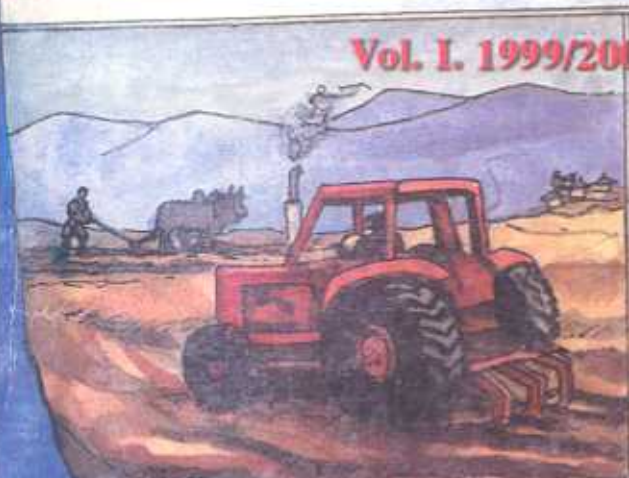


THE ETHIOPIAN
ECONOMIC ASSOCIATION

Annual Report on the
Ethiopian Economy

Vol. I. 1999/2000



Edited by
Befekadu Degefe and Berhanu Nega

The Ethiopian Economic Association

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Volume I 1999/2000

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Second Edition

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This book is dedicated to the memory
of *Dr. Eshetu Chole* (1945 – 1998),
Founding President of the Ethiopian
Economic Association (1991 – 1994).

FOREWORD

After years of a state-centered, controlled, and mismanaged economy and its attendant micro and macro economic problems with serious, real, and mostly disastrous economic effect on the daily life of millions of citizens, Ethiopia is now in the process of fundamental reorientation of its economy. The key elements of this reorientation, at least in its broad terms if not in its details, are now familiar to everyone with minor acquaintance in economic matters. Among other things this include market allocation of scarce economic resources by allowing free market prices to serve as an index of scarcity. To limit the direct role of the government in the economy, privatizing government owned parastatals or to run these institutions on strict market principles is also part of this package. Furthermore, measures to reduce both the internal (budget) and the external (BOP) deficits and devolution of authority from the all important central government to regions and in some cases to encourage the private sector and/or non governmental institutions to play an active role in the policy making process are also measures that are supported.

Any attempt to ensure the active participation of civil society in policy matters requires, above all, breaking the state monopoly on information. An essential prerequisite for constructive public discussion is reliable information and that is a rare commodity in societies with little or no democratic tradition or even less strong democratic institutions. The dearth of reliable data is made worse in developing countries by the sheer absence of independent institutions, which usually are a result of lack of resources for such endeavors, and the high risk associated with antagonizing the state. So, what we had in the form of civil society participation in the policy making process, by in large, involves the official government proclamation of "unanimous acceptance and public support" for whatever is presented by the government with out any meaningful public debate, on the one hand, and a complete mistrust by the public of whatever is said by official government agencies on the other. In other words no civil society participation on the policy making process that affects their daily lives.

This state of affairs might have served totalitarian governments well since the underlying assumption in policy formulation is that the government (and its trained bureaucrats) know every thing that is to know (have full information) about all issues and that they know what is in the best interest of the general public, even in the area

of consumer interest, much better than the consumer itself. But, the economic reforms that are underway in countries such as Ethiopia are premised upon the basic idea of consumer sovereignty, which in essence says that the individual economic agent (the consumer) knows its interest better than any one, particularly better than the state. Under such assumptions the supplier of the product (whether it is the individual business firm or the state as a supplier of various public goods) must carefully monitor the interest of the consumer. This, among other things, imply that there must be a reliable mechanism not only to gauge the changing tastes of the consumer but equally importantly to allow the consumer to participate in some form in the formulation or design of the product. In the policy making process this simply means to enable the public to freely and constructively engage both in the process of making policy and in the process of evaluating the overall performance of established policies. And that requires reliable information that is accepted by the public to be reasonably accurate which in turn necessitates either strong and independent public institutions or an independent mechanism of verification.

The shortage of information to engage in reasoned debate is more acute in the field of economics partly because of the extensive nature of the data required but more importantly because of the heavy reliance on reliable and consistent data to make a meaningful economic analysis. The temptation to tamper with data is also much higher in this field because of the close association of political stability with economic success. The matter is not helped by the deliberate manipulation of statistical data to fit a priori held results of which economists are sometimes accused.

In spite of all this difficulties, however, developing a reliable and consistent data base from different primary sources in a manner that allows rigorous empirical analysis and providing independent professional commentaries in matters related to the economy in an open, continuous, systematic and constructive form *by independent professionals* to the general public and policy makers is indispensable to the success of the reform program in the short run and even more important to the sustainability of such programs in the long run.

It is these general principles that motivated the EEA to engage in this rather ambitious program to develop a consistent data base on the Ethiopian economy and make it available to its members and other professional economists and the larger public interested in doing research on the Ethiopian economy. In addition to generating the database, the project includes generating an annual publication on the Ethiopian economy that contains this raw data and a careful analysis of the macro and sectoral performance of the economy by a selected group of professionals doing

research in their specific area of interest. *A sort of a civil society report card on the performance of the economy and/or the policies that contributed towards this performance.*

This first Annual Report on the Ethiopian Economy is the first step in fulfilling this objective. While the reports following this report will largely concentrate on the performance of the economy beginning the last year covered by this report and deal in much more depth on selected economic issues, this report is presented as a survey of the performance over the past seven years with some comparison with the previous few years of the Derge period. We hope it will provide a background to the Ethiopian economy as well as assessing performance. Obviously this report did not cover every aspect of the Ethiopian economy. But, we believe the major sectors of the economy and the key issues and challenges facing the economy are addressed. Future issues of the report will deal with those sectors that are not covered here or are not covered adequately.

We in the association are very excited about this project and hope that it will contribute towards the broadening of the debate on economic issues and move us closer to a more inclusive policy making environment. It took at least two years of preparation by the Ethiopian Economic Association to reach this stage in the project. Lots of hours of hard work was put by all the editors, outside discussants, research assistants and EEA staff to make this possible and the association would like to thank them all. The EEA would like to specially mention Dr. Eshetu Chole, in whose memory this report is dedicated and who was part of the team at the inception of this project. We also would like to thank our sponsors the Friedrich Ebert Stiftung, the Swedish and Norwegian embassies in Addis Ababa for their support. We hope this report and the larger project will, at least partially, fulfill the association's core objective of "contributing to the development of the Ethiopian economy."



Berhanu Nega

President

Ethiopian Economic Association

December, 1999

Acknowledgement

This is a truly collaborative work. Lots of people both within the EEA and outside the organization have directly or indirectly contributed to this report and it would take lots of pages to mention all of them by name. At the top of those we mention by name are the team of contributing editors that prepared background papers for this report including Mulat Demeke, Alemayehu Geda, Aklilu Kidanu, Getahun Tafesse, Mengistu Bediye, Ibrahim Abdullahi Zeidy, Netsanet Walleign, Addis Anteneh and Admit Zerihun for their intellectual contributions and their patience. Both the final report and the background papers for the report benefited from excellent research assistance from Seid Nuru, Belayneh Taye, Dawit Mekonnen, Beyene Tadesse, Endalkachew Alamnew, Yared Mekonnen, Fasil Tassew, Getachew Abebe, Dereje Gudeta, Tenagne Bayeh, Melesse Gizaw, Elias Kedir, and Demerew Getachew and we are very grateful. The quality of the report have significantly improved by the numerous comments we received from the participants of the two workshops prepared to discuss the sectoral reports and the first draft of this report. We are in particular indebted to Dessalegn Rahmeto, Abi Wolde Meskel, Dejene Aredo, Jemal Mohammed, Gebrehiwot Ageba, Berhane Mewa, Seyum Gebre Selassie, Melisachew Mesfin, Assefa Belay, Meshesha Getahun, Abebe Shimelis, Itana Ayana, Getachew Adem, Gebreyesus Guntl, Yohannes Ayalew and, Solomon Wole and we thank them very much. Our thanks go to Shiferaw Girma for the cover design. We also would like to acknowledge the assistance we got from Ayeligne Fentahun for data entry on time, Tesfay Wolde Gebriel for typesetting the manuscript and Rahel Yilma for more than adequately managing the day to day affairs of the project.

Although the executive committee of the EEA has changed hands since the inception of the project, all the members that served in the past three years have contributed to this report in one form or another. The late Mekonnen Tadesse and Bereket Kebede not only strongly supported the project but also participated in the drafting of the first proposal for funding. Senait Seyum, Selamawit Abebe, Andualem Tegegn, Assefa Admassie from the old executive committee have been very supportive and we are very thankful. Wolday Amha, Alemu Mekonnen, Getahun Tafesse, Alemayehu Geda, Helina Haileselassie, Tiruwork Tizazu and Getachew Adem from the current executive committee have not only been with us all the way through this report, more importantly, their efforts on behalf of the association have guaranteed the sustainability of this important project in the long-run. The efforts put into this project by all these members of the association is too huge to quantify even for economists and much beyond what can be justified by "self interest."

Finally, we would like to forward our most sincere appreciation to our sponsors, the Friedrich Ebert Stiftung, the Norwegian Embassy and the Swedish Embassy for sharing the visions of the Association and for trusting it to implement it. We hope their cooperation with the Association will continue and expand.

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INTRODUCTION

Ranked at 210th out of a total of 210 countries in GNP per capita terms and 208th in terms of GNP per capita measured at Purchasing Power Parity (PPP) by the most recent World Bank, World Development Report, Ethiopia is, by any measure, one of the poorest countries on earth¹. This standing of the country among the community of nations is confirmed by the human development based rankings in the latest Human Development Report of the UNDP, which locates it at 172nd out of 174 countries².

The miserable condition of the Ethiopian people is reflected in every sector and by all standard social and economic indicators one chooses to use. Ethiopia's real per capita GNP calculated in dollar terms for 1998 was \$100³. The average figure for low-income countries for the same year was \$520 while the average for Sub Saharan Africa was \$480⁴. Using purchasing power parity (PPP) which is more indicative of people's buying power in their own countries, Ethiopia's real GDP per capita for 1998 amounted to \$500, the third lowest figure in Africa, only higher than those of Sierra Leone's \$390 and Tanzania's \$490. The Ethiopian PPP measured per capita is only a fourth of the average for the LDCs (\$2130), and nearly a third of the average for Sub Saharan Africa's \$1430. Our close neighbor, Kenya, has a per capita income more than twice that of Ethiopia at \$ 1130.

Ethiopia's underdevelopment is more astounding when the condition of the people is taken into perspective. An estimated 50 per cent of the population live in absolute poverty. 12 out of 100 children born alive do not celebrate their first birth day. 8 out of 100 children who survive their first year die before they reach their 5th birthday. A child born in 1998 can expect to live to age 43 only, and 66 per cent of the people are not expected to survive to age 60⁵. What is more shocking is that the major causes of death in the country are those that are easily preventable.

Neither do the people see any light at the end of the tunnel. Less than a third of the primary school aged children go to school, of which only 19 per cent advance to the junior secondary level. Only 9 per cent of the appropriate age cohort are at the secondary level and one per cent advance to the tertiary level. Associated problems

¹ "Entering the 21st Century: World Development Report, 1999/2000

² United Nations Development Program, 1999. Human Development Report 1999, (table 8.171).

³ The World Bank is generous with this level of real per capita GDP. The official size of the GNP for 1997/98 is not more than Birr 40 billion or US\$5 billion with a population of 60 million. The Official per capita income (in current prices) is about Birr 667 or US\$83.

⁴ World Bank, World Development Report, op.cit. PP. 230-231

relate to the relevance, appropriateness and quality of the education that is provided to students and the capacity of the country to retain the best of the brains that it has trained. With an inordinate emphasis on academic training and virtually no skill formation, schools in Ethiopia have degenerated into manufacturers of an unemployable people more than anything else. The level of the educated unemployed, particular those that have completed high school are very high and increasing.

The implication of all this to the daily life of the average Ethiopian is clear. The level of poverty that is observed in the rural areas of the country and in the significant portion of the urban population is simply staggering.

The singular challenge that policy makers face is the reduction of poverty in the country. The challenge becomes more daunting when one looks at what the country needs to do to reduce and eventually eliminate poverty. A recent study by the UN Economic Commission for Africa (UNECA 1999)⁶ suggests that Ethiopia must increase its growth rate to 8 per cent per annum and sustain this over the target period if it is to reduce poverty by half by the internationally agreed year of 2015.

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

Eight years have passed since Ethiopia has again charted a new course to address these same economic issues. A new pro-capitalist and market friendly regime that reversed the dirigistic policies of the past was instituted to stabilize the economy and

⁵ UNDP Op Cit, table 8 p. 171.

⁶ United Nations Economic Commission for Africa. 1999. Economic Report on Africa: The Challenge of Reducing Poverty and Sustainability.

eventually achieve a healthy and dynamic economic growth. Various policy measures, some of which are homebred while others are standard versions of those subscribed by international financial institutions, were introduced to achieve the intended objective of macroeconomic stability and the long term objective of sustained economic growth. In addition to these broad policy measures, various sector specific social and economic policies and programs were implemented to complement and support the macro policies.

Despite the fragile nature of the economy and its susceptibility to exogenous shocks such as the weather and international commodity prices as well as unstable performance of the recent past, we believe that it is possible that the country could be located on poverty reducing high growth trajectory, if only the government could rise to the occasion. Among the tasks that the government needs to embark on immediately, if it is to meet this challenge, is the development of poverty reducing growth strategy and above all match its rhetoric with visible commitment. In particular, the government's obstinate insistence that it be the sole producer of policy reducing the rest of society as extraneous policy consumers must stop. Ethiopia need to move to an inclusive policy making process that allows a genuine participation of stake holders in the design, formulation and implementation of economic policy.

This Report aims to review and evaluate the performance of the Ethiopian economy in the past seventeen years. This maiden issue is not designed to provide a definitive assessment of the successes or failures of the various policies implemented in the country over the past two decades. Such an endeavor requires a much more detailed and careful analysis of all the sectors of the economy and their interrelationship and the degree to which the policy measures were responsible for the actual performance of the economy. Clearly this report does not do that. Instead, what is attempted here, is to provide a broad indicative assessment of the performance of the Ethiopian economy in the past seventeen years in general and, in particular, for the period since the Ethiopian Peoples Revolutionary Democratic Front (EPRDF) took power in 1991 and briefly review the various policies that might have contributed towards this performance.

The intention behind the Report is to provide an *independent assessment* of the challenges the country faces and assist the government in formulating appropriate policies. This maiden issue of the Report may not have gone the intended distance. Hopefully future issues would be more expansive in coverage and depth.

MACROECONOMIC PERFORMANCE

1. INTRODUCTION¹

As intimated in the introduction to this report, Ethiopia is clearly one of the poorest countries on the planet. The level of poverty that is observed in the rural areas of the country and in the significant portion of the urban population is simply staggering. The level of deprivation is much more than what we read about the medieval period in the history books. The problem with the Ethiopian economy is not only about where it is now. It is more daunting when one looks at where we are heading and the degree to which we are able to narrow the development gap between Ethiopia and other countries. As can be seen from Table I.1, for Ethiopia to reach the level of per capita GDP that is currently achieved by the average low income country (520 USD) it will take her about 42 years even if we assume the other countries register no per capita income growth and Ethiopia grow at an annual rate of growth of PCI of 4% or a real GDP growth of 7% per year. It will take 24 years if we grow by 10%. By the same token it will take us about 40 years to reach the level of the average Sub Saharan African country with a 7% GDP growth and 23 years with a 10% growth. On the other hand, achieving the growth level of middle income countries will take over three generations. But, to be realistic, other countries will not wait for us when we register such a high growth rate. The situation looks even more hopeless when we consider a PCI growth rate of 4% for them while we grow at 7%. In this scenario, it will take us about 58 years to achieve average low income level, 55 years to reach the average SSA country, and almost 120 years to reach the average middle income country

¹Most of the data and the analysis for this section is taken from a paper commissioned for this report and later presented at the 8th Annual Conference on the Ethiopian Economy by Berhanu Nega and Seid Nuru. The complete paper can be obtained from the Ethiopian Economic Association.

level.² We might as well forget the possibility of convergence with the developed countries.

Table 1.1

The Number of Years Required for Ethiopia to Catch up With Other Countries

Ethiopia: with Per Capita GDP of \$100		Low Income Countries (USD 520)		SSA (USD 480)		Middle Income Countries (USD 2950)		To Double PC
		g = 0%	g = 4%	g = 0%	g = 4%	g = 0%	g = 4%	
No. of Years Required for Ethiopia to Catch up	g = 4%	42.1	*	40	*	86.5	*	17.7
	g = 7%	24.4	57.7	23.2	54.9	50	116.5	10.2

Where g = growth rate of per capita GDP

Source: Authors' calculation using the method provided in footnote 2

It is this dismal economic scene that formed the background for the 1974 revolution against the Haile Selassie regime. The revolutionaries diagnosed the problem as the alliance between feudalism and imperialism and a quick solution was proposed through the socialist ideology. Socialist policy was hoped to release the productive forces of the country for a more rapid economic growth on more egalitarian grounds. After seventeen years of this experiment (although a stunted version) what was successfully achieved was an effective distribution of poverty.

²Let Y_0 and Y_0^* be the levels of the per capita GDP of Ethiopia and other countries' group (low income, middle income and SSA countries), respectively, in year 0. And let Y_t and Y_t^* be levels of per capita GDP of Ethiopia and other countries' group, respectively, at year t . Then, the number of years required to catch up the other countries whose economy grow at an average of g^* , if Ethiopia's economy grows at a rate of $g\%$ per annum in per capita terms, can be calculated as follows:

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

Presuming that the economic problems of the country are caused by the policies of the previous regime, the new government under EPRDF has adopted the exact opposite ideological stance with a package of pro capitalist policies. Although it is still too early to pass a definitive judgement about the success or failure of these new policies, there is enough data to make a broad indicative assessment of the performance of the economy over the past eight years and make comparisons with the previous policy regime. That is what this chapter aims to do.

The chapter proceeds as follows. The first section will review the "initial conditions" that the new government inherited from its predecessor including a brief assessment of the performance of the Ethiopian economy for the ten years before the new government took over. By way of comparison, the second section will review the various policy measures undertaken by the new government and provide an analysis of the performance of the economy since 1991. The last section will provide a summary of the findings and raise a number of policy challenges that are ahead of us if we are to have any hope of improving the life of the majority of our population.

2. INITIAL CONDITIONS

2.1. The Structure of the Ethiopian Economy before 1991

The rebels that succeeded in overthrowing the Mengistu regime in 1991 took over an economy that was in shambles, a very unstable political climate and a society that was terribly beaten down by a ruthless dictatorship and a pervasive bureaucracy, and little hope for a better future. Probably the biggest asset of the new government was the good will that it enjoyed from the international donor community. By the time the Derge left power, the structure of the Ethiopian economy was not significantly different from the early 70s. As can be seen from Table 1.2, agriculture contributed about 53% of the country's GDP on average between 1980/81 and 1990/91 with very high values of 58.1% at the beginning of the period and 56.3% in the last year. Industry averaged 12.2% while services averaged some 34.8% of which distributive services account for 14.7%. Industry's contribution to GDP was higher in 1980/81 at 10.9% compared with the last year of the Derge where it stood at 9.4. The only sector that showed improvement was the other services sector, which grew from 17% of GDP to some 22%.

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

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

It is not only the structure of the economy that did not change during Derge's tenure, but the overall performance of the economy was actually terrible. Real GDP growth was actually negative in four of the ten years considered with three exceptionally good performances one of which started with a low base of two consecutive negative growth of -6.3% and -9.7% following the drought years of the mid 1980s. The highest "normal" rate of growth of GDP registered during this period was the 14% growth rate achieved in 1986/87 following the 9.9% growth rate of the previous year. The average real GDP growth for the last 10 years of the Derge period was 1.9% per year compared with an average population growth of 3% leading to a net decline in per capita income of 1.2% per year. If we take the 1990/91 year as an abnormal year because of the political instability, GDP growth rate improves to 2.5% while per capita income declined by 0.5%. This dismal performance is reflected in all the sectors except for the service sector. Agricultural production grew by a mere 2% per annum during the period while industry and distributive services grew by 0.57% per year on average. Of the four years negative growth rates of GDP was registered, three of them were years of negative growth in agriculture while the last year of the Derge saw a reasonably high growth rate in agriculture while all the other sectors declined sharply leading to a negative growth rate in GDP.

Table 1.2
Sectoral Contribution to GDP (1980/81-90/91)

Year	Growth Rate of Real GDP	AGRICULTURE		INDUSTRY		DISTRIBUTIVE SERVICE		OTHER SERVICE		Growth Rate of Per capita GDP
		As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	
1980/81		58.1		10.9		14		17		
1981/82	0.51	55.7	-3.6	11.8	8.5	14.5	4.3	18	6.3	-2.4
1982/83	10.1	57.5	13.6	11.3	5.9	13.5	2.8	17.6	7.8	6.9
1983/84	-6.3	53.7	-12.5	12.8	5.7	14.5	0.3	19	1.1	-9
1984/85	-9.7	47.0	-20.9	14.8	4.5	16.2	0.9	22	4.4	-12.4
1985/86	9.9	49.6	16.0	13.3	-1.2	15.2	3.5	20.8	3.6	6.4
1986/87	14.0	51.7	18.8	13.6	16.5	15.4	15.1	19.3	6.2	10.4
1987/88	-0.1	50.3	-2.8	13.1	-3.8	15.9	3.4	20.7	7.1	-3
1988/89	0.3	50.6	1.0	12.2	-6.6	15	-5.5	22.2	7.5	-2.7
1989/90	4.1	51.2	5.3	11.2	-4.7	15	4.4	22.6	5.8	0.9
1990/91	-4.2	56.3	5.2	9.4	-19.1	12	-23.5	22.3	-5.5	-7.2
Average	1.9	52.9	2.0	12.2	0.57	14.7	0.57	20.1	4.5	-1.2

Source: MEDaC. National Income Accounts, Revised Series 1998

2.2.2. Trends in Savings and Investment

As is clear to any student of economics, economic growth is significantly affected by the rate of investment, which in turn is related to savings. Gross domestic Saving (GDS) as a percent of GDP was decent and reasonably steady over time reaching 13% in the last years of the imperial regime. The socialist state was supposed to increase savings by increasing taxes on luxuries and introducing mechanisms to increase savings from working people. Rather than an increase in the saving and investment ratios, what we achieved during the Derge was a tremendous fluctuation in savings ranging from a high of 12.5% in 1987/88 and a low of 3.4% in the last year. On average GDS was 7.2% over the last ten years of the regime. Gross fixed capital formation (GFCF) as percent of GDP averaged about 14.2% per annum during the ten years reaching a peak of 20.4 percent in 87/88 and dropping to about half that level in the last year.

The difference between domestic saving and investment commonly known as the resource gap widened during this period averaging 7.1% of GDP. This required increased foreign savings by way of grants and loans from abroad. Accordingly, the country's external debt and its debt service obligations increased.

External debt as percent of GDP increased from 25.6% in 1981/82 to a high of 43.1% in 1990/91 averaging about 35.7% for the ten years. The debt service ratio also showed a marked increase from a low 12.9% to a very high 69.9% averaging 34.4% for the whole duration. The decline in the saving and investment ratios is not a result of the public increasing its consumption from previous levels. As can be seen from Table 1.3, private consumption expenditure held relatively steady or even declined a bit during this time. What happened instead was a marked increase in government consumption as a result of the overall expansion of the bureaucracy and the military in particular. Public consumption as percent of GDP increased from a modest 14.2% in 1980/81 to over 19% in the latter part of the 80s averaging 16.7% for the ten years.

