# HIGHLIGHTS ON THE STATE OF ETHIOPIA'S EXTERNAL TRADE AND ITS GROWTH IMPLICATIONS

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## I. INTRODUCTION

The Ethiopian economy is linked to the economies of its trading partners in many aspects -- and to mention some -- its industries, service sectors, levels of income, employment, living standards and technology cannot be seen in isolation from the international economy. Although the linkage can take different forms, international trade is one aspect where the Ethiopian economy participates in world trade as a supplier of its products to the rest of the world and a consumer of products from the rest of the world. This dimension of economic integration that involves the flow of goods and services across nations, complex as it is, can, however, result in uneven effects among nations and among sectors within a given nation. After World War II, exports and imports as a share of national output reached unprecedented levels for many industrial countries with a declining market share in world trade for many developing countries. "The share of intra-African trade in the continent's total trade with the world is not only small but has been declining over the last decade. In 1975, intra-African trade reached a record level of 7.5% of the continent's total trade. However, this high rate declined steadily until it hit its lowest level at 3.7% in 1978. The latest estimates show that intra-African trade has been around 4 per cent" [Ethiopian Chamber of Commerce 1986: 9].

On the other front, the success story in increasing exports of manufactured goods and increasing advantages from world trade by the "newly industrializing countries" moved parallel with the marginalization and inability of a large group of developing nations to take advantages from international trade. Ethiopia falls within these category of nations where foreign trade is believed to have not contributed much to growth and development of the domestic economy. This paper attempts to give highlights on the state of the foreign trade of the Ethiopia economy and its performance in the context of growth. Emphasis is on exports and the terms of trade to explain the problems and to show Ethiopia's dependence on international trade.

## II. BRIEF THEORETICAL BACKGROUND

Trade induced changes in the developing countries have been unfavourable to the domestic economy and growth through trade, it has been argued, has subjected developing countries to a slow rate of growth of national income and overall development. This has been attributed, among others, to their poor performance and the unfavourable international trading system. Although international trade is believed to provide benefits to domestic producers and consumers, some economists maintain that the current international trading system hinders economic development in countries like Ethiopia, as neither the static gains from trade nor the dynamic benefits have been realized overtime. It follows that the conventional international trade theory based on the principle of comparative advantage and the Heckshher-Ohlin theory has little relevance to the developing countries, as their trade structure is characterized by high degree of dependence on the industrialized countries and not vice versa. Similarly, different from Heckshher-Ohlin trade theory, intra-industry trade and economic integration has been dominant in the international economic relations among nations. In recent years, a considerable proportion (about 75 per cent) of the exports of developing countries went to the advanced industrialized countries, and about 70 per cent of their imports originated from the same countries [UNECA 1989]. This is a clear indication that trade among developing countries is limited, and that they are predominantly linked to the economies of the advanced countries. Moreover, no considerable change in the composition and direction of trade took place in many of these countries, and exports of manufactured goods relative to primary products have not increased in some of the African countries. What is more, exports of manufactured goods by these countries are usually labour-intensive and contain modest amounts of modern technology in production. Their adaptability and flexibility to changes in world demand is low, and thus their exports have been facing deteriorating terms of trade.

## III. UNSTABLE FOREIGN TRADE SECTOR

The Ethiopian economy is characterized by an unstable export sector, and its exports are concentrated in a small number of primary products. It's export sector has been lagging behind in its contribution to the growth of the economy and, needless to mention, its export earnings have been unstable overtime. Its major export items are agricultural products, with coffee as the major foreign exchange earner. The export sector's contribution to Gross Domestic Product (GDP) was around 11 per cent in 1988/89, and the contribution of foreign trade taxes to central government revenue was around 14 per cent of which the share of export taxes was about 4 per cent during the same period. The balance of trade registered a deficit of about 10 per cent of GDP, and the current account balance showed an improvement to a deficit of around 6 per cent of GDP while the overall balance of payments showed a surplus of 0.4 per cent of GDP over the same period [UNECA 1989].

### A. Ethiopian's Exports and Imports

Ethiopia's export sector is characterized by overdependence on few agricultural products, with very limited exports of manufactured and semi-manufactured goods. According to UNCTAD calculations, Ethiopia's diversification index is found to be 0.924 with a concentration index of 0.644 which is an evidence of a near complete specialization of the export sector in a few commodities. The structural rigidity of the export sector and the dependence of the Ethiopian economy on primary products is illustrated in Table 1 where the shares of the major export items in the total value of exports are indicated.

