal producing areas, blockade of roads leading to the central market (i.e., Addis Ababa for which the price index is computed). This would be clear if one looks at the data compiled in Gregorian than Ethiopian Calendar (compare Table 1 below with Annex 1). The general price rose to 35.7 percent in 1991 from that of 5.1 percent in 1990. The biggest price increase was recorded, especially in the months between January and June which was around 27 percent. The end of the war and the restoration of political stability in the major parts of the country, therefore, caused prices to decline. As such, prices are affected basically by the variables operating under normal circumstances.

Table 1

Gregorian Year	1989	1990	1991	1992	1992			
					I	II	III	IV
Inflation rates	7.8	5.1	35.7	10.5	1.5	5.1	5.1	0.6

Source: National Bank of Ethiopia

It is obvious from the table that the level of inflation registered in 1992 was only 10.5 percent. When we look at the quarterly computed indices, however, prices were relatively stable even before the October 1992 basic reform.

Secondly, the lion's share of consumer goods were imported either through black market or franco-valuta, whose prices are obviously quoted at the parallel market level. Moreover, most of the public enterprises were operating below capacity due to shortage of foreign exchange. The increased utilization of industrial capacity would therefore reduce the impact of devaluation through the reduced level of per unit production costs.

The on-going liberalization program , among other things, is intended to bring about a dynamic change in the involvement of private businessmen in exports. Devaluation of the birr, elimination of all export taxes except that on coffee, duty-draw backs and duty free importation of raw materials are among the major policy reforms undertaken in promote the export sector.

As briefly discussed in the previous sections, the reform has brought about economic stability at least over the period covered in this analysis. More specifically, inflation has gone down significantly; the real exchange rate and the real interest rate have become stable; and the gap between the parallel and official exchange rate is closing. These are positive economic signals that encourage private investment especially in the area of exports and, moreover, divert illegal exports into the official channel. In the short-run, however, only the effects on the latter are relatively more significant. For private investors to take investment risks, the country should be able to secure a relatively longer period of economic stability and investment barriers must be removed.

In the next few paragraphs the paper will try to look into the short-run effects of the reform on private export development. For comparison purpose the data is measured in quantum. Table 6 depicts that private exports have shown significant improvement since liberalization. In 1992/93 exports of coffee by private exporters increased to 15,946 tons from its level of 7,934 tons in 1991/92, registering a 101 percent growth. And this is even higher than those attained in 1989/90 and 1990/91. With respect to oilseeds and pulses also private, exports grew by 683 percent. 'Chat' export grew by 947 percent and spices by 45.1 percent. Whereas, export of Meat and Meat products registered a fall of 93.3 percent. This is due to the rising prices for cattle, whose upward trend is explained by increased competition from neighboring countries.

Table 6
Major Exports of the Private Sector 1989/90-1992/93
(In tons)

Type	1989/90	1990/91	1991/92	1992/93
Coffee	10,768	8,641	7,934	15,946
Meat and Meat prod.	-	-	60	4
Oilseeds and pulses	7,702	4,130	271	2,122
Fruits and vegetables	11,769	11,821	7,767	13,397
Chat	2,741	1,781	268	2,806
Spices	557	288	206	299

Source: Ministry of Trade, *Annual Reports*

Notes

1. The real exchange rate (RxR) is measured as the nominal rate (NxR) times on index of domestic prices (Pd) divided by an index of world prices of tradables (PW).

$$RxR = \frac{NR \times Pd}{Pw}$$

(Odl, working paper, No.33 *Exchange Rates and Structural Adaption. P.5)*

2. The rate is calculated using the formula

$$r^* = \frac{r}{P} \times 100 - 1$$ where r^* = the real rate of interest
r = nominal rate or interest
p = domestic inflation

3. The nominal rate taken for comparison is the twelve- month time deposit rate which IMF used to represent for the countries deposit rate. IMF (August 1993) *International Financial Statistics*.

4. According to King and Levine (1992) a country with a real interest rate of below -5.0 percent are grouped among the severely repressed economies.

REFERENCES

Calvo, D.F., "Argentina: Trade Reform, 1976-1982", in Shephered and Langonied (eds.), *Trade Reform: Lessons From Eight Countries*, International Center for Economic Growth Publicatinn, California, 1991, PP. 27-40.

Calvo, G.A., "On the costs of Temporary Liberalization/StabilizationExperiments", in M. Connolly and C. Gonzalez (eds.), *Economic Reform and Stabilization in Latin America*, Pracger, New York City, New York, 1987.

Carbo and Jaime de Melo, "Liberalization and Stabilization in the Southern Cane of Latin America: Overview and summary", *World Development 13*, August 1985, PP. 5-15.

Corden, W. Max, "Protection and Liberalization: A Review of Analytical Issues," *IMF Occasional Paper* No. 54, International Monetary Fund, Washington D.C., 1987.

Edwards, S., "Stabilization with Liberalization: An Evaluation of Ten Years of Chile's Experience with Free Market Policies", *Economic Development and Cultural Change*, No. 33, January 1985.

Fisher, "Economic Growth and Economic Policy", in V. Carbo, et al. (eds.), *Growth Oriented Adjustment Programs*, IMF-World Bank, Washington D.C., 1987.

Annex 1

Basic Macro Economic Indicators

Year	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93
GDP at constant factor cost[1]	9192.8	9341.8	9301.0	9442.1	8275.8	8944.7[3]
Gov't Revenu[2]	4103.0	4698.2	3559.6	3179.0	2640.9	4118.0
Gov't Expend.	4881.5	5725.9	5331.7	4864.1	4060.7	6040.1
Budget Deficit	(778.5)	(1027.7	(1772.1	(1685.1	(1419.8	(1992.1
Money Supply(M1)	3910.8	4173.8	4990.0	6130.8	6845.3	7683.6
Broad Money Sup(M2)	5238.7	5704.4	6708.2	7962.2	9010.9	10449.7
Domestic Credit (Gov't)	4007.8	4452.7	5670.9	6917.8	8062.8	7836.2
Memo						
Inflation (in percent)	2.2	9.6	5.2	20.9	21.0	10.0

Source: National Bank of Ethiopia.

1. at 1980/81 price
2. including grants
3. projected.