Table 1.3
GDS, GFCF, Resource Gap, Consumption and Total Debt (1980/81-90/91)

Year	(1) GDS as % of GDP	(2) GFCF as % of GDP	(2-1) Resource Gap	External Debt as % of GDP	Debt Service Ratio	Public Consumpti on as % of	Private Consumpti on as % of	(3+4) Total Consumpti
1980/81	7.6	13.6	-6.0			14.2	78.3	92.6
1981/82	5.9	13.7	-7.8	25.6	12.9	15.3	78.7	94
1982/83	5.5	12.2	-6.7	27.6	16.2	16.8	77.8	94.6
1983/84	8.1	16.8	-8.7	31.7	16.1	17.3	74.6	91.9
1984/85	2.8	10.7	-7.9	33.6	24.8	15.3	81.8	97.1
1985/86	8.6	16.4	-7.8	36.10	25.6	15.8	75.6	91.4
1986/87	7.6	15.6	-8.0	37.4	37.2	15.7	76.7	92.4
1987/88	12.5	20.4	-8.0	41.3	43.5	18.1	69.4	87.5
1988/89	8.9	14.4	-5.5	41.2	39.2	19.4	71.7	91.1
1989/90	7.9	12.5	-4.5	43.1	58.9	19.2	72.9	92.1
1990/91	3.4	10.4	-7.0	39.1	69.9	16.5	80.1	96.6
Average	7.2	14.3	-7.1	35.7	34.4	16.7	76.2	92.8

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

2.2.3. The External Sector

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

2.2.4. Monetary and Fiscal Developments

For the promise of rapid economic growth to materialize the country has to raise investment which requires investible resources. One possible source of finance for investment was foreign savings. However, the government's anti-imperialist rhetoric could not ensure such a supply from the more capable western sources forcing the government to largely rely on domestic sources of finance. The preferred method of the Derge was massive domestic borrowing and printing money. Money supply (both broad money and narrow money) had growth rates much higher than the growth rate of both nominal and real GDP. As can be seen in the following table money supply was increasing by more than twice the rate of GDP growth on average during the 9 years under consideration. Despite the fact that there was in general monetary deepening in the economy, it has apparently passed with out many harms on the inflation side because of the price controls exercised by the authorities. The increase in the money supply has also helped private savings to rise a bit as the venue for private investment is reduced because of the imposition of capital ceilings.

On the fiscal side the government's expenditure was rising significantly with out a comparable rise in revenue. The government's socialist strategy required that most productive activities, particularly industrial activities, had to be under state control. Recurrent expenditure was rising fast partly owing to the government's expenditure on defense rising from 14.1% of GDP in 1973/74 to over 26% in 1987/88 out of which general government outlay accounted for 15%. To finance these investment activities and the recurrent expenditures, it imposed confiscatory tax rates as high as 89% which, except for its disincentive effect on saving and investment, never was able to match the rising expenditure.

Table 1.4: Value of Exports and Imports (as percent of GDP)

Year	Value of Exports	(1) As % of GDP	Value of Imports	(2) As % of GDP	(1-2) Resource Gap	Share of Value of Imports (%)						Growth Rates of Volume of Exports			Share of Coffee in the Value of Exports	
						Raw Materials	Semi Finished Goods	Fuel	Capital Goods	Consumption Goods	Miscellaneous	Coffee	Non-coffee	Total		
1980/81	10.6		16.6		-6.0											
1981/82	9.5		17.2		-7.6											
1982/83	9.0		15.8		-6.7											
1983/84	10.0		19.3		-8.7											
1984/85	8.1		10		-7.9											
1985/86	9.4		17.1		-7.8	3.8	11.7	11.4	33.6	39.3	0.2					
1986/87	8.2		16.3		-8.0	2.2	12	10.1	42.8	32.6	0.3					64.8
1987/88	8.1		16		-8.0	2.4	14.4	9.5	47.1	26.3	0.3	-11.3	11.4	6.4		55.7
1988/89	9.0		14.6		-5.5	2.6	16.9	10.1	39	30.7	0.7	32.1	-17.9	-8.8		68.3
1989/90	7.7		12.3		-4.5	3.1	17.4	13.8	37.9	27.6	0.2	-5.5	-8.2	-7.5		53.8
1990/91	5.5		12.5		-7.0	2.7	11.1	9.9	45.3	30.2	0.9	-34.5	-10.9	-17.2		46.9

Table 1.5
Growth Rates of Money Supply and GDP

Year	Growth Rate of Nominal GDP	Growth Rate of Real GDP	Growth Rate of Narrow Money	Growth Rate of Broad Money	Inflation Rate	
					CPI*	GDP Deflator**
1982/83	10.7	10.1	15.2	15.0	3.8	2.9
1983/84	-6.7	-6.3	9.1	11.3	-0.5	-3.9
1984/85	18.6	-9.7	13.2	13.6	18.4	3.4
1985/86	4.2	9.9	18.1	15.6	4.6	-5.5
1986/87	6.0	14.0	12.1	8.1	-9.5	-7.1
1987/88	4.0	-0.1	9.7	8.9	2.2	3.6
1988/89	5.1	0.3	6.7	8.9	9.6	5.2
1989/90	6.9	4.1	19.5	17.6	5.2	3.7
1990/91	14.1	-4.2	22.9	18.7	20.9	19.7
Average	6.99	2.01	14.06	13.08	6.08	5.84

* Calculated using the Consumer Price Index of the Addis Ababa retail price, (1963 = 100)

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

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

3. PERFORMANCE OF THE ETHIOPIAN ECONOMY: 1991 - 1998.

3.1. General

There isn't a lot of disagreement about the nature of the performance of the Ethiopian economy in the seven years since EPRDF took power for which complete data is available. Although there might be differences in emphasis and even disagreement on the appropriate comparator to use to get a proper picture of the Ethiopian economy, most observers agree that the Ethiopian economy did reasonably well by most standard criteria between 1991-98. While the government emphasizes the correctness of its overall strategy and its specific policies as the reasons behind its presumed success, its detractors argue that the achievements are not to be exaggerated and that its performance, when evaluated in relation to what could have been achieved with a better policy package, is much worse than what the

government wants us to believe. Even the little success the opponents grudgingly accept, they attribute it to the generosity of donors which have showered the government with massive amounts of loans that is bound to be a serious burden in the long run and a reasonably good weather. It is by no means an easy task to accurately assess cause and effect in such a case where there are so many factors that have contributed to the performance of the Ethiopian economy in the past seven years. What we will try in the following pages is to briefly discuss the broad policy framework of the government and provide the reader with what the official data shows about the performance of the economy. We will provide our assessment of the factors that contributed to this performance next.

3.2. Economic Policies of the EPRDF

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

This broad thinking is encapsulated in four core policy items of the government. The first one is the government's strategy known as Agriculture Development Led Industrialization (ADLI).³ The essence of this strategy rests in the belief that the agricultural sector can serve as the driving force for the rest of the economy. The

³ For details on this strategy, see EPRDF's five-year development program, EPRDF publication, 1995.

logic is simple and mostly persuasive. For a country such as Ethiopia to develop rapidly, it needs to make better use of the abundant available resources in its hand, namely agricultural land and a massive peasant population. Currently, this sector is seriously under utilized and backward. Both land and labor productivity is so low in this sector that the 85% of the population ekes out a meager subsistence with very little contribution to the overall development of the country. The strategy hopes to increase the level of productivity in agriculture via the introduction of modern agricultural techniques and a supply of agricultural technology ranging from fertilizers and improved seeds to comprehensive extension services. The increase in income of the rural population following the increase in productivity has more than egalitarian benefits. Higher incomes imply higher savings that can then be harnessed for investment in other sectors. Demand for industrial goods, particularly consumer goods and agricultural inputs, will also grow as a result of rising living standard of the rural population. Surplus agricultural output also benefits industry by making relatively cheap raw materials available for industrial processing. The fact that agriculture is at such a low level of development in Ethiopia also meant that small improvements in agricultural techniques, requiring relatively small capital outlay, have a potential to increase output significantly. In other words, the capital output ratio in agriculture is so low that it is a much cheaper strategy to increase economic growth compared with other strategies. All these advantages, they believe, makes this strategy suitable for Ethiopian conditions.

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

the presumed successful experiences of South Korea and Taiwan.⁴

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

Finally, EPRDF's core thinking strongly believes in achieving some kind of regional balance as a key objective of its overall policy. To achieve this objective it has implemented several measures that gives preference in budget allocation to relatively undeveloped regions and a number of incentives to investors who wish to invest in such areas. In some form intertwined with all these beliefs is the party's land policy which essentially retained the core policy of the previous regime save for the new land lease system that largely operate in the urban areas. The area of land policy is probably one area where ideological convictions dominate the thinking of the party. In most other areas the party has proven to be much more pragmatic than many has given it credit for.⁵

Around these core beliefs one finds detailed policy pronouncements on a range of issues. According to the government's policy framework paper for 1996/97 – 1998/99, in the area of fiscal policy, the government wishes to improve tax administration and broaden the tax base on the revenue side and reduce expenditure to less than that of nominal GDP and improve expenditure efficiency. It also hopes to minimize government crowding out of the private sector by minimizing government borrowing from domestic sources. In the area of monetary and credit policy, the government tries to ensure growth of monetary aggregates consistent with targets for inflation and economic growth. It plans to create an environment to establish a modern

⁴ These and similar views on the role of the state and other core beliefs of the party are provided in an 85 page Amharic publication of the party entitled "Our Revolutionary Democratic Beliefs." EPRDF publication, Nehassie 1989 Ethiopian Calendar. South Korea and Taiwan are repeatedly mentioned in this document as the successful implementers of this wisdom.

⁵ One clear indicator of the flexibility of the government in changing ideologically held positions is reflected in the recent change in the investment proclamation which, among other things, changed the party's long held position against allowing foreign investment in power and telecommunications. The previously mentioned party document expressly held this position which was changed in less than six months by the Jimma Congress of the party in early 1990 E.C.

competitive financial system. It also plans to increase private investment by taking measures to encourage the private sector by speeding up privatization, improving the investment code, institutionalizing a regular dialogue between the private sector, and ensure the adequate supply of urban land for investment purposes.⁶ Given the above and other policy measures by the government, how does the Ethiopian economy perform in the last seven years? What contributed to this performance? These are the questions we now return.

3.3. Economic Performance under EPRDF

3.3.1. Trends in GDP and Value Added in Various Sectors

The structure of the Ethiopian economy changed very little in the past few years agriculture remaining the dominant sector with over 51.2% contribution to GDP since EPRDF took power. The average share for agriculture was 55.5 percent for the last 18 years reaching the low level of 45.7% in 1997/98 owing to a 10.3% decline in agricultural output rather than a normal increase in the share of the other sectors. The share of Industry in GDP, which should have been increasing under a normal growth path remained static over the seven-year period averaging 10.6% of GDP. The sector that showed a steady increasing trend is the services sector particularly the "other services" sector which grew to about 24.5% of GDP from about 20% during the previous regime while the distributive sector remained stagnant at about 13.6% of GDP.

The real GDP of Ethiopia has grown on average by 4.4% for the last seven years. Excluding the abnormal year of 1991/92, the average for the past six years showed a healthy growth of 5.8% with a per capita GDP growth rate of over 2.6% on average. This performance compares favorably with the 1.9% GDP growth of the last ten years of the Derge. The highest GDP growth rate registered since 1991 was in the

⁶ The interested reader can find the details of these and other numerous policy objective and measures agreed upon by the government and its donors in this policy framework paper prepared for the consultative group meeting of December 10-12, 1996, Addis Ababa.

following year which registered a 12% growth rate starting from a very low base of a -3.7% growth rate the previous year. The highest "normal" growth rate registered under EPRDF was the 10.6% growth achieved in 1995/96 partly as a result of the good harvest of the year. Although the influence of agriculture on GDP growth rate can not be denied and that oscillations in the growth rate of agriculture was highly associated with rainfall,⁷ the growth impetus for the post EPRDF era certainly did not come from the agriculture sector. As can be seen from Table 1.6, the average growth rate of agriculture for the seven years period was a mere 1.6% while industry and distributive services (trade, transport...etc.) were growing by about 8% each while other services (banking, insurance, public administration and social services) were growing by 7.4%.

Strangely enough, if one compares the growth rate in agriculture in the post reform period with the pre reform period, it shows that agriculture has performed better during the last ten years of the Derge at an average rate of growth of 2% than the post reform period of 1.6%. If we take the abnormal year of 1991/92, growth rate of agriculture for the six years averages an unimpressive 2.27% which is slightly better than the pre reform average. Although it is too early to talk about failure in the government's key strategy of ADLI, and this is discussed in detail in the chapter on agriculture, there is no basis whatsoever to claim unabashed success for the strategy either. What can be said definitively is that for agriculture to play the lead role that is given to it by the strategy, its dependence on the vagaries of nature has to end which means there need to be a structural transformation in Ethiopia's agriculture as suggested in the detailed discussion on the sector. What is also suggested from this data is that the other sectors are also important in influencing overall macroeconomic performance. In particular, as discussed in detail in the chapter on industry, a coherent strategy for the development of the industrial sector is imperative if the overall economy is to improve and the standard of living of the population is to change for the better.

⁷ For example, negative growth rates in the years 1983/84, 84/85, 93/94 and 97/98 are characterized by low rainfall below the average.

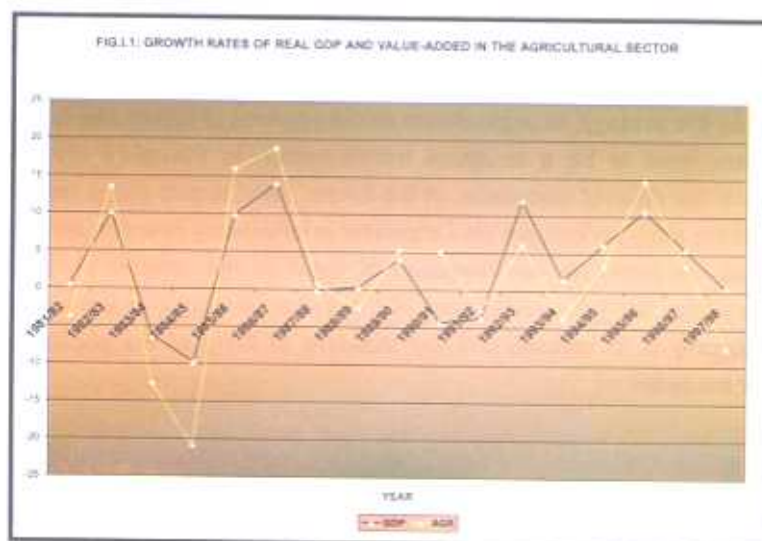
Table 1.6

Growth Rates of GDP and Value Added in the Various Sectors (1991/92-97/98)

YEAR	Growth Rate Of Real GDP	AGRICULTURE		INDUSTRY		DISTRIBUTIVE SERVICE		OTHER SERVICE		Growth Rate of Real Per capita GDP
		As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	As % of GDP	Growth Rate	
1991/9	-3.7	56.5	-2.7	9.0	-7.1	12.1	-2.5	22.4	-5.2	-6.7
1992/9	12.0	53.5	6.1	10.4	28.5	13.2	22.2	23.0	14.2	9.0
1993/9	1.7	50.7	-3.7	10.9	7.0	13.8	6.2	24.7	9.2	-1.5
1994/9	5.4	49.7	3.4	11.2	8.1	13.9	6.4	25.2	7.7	2.3
1995/9	10.6	51.5	14.7	10.6	5.4	13.7	9.0	24.1	5.9	7.5
1996/9	5.2	50.7	3.4	10.8	6.8	14.0	7.7	24.5	6.7	2.1
1997/9	-0.5	45.7	-10.3	11.6	6.3	14.8	5.3	27.9	13.3	-3.5
Average	4.4*	51.2	1.6	10.6	7.9	13.6	7.8	24.5	7.4	1.3

Source: MEDaC, National Income Accounts

*The average growth rate of real GDP for the years 1992/93-97/98 (i.e. excluding the year 1991/92 which was a year of political instability) is 5.8% and the corresponding per capita GDP growth rate is about 2.6%.



3.3.2. Trends in Savings and Investment

As discussed earlier, gross domestic savings has reached a high 13% during the Imperial period only to reduce to an average of 7.2% during the Derge or an even lower 6.9% for the entire post-revolution period. For the past 18 years GDS averaged about 6.8% of GDP. The figure was even lower if we take the average for the past seven years dropping down to 6.5% from an average of 7.2% for the last 11 years of the previous regime. Although the average was low for the last seven years, the trend shows a steady and increasing trend indicating that some of the measures taken by the government to encourage savings, such as raising the deposit rate significantly, have started to work. Even then, the highest level achieved in the last seven years, which was 9.9% in 1996/97, is still lower than the recommended rate of 13%-15% for sustainable economic growth. The decline by 2.5% to 7.4% the following year is a clear indication of its volatility. Even at its highest level, the domestic saving ratio could not support a growth rate more than 4.4% and if we take the average saving ratio of 6.5% the growth rate of GDP could not exceed 3.7% given the average capital labor ratio that prevailed in the country over the same period.⁸

Gross fixed capital formation as percent of GDP, on the other hand, did show a significant increase after the reform. While it declined markedly during the last eleven years of the Derge dropping to as low as 10% in the last year, it shows a healthy recovery in the post reform period averaging 15.2% over the past seven years. Even more important, it showed an increasing trend reaching as high as 17.6% in 1997/98. The average for the post reform period since 1992/93 is a full two percentage point above the Derge period at 16.2%.

Obviously, the low saving ratio could not finance this increase in investment. Accordingly, the resource gap widened in the past seven years from an average of 7.1% of GDP in the Derge period to an average of about 8.7% in the last seven years. As a result our debt burden increased from about 39.1% in the last days of the Derge rising to as high as 91% in 1993/94. The only good news in this area is that for the six years data was available, it shows a declining trend going down to as low as 64% in the last year reported. The debt service ratio also started to decline

⁸ The average capital labor ratio, for the period is estimated at 1.76 (see Alemayehu, 1999.)

sharply dropping from as high as 82% in 91/92 to 34.5% in 1995/96 only to rise again to 42.2% in 1996/97.

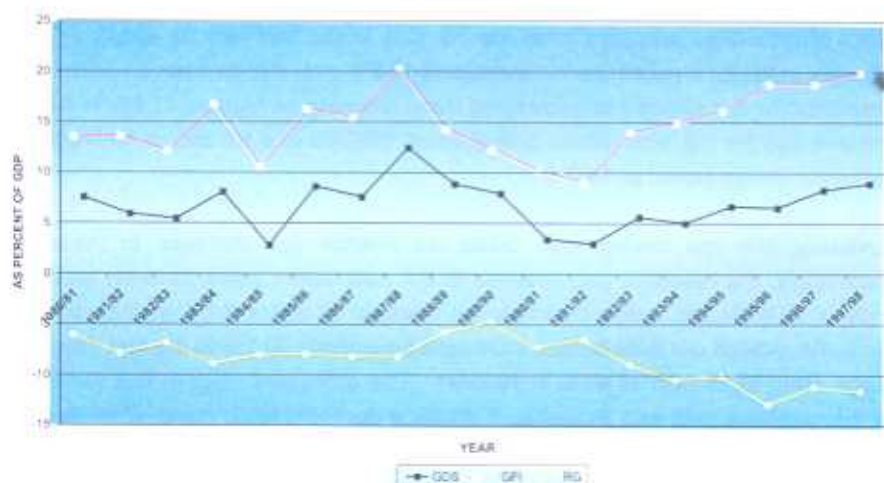
Table 1.7

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

YEAR	(1) GDS	(2) GFCF	(1-2) Resource Gap	Public Consumption	Private Consumption	Total Consumption	External Debt	Debt Service Ratio
1991/92	3.0	9.2	-6.2	10.1	86.9	97.0	31.5	82.5
1992/93	5.6	14.2	-8.6	10.6	83.8	94.4	70.4	53
1993/94	5.0	15.2	-10.1	11.1	83.8	94.5	90.8	56.9
1994/95	7.4	16.4	-9.0	11.9	80.7	92.6	81.8	36.7
1995/96	7.0	16.9	-9.5	11.2	81.8	93.0	71.4	34.5
1996/97	9.9	17.0	-7.1	10.9	79.2	90.1	64	42.2
1997/98	7.4	17.6	-10.2	13.9	76.8	92.7		
Average	6.5	15.2	-8.7	11.4	82.1	93.5		

Source: MEDaC and NBE Annual Bulletin

FIG.1.2 GROSS DOMESTIC SAVING, GROSS FIXED INVESTMENT & RESOURCE GAP



3.3.3. The Foreign Sector

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

FIG.1.3A: SHARE OF COFFEE IN FOREIGN EXCHANGE EARNINGS
(1986/87-1995/91)

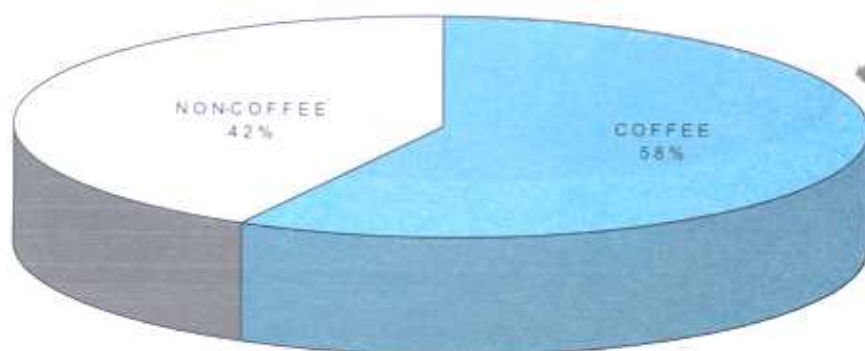


FIG.13B. SHARE OF COFFEE IN FOREIGN EXCHANGE EARNINGS
(1991/92-1995/96)

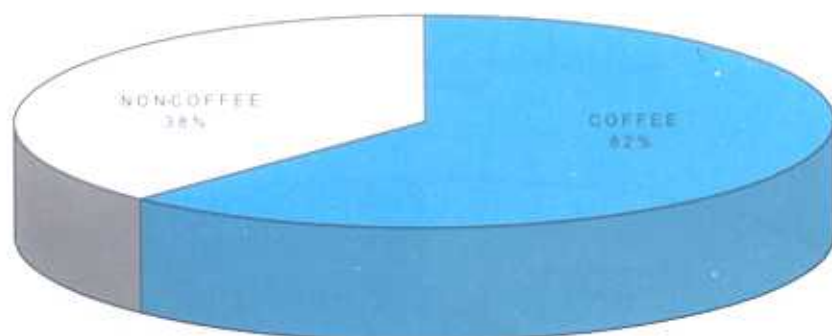


Table 1.8: Value of Exports and Imports (as percent of GDP)

Year	Value of Exports (1) As % of GDP	Value of Imports (2) As % of GDP	(1-2) Resource Gap	Share of Value of Imports (%)						Growth Rates of Volume of Exports		Share of Coffee in the Value of Export	
				Raw Materials	Semi Finished Goods	Fuel	Capital Goods	Consumption Goods	Miscellaneous	Coffee	Non-Coffee		Total
1991/92	4.5	10.7	-6.2	2.9	12.8	13.6	36.2	34.2	0.32	-44.6	-55.3	-53.9	52.9
1992/93	8.3	17	-8.7	2	9.0	22.7	35	31.3	0.1	108.9	47.1	62.6	56.6
1993/94	11.4	21.5	-10.1	1.8	16.3	15.3	29.2	35.1	2.2	2.65	93.8	84.4	50.6
1994/95	14.3	24.1	-9.8	2	17	15.2	31.9	32.5	1.5	18.9	-15.0	-8.2	63.6
1995/96	13.1	25.6	-12.5							18.7	-21.1	-10.7	66.1
1996/97	15.5	20.3	-10.8										
1997/98	17.2	28.4	-11.2										

Source: MEDoC & NRE Annual Bulletin

3.3.4. Monetary and Fiscal Developments

On the expenditure side the new Ethiopian government did not find it difficult to follow the fiscal conservatism of previous regimes. In fact fiscal prudence was exercised from the beginning and continued all the way through. When it comes to the various components of expenditure, there was a significant decline in defense expenditure over the first six years since the change in government. It has, however, changed since 1997/98 as the budget for defense significantly increased beginning this period. The preliminary actual data show that the expenditure as percent of GDP has increased to 4.6% in 1997/98 and 6.8% in 1998/99. This is equivalent to 65% and 71% of general service expenditure and 29.5% and 39.4% of total recurrent expenditure for the respective years. In terms of growth, defense expenditure as percent of GDP in 1997/98 has increased by 130% over 1996/97 and by about 53.3% over the figure in 1991/92, the highest record for the period 1991/92-1996/97. Even with the large base of 1997/98, the expenditure grew by 47.8% in 1998/99. This, of course, is expected to get even worse with the ongoing conflict with Eritrea and irrespective of how the conflict is resolved in the short run. In other items, what we observe is essentially a constant or very small change over the years since EPRDF came to power. Other developments since 1991 are increasing government savings and a narrowing budget deficit. As a result, domestic and banking system of financing the deficit have declined and even abandoned, at least up to 1998/99.