**Table 1: Percentage Shares of Ethiopia's Major Exports in the Total Value of Exports for Selected Years**

| Year | Coffee | Hides & Skins | Pulses | Oil Seeds | Combined Share |
|---|---|---|---|---|---|
| 1976 | 55.9 | 9.5 | 9.6 | 5.4 | 80.4 |
| 1978 | 84.5 | 10.7 | 2.8 | 1.8 | 99.8 |
| 1980 | 64.1 | 12.3 | 3.5 | 1.8 | 81.7 |
| 1982 | 61.2 | 10.1 | 4.2 | 3.0 | 78.5 |
| 1984 | 63.2 | 11.2 | 2.0 | 2.8 | 79.2 |
| 1986 | 71.9 | 12.9 | 1.4 | 0.8 | 87.0 |
| 1988 | 56.8 | 17.2 | 2.1 | 2.8 | 78.9 |

**Source: Customs and Excise Tax Administration and National Bank of Ethiopia, *Annual Report,* 1988/89.**

Accordingly, the shares of the four major export items fluctuated from year to year in terms of value due to the volatile and erratic behaviour of prices and unpredictable demand in the international market. Similarly, on the supply side, these agricultural items are influenced by a large number of factors that are endogenous and exogenous to the supplier's production decisions and behaviour.

Among the major exports of manufactured goods leather, leather products and shoes and textile products contributed 71 per cent and 10.8 per cent to the total manufacturing exports of Birr 194.3 million in 1988/89 which is about 13 per cent of the total value of exports. According to the National Bank Annual Report of 1988/89, increased domestic demand, fall in international prices and supply shortages are some factors which explain the declining shares of exports of manufactured goods. The export sector of the economy being highly vulnerable to such factors on the supply and demand side, any shortfalls in domestic supply and changes in market demand are expected to have significant effects on export revenues and consequently on domestic incomes and employment levels. Among other factors, it is believed that the low elasticity of demand and supply for Ethiopian exports remain to be the underlying key factors in explaining the instability of product prices and export receipts.

Export revenues are the major source of foreign exchange resources that are badly needed for development, and thus shortfalls in the export sector will reduce export revenues and limit the import capacity of the economy. In this direction, unregistered or illegal trade particularly of exports have an important implication. Assuming imports are financed by exports, the export revenues generated have not been sufficient to pay for the country's import bills, and the export/import ratio has been falling, making the economy more dependent on other sources of financing to cover trade deficits. Table 2 shows the fall in the export/import ratio which has been due to rising import/GDP ratio and declining shares of exports in GDP in value terms.

**Table 2: Export/Import, Export/GDP and Import/GDP Ratios for Selected Years**

| Year | Export/Import | Export/GDP | Import/GDP |
|---|---|---|---|
| 1976 | 0.86 | 0.143 | 0.182 |
| 1978 | 0.64 | 0.150 | 0.266 |
| 1980 | 0.586 | 0.197 | 0.336 |
| 1982 | 0.472 | 0.093 | 0.197 |
| 1985 | 0.419 | 0.083 | 0.198 |
| 1986 | 0.420 | 0.095 | 0.226 |
| 1987 | 0.353 | 0.079 | 0.224 |
| 1988 | 0.340 | 0.075 | 0.221 |
| 1989 | 0.428 | 0.081 | 0.189 |

Source: Calculated from data in National Bank of Ethiopia, *Annual Reports*, various years.

On the import side, industrial inputs, machinery and transport equipments and other investment goods take a larger share of Ethiopia's imports in value terms. Table 3 gives an overall picture of Ethiopian imports and the shares of development goods and consumer goods in the total value of imports. This is in line with the priority given for imports of capital goods and other essential inputs necessary for growth.