Table 1.9
Components of Recurrent Expenditure (as percent of GDP)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98*	1998/99*
General Service	4.4	4.8	4.9	5.1	4.5	7.1	9.5
Defense	2.6	2.3	2.2	2.0	2.0	4.6	6.8
Economic Services	1.3	1.6	1.7	1.8	1.6	1.5	1.6
Social Services	3.6	4.3	4.1	3.7	3.6	3.8	3.8
Education & Public Health	3.0	3.6	3.4	3.4	3.3	3.4	3.4
Pension Payments	0.9	0.9	1.0	0.8	0.7	0.7	0.0
Interest & Charges	2.0	3.4	2.5	2.4	2.2	1.9	1.9
Miscellaneous	0.3	0.07	0.14	0.13	0.2	0.4	0.03
External Assistance	0.5	0.2	0.6	0.4	0.6	0.4	0.4
Total Recurrent Expenditure	12.9	15.5	15.4	14.7	13.8	15.8	17.2

Source: Ministry of Finance

*Preliminary actual.

When one compares the average expenditures for the past six years with that of the Derge period, the share of general services has declined from an average of 54.1% before the war period to an average of 29.7% since 1991. It has however, increased to an average of 35.8% by 1998/99. This is obviously due to the rise in the defense expenditure which pushed it up to 45.3% and 55.1% in 1997/98 and 1998/99 respectively. The share of economic and social services in the past six years has shown a rise as compared to the average for the Derge regime though the trends seem to be declining for the last two years since the conflict with Eritrea.

Regarding capital expenditure, the average expenditure for economic development has shown a decline compared to the average in the past regime. But, the share of capital expenditure on roads has significantly increased. The average share of expenditure on economic development for the period 1986/87-90/91 was 86.3% while for 1991/92-94/95 it was 67.8%. The respective share of road in these periods was 5.9% and 16.7%. As opposed to the share of economic development, the share of social development has increased from an average of 10.8% in 1986/87-90/91 to 16.6% in 1991/92-94/95 period. Even in the presence of the war, the average shares of road and social development have increased to 18.6 and 19% for the past eight years. This trend seems to confirm the fact that the Ethiopian government has given priorities to infrastructures such as road, education and public health.

Table 1.10

Share of the Various Sectors on the Total Recurrent Expenditure (as percent of the total)

	1986/87-90/91 (average)	1991/92-94/95 (average)	1995/96	1996/97	1997/98	1998/99	1991/92- 1998/99 (average)
General Services	54.1	29.7	29.1	32.6	45.3	55.1	35.8
Of which Defense	43.8	15.9	13.1	14.6	29.3	39.4	20.1
Economic Services	5.9	8.9	10.7	11.6	9.3	9.2	9.6
Of which Agric. & Nat. Res.	3.2	5.1	6.1	7.2	6.9	6.4	6.0
Roads	1.3	1.2	na	na			
Social Services	18	23.5	23.3	26.2	24.3	22.1	24.1
Of which Educ. & Training	12.2	14.7	15.4	18.0	15.9	14.4	15.5
Public Health	3.6	5.1	5.4	5.8	5.6	5.4	5.4
Pension Payments	4.0	5.3	4.8	5.3	4.4	0.0	4.5
Interest & Charges	7.0	14.6	15.1	16.1	11.8	11.1	14.2
Others	11.1	28.1	16.9	8.2	5.0	2.6	16.9

Source: Ministry of Finance

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

Table 1.11
Capital Expenditure (Shares)

	1986/87-90/91	1991/92-1994/95	1995/96	1996/97	1997/98	1998/99	1991/92-92/93 (average)
Economic Development	86.3	67.8	73.5	69.8	57.5	60.1	66.5
Of which Agriculture and Natural Resource	33.5	24.8	21.9	18.3	19.7	23.2	22.8
Roads	5.9	16.7	19.0	17.3	21.1	24.8	18.6
Social Development	10.8	16.6	20.0	19.6	23.8	22.3	19.0
Of which Edu. & Training	3.0	6.3	12.4	9.8	10.2	10.8	8.6
Public Health	2.6	3.5	4.3	5.9	8.5	5.4	4.5
General Development	2.2	3.1	6.1	6.8	8.8	5.6	4.7
External Assistance & Grants	na	12.2	24.4	24.4	35.9	42.8	22.0

Source: Ministry of Finance

Table 1.12
Growth Rates of Money and Real GDP and Inflation Rates

Year	Growth Rates of			Inflation		
	M1	M2	Nominal GDP	Real GDP	From CPI	From GDP Deflator
1991/92	11.6	13.2	8.3	-3.7	21.0	14.9
1992/93	12.7	16.8	28.3	12.0	10.0	13.1
1993/94	8.6	10.2	6.2	1.7	1.2	2.5
1994/95	18.3	20.7	19.6	5.4	13.4	0.6
1995/96	0.10	11.8	12.0	10.6	0.9	-0.3
1996/97	0.63	5.5	9.3	5.2	-6.4	2.9
1997/98	9.5	12.0	8.6	-0.5	na	na
Average	8.8	12.9	13.2	4.4	6.7	5.6

Source: MEDaC and NBE Annual Bulletin

3.3.5. Price Developments

Partly because of the monetary policy and partly because of the improved performance of the agricultural sector, inflation has been reasonably controlled in the past seven years particularly compared with other countries in the region although it has been markedly higher compared with the last ten years average of the Derge. The average rate of inflation between 1980-90 was 3.6% compared with the 6.7% rate averaged in the 1990s.⁹ As can be expected and can be seen from Table 1.13, the inflation rate calculated from the Addis Ababa retail price index is slightly higher than the rate calculated nationally.

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

Table 1.13
Price Developments (Calculated from the Addis Ababa Retail Price Index)

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

Source: CSA, Statistical Abstract.

⁹ This is very close to the 8.9% rate given by the World Bank for the latter period. See World Development report, op cit., table 11, p. 210.

4. FACTORS THAT EXPLAIN THE ECONOMIC PERFORMANCE

Looking at all the above data, what we can say about the overall performance of the Ethiopian economy in the past seven years is that Ethiopian policy makers by in large followed the standard recommended medicine to stabilize the economy and partially succeeded in achieving that objective. The fiscal and monetary policies implemented succeeded in controlling expenditure within a certain limit and restriction in the growth of the money supply partially helped in controlling inflation. The much talked about "macro economic environment" conducive for long-term sustainable growth and structural transformation seem to be partially achieved. If the story is right, we are now ready to reap the benefits. However, a closer look at the macro economic performance of the last seven years does not render itself for such optimism as, at the structural level, the economy is as susceptible today to those traditional factors that undermine long term growth as ever before. In fact, the average growth rate achieved in the last seven years (4.4%) is very modest when one looks at the low base it started with let alone to produce a rate capable of inducing a structural transformation of the economy.

What one feels in looking at this data is the degree to which very little is achieved by way of structural change in the economy. The same old problems seem to affect the performance of the economy in more or less the same degree if we see the data over a long period. It is as though nothing is really changing on the ground although "revolutionary" changes seem to take place at the policy making level. One could always argue, we think legitimately to a certain degree, that the time frame is too short to move the pendulum to the side of pessimism so quickly. Be that as it may, we think it is important to encourage policy makers to look at the long term prospects and implement policies that have a potential to effect structural transformation.

In our view, the key constraint to the Ethiopian economy is the extremely high dependence of the economy on agriculture with one of the lowest levels of land and labor productivity on earth. The contribution of the other sectors toward the national economy has remained stagnant over a long period of time. This means that the degree to which the Ethiopian economy grows largely depend on the performance of the agricultural sector. The latter in turn entirely depend on the vagaries of nature and other man made uncertainties such as war. If this is empirically true as we

believe it is¹⁰, the suggestion that comes out of this report is that at least some portion of our policy making apparatus should devote its time in thinking strategically and come up with a policy framework that would quicken the pace of structural transformation of the economy.

5. CONCLUSION

There are a number of conclusions that emerge from the foregoing discussion. First, by standard criteria of macroeconomic performance the Ethiopian economy has performed modestly since EPRDF took power seven years ago. It is also true that what largely fueled this performance is the generous support the government received from donor countries and the first time positive effect of the dismantling of the most suffocating anti private sector policies of the previous regime. The high growth rates achieved in industry and services, which largely fueled the macro growth is mainly a recovery from the low level it has reached during the last years of the Derge period. The agricultural sector did not do as well as expected.

However, the mere size of the agricultural sector has a strong influence in the overall performance of the economy. In particular, the fluctuations in the performance of the macro economy is largely explained by the fluctuations in the agricultural sector which in turn is directly related to the availability of adequate rainfall and man made uncertainties. Clearly, with this kind of causality, we can not hope to go very far in achieving sustainable and rapid economic growth and structural transformation. To achieve these strategic objectives we need, in addition to pursuing the short-term objectives, devise a long-term strategy with clear objectives. Key elements of this strategy, we believe, should include first and foremost, significant transformation of the agricultural sector. The issues involved in relation to this sector are discussed in detail in the chapter on agriculture.

A second element of such a strategy must seriously think about reducing the role of agriculture in the economy by significantly increasing the growth in the other sectors particularly industry. In this area the government, in addition to supplying the necessary infrastructure, must carefully identify strategic industries in which Ethiopia

¹⁰ This has been confirmed by an econometric exercise to empirically validate this claim in the paper commissioned for his report. The interested reader can consult this paper for details on the model and its results.

can develop a dynamic comparative advantage in the long run and vigorously promote such industries either from local or international investors. This issue is discussed in greater detail in chapter seven.

Finally, the relationship between property rights, political stability and economic development is a strong relationship confirmed by a wide body of research.¹¹ As our exercise above indicates, one of the constraints to the growth of the agricultural sector in Ethiopia has been the uncertainty caused by political conflict. As we have shown in the introduction to this chapter, the level of development we currently have is so miserable even compared with other 'poor countries', we need generations of concentrated hard work to achieve the level of income they have reached. The degree to which differing policies can effect the future direction of the country is not worth the cost of engaging in potentially destabilizing conflict. So what should be included in this strategic thinking is developing a tolerant political atmosphere that freely allow constructive engagement, the underlying premise of which is a shared destiny.

¹¹ See for instance, Richard B. Freeman and David L. Lindauer, "Why not Africa?" Unpublished paper, 1998.

SAVINGS AND INVESTMENT IN ETHIOPIA

1. INTRODUCTION

As discussed in earlier chapters on the macroeconomic performance of Ethiopia, the country's economic position both in absolute terms and in relation to comparable low income countries in Sub Saharan Africa (SSA) and other regions is not very encouraging. The key to narrowing the development gap between Ethiopia and other countries is to quicken the pace of economic growth which depends largely on investment which in turn depends on the amount of the country's national income that is saved and her ability to attract foreign savings. To put the matter in perspective, if Ethiopia is to reach the level of per capita income achieved by the average SSA country today, the economy has to grow by about 10% per year (or per capita income growth of 7%) for the next 23 years. To achieve such a fantastic rate of growth of PCI for Ethiopia, it requires a historically unprecedented level of savings either from domestic or foreign sources. Ethiopia is required to ensure a saving rate of 16% of GDP to achieve a 10% growth rate of GDP.¹ The highest level of savings so far achieved in our country was 13% obtained in the last years of the Imperial regime.

This chapter aims to review and evaluate the saving and investment situation in Ethiopia over the past decade.² The paper attempts to provide a broad indicative assessment of the performance of savings and investment since EPRDF took power in 1991, and for the purpose of comparison look at the last few years of the previous regime and briefly review the various policies that might have contributed towards this performance. When the situation allows, attempts will be made to suggest some of the policy challenges that are ahead of us if we are to achieve a better performance in the future. The chapter proceeds as follows. After a brief introduction, the first section of the paper will provide a brief discussion on saving and investment and their

¹With a capital-output ratio of k , the saving rate required to achieve a growth rate of g may be derived using the simple Harrod-Domar model:

$$s = kg$$

For Ethiopia, there is no reliable investment function made so far. Hence, we used the method used by J. Bognar, that is, we divided the total gross investment (data for depreciation is not available) for the past ten years by the incremental change in GDP for the same period. This estimates the capital - output ratio to an average of 1.6 for the past 10 years. We have used this to calculate the figures that follow in the text.

² Most of the data and analysis for this chapter is taken from a paper commissioned for this report by Berhanu Nega entitled "Trends in Savings and Investment in Ethiopia."

Box II.1.

THE IMPORTANCE OF SAVINGS AND INVESTMENT TO ECONOMIC DEVELOPMENT

For Hicks, "It is very wrong to give the impression to a poor country which is very far from equilibrium even on past technology that capital accumulation is a matter of minor importance." [Hicks, 1965].

Empirical findings by Thirlwall, Pensmazoglu and Maddison have come up with a result that 30 to 55% of the growth of more than 20 countries is the share of capital formation in 1970s [Thirlwall, 1974:6]. It is found that 40%, 30 to 35%, and 35% of the growth of Argentina and Mexico, Israel, and Greece, respectively was the share of capital formation in the 1970s.

Countries followed different modalities to achieve economic growth through capital formation. Early accumulations assisted by colonization helped England to achieve industrialization parallel with invention. Capital formation through an effective usage of the banking system has helped Germany. Russia in the nineteenth century trusted the taxation power of the government to launch industrialization. Latin American countries make use of financial institutions to mobilize savings while SSA countries rely on government budget. In China, rural industries make spare parts using their own foundries. South East Asian countries make use of their human resource and the effective use of an interventionist state to launch industrialization. [Gillis, et.al., 1992:23]. Even in recent years where "capital fundamentalism" is criticized, it is still accepted that capital accumulation explains a significant part of growth.

"Although capital accumulation is no longer viewed as a panacea for poor countries, it is nevertheless clear that even mildly robust growth rates in incomes can be sustained over long periods only when societies are able to maintain investment at a sizable proportion of GDP. This proportion can rarely be much less than 15 percent and in some cases it must be as high as 25 percent, depending on the environment in which capital accumulation takes place and on what rate of income growth is deemed essential to allow progress toward basic societal goals." [Gillis, et.al., 1992:269].

According to students of the investment process, there are three important stages in the process of capital formation that need to be successfully completed if countries hope to achieve the desired level of investment and its expected fruits. These are the stage of saving - a stage where resources which might be used for consumption are put aside, the stage of canalization or resource mobilization - a stage where savings that is secured in the first stage are assembled and be ready for investors, and the investment (final) stage - a stage where resources that are mobilized are utilized for the production of capital goods [Misra and Puri, 1991:226-8]. An economy can have problems of mobilizing and using investible resources as a result of failures in any one of these stages. Though the usual recommended rates of saving and investment range from 12 to 15% and even as high as 25%, saving and investment rates are low in developing countries. Even worse, the quality of the capital so accumulated is not dependable in the sense that these resources may not be used efficiently. And without finding a way to mobilize resources to such a high level and effectively utilize the savings thus mobilized, countries such as Ethiopia can not hope to successfully achieve rapid economic growth and sustainable overall social and economic development.

relationship to overall economic development. The next section will discuss the "initial conditions" that the new government inherited from its predecessor including a brief assessment of the performance of the sector for the last ten years of the previous regime. By way of comparison, the fourth section will review the various policy measures undertaken by the new government and provide an analysis of the performance of the sector since 1991. The last section will provide a summary of the findings and raise a number of policy challenges that are ahead of us if we are to have any hope of achieving high levels of investment and rapid overall economic growth and development.

2. TRENDS IN SAVINGS AND INVESTMENT IN ETHIOPIA

2.1. Initial Conditions

As briefly discussed earlier, economic growth is largely related to the rate of investment which in turn is related to savings. It is therefore important to pay close attention to this phenomena if we are to achieve rapid economic growth. Policy makers in the imperial regime believed that the traditional pattern of consumption of the society might have an important impact on savings. In the first and second five-year Development Plans, it is pointed out that some of the problems of achieving higher levels of savings resulted from the fact that the largest portion of the national income was produced and at the same time consumed in the subsistence sector with a traditional consumption pattern. The ceremonious culture of the society with so many holidays and the extravagant spending on these holidays, the positive attitude towards generosity vis-à-vis thrift may be important factors to affect savings. The policy designed as a way out in the first two plans of the imperial government was to monetize the economy such that voluntary private saving could be forthcoming. In the development plans, it was indicated that one of the challenges was to make such transformation as the process involves changes in the traditional consumption patterns [See the Second Five-Year Development Plan].

Even then despite the traditional extravagance of the society, there were mechanisms by which people (both urban and rural people) secure future consumption and other future

goals. In this case, in the informal financial sector, the "Iqqub", "Iddir" and "Arata"³ are the common mechanisms of mobilising and using savings even today. Particularly "Iddir" has an important contribution to the formal financial sector as the money collected by this mechanism is finally deposited in banks [Daniel, 1995:33-5]. In the last years of the imperial regime Gross domestic Saving (GDS) as a percent of GDP was a decent and steady 13%. The socialist state was supposed to increase this by reducing the "conspicuous consumption" of the ruling classes and the sacrifice it anticipates from the lower classes.

In actual fact, the policy of imposing capital ceiling became a serious disincentive to the saving class and further encouraged conspicuous consumption. On the other hand, during the Derge, there was monetary deepening. Since prices were controlled by then, increase in money supply induced savings as additional money in the hands of individuals are not used for keeping real money balances leading to higher savings.

On balance, what we end up having during the Derge was not an increase on the saving and investment ratios compared with the previous regime. What we achieved during the Derge was a tremendous fluctuation ranging from a high of 12.5% in 1987/88 and a low of 3.4% in the last year. On average GDS was 7.2% over the last ten years of the regime. Gross fixed capital formation (GFCF) as percent of GDP averaged about 14.2% per annum during the ten years reaching a peak of 20.4 percent in 87/88 and dropping to about half that level in the last year of the regime. The gap between investment and domestic saving (the resource gap) averaged about 7.1% during this period requiring foreign savings which comes in the form of grants and loans from other countries. This is reflected in the country's debt burden which is measured by the country's external debt as percent of GDP and the debt service ratio. The former was steadily increasing from 25.6% in 1981/82 to a high of 43.1% in 1990/91 averaging about 35.7% for the ten years. The latter also showed a marked increase from a low 12.9% to a whopping 69.9% averaging 34.4% for the whole duration. As can be seen from Table II.1, the decline in the saving and investment ratios is not a result of the public increasing its consumption from previous levels. In fact private consumption expenditure held relatively steady or even declined a bit during this time. What happened instead was a marked increase in government consumption as a result of the overall expansion of the bureaucracy and the military in particular. Public consumption as percent of GDP increased from a modest 14.2% in 1980/81 to over 19% in the latter part of the 80s averaging 16.7% for the whole duration. Foreign direct investment during this time was largely absent.

³"Eqqub" is a type of traditional activity in which individuals form a group by relations, friendship and work place and pool money for future consumption or investment.

"Iddir" is formed by individuals or households in neighborhoods or religious affiliations. Money in this case is pooled to assist members in cases when there is loss of life or damage to property.

"Arata" is money lent by traditional money lenders.

Table II.1
Trends in Savings and Investment in Ethiopia: 1980/81 - 1997/98

YEAR	GDSCMP	GFCCMP	RGCMP	GDPCMP	GDS RATE	GFCC RATE	RG RATE	GVT CONS.	PVT CONS.	TOTAL CONS.
1980/81	763.7	1366.8	-603.1	10079	7.6	13.6	-6.0	14.2	78.3	92.6
1981/82	630.6	1456.6	-826	10635.8	5.9	13.7	-7.8	15.3	78.7	94
1982/83	644.7	1435.7	-791	11775.4	5.5	12.2	-6.7	16.8	77.8	94.6
1983/84	890.5	1850.7	-960.2	10987.6	8.1	16.8	-8.7	17.3	74.6	91.9
1984/85	368.3	1394	-1025.7	13026.5	2.8	10.7	-7.9	15.3	81.8	97.1
1985/86	117.1	2225.6	-1054.6	13575.2	8.6	18.4	-7.8	15.8	75.6	91.4
1986/87	1093	2244.6	-1151.6	14391	7.6	15.6	-8.0	15.7	76.7	92.4
1987/88	1867.4	3060.5	-1193.1	14970.5	12.5	20.4	-8.0	18.1	69.4	87.5
1988/89	1399.7	2269.2	-869.5	15742.1	8.9	14.4	-5.5	19.4	71.7	91.1
1989/90	1335.2	2100.5	-765.3	16825.7	7.9	12.5	-4.5	19.2	72.9	92.1
1990/91	660.4	1996.4	-1336	19195.3	3.4	10.4	-7.0	16.5	80.1	96.6
Average					7.2	14.3	-7.1	16.7	76.2	92.8
1991/92	825.2	1911.1	-1285.9	20792	3.0	9.2	-6.2	10.2	86.9	97.0
1992/93	1494.1	3792.1	-2298	26671.4	5.6	14.2	-8.6	10.6	83.8	94.4
1993/94	1426.2	4293.7	-2867.5	28326.9	5.0	15.2	-10.1	11.1	83.8	94.5
1994/95	2517.1	5569	-3051.9	33885	7.4	16.4	-9.7	11.9	80.7	92.6
1995/96	2652.6	6404.4	-3752	37937.6	7.0	16.9	-9.5	11.2	81.8	93.0
1996/97	4107.6	7049.1	-2941.5	41465.1	9.9	17.0	-7.1	10.9	79.2	90.1
1997/98	3311.3	7926.1	-4614.8	45034.9	7.4	17.6	-10.2	13.9	78.8	92.7
Average					6.5	15.2	-8.7	11.4	82.1	93.5
Overall Average					6.9	14.7	-7.7	14.6	78.5	93.1

Source: MEDaC, National Income Accounts, 1998.

CMP = current market prices

2.2. Trends in Savings and Investment After 1991

2.2.1. Gross Domestic Savings and Gross Domestic Investment

As mentioned above, gross domestic saving by the time of the overthrow of the imperial regime was around 13%. Since that time GDS showed tremendous fluctuation but remained significantly lower than this high figure for the entire post revolution period. For the past 18 years GDS averaged about 6.9% of GDP. The figure was even lower if we take the average for the past seven years dropping down to 6.5% from an average of 7.2% for the last 11 years of the previous regime. Although the average was low for the last seven years, the trend shows a steady and

increasing trend indicating that some of the measures taken by the government to encourage savings, such as raising the deposit rate significantly, have started to work. Even then, the highest level achieved in the last seven years, which was 9.9% in 1996/97, is still lower than the recommended rate of 13%-15% for sustainable economic growth.

Gross fixed capital formation as percent of GDP, on the other hand, did not follow the trend of GDS. Investment averaged 14.7% for the entire 18 years while the last 11 years of the Derge period showed a significant decline in this ratio particularly in the last few years when it dropped as low as 10%. For the last eleven years of the Derge period, investment averaged around 14%. The trend in investment started to show a steady recovery since 1992 increasing to about 18% in 1997/98. The average for this period was 15.2%, which could have been even higher if we discount the first year of EPRDF which, by any account, was an abnormal year.

The low saving ratio clearly could not finance the investment level registered in the past seven years. Accordingly, the resource gap widened significantly in the past seven years from an average of -7.1% of GDP in the Derge period to an average of about -9% in the last seven years. As a result, our debt burden increased from about 39.1% in the last days of the Derge rising to as high as 91% in 1993/94. The saving grace in this area is that for the five years where data was available, it shows a declining trend going down to as low as 71% in the last year reported. The debt service ratio also declined sharply during these years dropping from as high as 82% in 91/92 to 34.5% in the last year reported which was almost the same as the average for the eleven years of the Derge. As can be seen from Table II.2, one of the success stories of the new government was its ability to control government expenditure particularly defense expenditure, at least until 1997/98. The level of public consumption as percent of GDP went down to an average of 11.4% from an average of 16.7% during the Derge period.

2.2.2. Trends in Private Investment

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

course, is to find an appropriate basis for comparison. There is no detailed comparable data for the pre EPRDF period to make a meaningful comparison. It is also analytically meaningless to compare it with the past since the policies pursued by the Derge have no intention of increasing foreign investment. The only data we can obtain comparing the two periods was from the recent World Bank World Development Report, which compares the value of FDI in 1980 with that of 1996. According to these figures, FDI in 1980 was 12 million USD compared with 5 million USD for 1996.⁴ Although this data is consistent with the data provided by UNCTAD's World Investment Report, it is difficult to take these values seriously as the data from the investment authority provides a much different picture as can be seen from Table II.2.

In the absence of the counterfactual, we can not compare the current performance with what would have happened with an alternative policy package. There are two sets of data that we can use for comparison purposes, however. The first deals with FDI inflows in the last few years of the Imperial regime with that of the first few years of the EPRDF government. The second set of data looks at the performance of Ethiopia in attracting FDI compared with a few African countries in a similar level of development and pursuing similar policies. Before we deal with these comparisons, however, let us look at the private investment data provided by the Ethiopian investment Authority and the regional distribution of investment projects.

For the purpose of this paper we have collected the data for the number of investment licenses issued by the investment authority for various sectors of the economy and compare those with the projects that are under implementation and that started production to get a sense of the gap between early intention and implementation as an indicator of business confidence. As can be seen from Table II.3, between 1992-97 some 26 billion Birr worth of projects were licensed by the authority for 3530 project. Of this total capital intended for investment, only 13.4% were in the implementation phase and 18.2% started production for a total conversion of 31.5%. This proportion roughly remained the same for the next year although the value of the total capital licensed increased by over 30% to 35 billion Birr. Some critics of the government suggest that this low ratio of implementation is a result of bureaucratic red tape, which discourages investors in the process of implementing their project. Particular mention is usually made about the slow process of land allocation and the monopoly price charged by the municipality government in Addis Ababa as the key constraint to private investment in Ethiopia in the past seven years.⁵

⁴World Bank World Development Report, 1998-99, table 21, p. 230

⁵So much is clearly stated in a recent study commissioned by the Addis Ababa Chamber of Commerce.. The overwhelming majority of the business people surveyed indicated that one of the most important constraints for business development is the land allocation system in the country in general and in Addis Ababa in particular. See Addis Ababa Chamber of Commerce, "The business Community's attitude towards Government Policy" in Amharic, Miz-Hasab Research Center, A/A Sene, 1990.

Table II.2: Cumulative Private Investment in Ethiopia by Sector of Investment: 1994/95 - 1997/98

SECTOR	1992 - June, 1994/97										1993 - March, 1997/98										Implementation Rate							
	Approved		% to the total	Implementation Phase		% to the total	Approved		% to the total	Implementation Phase		% to the total	Started Production		% to the total	Implementation Phase		% to the total	Started Production		% to the total	Implementation Phase		% to the total	1992 - June, 1994/97		1993 - March, 1997/98	
	No	Capital 000 Birr		No	Capital 000 Birr		No	Capital 000 Birr		No	Capital 000 Birr		No	Capital 000 Birr		No	Capital 000 Birr		No	Capital 000 Birr		No	Capital 000 Birr		No	Capital 000 Birr	No	Capital 000 Birr
	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	No	Capital 000 Birr	U.A.	P/A	[P/A] A	[P/A] A
Agriculture*	1001	4718164	18	114	527000.7	378	144285	1728.1	4	4854.8	559408	124	559408	17.2	38.9	47.7	18.8	45.7	64.2	84.2	30.5	39.3	58.8	40.8	31.4			
Fishing	4	4854.8	0.02	1	1478.9	1	1728.1	1	1728.1	4	4854.8	1	1478.9	30.9	39.3	58.8	40.8	31.4										
Mining and Quarrying	21	38498.9	1.5	7	116909.5	5	160422.5	19418.8	1.3	7	138936.3	5	160422.5	32.6	68.3	83	78.7	42.5	71.2									
Manufacturing	1493	8001014	31.3	241	1481160	201	822032.7	1788	13318603	27	648186.8	307	13318603	14.8	8.4	23.2	14.5	8.1	23.5									
Construction	87	3710275	14.2	17	807844.7	19	599103	317	4542538	18	848470.3	27	1180369	23.9	16.3	32.4	16.9	27.8	46.5									
Road Earth	310	3153492	12	21	10931.5	7	19967.3	362	562926	15.4	20	79323.8	8	14802.3	3.1	0.8	3.2	1.4	0.4									
Trade	122	383846.5	1.5	12	34628.9	12	33178	140	43434.8	1.2	20	88802.1	18	42881.2	13.2	8.4	12.2	13	14.3	37.5								
Water and Town	350	1163888	6	70	33742.5	21	32068.3	320	1865748	4.8	79	423142	41	194427.7	21.4	2.1	23.8	25	11.8	26.9								
Transport	32	1220642	4.7	5	6050	8	80273.8	36	127108	3.3	3	3	3	440788.1	21.6		73.8	33	78.4	78.5								
Education	81	263260.8	1.2	5	3852.2	8	23386	108	80629.3	2.5	3	10294.5	3	4396.2	1.4	0.2	0.3	1.1	0.3	2.0								
Health	11	212300	0.8	3	0	4	13240.8	11	312308	0.9	0	0	0	33586	0	4.8	4.8	0	3.4	11.8								
Other Services	55	441883.3	1.7	5	33255.7	1	387	84	547745	2.4	8	26253.3	6	38752.7	8	3.1	8.1	8.3	3.1	11.8								
Total	3436	2426886	100.0	493	161448	683	474143	4237	3236234	93.8	688	4864748	833	4898103.8	13.4	18.2	31.8	19.3	19	33.3								

i.e Capital of projects under implementation, P= Capital of projects that started production, A= Total capital of projects approved (=P+Pre-implementation phase)
 Source: Ethiopian Investment Authority

Another interesting observation about private investment in Ethiopia is the low level of foreign investment in the country despite the numerous attempts by the government to particularly encourage foreign investors. Between 1992 and 1998, only 3.46% with a capital share of 22.68% of all the investments licensed in the country were owned fully or partially by foreigners. Only 11.45% of the capital licensed was fully owned by foreigners. Of the 85 businesses licensed for (wholly) foreigners, only 7 new businesses started operation with additional 2 firms investing for expansion while 10 new businesses and 2 expansions started operation that are owned jointly by foreigners and local investors. The total capital of foreign owned businesses that started operation was roughly 3.2 billion birr for the whole six years of which about 52% is in joint venture. This is an average of about 73 million USD per year assuming the then exchange rate of 7.3 birr per dollar. The proportion of foreign investments (both wholly owned and joint venture) that started operation is about 38.2% of the total foreign investment licensed while it is 36.3% of the total investment that have started operation. The growth rates of foreign investment (both wholly and jointly owned) in terms of capital of projects approved in 1993/94, 94/95, 95/96, 96/97 and 97/98 are, respectively, 90%, 29.95%, -19.4%, 442% and 61.4%. But, what is more important is the actual volume of capital we are comparing and its continuity.

In terms of employment creation, the portion of employment to be created if all the licensed projects were implemented was about 227,000 permanent and 440,000 temporary of which only about 10% are accounted by foreign investment. The share of foreign investment in job creation is somewhat higher for projects under implementation which grew to about 14% for permanent jobs and 35% for temporary employment. If we calculate the amount of capital required per employee, we can get some idea about the capital intensity of the projects submitted by foreign investors compared with domestic investors. Of all the projects licensed, the capital per permanent employee averages birr 139,291 for domestic investment compared with 281,230 for fully foreign owned and 443,618 for joint venture. The gap gets even wider when we look at the projects under operation or those under implementation. For the former, the capital per permanent employee is birr 96,109 for domestic 435,304 for fully foreign owned and 577,647 for JV. For projects under implementation, it is 143,144 for domestic, 153,696 for fully foreign and 539,507 for JV indicating that JV's have the highest capital intensity in all cases.

Table II.3 : Number, Capital and Employment Creation of Investment Projects (July 1992 - July 7, 1998) (Investment Capital in Millions of Birr)

DESCRPTION		D O M E S T I C				WHOLLY FOREIGN				JOINTLY WITH DOMESTIC				TOTAL	GRAND TOTAL	% TO APPROVED	FOREIGN OVER TOTAL (%)
		NEW		TOTAL		NEW		TOTAL		NEW		TOTAL					
		EXPAN	NEW	EXPAN	TOTAL	EXPAN	NEW	EXPAN	NEW	EXPAN	NEW	EXPAN	NEW				
APPROVED	Number of Projects	3857	300	4240		60	5	65		63	4	67	152	4368	100	3.46	
	Investment Capital	24341.71	5940.14	20281.85		3844.82	233.88	4196.81		3886.12	118.31	4103.03	8203.64	38575.48	100	22.68	
	Permanent Job	174108	28443	202551		13877	2024	14901		9722	127	8249	28130	277191	100	10.63	
	Temporary Job	515294	22055	537349		3133	6	3136		4184	-	4184	44323	438672	100	10.08	
OPERATION	Number of Projects	1031	132	1163		7	2	9		10	2	12	21	1184	28.02	1.77	
	Investment Capital	43173.78	5188.98	48362.75		1338.16	151.45	1489.61		1604.88	78.15	1679.85	3169.41	8711.56	23.87	36.30	
	Permanent Job	48875	8060	56935		1423	1349	3422		2813	85	2908	6330	64203	28.28	9.86	
	Temporary Job	347864	18420	366284		50		50		34848		34848	54896	301140	84.50	11.60	
INVESTMENT	Number of Projects	605	88	693		18	12	12		11	11	11	33	708	18.05	4.87	
	Investment Capital	3517.84	055.34	4114.18		418.38		418.38		1257.05		1257.05	1875.41	8188.59	18.02	27.07	
	Permanent Job	26737	4719	31556		2722		2722		2335		2335	5053	56588	18.15	13.81	
	Temporary Job	6731	2464	11195		-	-	-		6005		6005	4250	17175	3.91	34.04	

Source: Ethiopian Investment Authority

Another interesting observation about private investment in Ethiopia is the low level of foreign investment in the country despite the numerous attempts by the government to particularly encourage foreign investors. Between 1992 and 1998, only 3.46% with a capital share of 22.68% of all the investments licensed in the country were owned fully or partially by foreigners. Only 11.45% of the capital licensed was fully owned by foreigners. Of the 85 businesses licensed for (wholly) foreigners, only 7 new businesses started operation with additional 2 firms investing for expansion while 10 new businesses and 2 expansions started operation that are owned jointly by foreigners and local investors. The total capital of foreign owned businesses that started operation was roughly 3.2 billion birr for the whole six years of which about 52% is in joint venture. This is an average of about 73 million USD per year assuming the then exchange rate of 7.3 birr per dollar. The proportion of foreign investments (both wholly owned and joint venture) that started operation is about 38.2% of the total foreign investment licensed while it is 36.3% of the total investment that have started operation. The growth rates of foreign investment (both wholly and jointly owned) in terms of capital of projects approved in 1993/94, 94/95, 95/96, 96/97 and 97/98 are, respectively, 90%, 29.95%, -19.4%, 442% and 61.4%. But, what is more important is the actual volume of capital we are comparing and its continuity.

In terms of employment creation, the portion of employment to be created if all the licensed projects were implemented was about 227,000 permanent and 440,000 temporary of which only about 10% are accounted by foreign investment. The share of foreign investment in job creation is somewhat higher for projects under implementation which grew to about 14% for permanent jobs and 35% for temporary employment. If we calculate the amount of capital required per employee, we can get some idea about the capital intensity of the projects submitted by foreign investors compared with domestic investors. Of all the projects licensed, the capital per permanent employee averages birr 139,291 for domestic investment compared with 281,230 for fully foreign owned and 443,618 for joint venture. The gap gets even wider when we look at the projects under operation or those under implementation. For the former, the capital per permanent employee is birr 96,109 for domestic 435,304 for fully foreign owned and 577,647 for JV. For projects under implementation, it is 143,144 for domestic, 153,696 for fully foreign and 539,507 for JV indicating that JV's have the highest capital intensity in all cases.

Table II.3 : Number, Capital and Employment Creation of Investment Projects (July 1992 - July 7, 1998) (Investment Capital in Millions of Birr)

DESCRIPTION	D O M E S T I C				WHOLLY FOREIGN				JOINTLY WITH DOMESTIC				GRAND TOTAL	% TO APPROVED	FOREIGN OVER TOTAL (%)
	NEW		EXPAN		TOTAL	NEW		EXPAN		TOTAL					
	NUMBER OF PROJECTS	AMOUNT	NUMBER OF PROJECTS	AMOUNT		NUMBER OF PROJECTS	AMOUNT	NUMBER OF PROJECTS	AMOUNT						
APPROVED	Number of Projects	3057	309	4,246	80	3	85	83	4	87	152	4,398	100	3.49	
	Investment Capital	24,541.71	3,940.14	28,581.85	39,54.92	235.69	4190.61	3996.12	1146.91	4103.03	4,293.84	36,875.49	100	22.08	
	Permanent Job	174106	20043	203041	1,28,377	2024	14,005	9,322	127	9,449	24,160	2,27,191	100	10.63	
	Temporary Job	373,204	22,015	3,95,340	3,133	8	3,136	41,184	-	41,184	44,328	4,36,572	100	10.58	
DRAFTED	Number of Projects	1033	132	1,165	7	2	9	10	2	12	21	1,184	38.82	1.77	
	Investment Capital	4,375.76	1,188.56	5,562.15	1,338.16	115.45	1,453.61	1,654.64	75.12	1,629.76	3,164.41	8,751.56	23.87	36.30	
	Permanent Job	48,073	8,000	56,073	1,423	1,509	3,422	2,813	85	2,908	6,330	64,023	28.28	9.89	
	Temporary Job	2,47,964	18,420	2,66,384	50	-	50	34,848	-	34,848	34,848	3,01,180	88.50	11.39	
UNDER CONSIDERATION	Number of Projects	665	68	733	18	-	18	11	-	11	33	766	18.01	4.87	
	Investment Capital	3,557.84	666.34	4,224.18	418.36	-	418.36	1,257.58	-	1,257.58	1,875.41	8,189.14	18.92	27.07	
	Permanent Job	20,757	4,719	25,476	2,122	-	2,122	2,330	-	2,330	5,652	36,688	18.10	13.81	
	Temporary Job	8,111	2,464	10,575	-	-	-	6,660	-	6,660	8,660	1,7175	3.81	34.84	

Source: Ethiopian Investment Authority

The situation regarding foreign investment gets even more dismal if we take out the investment activities of the MIDROC group which every one accepts to be a special case. This can be seen from Table II.4 indicating the distribution of foreign investment in general compared with that of the MIDROC group up to 1997 where such data was available. As can be seen from the table, close to 70% of all the foreign investment is accounted by the MIDROC group. If we take the five year data to be roughly applicable for 1998 and the proportion between licensed investments and those that start operation and are under implementation roughly holds (there is good reason to suspect that this proportion would be higher for MIDROC than for other foreign investments) the non MIDROC foreign direct investment inflow to Ethiopia ends up being less than 22 million USD per year for the past six years. To get a sense of whether this is a good performance or not, it might be worth comparing this performance with a few comparable countries in our region.

Table II.4
Foreign Investment and Share of MIDROC (July 1992-July 1997)

REGION		FOREIGN INVESTMENT '000 BIRR	FOREIGN OVER TOTAL		MIDROC'S INVESTMENT	MIDROC OVER FOREIGN	MIDROC OVER TOTAL
Tigray	1	3602	0.11	-	-	-	-
Afar	3	494,376.2	45.1	3	494,376.2	100	45.1
Amhara	3	1,452,435	39.1	2	1,265,700	87.1	49.6
Oromia	11	456,951.9	13.0	1	354,100	75.5	9.8
Somali	-	-	-	-	-	-	-
Benishangul-Gumuz	-	-	-	-	-	-	-
SENNP	3	175,196.5	2	2	153,422	93.4	11.4
Gambella	-	-	-	-	-	-	-
Harari	-	-	-	-	-	-	-
Addis Ababa	42	1,457,050.3	7	7	530,907.7	36.4	4
Dire Dawa	-	-	-	-	-	-	-
Ethiopia	63	4,039,611.9	15	15	2,789,505.9	69	10.6

Source: Own calculation based on data from Ethiopian Investment Authority.

Such a comparison is made in Table II.5. For purposes of international comparison we have used the most recent World Bank data which uses 1996 as the last reporting period.⁶ As can be seen from the table, FDI inflows to Ethiopia are the lowest by a wide margin both in actual quantity and as a proportion of the GNP. The gap is even wider when we compare Ethiopia with the two countries that are usually mentioned along with Ethiopia as countries pursuing prudent macroeconomic policies by the standards of multilateral financial institutions. So, no matter which way one look at it, the amount of foreign direct investment coming to Ethiopia is rather small. It is small in absolute quantity; it is significantly small compared with domestic investment and small compared to FDI inflows in comparable neighboring countries. This raises a very important question of why Ethiopia is unable to attract foreign investment and what need to be done about it. This is an issue we will consider towards the last part of this chapter.

Table II.5
Foreign Direct Investment for Comparable Countries

COUNTRY	FDI (MILLION USD)		FDI AS PER CENT OF GNP (1996)
	1991-95	1996	
Ethiopia	6	5	0.084
Ghana	102	120	1.94
Uganda	54	121	2.00
Kenya	13	13	0.15
Low-income Countries	27702	49531	Na
All LDCs	6642	118960	2.05

Source: World Bank, Global Development Finance, 1998.

⁶We have checked this data with the recent UNCTAD publication and with some minor differences the data seem to be commensurate. See UNCTAD, World Investment Report, 1998.

FIG. 8.1A
REGIONAL DISTRIBUTION OF CAPITAL OF INVESTMENT PROJECTS UP TO 1996

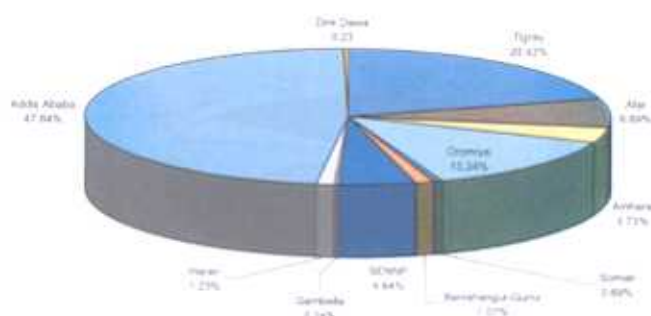


FIG. 8.1B: REGIONAL DISTRIBUTION OF CAPITAL PER REGIONAL POPULATION OF INVESTMENT PROJECTS LICENSED UP TO 1996



FIG. 8.2A
REGIONAL DISTRIBUTION OF CAPITAL OF INVESTMENT PROJECTS LICENSED UP TO 1988

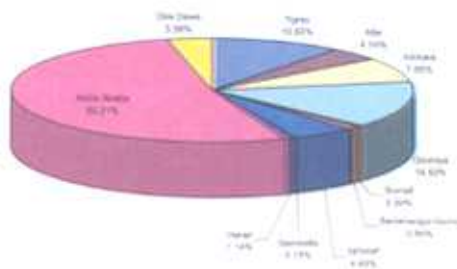
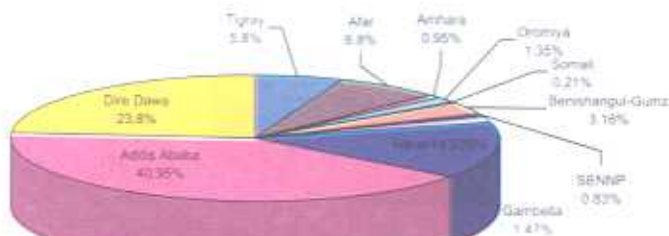


FIG. 8.2B
REGIONAL DISTRIBUTION OF CAPITAL PER HEAD OF INVESTMENT PROJECTS LICENSED UP TO 1988



Finally, there is the issue of regional distribution of investment within Ethiopia. Despite the clearly stated objective of the government to undo regional imbalance in economic growth, new investment is still attracted to areas where sufficient infrastructure is available and the demand for goods and services is more concentrated. These issues apparently figure more in investors' decisions about where to locate their projects than tax and other incentives (for example easy access to land) that regional governments provide to new investors compared to the incentives provided to Addis Ababa. Table II.6 below clearly shows this disparity in spatial location of investment as more than 52% of the licenses issued are for projects intended to be located in this region. In per capita terms the traditionally "backward" regions still have a very difficult time attracting investment the worst being the Somali region followed by the South. Surprisingly, the Amhara region is next in line in its inability to attract investment in any meaningful way. Once we take the exceptional cases of the city-states of Addis Ababa, Harari and Dire Dawa out, Afar and Tigray are the best performers.

Table II.6
Regional Distribution of Capital of Investment Approved

REGIONS	UP TO JAN, 9, 1996				UP TO JULY 1998			
	Capital of Investment Projects Approved		Capital of Investment Projects Approved Divided by Population		Capital of Investment projects Approved		Capital of Investment Projects Approved Divided by Population	
	Million Birr	Share	Birr	Share	Million Birr	Share	Birr	Share
Tigray	3040.21	20.42	926.9	13.07	3859.89	10.55	1122.1	5.85
Afar	995.7	6.69	897	12.65	1513.83	4.14	1305	6.8
Amhara	554.7	3.73	38.5	0.54	2760.75	7.55	182.5	0.95
Oromia	1985.91	13.34	101.7	1.43	5310.73	14.52	258.9	1.35
Somali	102	0.69	30.5	0.43	141.9	0.39	40.4	0.21
Benishangul-Gumuz	159.5	1.07	332.3	4.7	306.26	0.84	606.5	3.16
SENNP	690.54	4.64	63.9	0.9	1803.36	4.93	159.2	0.83
Gambella	21.33	0.14	112.3	1.58	56.19	0.15	282.4	1.47
Harari	182.96	1.23	1306.9	18.43	418.2	1.14	2806.7	14.63
Addis Ababa	7124.04	47.84	3152.2	44.46	19093.75	52.21	7857.5	40.95
Dire Dawa	34.66	0.23	128.4	1.81	1310.63	3.58	4566.7	23.8
Total	14891.55	100.02	266.9	100	36575.49	100	623.6	100

Source: Ethiopian Investment Authority and own computations.

3. COMMON EXPLANATIONS FOR THE POOR PERFORMANCE OF SAVING AND INVESTMENT IN ETHIOPIA.

3.1 Savings

In Ethiopia, the issue of savings is very much related to income. As discussed at the beginning of this report, we are talking about a society where over 89% of the population lives under a \$2 a day poverty line. With this kind of income, much can not be expected by way of saving from the great majority of the population. In rural areas, the few that can save are not able to do so by way of contributing to the national pull for investment owing to the limited spread of financial institutions. Furthermore, as mentioned earlier, some of the consumption habits of the population particularly related to primordial cultural traits reflected in the extravagant expenditure during holidays and occasions such as weddings and funerals have their negative contributions to savings. In terms of traditional determinants of savings, nominal interest rate has been exogenously determined in the past without significant effect on savings. However, recent increases in saving deposits is generally associated with the positive real interest rate that followed financial liberalisation in Ethiopia. Although there is no definitive empirical work to validate it, it is safe to say that real interest rates have a positive relationship to savings in Ethiopia. The practice of forced saving through inflation has not been a commonly used instrument in the Ethiopian condition as most Ethiopian governments have maintained a relative fiscal prudence even under trying circumstances.