**Table 3: Share of Selected Imports by End Use (Percent of total)**

| Imports | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|---|---|---|---|---|---|---|---|---|
| 1. Raw Material Inputs | 3.3 | 3.5 | 3.8 | 4.0 | 3.5 | 3.6 | 3.7 | 4.1 | 2.9 |
| 2. Semi-finished Inputs | 18.0 | 14.5 | 16.0 | 17.6 | 18.3 | 11.8 | 13.7 | 13.7 | 14.3 |
| 3. Machinery/Transport | 29.1 | 27.8 | 33.4 | 34.0 | 29.8 | 36.2 | 32.7 | 34.8 | 41.7 |
| 4. Fuel | 15.5 | 15.8 | 13.4 | 19.4 | 24.0 | 23.3 | 24.6 | 19.3 | 18.5 |
| 5. Total Share of Development or Investment Goods (1+2+3+4) | 65.9 | 61.6 | 66.6 | 68.4 | 75.6 | 74.9 | 74.7 | 71.9 | 77.4 |
| 6. Durable Consumer Goods | 12.4 | 9.5 | 10.2 | 9.3 | 8.0 | 8.6 | 8.8 | 7.0 | 6.1 |
| 7. Non-durable Consumer Goods | 20.5 | 24.1 | 21.8 | 15.2 | 15.8 | 16.4 | 16.4 | 20.0 | 16.3 |
| 8. Total Share of Consumer Goods (6+7) | 32.9 | 33.6 | 32.0 | 24.5 | 23.8 | 25.0 | 25.2 | 27.0 | 22.4 |

Source: Customs and Excise Tax Administration.

This is the result of the absence of domestic capital goods production to meet domestic demand and the high degree of dependence of the industrial sector on foreign inputs. This state of affairs would imply that any expansion or increase in production capacity of the industrial sector would demand imports of capital goods that could only be met if exports and export revenues are increased. In this sense, the rate of growth of export revenues, other things being equal, would have a considerable impac' on the rate of investment which would also limit the rate of growth of the economy. It follows that economic growth will be influenced by the ability to pay import bills through export revenues and the external trade performance of the economy. Ethiopia's limited production capacity of exports, weak competitiveness in the international market, high import requirements of domestic production are some factors explaining the poor state of affairs of the external trade of the country.

### B. Export Markets

Analysis of growth trends in exports, identification of the composition of growing commodity exports and destination of these exports could also help to show the linkages of the Ethiopian economy to the rest of the world and the nature of trade relations between Ethiopia and its export markets. The major trading partners of the Ethiopian economy and the proportion of total Ethiopian exports destined to each of the markets is as indicated in Table 4.

**Table 4: Share of Total Exports and Annual Growth Rates by Destination (1976-1985)**

| Export Markets (Destination) | Share of Total Exports (Per cent) | Average Annual Rate of Growth in Exports (Per cent) |
|---|---|---|
| USA | 24.07 | 10.12 |
| Federal Republic of Germany | 9.89 | 21.30 |
| Italy | 6.95 | -4.21 |
| France | 4.41 | 6.72 |
| United Kingdom | 2.49 | -3.31 |
| Other Europe | 10.42 | 3.96 |
| Asia | 16.23 | 2.04 |
| Africa | 9.10 | -7.57 |
| Rest of the World | 16.44 | 7.43 |

Source: National Bank of Ethiopia, *Annual Reports*, various years.

Accordingly, around 50 per cent of the total exports from Ethiopia are destined to the major five industrialized countries, namely, USA, Federal Reepublic of

Germany, Italy, France and the United Kingdom. The rate of expansion of the export trade with these countries over the period has been increasing. Trade with African countries, on the other hand, has not been expanding, despite efforts towards increasing intra-African trade. These features imply that the linkage of the Ethiopian foreign trade sector is with the advanced industrialized countries that are referred to as price-makers in the world market. The Ethiopian economy, as a small economy in world trade, would then have a low bargaining power and thus cannot decide on prices or sell large volumes in these markets. Infact, world demand and consumption of Ethiopian exports has not grown significantly and, in some instances, has fallen due to technological changes taking place in the industrialized nations. Technical progress in the advanced countries has moved in the direction of cost-reducing innovations which reduce or substitute imports of agricultural raw materials from developing countries like Ethiopia. This is reflected in the declining demand for agricultural exports of these nations and their decreasing market shares in world trade.

Looking at the growth of the commodity exports of the Ethiopian economy, we observe that annual growth rates of the major export items have not been promising. Comparison of the annual growth rates in the value of total exports with the annual growth rates in the value of major export commodities shows that there has been a better performance in coffee and hides and skins, with poor performance in the exports of pulses and oil seeds. The relative decline in agricultural production in general, lack of diversification and the nature of agricultural production techniques, in addition to the factors considered above, have contributed both to the slow growth in the volume of exports and lower prices in the international market. Table 5 illustrates the situation where coffee, hides and skins, pulses and oilseeds combined, which account for an annual average share of 83.4 per cent of the total export value, have experienced differential rates of growth. This could be explained by the trends in the individual commodity prices in the international market, a problem dealt with in the following section.