Foreign aid particularly during famine reached the people directly and it may have increases savings in some rural areas as this aid augments households' staple crops. Particularly during the Derge period, there was no discrimination between households (rich and poor) in distributing the food aid. Thus the relatively well off house holds were able to increase their income even more than normal times leading to higher savings.

3.2. Investment

Factors contributing to the low level of Investment in Ethiopia are a bit more controversial. As we have discussed above, gross fixed capital formation has yet to reach the level achieved during the imperial regime. The reasons for this are obvious for the Derge period. Its policy of imposing capital ceilings has made the government the only investor in medium and large-scale industries during its seventeen years rule. The incredible expansion of the state and its bloating bureaucracy has significantly

increased government consumption at the expense of investment activities. Its nationalization of foreign owned businesses and its anti-imperialist rhetoric has simply stopped the flow of FDI to Ethiopia during its tenure.

What is not clear and controversial is the reasons why investments are not increasing as high as expected after 1991. Clearly, as the data provided above show, the performance of investment was much better in the last six years compared with the Derge period. However, investment in general and foreign direct investment in particular have fallen substantially lower than expectations and are significantly lower than investment inflows for comparable countries in the region. There are two schools of thought that attempt to explain this phenomena. For the sake of this report, let us call them the liberal view and the structuralist explanation. Let us briefly present each of these explanations.

The liberal view essentially suggests that the reason investment is not flowing to Ethiopia is because the country did not liberalize its economic policy enough. They cite numerous "restrictive policies" as proof of their explanations. Until recently, the government has restricted private investments in power and telecommunications as well as defense related industries which, they argue, are serious disincentives for investors in all sectors as they are indicators of the government's overall openness to foreign investment. The slow movement in financial liberalization in general and the restriction of the sector only to local investors is another indicator of lack of sufficient liberalization according to this view. The slow process of privatization is also considered a clear manifestation of the government's lack of clear commitment to liberalizing the economy. In addition to these specific areas, proponents of this view argue that the government's land policy, overall bureaucratic red tape and inefficiency, a dysfunctional legal environment, lack of infrastructural development are serious constraints to private investment in general and foreign investment in particular. All these issues combined make the cost of doing business in Ethiopia very high compared to alternatives else where in the world or even in neighboring countries according to this view.⁷ Most of the argument of this view concentrates the problem of lack of investment as it relates to FDI. Concerns about shortage of domestic private investment is seen as an extension of that rather than a unique problem to be looked at in its own right.

⁷This view is particularly advocated by IMF as reflect by the strains in negotiations with the government for further liberalization. A specific advocacy of this position in Ethiopia can be seen from a recent study commissioned by the Addis Ababa Chamber of Commerce. See Rosalind Thomas: "Review of the investment regime in Ethiopia: Recommendations made to the Ethiopian Chamber of Commerce," 1998.

The structuralists, on the other hand, believe that the main concern for lack of investment in Ethiopia should not be on the shortage of FDI. Instead it is more fruitful to look at the problem from the perspective of domestic investment. Although they see the importance of some liberalization and agree with the liberal view on the constraints imposed by the land policy and overall bureaucratic red tape, they generally believe that the inflow of FDI generally reacts to the overall dynamism of the economy, the market size, and other cost variables than the degree of openness as such. For them foreign investment comes in a growing economy where profit possibilities are high rather than in a weak economy to help it grow no matter what the policy environment. In fact, if we look at the nature of foreign investment, it usually takes two forms according to this view. The first is resource based investment such as mining, which is not particularly concerned with policies other than those specific to the industry and is largely concerned with political stability rather than liberalized economic environment. The second kind of foreign investment, which deals with manufacturing and related activities and is mostly driven by the availability of markets which is determined by the size and income of the population and the degree of insulation from outside competitors. As such these kinds of foreign investments prefer, just like domestic investment, a more protective policy environment than a liberalized one. It is these factors that explain the scramble of foreign investors to China rather than its liberal policies. Although there was some liberalization in China since the 1980s, compared to many developing countries it is very difficult to argue that liberalized economic and/or political environment explains the massive inflow of investment to "Communist" China. This means, for a country such as Ethiopia, the initial impetus for growth must come from domestic investors and/or Ethiopians or foreign nationals with Ethiopian ancestry or some other attachment to the country [as in the case of MIDROC] whose motivation is more than just profits and whose interest does not necessarily coincide with the interest of foreign investors or those of multilateral financial institutions.⁵

The policy implication of this is rather obvious. If this analysis is roughly right, policy makers should then concentrate on matters that impede domestic investment and implement policies that would encourage it and make efforts to attract Ethiopians in the diaspora.

⁵For studies reflecting this general theme for Africa, see a number of the articles written for the conference on "African Development in a Comparative Perspective" organized by UNCTAD in September 1998. For a good summary of the role of the state in Africa, see Mkandawire's article in this collection "Thinking About Developmental States in Africa." For a reflection of such a view in Ethiopia, see for example Befekadu Degefe in *Economic Focus* vol. 1, no. 3, and Berhanu Nega "Domestic Industry and International Competition" (in Amharic) on the same issue of *Economic Focus*.

One area of conflict, for example, between the interest of domestic investors and the "liberalizers" will be on the issue of protection. The recommendation of liberal free traders to fully open the domestic market for foreign competition does not bode well with the interest of domestic or for that matter foreign investors who might seek protection for infant industries that they wish to invest in. Domestic investors starving for capital would like to see some government regulation on interest rates and even interest rate subsidies for high capital requiring strategic investments rather than leaving financial allocation and interest rate determination for blind market forces. Putting a provision such as domestic input content might not be very attractive to foreign investors but certainly is of significant interest to domestic investors. In other words, there are a number of areas where the role of the state in the economy is crucial to encourage domestic investment whose dynamism will produce the most important incentive to attract foreign investment.

So, the main constraint to private investment in Ethiopia and what explains the poor performance of this sector is not lack of sufficient liberalization although there are some areas that need such liberalization. Instead, it is all the factors that domestic investors have been complaining about such as shortage of demand, inability to compete with cheap imports, shortage of capital, difficulty in obtaining land at a reasonable cost, bureaucratic incompetence, unfair competition...etc. that need serious and quick attention if the investment atmosphere is to improve and domestic investors are to play the role they are expected in developing the national economy. The traditional animosity between the state and the domestic private sector has to be broken and a new partnership has to be established with national development as its main focus. As Mkandawire forcefully put it, the problem with lack of such partnership in Africa is largely a result of the states' hostility to the local capitalists. He says:

[O]ne should note that, whereas the first generation of African leaders concentrated their energies on the politics of nation building, there are signs of a new leadership whose focus is on the economics of nation building. These new leaders swear by economic growth and seem to view good growth indicators as the main source of their legitimacy. In addition, if the earlier nationalist leaders associated capitalism with foreign control, the new leadership seems much less preoccupied with that. They have embraced privatization and attraction of foreign capital as centerpieces of their policy initiatives. Ominously, these leaders are more attentive to the apprehensions and appreciation of international organizations than to their domestic capitalists. While assiduously cultivating a good image in the eyes of international financial institutions (IFIs) and seeking out foreign capital, they tend to have a jaundiced view of domestic capitalists, whom they hold

in spite and incessantly vilify for parasitism, failure jointly to set up modern enterprises able to compete internationally, etc.⁹

The only point we would like add and emphasize here is the issue of attracting Ethiopians from the diaspora. Unlike Vietnam, Lebanon, China and other such countries that are very successful in this area, Ethiopia has not successfully attracted Ethiopians in the diaspora to participate in the country's development efforts. We believe this is a very important resource that need to be looked at carefully. Small decisions such as building a house by a sizable number of these Ethiopians could have a significant impact on the economy.¹⁰

4. LOOKING AHEAD: WHAT NEED TO BE DONE TO INCREASE INVESTMENT IN ETHIOPIA?

Thinking about the future prospect of investment in Ethiopia, the obvious starting point is the explanation for the past weak performance. Ethiopian policy makers, in an attempt to lure investment, particularly foreign investment, have been trying to improve the investment environment by taking more and more liberalization measures that are demanded of them by multilateral institutions. In these respect three improvements have been made in the investment code over the last five years with very little tangible benefit by way of increased FDI inflow. This suggests that while some liberalization measures might help in attracting some FDI, the more structural issues raised by the "structuralist" argument above might be where our policy makers' attention should be geared. This means that our policy should, rather than restricting the role of the state in economic affairs, better target its presence in areas that it could be more productive and even expand its activities when necessary to promote domestic entrepreneurship and the expansion of educated and skilled work force. The main thrust of this argument is that there is a need for close cooperation between the state and the private sector in a wide range of clearly defined areas and objectives, including close consultation in policy formulation, that takes into account the fundamental weaknesses of the domestic entrepreneurial class.

⁹ Mkandawire, Tandika, "Thinking about Developmental States in Africa." UNCTAD, study no. 9, p.9.

¹⁰ The potential for attracting savings from Ethiopians living abroad should not be under estimated. A simple back of the envelop calculation indicates that, assuming there are some 500,000 Ethiopians living abroad, and 20% of them were convinced to build a house in Ethiopia at the cost of \$20,000 in the next ten years, this could bring 200 million dollars per year for the next ten years. That is much higher than we can hope to attract from all foreign investors

One of the weaknesses of the domestic private sector is lack of exposure and experience in identifying profitable productive opportunities. The state can help fill this gap by identifying profitable projects that are consistent with the state's long term developmental goals. For example there are a number of projects studied by the former Project study and implementation institute that are gathering dust somewhere. The government should utilize its experts to generate detailed feasibility studies on these projects and make these studies openly and equally available to the business class. Based on transparent criteria, the government can then choose its priority projects and openly announce a package of incentives that would make these projects attractive. This includes, making domestic or foreign loans available at subsidized interest rates, tax incentives, protection from foreign competition for a limited time and the use of government experts to see through the project when necessary. This package of incentives must be accompanied by a clearly stated and administered performance criteria to ensure efficiency in production and to protect abuse of the system.

The government should also introduce special incentives for reinvestment of profits such as investment tax credits. For investment projects whose capital requirements are high and difficult for the domestic capital to raise, the government should either participate in joint venture or search foreign partners for them with some government guarantees. It can also introduce laws to make capital pooling easy and attractive.

One of the pervasive attitudes among the business community is the lack of trust in the government's or most of its institutions fairness in administering particularly economic matters. It is therefore very crucial that these incentives are provided with fairness and clearly transparent criteria to avoid corrupting the process and providing the business community with the confidence in government it so desperately needs.

III

THE ETHIOPIAN POPULATION*

1. INTRODUCTION

Ethiopia is endowed with a large and fast growing population and is globally acknowledged and included among the largest countries of the world. According to the UN (1998), an estimated population of 18 million in 1950 ranked it 25th in the world. Since then both the number and the ranking have grown to 20th in 1998 with a population of 60 million. Projected population of 169 million for 2050 will rank the country as the 9th most populated in the world and the 2nd in Africa following Nigeria.

A growing population offers opportunities as well as challenges in the pace and processes of development. An improvement in the standard of living of an increasing population necessitates a growth in GDP in excess of the rate of population growth, a choice of technique that makes use of the most abundant and increasing resource of the country (labour) and an equitable distribution of the benefits of growth among the people as well as the regions. This chapter highlights the size and growth of population along with their determinants. Population distribution among the regions as well as their actual and potential impacts on the socio-economic development of the country are also discussed, albeit succinctly.

2. SIZE, GROWTH, COMPOSITION AND STRUCTURE

2.1. Size

2.1.1 Estimates

The Ethiopian population is most authoritatively estimated at 59.9 million for 1998. This figure is derived on the basis of the 1994 census, the second of its kind in the country.

*Editors are grateful to Dr. Aklilu Kidanu who authored the background paper for this chapter and Ato Assefa Beley, Demographer UNECA, for very useful comments and suggestions both on the background paper and an earlier draft of this chapter.

*The first census at the national level was conducted in May 1984.

The 1994 census data revealed that the 53.5 million population of 1994 were clustered in 11.1 million households with an average of 4.8 persons per household. Although it is hazardous to guess how the additional 6.4 million people by 1998 were accommodated, it is most probable that the size of the household may have increased.² It is also possible that those who graduated from children to adulthood may have moved out to establish their own household. On the assumption that the household size increased from 4.8 in 1994 to 5 in 1998, the 60 million population must have been clustered in 12 million households.

The 1994 census also showed that the Ethiopian population was rural based. Of the nearly 54 million people, housing 86% or 46.2 million were rural based. Projections for 1998 estimates the rural population at 51 million and the urban population at nearly 9 million.

The sex ratio at the national level seems to be moving towards parity, from 1.02 male/female ratio in 1984 to 1.01 in 1998. On rural/urban divide, the male population exceeds the female population in the rural areas while the opposite is true for the urban areas where the female outnumber the male. Among other factors, this may be explained by female migrants exceeding male migrants.

It may be of interest to note that population estimates by international organizations do not tally with the census and census based official estimates, as shown in Table III.2.

Table III. 1
Population by Residence and Sex

	1984		1994		1998	
	Size (in Mill.)	%	Size (in Mill.)	%	Size (in Mill.)	%
Total Population, of which	40.1	100.0	53.5	100.0	59.9	100.0
Male	20.2	50.4	26.9	50.3	30.1	50.3
Female	19.9	49.6	26.6	49.7	29.8	49.7
Urban Population of which	4.5	11.2	7.3	13.6	8.7	14.5
Male	2.2	48.9	3.5	48.0	4.3	49.4
Female	2.3	51.1	3.8	52.0	4.4	50.6
Rural Population of which	35.6	88.8	46.2	86.4	51.7	86.3
Male	18.1	50.8	23.4	50.7	25.8	50.4
Female	17.5	49.2	22.8	49.3	25.4	49.6

Source: CSA 1984, OPHCC/CSA 1994

² This position is assumed taking into consideration the relatively inflexible land distribution in the rural areas, shortage of housing and employment opportunities in urban areas.

Cursory examination reveals that the World Bank (WB) estimate not only departs significantly from the census based national estimate but also has the highest population size compared to the official and the United Nations (UN) estimates. WB's 1985 estimate exceeds the census based national estimate by 5.6 %. For the succeeding years, the difference increases at an increasing rate to 6.4 % for 90 and 10.4% for 1995. The UN estimate closely approximates the inter-census national estimate, the only discrepancy being the estimate for 1995. The population estimate by the UN for 1995 exceeds that of the CSA estimate by nearly 0.8 million or 1%.

Table III.2
The Ethiopian Population: Census and Estimates 1984 – 1998

Source	Years					
	1984	1985	1990	1994	1995	1998
World Bank	-	43.4	51.2	-	60.3	-
United Nations	40.2	41.2	48.1	53.8	55.4	59.9
Ethiopia	40.1	41.1	48.1	53.5	54.6	59.9

Source: World Bank Tu, Bos and Levin Table 10, UN, ECOSOC 1998 Table A.3, Ethiopia CSO/CSI 1987 and 1998.

2.1.2. Projections

Population projections for the next two decades evidence the continuation of its increase although these projections may be compromised and tempered by the HIV/AIDS pandemic. Starting from the census year of 1994, the CSA projects the Ethiopian population at 63.5 million for year 2000 and 106 million two decades later.

The CSA projections are the lowest relative to those of the World Bank and the UN, as shown in Table III.3. The World Bank projections again departs significantly from the national projections, with the difference widening as the years advance.

The World Bank projects the population to break the 100 million mark in 2011, a size that is not reached until 2017/18 in the national projection. The growing gap between the two projections are 8 million or 13% for 2000 and 30 million or 28% in 2020. Although the UN projections start with a higher base year (1995) population, it has the lowest figure under various growth assumptions.

The conspicuous differences between the three estimates and projections derives from their difference in the size and age-sex structure of the base year population, the assumed growth rates which in turn depends on the fertility, birth and death rates. We will discuss the latter two later in the chapter and confine ourselves to the growth rate next.

Table III.3
Population Projection 1995 – 2020 (in millions)

Source	1995	2000	2005	2010	2015	2020
World Bank	60.3	71.5	84.7	99.7	116.6	135.5
UN (MV)	55.4	62.6	70.5	79.9	90.9	102.9
(LV)	55.4	62.2	69.4	77.9	87.7	98.1
(HV)	55.4	62.7	71.1	81.1	92.9	106.1
Ethiopia	54.6	63.5	73.1	83.5	94.5	106.0

MV= medium variant, LV=low variant, HV=high variant

Source: CSA; UN 1998 and Vu, Bos and Levin for World Bank figures.

2.2. Growth Rates

Average growth rates for the period 1985-2020 is given in Table III.4. Important observations emerging from the table are:-

- 1) the growth rates given by the three sources differ significantly, ranging from 2.9% of the CSA to the World Bank's 3.3% with the UN's medium variant of 2.62% per annum. It is this difference in growth rates, along with the divergence in the base year size, that is responsible for the different estimates as well as the projected national population emerging from the three institutions.
- 2) The rate of population growth peaks during the 1995-2000 period and declines thereafter in all three scenarios. The World Bank growth estimate, increases to 3.4% per annum for the 1995-2000 period and thereafter projects the population to increase at a decreasing rate. On the otherhand UN projections indicate a declining growth rate between 1985-2005, increasing between 2005-2015 and declining thereafter. The fluctuations in the UN growth rate is perhaps due to the impact of AIDS on mortality and fertility.

Table III. 4
Population Growth Rate 1985 – 2020

	World Bank		UN (MV)		Ethiopian	
	Growth Rate	Change in population (millions)	Growth Rate	Change in population (millions)	Growth Rate	Change in population (millions)
1985-1995	3.30	-	2.97	-	2.90	-
1995-2000	3.39	11.2	2.45	7.2	2.92	8.9
2000-2005	3.38	13.2	2.38	7.9	2.73	9.6
2005-2010	3.26	15.0	2.52	9.5	2.62	10.4
2010-2015	3.15	16.9	2.58	11.0	2.44	11.0
2015-2020	3.00	18.9	2.48	12.0	2.26	11.5

MV= medium variant

Source: same as Table III. 1

The CSA growth estimates and projections are consistent with the above two sources with respect to the peaking period but differ substantially in magnitude. The CSA growth peaks at 2.92% per annum for the 1995-2000 period and declines monotonically thereafter to a minimum of 2.26 during the 2015-2020 period.

Despite the declining growth rates in all the three sources, it is important to note that the absolute size of the population continues to increase at an increase rate. Thus under the World Bank's growth scenario, the quinquennial growth in population increases from 11.2 million during 1995-2000 to 19 million for the 2015-2020 period. While the Ethiopian projection confirms this general trend, the size is much smaller compared to that of the World Banks at 8.9 million and 11.5 million respectively.

Although data relating to the stationary population and the year when the net reproduction rate (NRR) becomes one is not available from the UN and Ethiopian sources, the World Bank provides such a data. The stationary population estimated by the World Bank is 417 million and will be reached in 2050 when the NRR of one is arrived at.

Box III.1

**ETHIOPIA'S POPULATION:
FROM GUESS ESTIMATE TO ESTIMATE TO CENSUS**

In historical perspective Ethiopia's population has been of interest to foreigners much more than to Ethiopians themselves. For a people for whom being counted was an anathema, the lack of interest in how much they numbered is understandable.

The first attempt at guessing the size of Ethiopian population dates back to the days of foreign travelers who visited the country more than a century and half ago. Revealed interest notwithstanding, the foreigners encountered considerable difficulty to guess the size of the whole population. The first and major reason was the limit on full coverage of the geographic area of the country. The foreign travelers had their own specific interest and purpose for their visit, which limited their coverage to the route they traveled and the part of the country they visited. As a result, early attempts at estimating the population were limited to the part of the country they traversed and visited. The second problem confronting any one attempting to estimate the population of the country was the fluid and elastic nature of the national boundary, which expanded and contracted, depending on the might of the rulers.

According to Pankhurst (1961), the first population guess was made for Shoa in the 1840s. Various guesses were made by different travelers. The lowest being one million and the highest 2.5 million. In the 1850s, visitors to the Court of Emperor Theodores made several estimates of the population inhabiting the areas under his control. All estimates varied between 3 and 4 million. Attempts made during the reign of Emperor Yohannes for his three provinces of Tigre, Amhara and Shoa placed the population at 4 million.

While these figures more or less reflected the estimates of the travelers, they did not go unchallenged. For example, A.B. Wylde, British Vice-Council for the Red Sea thought that the estimates understated the size of the country's population, stating that (Pankhurst 1961:147) "there can be no doubt that the country carries a much larger population than most travelers give it, as the most populous districts are not along the main road frequented by the travelers."

Under Emperor Menelik the geographic size of the country increased considerably and with it the population, which was guessed to range between 9 and 12 million by 1902/03. Dr. Merab, Emperor Menelik's physician, thought that the population of the country was about 10 million for 1900 increasing to 12 million by 1909, at the growth rate of 2% per annum. With the advantage of hindsight, Dr. Merab seems to have made a most enlightened guess. His 10 million population for 1900 is very close to the 11.8 million obtained by reconstructing the population by the CSA from the 1984 census. Population guesses for the decades of the 1920s varied between a low of 4 million and a high of 14 million, although the majority clustered at 9 to 10 million.

Population estimates for the 1930s were the most outlandish and contentious reflecting the political tug-of-war of the period and were greatly influenced by the sympathies of the authors. Pro-Ethiopian writers gave figures as high as 15 million while pro-Italian authors put the population at 7 million. A 1938 Italian Tourist Guidebook informed its readers that the population of the entire Italian East Africa (made up of Ethiopia, Eritrea and Somalia) was 7.5 million.

Not much was done during the post-war period until Professor Mesfin Wolde Marian, a pioneer in the study of population in the country, made his estimate for 1954 at 23.4 million. Although his estimate was on the high side relative to estimates made thereafter for that year, he must nevertheless be acknowledged as the first scholar to apply an objective statistical methodology to the study of demography in the country and provide the first population estimate at the national level.

The first official estimate by the Ethiopian Government was made in 1960 with historical data going back to 1950 and projections to 1966 based mainly on information provided by the Ministry of Interior. Accordingly, population was estimated at 17.8 million for 1950 with a growth rate of 1.5% per annum, increasing to 21 million by 1961 and to 22.6 million by 1966.

Modern statistical studies on the Ethiopian population was initiated in the 1960s by the Central Statistical Authority (CSA), which conducted a series of national sample surveys, the results of which provided demographic data for administrative, planning and research purposes until the first census was conducted in 1984. The 1984 census, the first of its kind in the country, brought to an end the guesses and estimates of Ethiopia's population that had its beginning at least a century ago.

*This Box draws heavily from Richard Pankhurst "Nineteenth and Early Twentieth Century Population Guesses" *Ethiopia Observer*, Vol. V, 1961 pp. 147-150, and Gettom Ghirmatsion, "Highlights on the Historical Evolution of Ethiopia's Population: Growth, Distribution and Direction of Population Change", Paper Presented at the Ethiopian Economic Association's 7th Annual Conference on the Ethiopian Economy.

2.3. Explaining Population Growth and Growth Rates

Fertility and mortality are the two determinants of population growth in Ethiopia as international migration is insignificant. These would be discussed sequentially.

2.3.1. Fertility

Fertility estimates record significant reduction for recent years. According to the CSA, total fertility (TFR) declined by nearly 12% from 7.52 to 6.74 births per woman between 1984 and 1994. The declining trends are consistent with World Bank and UN estimates. While the CSA and World Bank estimates for TFR start from the same position in 1984, they differ in the rate of decline, being slower in the latter compared to the former.

Table III. 5
Total Fertility Rates 1985 – 2020.

	<u>CSA</u>	<u>World Bank</u>	<u>UN (MV)</u>
1984/85	7.5	7.5	6.84
1994/95	6.7	7.5	6.60
1995-2000	6.5	7.5	6.30
2000-2005	5.8	7.2	5.94
2005-2010	5.3	6.6	5.43
2010-2015	4.8	6.0	4.92
2015-2020	4.3	5.4	4.41

Source: as in Table III.1.

CSA expects a decline in fertility in the orders of 43% from 7.5 in 1984 to 4.3 in 2020 while the World Bank estimated constant TFR for the 1985 – 2000 period, projecting a gradual decline of about 28% or from 7.5 to 5.4 between the years 2000 and 2020. The UN – medium variant estimates and projections are very close to those of CSA.

The decline in fertility spans both the rural and urban milieu, albeit at different paces. The urban TFR fell from 6.33 in 1984 to 4.5 in 1994, a decline of 29% while the deceleration in the rural area was from 8.1 in 1984 to 7.2 in 1994, a reduction of 11%.

The accelerated reduction in the urban TFR is due to the more intensive use of contraceptives and exposure to the benefits of family planning. This is particularly true for Addis Ababa, which accounts for 29% of the urban population. In Addis Ababa "contraceptive use among married women of reproductive age (15-49 years) increased from 32.8% in 1990 to 41.6 % in 1995" while "contraceptive prevalence increased from 4.4% to 9.8% between 1990 and 1997" (Sisay 1998).

At the regional level, the highest TFR was recorded for Oromia at 7.3 followed by SNNP at 7.2 and Tigray at 7.0 (see Table III.6) and the lowest was that of Gambella at 4.7.

The lowest TFR are recorded in the urban-based regional states of Addis Ababa, Harrari and Dire Dawa.

Table III. 6
Fertility, Infant Mortality and Life Expectancy by Region 1994

Region	TFR	IMR	Life expectancy
Oromia	7.26	118	50.4
Amhara	6.76	116	50.8
SNNP	7.16	128	48.6
Somalie	6.73	96	54.8
Tigray	6.95	123	49.5
Addis Ababa	2.15	78	58.4
Afar	6.39	118	50.3
Benishangul	6.46	140	46.5
Dire Dawa	4.95	115	51.1
Gambella	4.72	96	54.7
Harrari	4.68	113	51.4
National	6.74	116	50.7

CSA, the 1994 Population Census Vol. I.

2.3.2. Mortality

Mortality, the second determinant of population growth, evidences significant deterioration during the inter census years. As shown in Table III.6 and Table III.7 life expectancy at birth was 50.7 years in 1994 compared to 52 years in 1984, a decline of

1.3 years. With respect to infant mortality (IMR) there was an increase from 110 per 1000 live births in 1984 to 116 in 1994. The trend with the under 5 mortality (U5MR) rate was in consonance with the above two, increasing from 166 death per 1000 to 171 in 1994.

The decline in the survival probability of infants and children and the fall in life expectancy are indicators of the generally poor and deteriorating health services as well as reflecting the impact of the HIV/AIDS pandemic.

Table III. 7
Crude Birth Rates, Mortality and Life Expectancy 1984 and 1994

		1984	1994	1995-2000	2015-2020
Crude Birth Rate					
	National	46.4	44.4	44.2	30.6
	Urban	43.1	34.9		
	Rural	48.8	45.8		
Mortality					
IMR	National	110	116	110.0	61.0
	Urban	94	98	-	-
	Rural	112	121	-	-
U5MR	National	166	171	161.1	84.1
	Urban	135	140	-	-
	Rural	162	178	-	-
Life Expectancy					
	National	52.0	50.7	52.0	62.0
	Urban	55.1	54.3	-	-
	Rural	51.7	49.9	-	-

Source: CSA 1984 and 1994 Population and Housing Surveys.

As depicted in Table III 6, there is wide variation in infant mortality and life expectancy among the regions. With respect to IMR, the lowest rate is recorded for Addis Ababa at 78 per 1000 live births followed by Somalie and Gambella at 96. With respect to life expectancy at birth, these three regions also lead the nation with 58 and 55 years respectively. While the low IMR and relatively high life expectancy for Addis Ababa is understandable and results from relatively easy access to health services, it is difficult

to explain the reasons behind the relatively high life expectancy as well as the spectacularly low IMR for Gambella and Somlie, arguably the least privileged with medical and educational services.

Benishangul and SENNP are ranked at the tail-end of both IMR and life expectancy. In Benishangul the IMR is the worst at 140 followed by SENNP at 128. Similarly they have the lowest life expectancy at birth at 47 and 49 years respectively.

It was shown in the previous sub-sections (vide Table III.3 for example) that the CSA growth rate was not only the lowest but that it was also declining faster than both the World Bank and UN estimates and projections. The relatively high pace of the decline in population growth may in part be explained by the sharp fall in infant and U5 mortality and decreasing life expectancy as well as the precipitous fall in fertility.

Both infant and U5 mortality rates are projected to decline steeply while life expectancy is expected to increase sharply in the years ahead. From the 1994-IMR of 116 per 1000 live births and U5MR of 171 per 1000 live birth, both are projected to decline by half over the next decade and half and life expectancy is to increase from 51 years to 62 years by 2020. These rates of decline in mortality and rise in life expectancy projected by the CSA seems too optimistic.

2.4. Age Structure and Dependency Ratio

Ethiopia is predominantly a nation of young people. According to the 1994 census 15% are less than 5 years old; 31% are less than 10; 45% are less than 15; 57% are less than 20 years of age. Only 3% of the population are 65 and above, while those within the 20 to 64 age bracket are 40% of the total population. According to the UN, the median age was 17.1 years in 1995. This means that 50% of Ethiopia's population was less than 17.1 years and 50% older than 17.1 years. The predominance of the young is expected to continue well into the future. In 2020 the UN projects the median age at 18.5 rising to 28.1 years in 2050.

Dividing the population into the four categories of child (0-14 age group), youth (12-24), adult (25-59) and the elderly (60+) shows the overwhelming dominance by the younger age group as shown in the Table III.8.

A number of interesting observations emerge from the table. The first is the dominance of the child and youth in the population reiterating the point made earlier. In 1984, the child age cohort i.e. 0-14 years of age accounted for 48% of the

population and together with the youth (15-24 age cohort) made up 62% of the total. The working age population (15-59 years) had a share of 45%, less than the child population. The elderly made up only 7% of the total population at 3 million.

Table III. 8
Population Size by Age Group and Sex 1984 – 2015 (millions)

Age/Sex Group	1984		1994		1998		2015	
	Number (Millions)	%	Number (Millions)	%	Number (Millions)	%	Number (Millions)	%
All Ages								
Both sexes	40.1	100.0	53.1	100.0	59.9	100.0	94.5	100.0
Male	20.7	100.0	26.7	100.0	30.1	100.0	47.4	100.0
Female	19.4	100.0	26.4	100.0	29.8	100.0	47.1	100.0
Child (0-14)								
Both sexes	19.4	48.4	24.1	45.4	26.3	43.9	38.1	40.3
Male	9.3	23.2	12.4	23.4	13.3	22.2	19.3	20.4
Female	10.1	24.9	11.7	22.0	13.0	21.7	18.8	19.9
Youth (15-24)								
Both sexes	5.6	14.0	10.3	19.4	12.2	20.4	19.1	20.2
Male	2.8	7.0	5.1	9.6	6.2	10.4	9.6	10.2
Female	2.8	7.0	5.2	9.8	6.0	10.0	9.5	10.0
Adults (25-59)								
Both sexes	12.3	30.6	13.7	25.8	18.5	30.9	33.0	34.9
Male	5.9	14.6	7.7	14.5	9.1	15.2	16.4	17.4
Female	6.4	15.9	6.0	11.3	9.4	15.7	16.6	17.5
Elderly (60+)								
Both sexes	2.8	7.0	2.8	5.3	2.9	4.8	4.4	4.7
Male	1.5	3.7	1.5	2.8	1.5	2.5	2.1	2.2
Female	1.3	3.3	1.3	2.5	1.4	2.3	2.3	2.5

Source: CSA, 1984 and 1994 Census Reports

The 1994 census tells the same story of increasing child population albeit with lower shares of the total. While in absolute numbers the child population increased from 19 million in 1984 to 24 million in 1994 its share declined from 48% to 45% of the population. At the same time, the share of the adult (25-59) and the elderly (60+) also declined from 7% to 5%. The beneficiary age group was the youth (15-24) which increased its share from 14% to 19%.

The 1998 age distribution repeats the pattern of the two census years of 1984 and 1994. The children outnumber all the other categories claiming 44% of the population, slightly lower than their 1994 share. The youth and the elderly accounted for a little over half of the population.

The age structure on a male/female divide shows mixed pattern through the years. At the child age category, the male population exceeds the female population. This may be because of the higher IMR and U5MR child mortality being higher for female relative to the male and/or male favored natural selection. This pattern is true for the other categories, with some exceptions such as for the youth (equal) and adults (female outnumber male) in 1984 and 1998. It is also interesting to note that despite the fact of female life expectancy being higher than the male notwithstanding, the male elderly outnumber the female elderly with the exception of the projected size in 2015.

The second point to note is that the dominance of the child and the youth would continue well into the future, as evidenced by their projected size for 2015 and pointed out earlier with respect to the median age. While the proportion of the child in total population would continue on the declining trajectory, their absolute size would rise to 38 million in 2015. Although the share of the youth would increase to 20% by 2015, their absolute size remains at less than half of the child population. The largest proportional gain goes to the adults whose share at 35% and an absolute size of 33 million ranks them second, after the children.

The third point to note is that whether in 1994 or 1998 or beyond, the national life expectancy is likely to remain low, as evidenced by the small number and share of the population graduating to the elderly group. For example, of the adult population of 12.3 million in 1984 about 10 million did not live for an additional 10 years, the elderly being 2.8 million in 1994. By 2015 the CSA's projection of 4.4 million people suggests that 14 million of the adult population would not have lived for an additional 17 years.

The fourth point emerging from the age distribution is the proportion of the dependant population i.e. the proportion of the non-working population due to age relative to the working age population. On the assumption that the working age spans the 15-59 age group, and that the 0-14 and the elderly (60+ age group) are dependant, the dependency ratio fell dramatically from a high of 124 in 1984 to 95.1 in 1998 and is expected to decline 92.8 in 2015. This is a welcome relief to the working age population i.e. to the 15-59 age group since they would support on a per capita basis, less than one dependant.

Such a dependency structure has important implications on the socio-economic development of the country. The first is the burden it imposes on the working age population. In 1998 for example, and considering the dependant ages of 0 – 14 and 60+, 1 working age person supported close to 1 dependant. By 2015 this number would decrease to 0.93. Given the fact that not everyone in the working age is gainfully employed due to lack of employment opportunity or disability, the actual dependency ratio relative to gainfully employed population is likely to exceed one, i.e. one working person would be supporting more than one person.

Table III.9
Dependency Ratio 1984 – 2015 (size in million)

	1984	1994	1998	2015
Population 15-59	15.4	26.2	30.7	45.8
Young dependency ratio				
Size of 0 – 14	16.6	24.1	26.3	38.0
Young dependency ratio	107.8	92.0	85.7	83.0
Old age dependency ratio				
Size of 60+	2.5	2.8	2.9	4.5
Old dependency ratio	16.2	10.7	9.5	9.8
Total dependency ratio				
Total dependant population	19.1	26.9	29.2	42.5
Dependency ratio	124.0	102.7	95.1	92.8

Source: CSA/DPHCC 1984 and 1994 Census.

Secondly high dependency or a large number of children and the elderly would increase consumption, which reduces the amount of saving families would have made, with dire consequences on the volume of resources that could be available for investment.

Thirdly, it imposes pressure on public resources in the form of expanding schools to accommodate school-age children as well as health services for the elderly. For example, the CSA projects school age population i.e. those aged 7-18 at 25 million in 2010 compared to 18 million in 1998. The 7-12 alone would increase from 10 million to 14 million. Expanding educational opportunities to accommodate all would require massive investment in schools and accessories.

Fourthly, a society with booming babies requires commensurate expansion of employment opportunities by the time they come of age, if high unemployment is to be avoided. This in turn would have implications on the dynamics of employment generating growth as well as the choice of labor intensive technologies. These points would be elaborated upon later in this chapter.

3. POPULATION DISTRIBUTION

3.1. Spatial

Population breakdown at the regional level shows continued increase reflecting the national trend. It is interesting to note that the population distribution in percent among the regions remains more or less constant, with Oromia, SENNP, Addis Ababa, Gambella and Harrari marginally increasing their share.

Disaggregation of the national population indicates that Oromia has the largest population accounting for 35% of the total followed by the Amhara region at 25.3% and SENNP with 20%. These three regions together account for 81% of the total population. With respect to their total landmass, these three regions occupy 50% of the physical space. The conclusion that emerges from here is that 81% of the total population are concentrated over 50% of the landmass. The remaining five regions of Somali, Tigray, Afar, Benishangul Gumuz and Gambella house 9 million people or 15% of the total population but account for 50% of the land area.

Projections into the future will not affect the regional population distribution significantly. By 2020, the three most populace regions would account for 81% of the population. Oromia would have increased its share from 35% to 36%, Amhara to 27% and SENNP to 21%.

Table III.10 also provides crude population density for 1998. At the national level, 48 persons occupy one square kilometer. At the regional level, the urban centered regions have the highest density. Excluding the urban based regions, the SENNP is the most densely populated followed by the Amhara region.

Table III.10
Regional Population Distribution and Crude Density, 1998

Region	1998		2020		Area (Sq. km.)	Crude Density (person/sq. km.)
	Population ('000)	% Share	Population ('000)	% Share		
Oromia	21,046	35.2	37.8	35.7	353,007	59.6
Amhara	15,412	25.8	26.8	25.3	159,202	96.8
SENNP	11,753	19.6	21.1	19.9	112,343	104.6
Somalie	3,510	5.9	6.0	5.7	-	-
Tigray	3,494	5.8	6.0	5.8	50,079	69.8
Addis Ababa	2,354	3.9	4.2	4.0	530	444.0
Afar	1,160	1.9	1.8	1.7	-	-
Benishangul	509	0.9	0.9	0.9	49,290	10.3
Dire Dawa	294	0.5	0.6	0.6	1,213	242.3
Gambella	200	0.3	0.3	0.3	25,802	7.8
Harrari	150	0.2	0.3	0.3	311	481.9
National	59,882	100.0	105.9	100.0	1,251,282	47.9

Source: Sisay Worku 1998 Table 3.

While the crude density is interesting, the more important measure is the population relative to the economic opportunities available in these regions. Given the overwhelming significance of agriculture, the land area that are designated as appropriate for this line of occupation in each of these regions are measured against their population.

Excluding the urban centered regions of Addis Ababa, Dire Dawa and Harrari, the agricultural population at the national level is measured at 7 persons per hectare of agricultural land. It should be pointed out at the outset that this density is very crude measure. The agricultural land in the regions does not necessarily reflect the potential of each of the regions since the agricultural density land area includes only those that were covered by major crops during the 1996/97 – 1997/98 crop years.

This national average is exceeded by the agricultural density in the SENNP, Somalie, Afar, and Gambella. While the high density in the SENNP could be explained more by the population relative to their agricultural land, in the other three high density regions the large ratio is due to the smaller proportion of land that is appropriate for agriculture relative to the large land mass and small population. With proper domestication of the land through for example irrigation in the Somalie and Afar

regions and investment in Gambella region, there is no doubt that the agricultural density would decline in the years to come.

Table III.11
Agricultural Density by Region 1998

	Rural Population (‘000)	Average Area 1996/97 – 1997/98 under major crops (‘000 hectares)	Agricultural Density (persons per hectar)	Livestock
Oromia	18,649	3361.2	5.6	
Amhara	13,881	2769.5	5.0	
SENNP	10,888	609.0	17.9	
Somali	2,998	51.2	58.6	
Tigray	2,929	497.6	5.9	
Addis Ababa	-	8.4	-	
Afar	1,068	22.8	46.8	
Benishangul	466	121.9	3.8	
Dire Dawa	85	5.1	16.7	
Gambella	167	9.0	18.6	
Harrar	60	5.2	11.5	
National	51,191	7461.0	6.9	

Source: Sisay Worku 1998

3.2. Ethnic Composition

Of the 80 ethnic group identified by the CSA in its census of 1994 and making up the national mosaic 55 had a population of less than 100,000 (OPHCC/CSA 1994 Table 2.14 p.66-67). Of the ethnic group with population in excess of 100,000, 10 have population of less than 200,000; 4 have between 200,000 and 400,000; 3 have population ranging between 400,000 and 700,000. 3 have population exceeding 900,000 but less than a million.

Only 7 ethnic groups (Oromo, Amhara, Tigray, Gurage, Somali, Sidama and Wolaita) have population larger than one million.

The ethnic composition of the country's population shows remarkable stability with the exception of Tigray whose share declined from the nearly 10% of 1994 to 6% in 1994 due to the secession of Eritrea. The share of the largest ethnic group in the country increased from 29% (or 12.4 million) to 32% with a population of 17 million. The

Amharas numbering 12.1 million made up 28% of the population in 1984 increased their share to 30% with a population of 16 million in 1994. These two ethnic groups together make up more than 60% of the population of the land.

Table III.12
Ethnic Composition of the Ethiopian Population 1984 and 1994
(size in millions)

Ethnic Group	1984		1994	
	Size	%	Size	%
Oromo	12.4	29.1	17.1	32.2
Amhara	12.1	28.3	16.0	30.1
Tigrawi and Tigre	4.8	11.3	3.3	6.2
Gurage	1.9	4.5	2.3	4.3
Somalie	1.6	3.8	3.2	6.0
Sidama	1.3	3.1	1.8	3.4
Wolaita	1.1	2.6	1.3	2.5
Others	7.4	17.3	8.1	15.3
Total	42.6	100.0	53.1	100.0

Source: OPHCC/CSA 1984 and 1994 Census

3.3. Ethnic Diffusion

Practically all the ethnic groups in the country reside in all the different regions as shown in the Table III.13.

On the basis of the statistics contained in the table, Addis Ababa and the SENNP region have the largest ethnic representation where 80 ethnic groups reside. These are followed by Oromia Region (79), Somalie (72) and Amhara (71). The region with the smallest number of ethnic groups is Harrari where 47 ethnic groups live followed by Dire Dawa at 55.

The ethnic group with the largest dispersion are the Amharas followed by the Oromos. The Amharas are the second largest population next to the indigenous ethnic group in 8 of the 11 regions. Oromos are the second largest in 4.

Table III. 13
Ethnic Diffusion

Region	Ethnic No.*	Largest ethnic*	Population of largest (millions)
Tigre	54	Amhara	00.81
Afar	63	Amhara	0.05
Amhara	71	Oromo	0.42
Oromia	79	Amhara	1.68
Somalia	72	Oromo	0.07
Benishangul Gumuz	56	Amhara	0.10
SENNP	80	Amhara	0.31
Gambella	60	Amhara	0.01
Harrari	47	Oromo	0.07
Addis Ababa	80	Amhara	1.02
Dire Dawa	55	Amhara	0.07

Source: OPHCC/CSA, 1994 Census.

3.4. Language

An overwhelming majority Ethiopians numbering 44.8 million understand and speak only one language i.e. their mother tongue.

The languages most widely spoken is Amharic. 17.4 million claim it as their mother tongue i.e. first language and is a second language for another 5.1 million. The second most widely spoken language is Oromigna. 16.8 million claim it as their mothers tongue and another 1.5 million as a second language.

Other languages of national importance are Tigrigna (mother tongue for 3.2 million and second language for 1.5 million), Somaligna (3.2 million and 0.01 million); Guragigna (1.9 million and 0.1million) respectively.

3.5. Religion

Ethiopians are generally religious. According to the 1994 census (Table 2.20A p.129) 62% profess Christianity as their religion of which those affiliated with the Orthodox church claim 51% or 26.9 million of the total population of 53.2 million. Muslims are the second largest with 17.4 million or a third of the nation.

4. MIGRATION AND URBANISATION

Population distribution and re-distribution through migration are among the main features of the population dynamics in Ethiopia. The following discussion describes the major characteristics, trends, and differentials of internal migration, urbanisation and population distribution in Ethiopia using data from the two census years - 1984 and 1994.

4.1. Migration

Migration is the movement of people in space, often involving a change in the usual place of residence. Internal migration, the focus here, is such movement within national borders. The typology of migration include rural-rural, rural-urban, urban-rural and urban-urban.

In 1984, 5.6 million (or 13.2 percent of the total population) migrated and changed their place of residence permanently. The corresponding figure for 1994 was 6.9 million (or 13 percent). Although the proportions of the migrant populations remained the same in 1984 and 1994, the number of migrants increased by 1.3 million, indicating a 23.2 per cent increase over the ten-year period.

4.1.1. Rural-Rural Migration

In Ethiopia, 86 per cent of the population live in rural areas. Hence, rural-rural migration is the most prevalent and important type of migration in the country. In general, this type of migration involves farmers moving spontaneously in search of new land, government rural development schemes etc. Involuntary migration due to environmental degradation and political instability have nowadays become major causes for rural-rural migration. In 1984 rural-rural migration constituted 55.8 per cent of the total migrant population; in 1994 it constituted 48.8 per cent (Table III.14).

4.1.2. Rural-Urban Migration

Rural-urban migration in Ethiopia is another significant type of movement for spatial distribution of population. The attraction to urban areas, mostly to one primate city (Addis Ababa), is largely economic and due to rural-urban income and quality of life differentials. In recent years, these fundamental forces have been supplemented by socio-political instability including the land reform in 1975 and subsequent anti-feudal and landlord movements as well the post 1991 ethnic related relocations.

In 1984, rural-urban migrants constituted 28.7 per cent of the total migrant population. The corresponding figures for 1994 was 24.8. Although there is a decline in the proportion of rural-urban migrants between 1984 and 1994, the actual number of such migrants increased by 47 thousand (or by 6 per cent) during the same time (Table III.14). The 1994 census shows that among the residents of Addis Ababa, 46.4 percent were migrants. The highest proportion of these migrants (58 per cent) came from rural areas while 42 per cent came from other urban areas.

Table III. 14
Migrant Population by Type of Migration:
Ethiopia and Addis Ababa 1984 and 1994

Area/Type of Migrants	1984		1994	
	Migrants	Percent	Migrants	Percent
Ethiopia				
All Migrants	5643820	100.0	6916653	100.0
Rural-Rural	3148280	55.8	3379398	48.8
Rural-Urban	1618053	28.7	1714682	24.8
Urban-Rural	115630	2.0	507395	7.3
Urban-Urban	761857	13.5	1305148	18.9
Addis Ababa				
All Migrants	718820	100.0	974839	100.0
Rural-Rural	-	-	4502	0.5
Rural-Urban	555204	77.2	561202	57.6
Urban-Rural*	-	-	1869	0.2
Urban-Urban	163576	22.8	403296	41.4

Source: 1984 and 1994 Census

* This may refer to the 'rural' areas with the Addis Ababa area

Females constituted 52 per cent of all migrants to Addis Ababa, of which 59 per cent originated from rural areas (Table III.15).

Table III. 15
Migrant Population by Sex: Ethiopia and Urban 1994*

Area/Sex	Total		Percent Migrated from	
	Migrants	Percent	Urban Areas	Rural Areas
Ethiopia				
Total	6916653	100.0	26.3	73.7
Male	3194423	46.2	30.0	70.0
Female	3722230	53.8	23.8	76.2
Urban				
Total	3025690	100.0	43.1	56.9
Male	1436910	47.5	44.0	66.0
Female	1588780	52.5	42.3	67.7
Addis Ababa				
Total	974839	100.0	41.6	58.4
Male	471368	48.3	42.1	57.9
Female	503471	51.7	41.0	59.0

Source: 1994 Census

* Excludes Afar and Somali Regions

4.1.3. Urban-Rural Migration

Urban-rural migration in Ethiopia consists of periodic return migration, coinciding with peak agricultural activities mostly by unemployed people, retirees or unsuccessful urban migrants.