**Table 5: Annual Growth Rtes of Total Exports and of Selected Major Export Items (Selected years)**

| Year | Annual Growth Rates | | | | |
|---|---|---|---|---|---|
| | Total Exports | Coffee | Hides & Skins | Pulses | Oildseeds |
| 1976 | 21.4 | 112.63 | 60.8 | -13.9 | -62.8 |
| 1978 | -10.5 | 0.19 | 38.8 | -60.4 | -30.05 |
| 1980 | 1.2 | -4.90 | -23.6 | 5.92 | 67.10 |
| 1982 | 6.84 | 8.82 | -14.9 | 45.98 | 14.4 |
| 1985 | -19.8 | -20.7 | 14.67 | -43.10 | -42.07 |
| Average Rate of Growth (1976-85) | 7.29 | 15.9 | 18.17 | -11.8 | -16.5 |

Source: Computed from data provided by Customs and Excise Tax Administration.

## C. Terms of Trade

One of the mechanisms through which trade contributes to growth is through the terms of trade effects on the domestic economy. The controversial nature of the gains from trade, especially to economies like that of Ethiopia whose exports are concentrated in primary products, has been tied to the worsening terms of trade. Table 6, which presents the terms of trade movements for LDCs and Ethiopia, clearly illistrates the unfavourable terms of trade the Ethiopian economy has been facing in the international market.

**Table 6: Terms of Trade Indices for LDCs and Ethiopia for Selected Years**
(1980 = 100)

| Year | Index of TOT (LDCs) | Index of TOT (Ethiopia) | Index of Export Prices | Index of Import Prices |
|---|---|---|---|---|
| 1976 | 109 | 34 | 62 | 185 |
| 1977 | 124 | 63 | 124 | 196 |
| 1978 | 109 | 44 | 89 | 201 |
| 1979 | 103 | 170 | 92 | 54 |
| 1980 | 100 | 100 | 100 | 100 |
| 1982 | 92 | 72 | 78 | 109 |
| 1986 | 92 | -- | -- | -- |
| 1988 | 85 | -- | -- | -- |

Source: Computed fromd data in UN, *Statistical Yearbook*, 1986.

Since the prices of exports and imports are what constitute the terms of trade, it is important to analyse and look at the movements of these prices. However, terms of trade effects on growth and welfare should be viewed with an eye to the causes and effects on quantities of exports and imports or the volume of trade rather than the simple price changes. In the Ethiopian case, there have been fluctuations in prices of both exports and imports, as indicated in Table 6, the bad years being 1976, 1977 and 1978 in which the terms of trade highly deteriorated and an improvement recorded only in 1979 to be followed by declining terms of trade for the rest of the period under study. It is, however, difficult to conclude from the figures in the table whether developing countries as a whole have experienced a deterioration or an improvement in their terms of trade. But it is clear that there are also studies about the terms of trade movements suggesting improvements for developing countries at particular periods [Sporas 1983; Michaely 1984]. The Ethiopian economy has been facing a deterioration in its terms of trade, but this cannot be used to make conclusive statements regarding the performance of the economy since there are problems associated with using the terms of trade alone to this effect.

Although we would not be surprised by the unfavourable terms of trade the Ethiopian economy faces, the implication on the domestic economy and living standards should not be underestimated. In the 1980s, the value of world exports grew by 5.7 per cent per year while the purchasing power of exports from developing countries rose by only 3.1 per cent per year [UN 1984]. In the Ethiopian case, the purchasing power of exports has fallen by 37.8 per cent in 1990 alone. The effect of such a situation is that larger volume of exports will be required to buy a fixed volume of imports or, conversely, a fixed volume of exports will command smaller volume of imports. For the Ethiopian economy, the adverse effects of the declining purchasing power of exports will be reflected in low national income and in limited import capacity of the economy. The latter would have its impact on development and welfare, particularly when essential imports are cut for lack of foreign exchange resources. This is typical of the Ethiopian economy where, at times, such imports as pharmaceutical products, fuel and spare parts are made to depend on foreign exchange rationing. The terms of trade will also be a major factor contributing to deficits in the balance of trade (see Table 7 for the magnitude of deficits) which would force the economy to depend on other sources of financing, mainly external loans and running down of foreign exchange reserves.

**Table 7: Value of Ethiopian Exports, Imports and Balance of Trade for Selected Years**

| Value (in million US$) | 1963 | 1973 | 1983 | 1987 | 1988 | 1989 |
|---|---|---|---|---|---|---|
| Value of Exports | 90 | 239 | 402 | 371 | 446 | 420 |
| Value of Imports | 111 | 213 | 876 | 1,101 | 1,075 | 1,100 |
| Balance of Trade | -21 | 26 | -474 | -730 | -625 | -680 |

Source: UN, *Statistical Yearbook*, various yeears and
UNCTAD, *Handbook of Intematianal Trade and Development Statistics*, 1990, pp. 6-8.

Analysis of the changes in the terms of trade of Ethiopia and their long-run development is necessary for an explanation of the nature of economic growth taking place in Ethiopia. This is also useful to show how economic growth affects the direction and size of changes in the terms of trade, although the outcome of the change in terms of trade will depend on a number of variables such as price and income elasticities of importables and exportables, growth of export and import-competing sectors, production and consumption levels of importables and exports in both the Ethiopian economy and in the economies of its trading partners. Changes in the terms of trade for the Ethiopian economy, as indicated in the Table 8, have largely moved in the negative direction with positive rates of change only in a few years. However, the positive rates of change are relative improvements in the terms of trade from an unfavourable magnitude in a preceding year and should be interpreted with caution.

**Table 8: Percentage Changes in TOT and GDP**

| | 1970 | 1975 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Overall TOT | -0.3 | -3.2 | 67.9 | -6.0 | -10.5 | 0.1 | -13.9 | -8.4 | -14.1 | | | | | |
| Coffee TOT | -- | -0.27 | 2.32 | -0.41 | -0.03 | -0.20 | -0.18 | 0.11 | 0.06 | 0.15 | 0 | -0.41 | -0.04 | -- |
| Oil Seed TOT | -- | -0.10 | 0.09 | -0.05 | 0.007 | -0.22 | -0.003 | -0.17 | 0.23 | 0.4 | 0.63 | 0.07 | 0.17 | -- |
| GDP | -- | -0.09 | -0.07 | 0.06 | 0.08 | 0.06 | 0.01 | 0.05 | -0.03 | -0.06 | 0.06 | 0.09 | 0.01 | 0.02 |

Source: Computed from data in UNCTAD, *Handbook of International Trade and Development Statistics*, 1990; IMF, *International Finance Statistics Yearbook*, 1989; World Bank, *Trends in Developing Economies*, 1990; and National Bank of Ethiopia: *Annual Reports*, various years.

The state of the export sector in Ethiopia, which is dominated by agricultural products that are highly income and price inelastic in the international market, coupled with weak import-competing production has resulted in the unfavourable terms of trade and implies dismal prospects in the future. Ways have to be devised if this picture is to change.

Analyses of the effects of alternative trade strategies on growth rates suggest that export promotion generally results in improved performance than import substitution. This has been shown in the cases of Brazil, Colombia and South Korea that shifted from import substitution to export promotion trade strategies starting in the 1970s [Carbaugh 1989]. A strong relationship between export growth and overall growth rate of the economy, as measured by the real GDP, have been suggested. In the case of the Ethiopian economy, the export sector's contribution has been modest with no significant influence on the overall development of the economy. Needless to mention the weak export sector and the overvalued exchange rate, in addition to illegal trade of exportable items, have reduced the volume of foreign exchange earnings and government revenue that would be channelled for growth and development. The conclusion that follows is then *ala* Johnson and Bhagwati which states that if a nation is faced with a sluggish demand in her export market and her growth is confined to the export sector and her adaptability is low, growth through trade might turn fruitless [Lindet 1989]. Falling terms of trade will contribute in this direction by lowering realized growth rate of the economy, even if higher rates of autonomous growth occurs, which would imply export-led growth becomes a difficult process. This also holds *mutatis mutandis* to the Ethiopian economy, given the state of the export sector and its trade relations with the advanced industrialized countries.

## IV. CONCLUSION

The contribution of Ethiopia's foreign trade sector's to growth and development has been very negligible, and a tendency towards continuing dependence on very few and strong trading partners has been perpetuated over time on both exports and imports. In the post-1974 period, trade performance of the economy was poor, and interventionist policies and the demand patterns and economic situations in the trading partners as determinant factors of the terms and volume of trade greatly influenced the patterns of trade. The structural rigidity of exports and the deteriorating terms of trade have also resulted in the declining purchasing power of exports and thus increasing the balance of trade deficits. In view of these problems, redirecting its trade towards expanding exports to the LDCs and improvements in the quality of those products on which it has a comparative advantage is essential.

Pragmatic trade policies and strategies that redress a balance between export-promotion and import-competing production is desirable to this effect. Dynamism in the export sector is a key factor in changing the state of affairs of the export sector, and the role the private sector, rather than the public sector, could play in this direction is considerable.

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