The 1984 census show that such migrants comprised only 2.0 per cent of the total migrant population while the 1994 census shows 7.3 per cent. This increase in the proportion of urban-rural migrants during the ten-year period translates to 392 thousand additional people who left urban areas for rural areas.

4.1.4. Urban-Urban Migration

Urban-urban migrants in Ethiopia comprised 13.8 per cent of the total migrant population in 1984 and 18.9 per cent in 1994.

In 1994, among the migrants of Addis Ababa, 41.6 per cent came from other urban areas. Like the national trend most (51 per cent) of these urban-urban migrants to Addis Ababa were females.

4.1.5. Age and Sex Selectivity of Migrants

The peak age of migrants in Ethiopia, based on the 1994 census, was 25-29 which accounted for 12.1 per cent of the total migrant population; followed by the 20-24 age group which accounted for 11.4 per cent. The 25-29 age group were the peak age of migration both for males and females.

In 1994, 53.8 per cent of all migrants in Ethiopia were females. The sex ratio was 85.8 indicating that for every 86 male migrants, there were 100 female migrants. This is also true for Addis Ababa migrants where 51.6 per cent were females; and the sex ratio was 93.6.

4.2. Urbanisation and Urban Growth

Urbanisation refers to the change in the proportion of a population living in urban areas. In the Ethiopian situation, it could occur as a result of internal rural-urban migration, natural increase or the reclassification of places to urban.

Urban growth, on the other hand, refers to the growth rate of urban areas themselves. It is the annual net additions to urban population divided by the size of the total urban population. With these definitions in mind, the following discusses urbanisation levels and trends, rate of urban growth and the proportion of the urban population in the country.

4.2.1. Urbanisation Levels and Trends

In Ethiopia a locality is defined as urban by the CSA if the resident population is 2000 and above. In 1984 4.9 million people (or 11.4 per cent of total population) lived in urban areas (localities with 2000 or more inhabitants). By 1994 this figure had increased to 7.3 million (or 13.8 per cent). The 1994 census projections show that the 2005 total urban population will grow to 11.7 million (or 16.0 per cent), and by years 2015 and 2030 the proportions of the total populations living in urban areas would grow to 17.5 million (or 18.5 per cent) and 29.7 million (or 22.2 per cent), respectively.

Although urbanisation levels and trends show steady increase, even by 2030, Ethiopia's vast majority (over 75 per cent) would still be living in rural area.

Although the total urban population of Ethiopia has been and will be increasing substantially all the way to 2030 and beyond, the rate of growth would be declining. In other words, the urban population is expected to increase at a decreasing rate.

Table III. 16
Urbanisation Levels and Trends: Ethiopia 1984-2030

Year	Total Population	Urban Population	
		Total	Percent
1984	42616876	4869289	11.4
1994	53132251	7315678	13.8
2000	63494702	9472971	14.9
2005	73043510	11674521	16.0
2010	83483873	14351355	17.2
2015	94528173	17477525	18.5
2020	106003325	21076175	19.9
2025	117585736	24145066	20.5
2030	129057942	29745825	23.0

Source: 1994 Census

4.2.2. The Primate City

Like most developing countries, Ethiopia's urban population is concentrated in one primate city, Addis Ababa, whose population grew from 1.4 million in 1984 to 2.2 million in 1995, representing 29.8 and 28.4 per cent of the urban population of the country. The city's population is expected to grow to 2.5 million in year 2000, to 2.9 million in 2005 and to 3.3 million by year 2010. These figures would represent 26.3, 24.7 and 23.2 per cent of the total urban population in the country. By 2030 the city's population is projected to reach 5 million, which amounts to 3.9 per cent of the national population and 17 per cent of the total urban population.

Although the proportion of the urban population residing in Addis Ababa is decreasing, the city still comprises over 25 per cent of the total urban population, and growing at annual average rate of 3.6 per cent. But like the total urban population, the Addis Ababa population is increasing at a decreasing rate.

Table III. 17
Projected Population Size: Addis Ababa 1995-2030

Total Population (in 000s)	1995	2000	2005	2010	2015	2020	2025	2030
	2157	2495	2887	3328	3792	4246	4664	5087
% Country	3.95	3.92	3.95	3.99	4.01	4.05	3.96	3.94
% Urban	28.43	26.34	24.73	23.19	21.70	20.14	18.55	17.10
Sex Ratio	94.00	93.00	92.40	92.20	92.20	92.30	92.30	91.70

Source: 1994 Census

Box III.2

Migration and Urbanisation

1. In 1984, about 6 million people (or 13 per cent of the total population) migrated or changed place of residence within the country. The corresponding figure for 1994 was 7 million (or 13 per cent).
2. About 56 per cent in 1984 and 49 per cent in 1994 of these migrants were rural-rural migrants; about 29 per cent in 1984 and 25 per cent in 1994 were rural-urban migrants.
3. Although the proportion of the rural-urban migrants decrease, their number actually increased.
4. In 1994, 46 per cent of the residents of Addis Ababa were migrants. A majority of them were females who migrated to the city from rural areas.
5. In 1984 about 5 million (or 11 per cent of the total population) lived in urban areas; this figure increased to 7 million in 1994 and is expected to increase to 14 million (19 per cent) in 2015 and to 30 million (or 22 per cent) in 2030.
6. The number of people residing in urban areas is also expected to increase between 1995 and 2030, but at a decreasing rate.
7. The population of Addis Ababa will increase from 2.2 million in 1995 to 3.8 in 2015 and to 5.1 in 2030. Its share of the total population will remain around 4 per cent, but its share of the urban population is expected to decrease from 28 per cent in 1995 to 22 per cent in 2015 and to 17 per cent in 2030.

5. LABOUR FORCE AND EMPLOYMENT

The 1984 and 1994 Census define the 'labour force' as those persons aged 10 years and over. Within the labour force; there are those who are economically active and those who are non-active. Within the economically active population are included those who are employed and those who are unemployed.

The employed population consists of those who were engaged in productive activity for at least one day in the seven days before the census (for urban areas) and for most of the 12 months before the census (for rural areas). Productive activity, in the census, was defined as any work which involved the production of goods and services for sell or for exchange. The unemployed population consists of those who were not working during the reference period and who were (or were not) looking for work but were ready to take it if one was available.

On the basis of these definitions of the Central Statistical Authority (CSA), the following discussion looks at the distribution of the labour force by age, sex and activity status for the country and for urban areas. It also presents employment by age, sex and occupational status.

A point of crucial importance that needs to be flagged at this juncture is the assumption of full employment in the rural milieu and that unemployment is solely considered as an urban phenomenon. This is an unrealistic assumption, rendering the official statistics suspect. The reader is advised to treat the unemployment figures very cautiously.

5.1. Labour Force and Activity Status

In 1984, 21.9 million people (or 51 per cent of the total population) were in the labour force, compared to 36.6 million (or 69.0 per cent) in 1994. This represents a 66.9 percent increase in the size of labour force in the 10-year period. The proportion of the male and female member of the labour force, both in 1984 and 1994, were about the same.

In terms of activity status, 67.2 (in 1984) and 72.5 per cent (in 1994) of the total labour force were considered economically active. Among male members of the labour force the activity rates were higher (79.2 and 82.11 per cent in 1984 and 1994, respectively) for the male than among female members of the labour force (55.5 and 62.9 per cent). This national trend seems to be true for each of the five-year group with the highest

activity rate (97.6 per cent) reported for males in age group 35-39. The highest female activity rate (70.1 per cent) was reported for age group 30-34.

In urban areas of the country, 3.3 million people (or 68.5 per cent of the total urban population) in 1984, and 5.5 million people (or 75.8 per cent) in 1994, were members of the labour force. This amounts to a 66.3 percent increase in the urban labour force between 1984 and 1994.

In terms of activity rates, 43.5 per cent (in 1984) and 49.9 per cent (in 1994) of the total urban force were considered active. Among the urban male members of the labours force 58.2 per cent and 62 per cent were economically active in 1984 and 1994, respectively. The corresponding figures for females were 31.2 and 39.1 percent. Overall, while the urban labour force increased by 66.3 per cent the activity rate increased by only 6.4 per cent between 1984 and 1994.

5.2. Employment by Age, Sex and Occupational Status

Over 98 per cent of the total economically active population in 1984 were employed; this figure declined to 97 per cent in 1994. Although there were some variations, employment for the most part remained over 95 per cent for all age groups both in 1984 and 1994.

In urban areas, about 92 per cent of the total economically active population was employed; this figure declined significantly to 78 per cent in 1994. The employment rates declined dramatically for specific age groups such as the 20-24 age group where the rates declined from 85 per cent to 61 percent between 1984 and 1994.

5.2.1. Status in Employment

Table III.18 shows that 'self employment' was the most prevalent form of employment in 1984, while 'unpaid family work' was prominent in 1994. However, looking at the data by sex, it is noted that most males, both in 1984 and 1994, were self-employed while most females, both in 1984 and 1994, were 'unpaid family workers'. In urban areas, self employment dominates among the economically active people both in 1984 and 1994, although 'government employment' was a strong second with 33 per cent in 194 and 25 per cent in 1994. While females dominated the self-employment category, much more males tended to be government employees.

In urban areas, 'private employment' was also an important employment type with 19 per cent in 1984 and 17 percent in 1994. In urban areas, in 1984, production related occupations (29 per cent) and sales (24 per cent) were dominant among the economically active population. The proportion of male production workers (36 per cent) was higher than the female's proportion (17 per cent). On the other hand, the proportion of female sales workers (34 per cent) was higher than the proportion of male sales workers (17 per cent).

In 1994, in urban areas, the highest proportion of the economically active population (28 per cent) was involved in service and sales occupation category, followed by craft-related trade works (15 per cent). There was a higher proportion of females (37 per cent) engaged in sales and service than males (22 per cent). Among the group engaged in crafts-related occupation, a higher proportion of males (16 per cent) was involved than females (13 per cent).

Table III. 18
Economically Active Population By Status in Employment: Ethiopia and Urban
1984 and 1994

Status In Employment	1984			1994		
	Both Sexes	Male	Female	Both Sexes	Male	Female
Country Total	14618361 (100%)	8522881 (100%)	6095480 (100%)	25883199 (100%)	14711261 (100%)	111719 (100%)
Employer	0.9	0.9	1.0	2.6	3.6	1.3
Self Employed	57.1	71.1	37.6	39.5	51.3	24.0
Government Employee	4.0	5.1	2.4	2.7	3.5	1.7
Private Employee	2.2	1.8	2.7	3.0	3.5	2.2
Member of Cooperative	0.9	1.0	0.7	0.1	0.1	0.1
Unpaid Family Worker	34.2	19.4	54.9	51.1	37.1	69.6
Others/Not Stated	0.6	0.6	0.6	0.8	0.8	0.9
Urban Total	1364961 (100%)	838323 (100%)	526638 (100%)	2266217 (100%)	137329 (100%)	892688 (100%)
Employer	1.7	1.4	2.3	3.0	3.2	2.7
Self Employed	40.8	39.1	43.6	39.0	39.0	39.0
Government Employee	32.8	40.3	20.9	24.5	29.1	17.5
Private Employee	18.6	13.3	27.2	17.0	15.2	19.7
Member of Cooperative	1.8	2.2	1.0	0.3	0.4	0.3
Unpaid Family Worker	2.4	3.4	1.7	10.5	7.5	15.0
Others/Not Stated	1.9	2.0	1.6	5.6	5.5	5.7

Sources: 1984 and 1994 Census

Box III.3a**GENERAL OBJECTIVES OF THE NATIONAL POPULATION POLICY**

- Closing the gap between high population growth and low economic productivity through planned reduction of population growth and increasing economic returns;
- Expediting economic and social development processes through holistic integrated development programmes designed to expedite the structural differentiation of the economy and employment;
- Reducing the rate of rural to urban migration;
- Maintaining/improving the carrying capacity of the environment by taking appropriate environmental protection/conservation measures;
- Raising the economic and social status of women by freeing them from the restrictions and drudgeries of traditional life and making it possible for them to participate productively in the larger community;
- Significantly improving the social and economic status of vulnerable groups (women, youth, children and the elderly).

**Box III.3b****SPECIFIC OBJECTIVES OF THE NATIONAL POPULATION POLICY**

- Reduction the current total fertility rate of 7.7 children per woman to approximately 4.0 by the year 2015;
- Increasing the prevalence of contraceptive use from the current 4.0% to 44.0% by the year 2015;
- Reducing maternal, infant and child morbidity and mortality rates as well as promoting the level of general welfare of the population;
- Significantly increasing female participation at all levels of the educational system;
- Removing all legal and customary practices militating against the full enjoyment of economic and social rights by women including the full enjoyment of property rights and access to gainful employment;
- Ensuring spatially balanced population distribution patterns with a view to maintaining environmental security and extending the scope of development activities;
- Improving productivity in agriculture and introducing off-farm non-agricultural activities for the purpose of employment diversification;
- Mounting an effective country wide population information and education programme addressing issues pertaining to small family size and its relationship with human welfare and environmental security.

Source: The National Office of Population Ministry of Economic Development and Cooperation

Box III.4**IMPACT OF POPULATION GROWTH ON ECONOMIC DEVELOPMENT**

On the basis of the most optimistic assumptions the Ethiopian population would increase at an average annual rate of 2.5% during the first two decades of the new century and millennium. The rate of growth is very high and is appreciated by the national authorities dealing with population issues.

What are the impacts of high population growth on economic development? Few issues in economics have and continue to generate controversy and disagreement. In modern times the issue was raised by Malthus in the 18th century. In his famous book *'An essay on the principle of population as it affects the future improvement of society'*, he argued that food production will increase at a pace slower than population growth resulting in recurrence of famine and economic stagnation. The essay generated an acrimonious debate that has yet to be resolved.

Those arguing for lower population growth hold that an unchecked population increase dampens economic growth through capital shallowing effect i.e. reduction in the capital/labour ratio; age dependency effect and the resulting increase in consumption and depleting savings; investment reduction effect i.e. investment declines for lack of savings; and investment diversion effect i.e. government shift resources from capital to recurrent expenditure. Further to this is the impact of increasing population on the environment-soil depletion due to intensive and extensive farming, deforestation etc.

Those who dispute the negative effect of population growth pin their argument on technological development and the scale effect of larger population. These people point out the advances in technology increase productivity that outstrips any population growth induced constraints. In agriculture the productivity of the factors of production (land, labour and capital) would increase and alleviate food shortages. In the industrial sector new technologies increase employment opportunities as well as productivity.

The scale effect argument of population expands the domestic market for both industrial goods and agricultural products, which in consonance with foreign trade tends to improve the standard of living of the people.

Although the debate among the protagonists continues, the weight of evidence as well as the realities on the ground in developing countries favors the pro-population control group. On the other hand the anti-population growth position would enjoy sympathetic hearing in the developed countries that have a large and increasing old age dependants in the face of declining or at best stable population growth.

The Ethiopian government's position is for is for controlling and reducing the rate of population growth. This is understandable, in view of the frequent famine, excessive pressure on the land, environmental degradation etc. However and regardless of population growth, an assured means out of misery lies in changing the farming culture by introducing technological innovations and liberating the agricultural sector from the vagaries of nature through, for example, irrigation, improved transport infrastructure and upgrading marketing institutions.

Table III.19: Economically Active Population 1984 and 1994

Occupational Group	1984				1994			
	National		Urban		National		Urban	
	Both Sexes	Male	Female	Both Sexes	Male	Female	Both Sexes	Female
Total	146,836 (100)	83,228 (100)	60,946 (100)	134,001 (100)	83,823 (100)	52,463 (100)	258,317 (100)	117,936 (100)
Unskilled, Senior Official & Managers	1.3	1.7	0.3	10.4	11.1	6.2	0.6	0.1
Professional and Technical	0.1	0.0	0.2	1.1	1.8	0.3	0.2	0.1
Administrative and Managerial	0.6	0.5	0.6	5.6	5.6	5.8	4	0.4
Clerical Writing	1.1	2.0	5.1	23.5	17.1	33.8	7.8	5.4
Service Workers and Shop & Mark	1.9	1.3	2.9	18.6	11.4	30.0	21.2	21.2
Sales Workers								
Agricultural, Animal Husbandry & Forestry	88.5	80.1	83.6	9.0	33.4	5.0	50.4	67.8
Production/Related Worker, Transport Operator & Laborer	3.3	4.5	2.6	28.8	36.4	16.7	2.2	2.5
Crafts & Related Trade Workers							0.4	0.1
Plant and Assemblers							20.7	19.8
Elementary Occupation							0.8	0.9
Not Stated	0.6	0.6	0.6	2.8	3.2	2.2	0.8	6.0

Source: 1984 and 1994 Censuses

5.2.2. Occupational Groups

Most employed Ethiopians were engaged in agricultural activities both in 1984 (88 per cent) and 1994 (70 per cent). This was true both for males and females, although the proportion of males was slightly higher than females (Table III.17).

5.2.3. Unemployment by Age and Sex

Unemployment in Ethiopia is measured on the assumption that there is no unemployment in the rural areas i.e. all the labor force is fully employed and that unemployment is exclusively an urban phenomenon.

In 1984, of the total 14.7 million economically active population, 170 thousand (or 1.2 per cent) were unemployed. In 1994, among the 26.5 million economically active people, 770 thousand (or 2.9 per cent) were unemployed. This shows the number of unemployed people nation-wide increased by 600 thousand people, representing a 35.2 per cent increase during the ten-year period. Looking at the age and sex distribution of unemployment, there does not seem to be major differences both in 1984 and 1994.

On educational classification, the two unemployed clusters are the illiterate and those who completed grade 12. The unemployed illiterate increased 3 fold between 1984 and 1994 while those who completed grade 12 jumped 7 fold.

The age group with the highest rate of unemployment in 1984 was 15-19 with a 5.5 per cent rate; in 1994 the highest unemployment rate was observed for the 20-24 age group with 6.6 per cent. In both cases the proportion of female unemployed were higher than the male's. In the urban areas of the country, among the 1.5 million economically active people in 1984, almost 8 per cent were unemployed. In 1994, the unemployment rate increased to almost 22 per cent among the 2.7 million economically active people. The proportions female unemployed were higher than the male proportions both in 1984 and 1994.

In 1984, in urban areas, the 15-19 age group had the highest unemployment rate (19.2 per cent) followed by the 20-24 age group (14.6 per cent). In 1994, the highest unemployment in urban areas was seen among the 20-24 age group (38.5 per cent), followed by the 15-19 age group (37.5 per cent). In the younger age groups, there were higher proportions of unemployed females than there were males. However among the older group, the proportion of unemployed males was much higher.

Table III.20
Level of Unemployment by Education and Sex, 1984 and 1994, ('000)

Level of Education	1984			1994		
	Male	Female	Total	Male	Female	Total
Illiterate	33.0	45.2	78.2	136.4	143.2	279.6
Non-regular	5.7	3.0	8.7	11.7	7.4	19.1
Grade 1-6	21.6	16.4	38.0	71.2	50.2	121.4
Grade 7-8	3.7	2.3	6.0	43.2	30.2	73.4
Grade 9-11	4.4	3.6	8.0	43.4	20.5	72.9
Grade 12	13.5	15.0	28.5	101.7	88.2	189.9
Beyond grade 12	1.0	1.0	2.0	13.4	8.9	22.3
Not stated	0.2	0.1	0.3	0.5	0.4	0.9
Total	83.1	86.5	169.6	421.4	358.1	779.5

Source: Calculated from CSA 1984 and 1994 Census.

Box III.5

LABOUR FORCE AND EMPLOYMENT

1. The number of people in the labour force increased from 22 million (or 51 per cent) in 1984 to 36 million (or 69 per cent) in 1994, indicating a 67 per cent increase in the ten-year period.
2. Of those in the labour force, 67 per cent in 1984 and 72 per cent in 1994 were economically active.
3. Among the urban residents of the country, 3.3 million (or 68 per cent) in 1984 and 5.5 million (or 76 per cent) in 1994 were in the labour force. Of these, 43 and 50 per cent were economically active in 1984 and 1994, respectively.
4. A higher proportion of males than females were 'self-employed' both in 1984 and 1994. On the other hand, during both census years, a higher proportion of females than males were in the 'unpaid family worker' category.
5. By far most Ethiopians, males and females, were engaged in agricultural activities. In urban areas, production-related and sales activities dominated among the economically active population group.
6. In urban areas, a higher proportion of females than males were engaged in sales and service-related activities. On the other hand, a higher proportion of males dominated the crafts-related occupations.
7. In 1984, only 1.2 per cent of the economically active population was unemployed nation-wide; in 1994 the percentage increased to almost 3 per cent. The 15-19 age group had the highest unemployment rate in 1984 followed by the 20-24 aged group. In 1994 the two age groups switched place.
8. Among the economically active urban population, about 6 per cent in 1984 and 22 per cent in 1994 were unemployed, indicating a 430 per cent increase in unemployment rate over the ten-year period.
9. Among the younger age groups (up to 40-44), a higher proportion of females than males were unemployed. On the other hand among the older age groups the reverse held true.

6. POPULATION AND DEVELOPMENT

One of the areas where there is a strong relationship between population and development is the area of food production. Malthus says, where population growth is in 'geometric' progression and where food production grows in 'arithmetic' progression, natural calamities such as drought and famine will take care of the excessive population.

Unfortunately for Ethiopia, as we have seen earlier, its population is growing in geometric progression, doubling every 23 years and will continue to do so for some time to come. What about its food production?

The following discussion briefly relates population growth to size of landholdings, food output and gross domestic products.

6.1. Population Growth and Per-Capita Land Holding

The size of the farm land, in a country like Ethiopia where 85 per cent of the population is engaged in agriculture, is a factor of the population size. As the population size of the country has been and will be increasing dramatically, the per-capita landholding diminishes. Table III.21 shows that as the population of the country increased from 23 million in 1960 to 37 million in 1980 and to 49 million in 1990, the per capita land holding decreased from .28 hectares to .13 hectares and to .10 hectares, respectively. Per capita food output also decreased dramatically between 1960 and 1990.

Table III.21
Population Growth, Per Capita Food Output and Landholding, Ethiopia, 1960-1990

Year	Population (000)	Per capita Food Output (in kg)	Per capita Landholding (in ha.)
1960/61	23,550.0	240.2	0.28
1969/70	28,784.4	242.7	0.25
1979/80	36,663.3	204.4	0.13
1989/90	48,648.8	141.7	0.10

Source: Ezra (1997)

6.2. Population Growth and Food Production

The amount of food production, in the Ethiopian situation, is strongly related to access and size of farmland which, as we have seen above, is strongly and negatively related to population size. Although food production increased 'arithmetically' in some years between 1960 and 1990, for the most part it was fluctuating up and down. The years between 1962 and 1972 were the period in Ethiopia when food production was actually increasing, and the percent change was about the same as the percent change in population size.

Between 1973 and 1979, the time of harsh drought and famine in the country, food production declined by as much as 18 percent (in 1977/78). Since 1960/61 the population continued to grow unabated, growing at an increasing rate of 28 percent by 1971/72 to 52 per cent by 1978/79. Since 1987, food production in the country had been increasing at a decreasing rate while population size has been increasing at an increasing rate (Table III.22).

Table III.22
Population Growth and Food Output, Ethiopia, 1960-1990

Year	Food Output (000 tons)	% Change over the base year in food output and population	
		Food Output	Population
1960/61	5657.2	0.00	0.00
1964/65	6116.1	8.11	9.10
1969/70	6984.7	23.47	22.24
1974/75	6107.6	7.96	37.14
1979/80	7495.5	32.49	55.68
1984/85	4855.2	-14.20	78.71
1989/90	6895.4	21.89	100.6
1993/94	5331.3	-5.76	132.5

Source: Ezra (1997)

6.3. Population and Gross Domestic Products

Agriculture in Ethiopia, subsistent as it is, contributes 55 per cent of the Gross Domestic Product (GDP) and 85 per cent of the export revenue. However, as the Table III.23 shows, the GDPs, both overall and per capita, have been declining, while the population of the country has been increasing at an increasing rate.

Table III.23
Population and GDP Growth Rates, Ethiopia, 1978-1990

Year	GDP Growth Rate		Population Growth Rate
	Overall	Per capita	
1978	2.0	-0.6	2.6
1983	2.4	-0.4	2.8
1986	1.9	-1.0	2.9
1990	0.4	-2.6	2.95

Source: Aklilu Kidanu 1999.

6.4. National Population and Women Policies

6.4.1. Population Policy

The National Population Policy of Ethiopia (NPPE) is now 6 years old. The main objective of the policy include: (1) to harmonise population growth with the country's natural resources such as land, forest, water etc.; (2) to reduce fertility rates through information, education and communication (IEC) strategies and community-based distribution (CBD) programs of contraceptives, and (3) to reduce mortality through the promotion of maternal and child health programs.

Within this framework, the NPPE, by 2015, hopes to see the reduction of total fertility rate from the current 7 to 4; increment of contraceptive prevalence rate from the current 4 to 44; and reduction of infant and child mortality rates. These might be easier said than done. Neither IEC nor CBD strategy seems to be the best approach in Ethiopia where economic and social factors impede large-scale effects. Not to speak of the lack of health personnel and facilities.

6.4.2. National Women Policy

Women, who comprise half of the population of the country, are overworked with the responsibilities that include production, child bearing, household activities and social obligations. Most significantly, Ethiopian women, on the average, go through the hardship of bearing as many as 7 children during their reproductive years. Not to speak of the responsibilities of raising them. None of these is appreciated fully.

The Ethiopian National Policy on Women does not directly address fertility reduction as one of its objectives. But, by working to facilitate the human and property rights of women, it is expected that the policy's outcome would have negative impacts on fertility and population growth rates in the country. In terms of the strategies, however, there seem to be too much reliance on government structure and resources. Not a good sign, given government resources required to realise policy objectives that might directly go contrary to long-established cultures and behaviours of a population.

Having said this, note should also be taken that, the government has taken actions to promote women's full and equal participation in the labour force; to encourage women's participation in decision making, and to include improvement of women in the legislation.

Box III.6**POPULATION AND DEVELOPMENT
BETWEEN 1960 AND 1990**

1. The population of the country increased dramatically, doubling every 23 years, while percapita landholding declined all the way down to less than a tenth of a hectare.
2. Percapita food output decreased to 141 kg while population steadily increased and landholding steadily decreased.
3. Food output in 1990 declined from the 1960 level, representing a 6 per cent decline, while the population increased by 132 per cent during the same time.
4. The GDP growth rate in 1978 was four times higher than the 1990 rate while percapita GDP declined to almost zero in 1990 from 2.6 in 1978.
5. The National Population Policy of the country proposes to harmonise population growth with natural resources.
6. The policy also aims to reduce the total fertility rate from 7 to 4 and to increase the contraceptive prevalence rate from 4 to 44 - by 2015.
7. The National Women Policy does not directly address the issue of fertility reduction; but it might have its indirect impact if it successfully addresses the issue of human and property rights of Ethiopian women.

IV

THE HUMAN CONDITION IN ETHIOPIA*

1. INTRODUCTION

The basic objective of economic management and indeed the fundamental goal of government every where and at all times is to see to it that the standard of living of their people improves over time. Although the components that define and determine the standard of living in a country are multidimensional and incorporate social, political and economic factors among others, the latter is operationalized through high rates of economic growth, full employment, equitable income distribution, stable prices and sustainable balance of payment position. The extent to which these aspirations are realized would, by and large, determine the quality of life in the country. The lower the rate of economic growth, the higher the level of unemployment, the more inflationary the economy, the higher the degree of income inequality, and the more unsustainable the balance of payments are, the lower the standard of living of the people. It is also important to note that the larger the number of these qualifying factors are satisfied, the better the human condition. Thus a robust economic growth in an environment of high-income inequality would result in few wealthy people while the majority wallow in poverty.

A review of the human condition in a country would serve a number of useful purposes. First it would inform policy makers on the state of the human condition in the country. Secondly, it would assist the government in the progress (or lack of it) that has been made over a given period of time, as well as what and how much remains and needs to be done. Thirdly it would help policy makers identify and filter the quintessential factors constraining improvement in the standard of living of the people and prioritize their focus and strategies accordingly.

The standard of living of a people in a country used to be exclusively assessed on the basis of per capita GDP for a long time. While this yardstick continues to be used and remains dominant, it is being increasingly challenged as an inadequate measure of the quality of life in a country by a growing number of people. The critiques have sought to expand the determinants to include a broad range of parameters consisting of economic, political and social factors (See Box IV.1).

*The editors are grateful to Ato Getahun Tafesse who authored the background paper for this chapter and Ato Assefa Belay, Demographer at UNECA, for very useful comments and suggestions on an earlier draft of this chapter.

The new school of thought identifies and explores two wide-ranging constituencies in the evaluation of well-being in a country. The first is the choice that is available to people. Although (UNDP-Ethiopia 1998:11) "people's choice are infinite and can change from time to time, healthy life, knowledge, and access to resources" are considered the most essential. The second set of factor, and one that is closely related with the first is the extent to which people are empowered to make use of, and expand the choices that are available to them. Empowerment assumes critical importance for two reasons. Firstly it improves the productive capacity of the people as producers and secondly it increases their capacity to access the goods and services that are produced.

The human condition in Ethiopia has been assessed from these broad perspectives by government institutions, university based research centers as well as by international organization. Among government institutions, the Ministry of Economic Development and Cooperation (MEDaC) and the Central Statistical Authority (CSA) are in the forefront of the exercise. MEDaC in cooperation with local and international institutions, has been conducting periodic poverty assessment in Ethiopia, the latest of which is the "Poverty Situation in Ethiopia" published in February 1999. The World Bank's (1998) country study on the social sector also goes over the same territory as that of MEDaC, albeit with earlier sets of data. The Economics Department and the Institute of Development Research (IDR) both of Addis Ababa University in cooperation with Oxford and Gothenburg Universities have undertaken extensive research. The UNDP has two publications that provide information on the state of the human condition in Ethiopia. The first is the Human Development Report (referred to in this chapter as HDR- Global or HDRG for short). The second is the 1998 Human Development Report on Ethiopia produced by the UNDP office in Ethiopia and referred to in the following sections as HDR-National or HDRN for short.

This chapter draws on these and other sources and the background paper prepared for this project and summarizes their findings. The chapter starts by reviewing the human condition in Ethiopia and goes on to explore the factors behind the low level of human development.

2. THE STATE OF HUMAN DEVELOPMENT IN ETHIOPIA

The Human Development Index (HDI) a concept popularized by the United Nations Development Program is derived from three basic components (HDRG, Technical note: 107 and HDRN, Appendix 3:81) of longevity measured by life expectancy at birth; educational attainment, measured by a combination of adult literacy and the total of first, second and third level gross enrolment ratios and standard of living, measured by adjusted GDP per capita or Purchasing Power Parity (PPP) dollars denominated GDP.

Two human development indices (HDIs) are available for Ethiopia – one, as pointed out above, in the Human Development Report of UNDP which assess the quality of life in all the member countries of the UN (referred to in this chapter as the Human Development Report-Global or HDRG) and the other prepared by the UNDP-Ethiopia office and limited to Ethiopia (HDRN). Both indices measure the quality of life in the country on an annual basis. HDI of HDRG provides measures from as far back as 1987 and as early as 1995. The HDRN has an annual series of HDI from 1990 to 1996. These two assessments of the social and economic conditions inform the discussion in this section. These two indices are reproduced in Table IV.1.

Table IV.1
The Human Development Indices and Ranking for Ethiopia

For Year	HDI Value (HDRG)	Ranking	HDI Values (HDRN)
1987	0.282	111/130	-
1988	0.166	141/160	-
1989	0.173	138/160	-
1990	0.172	151/173	0.357
1991	0.249	161/173	0.322
1992	0.229	165/173	0.292
1993	0.257	168/174	0.276
1994	0.244	170/175	0.235
1995	0.252	169/174	0.255
1996	-	-	0.260

Source: UNDP Human Development Reports 1990 – 1996 for Global HDI. UNDP Human Development Report 1998 Ethiopia for National HDR.

The table is useful for two basic purposes. First it enables one to assess the country's standing relative to other countries, and second, and more importantly, it provides information to review and appraise the status and development in well-being over the years.

In the discussion that follows, a distinction needs to be made between trend and level. The trend provides a picture of how human development or the quality of life behaved over time. By comparing the values of human development index for different years, one can have ideas of improvement or lack of it over a given period of time. The level, on the other hand, gives measures of what the human development index is at a given period in time. This information helps in comparing the level of human development of Ethiopia against those obtaining in other countries.

Box IV.1

Over the past decades, a new concept of human development has evolved. While this dimension brings together the previously disparate indicators, it nevertheless goes beyond them by including factors that were not part of any of the earlier measures. Among the different concepts and approaches which assumed prominence in the past and very significantly inform the current idea are:

- a) The economic growth model, which assumed and focused on the growth of GDP/GNP as the necessary and sufficient means to human development.
- b) Human resources development models, which focused on enhancing human capital, not in its own right but as input in the growth/production processes.
- c) The welfare approach to development, which proposed that human beings should be the beneficiaries without recognizing their obligations and capacities as agents of change and development.
- d) The basic needs approach to development, which focused on providing goods and services to deprived population groups in the society.

In contradistinction to these approaches and models, the Human Development (HD) approach of the United Nations Development Program (UNDP) defines the concept as "A process of enlarging people's choices". Cognizant of the fact that people's choices are infinite and change from time to time, the HD approach singles out three basic parameters as the most essential – although not sufficient – inputs to increasing people's choices. These are capacities to lead a long and healthy life, knowledge to make them more productive as well as enjoy their long life; and access to the resources needed for a decent standard of living.

There are four major elements in the concept of human development these are:

- a) **Productivity** – It is through the production of more goods and services that the quality for life improves. Therefore people must be enabled to increase their productivity and to participate fully in the production and income generating processes. Thus economic growth becomes a subset of human development process.
- b) **Equity** - People must have access to equal opportunities. All barriers to economic and political opportunities must be eliminated so that people can participate in and benefit from these opportunities.
- c) **Sustainability** - Access to opportunities must be ensured not only for the present generation but for future generations as well. All forms of capital – physical, human, and environmental – should be replenished.
- d) **Empowerment** - Development must be by, and not only for the people. People must participate fully in the decision and processes that shape them.

Source: Adopted from UNDP Human Development

Box IV.2

Computing the Human Development Index

The HDI is based on three indicators: longevity, as measured by life expectancy at birth; educational attainment, as measured by a combination of adult literacy (two-thirds weight) and the combined first-, second- and third-level gross enrolment ratio (one-third weight); and standard of living, as measured by real GDP per capita (PPP\$).

Before 1994 the minimum values for each of the variables were determined at the level of the country that has the lowest value and the maximum at that of the country with the highest value. In effect the HDI of a country was defined as relative position between the worst and best performing countries. Since 1994 this approach to computing HDI was revised. For each indicator, minimum and maximum values were fixed independent of country performances as follows:

- Life expectancy at birth: minimum 25 years and maximum 85 years
- Adult literacy: minimum 0% and maximum 100%
- Combined gross enrolment ratio: minimum 0% and maximum 100%
- Real GDP per capita (PPP\$): minimum \$100 and maximum \$40,000 (PPP\$)

$$\text{Index} = \frac{\text{Actual } x_i \text{ value} - \text{minimum } x_i \text{ value}}{\text{Maximum } x_i \text{ value} - \text{minimum } x_i \text{ value}}$$

If, for example, the life expectancy at birth in a country is 65 years, then the index of life expectancy for this country would be:

$$\text{Life expectancy index} = \frac{65 - 25}{85 - 25} = \frac{40}{60} = 0.667$$

The construction of the income index is a little more complex. The world average income of \$3,990 (PPP\$) in 1995 is taken as the threshold level (y^*), and any income above this level is discounted using the following formulation based on Atkinson's formula for the utility of income:

$$\begin{aligned} W(y) &= y^* \text{ (for } 0 < y < y^*) \\ &= y^* + 2(y - y^*)^2 \text{ for } y^* < y < 2y^* \\ &= y^* + 6(y^*)^2 + 3(y - 2y^*)^2 \text{ for } 2y^* < y < 3y^* \end{aligned}$$

To calculate the discounted value of the maximum income of \$40,000 (PPP\$), the following form of Atkinson's formula is used:

$$\begin{aligned} W(y) &= y^* + 2(y^*)^2 + 3(y^*)^2 + 4(y^*)^2 + 5(y^*)^2 \\ &\quad + 6(y^*)^2 + 7(40,000 - 6y^*)^2 \end{aligned}$$

This is because \$40,000 (PPP\$) is between $6y^*$ and $7y^*$. With the above formulation, the discounted value of the maximum income of \$40,000 (PPP\$) is \$6,311 (PPP\$). No discounting is made for incomes below \$5,990 (PPP). We illustrate the calculation of HDI by using Ethiopian data for 1995 as follows:

Life expectancy at birth	50.7 years
Adult literacy rate	23.4%
Gross enrolment ratio (all levels)	20.5%
Adjusted GDP per capita (PPP\$)	430

Note that all figures refer to the year 1994.

Step One: Computing indices for life expectancy and educational attainment

$$\begin{aligned} \text{Life expectancy index} &= \frac{50.7 - 25}{85 - 25} = 0.428 \\ \text{Adult literacy} &= \frac{23.4 - 0}{100 - 0} = 0.234 \\ \text{Gross enrolment (all levels)} &= \frac{20.5 - 0}{100 - 0} = 0.205 \\ \text{Thus, Educational attainment index} &= [2(0.234) + 0.205]/3 = 0.224 \end{aligned}$$

Step Two: Computing the income index. Since PPP\$ 430 is far less than the threshold income level, we do not need to adjust it.

$$\text{Thus: Income index} = (430 - 100)/(6154 - 100) = 0.0545$$

Step Three: Computing the HDI

$$\text{HDI} = [0.428 + 0.224 + 0.0545]/3 = 0.235$$

Sources: UNDP, Human Development Report 1994 (Oxford University for UNDP) and UNDP, Human Development Report 1998 Ethiopia (UNDP, Addis Ababa, Ethiopia).

2.1. Ethiopia's Human Development Relative to the Rest of the World

Both indices on the level of human development in the country report unflattering values. According to the HDRG Ethiopia's HDI averaged 0.225 out of a possible 1.0 between 1987 and 1995. Even if one makes a strong case for the HDN as the better measure of the level of human development because of its proximity and better access to current data than the HDRG, the values do not paint a better picture, with an average of 0.285 for the 1990-96 period.

Ethiopia's HDI of 0.252 for 1995 (the latest year for which HDI is available at the global level) is only a third of the global average (see Table IV.2); less than half of the average for developing countries; and 27 per cent below the average for the least developed countries. Within the Africa continent, its HDI is less than a third of the country with the highest score (Mauritius at 0.833); and is only 26 per cent higher than the country with the lowest score (Sierra Leone at 0.185).

Neither does its HDI value compare favorably with its neighbors, nor countries with whom it shared similar experiences in recent years, as shown in Table IV.2.

Among its immediate neighbors, its HDI of 0.252 for 1995 was 84% lower than that of Kenya, about a third lower than those of Uganda, Djibouti and the Sudan and about 10% lower than that of Eritrea. Somalia is the only country that is consistently ranked below Ethiopia for the years for which HDI values were reported.

Neither does the country fare any better compared to countries with whom it shared similar experience. For example Ethiopia pursued similar ideologies and experienced war induced shocks as Vietnam, Cambodia, Laos and Mozambique. And yet all of these countries scored higher HDI values than it at 0.559, 0.415, 0.465 and 0.281 respectively.

With respect to its standing among the community of nations, its rank has been very low to begin with (111th of 130 countries in 1987), and has been growing lower through the years. In 1994 the country was ranked 170th among 174 countries, slightly improving to 169th in 1995. This deceleration in its relative position in the world can be explained either by the faster pace of improvement in the quality of life in other countries or by the deterioration in Ethiopia or both. Both observations are correct. In 1988 Ethiopia's HDI at 0.282 was higher than 19 countries (16 African and 3 Asian), (HDR 1991:121). In 1995 its HDI was higher than 5 African countries only¹ (HDR 1998:130), implying that 11 of the

¹ Of these 5 countries four (Mali, Burkina Faso, Niger and Sierra Leone) were ranked below Ethiopia in 1988 while one (Burundi) was rated higher in 1988.

African countries and the three Asian Countries (Bhutan, Nepal and Afghanistan) made sufficient progress and graduated to a higher rank. Among the 11 African countries that had a lower level of human development relative to that of Ethiopia in 1988 but recorded higher values and therefore were ranked better in 1995 are the Sudan and Djibouti.

Table IV.2
Ethiopia versus the World: Relative HDI Ranking for 1995

Country	HDI Value	HDI Ranking
Ethiopia	0.252	169/174
World	0.772	-
Developing Countries	0.586	-
Least Developed Countries	0.344	-
Highest HDI (Canada)	0.960	1
Highest in Africa (Mauritius)	0.833	61
Lowest HDI (Sierra Leone)	0.185	174
Neighbors		
Eritrea	0.275	168
Kenya	0.463	137
Uganda	0.340	160
Djibouti	0.324	162
Sudan	0.343	157
Similar Experience		
Vietnam	0.560	122
Cambodia	0.422	140
Laos	0.465	136
Mozambique	0.281	166

Source: UNDP Human Development Report 1998 Annex table 1 pp 128-130

Women in Ethiopia suffer low overall human development achievement as well as gender inequality – inequality in prestige, inequality in decision making and inequality in access

to resources. Women in Ethiopia face a double depreciation: low overall human development achievement and their inferior achievement relative to men.

2.2. Ethiopia's Human Development: Development Through Time

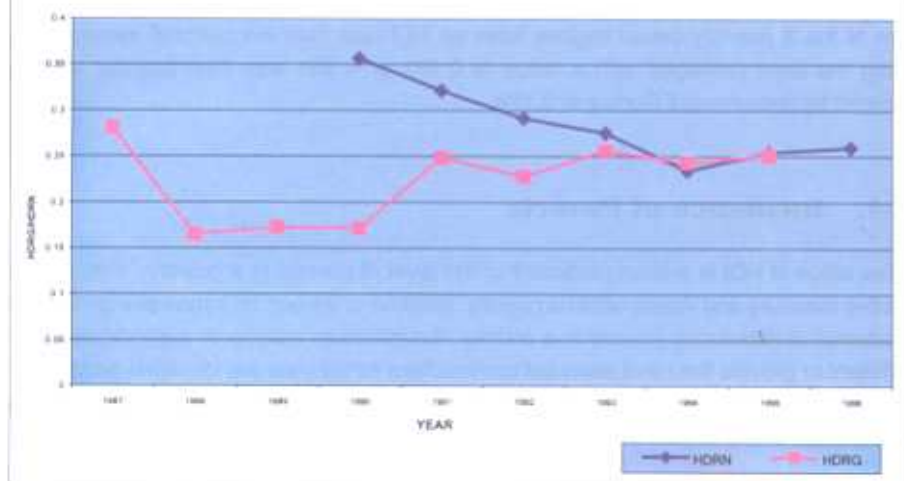
Table II.1 and the graph below show developments in the quality of life in Ethiopia as measured by the human development indices obtained from the two UNDP publications from 1987 to 1996. Both indices show a generalized decline in human development from their initial years i.e. 1987 for HDRG and 1990 for HDRN.

The HDI of the HDRG for 1987 was 0.282. Thereafter this value, although unstable, was on a declining trend until 1993 when it changed course and increased to 0.257 and declined thereafter. The value for the terminal year was 0.252, 12 per cent lower than the highest figure of 1987. Since 1990, however, the negative trend has changed course and is positively sloped, although it has some distance to cover before it catches up with the 1987 value.

The HDRN's HDI values depict the same trend. It starts at its highest value of 0.357 in 1990 and declined consistently to 1994 and assumed a positive trend since 1995. The highest value of 0.260 following the recovery in 1996 is still considerably below the 1990 value.

Despite the recent positive trends, the country continues to face frustrating constraints in its efforts to achieve sustainable human development. It is beset with poverty; shortage of skilled human resources; underdeveloped socio-economic infrastructure; low level and slow development of technologies and growing unemployment and underemployment. These problems are aggravated by more than two decades of civil war and recurrent drought. The structural adjustment programs, the inadequacy of political commitment to equitable human development in all the regions, the external debt and debt servicing obligation as well as the macro-economic instability as a result of its economic vulnerability to external shocks such as the sharp deterioration in external terms of trade are some additional factors that can be considered as causes for the low human development in Ethiopia.

Fig. IV.1: Human Development in Ethiopia 1987-1996



2.3. Human Development at the Regional Level

On the basis of the HDRN, human development at the regional level evidences conspicuous divergence and disparity. The highest HDI is recorded for Addis Ababa at 0.487 and the lowest for Afar at 0.182. The unweighted mean of the human development index for the whole country is 0.272, with a median of 0.229. The three urban based administrative regions of Addis Ababa, Harari and Dire Dawa top the list with HDI values exceeding the national HDI of 0.236 for 1994 by 106 per cent, 52 per cent and 21 per cent respectively. These three city governments along with Gambella and Tigray have

HDI values above the median. Gambella's HDI at 0.286 not only exceeds the national average but is also the highest of the non-city based regional governments. This may come as a surprise to many because of its being perceived as the least privileged. The relatively high rank for this seemingly deprived region is due to its having the second highest (next to Addis Ababa) life expectancy, the highest adult literacy and combined gross enrollment from among the non-city based governments (see Table IV.3 for details).

Five of the 8 non-city based regions have an HDI less than the national average, Afar being the least privileged with a value of 0.182 or a fifth less than national average followed by Benishangul Gumuz at 0.199.

2.4. Incidence of Poverty

A low value of HDI is a strong indicator of the level of poverty in a country. Poverty is a relative measure and varies within a country overtime or among countries at a given time. In attempt at measuring poverty in a country, the minimum income or expenditure that is sufficient to provide the most essential commodities for survival are identified and valued. This income is defined and taken as the border between those who are poor and those who are not, and is known as the poverty line.

A World Bank study in 1992 defined Birr 244 per month for a family of five as the poverty line and concluded that of the 6.9 million urban residents, 4 million or 58 per cent were poor, since they were earning/spending an amount which was less than the datum. A study by the Ethiopian government in 1992 estimated that 52 per cent or 22.4 million people were either suffering from chronic poverty, (29 per cent) are vulnerable to poverty (17 per cent) or were poor because of their style of life, mainly nomads.

These results were not significantly different from those obtained in earlier periods. A study of rural household income, consumption and expenditure survey by Central Statistical Authority in 1981 established that the per capita expenditure of the 75 per cent of the rural population was only Birr 460 per annum or less than 40 birr per person per month. A 1982 ILO/JASP mission study estimated that about 63 per cent of the urban population were earning an income below 100 birr per month.

Table IV.3
Regional Indicators of Human Development

REGION	Life expectancy at birth	Adult literacy Rate	Combined gross Enrolment Ratio	Real ^a GDP Per capita (PPP\$) 1994	Life expectancy index	Education index	GDP index	Human Development Index (HDI) 1994
Ynec	1994	1994	1994					
Tigray	49.6	20.47	32.74	430	0.410	0.246	0.055	0.237
Rural	49.5	13.68	21.18					-
Urban	49.9	57.20	94.04					-
Afar ^b	50.3	7.28	6.16	430	0.422	0.070	0.055	0.182
Rural	n.a	3.13	2.04					-
Urban	n.a	53.81	71.47					-
Amhara	50.8	17.79	13.52	430	0.430	0.164	0.055	0.216
Rural	50.7	12.95	6.49					-
Urban	53.6	61.79	80.0					-
Oromiya	50.4	22.40	17.93	430	0.423	0.209	0.055	0.229
Rural	50.0	16.41	10.74					-
Urban	55.3	68.05	77.5					-
Somali ^b	54.8	7.96	5.05	430	0.497	0.071	0.055	0.207
Rural	n.a	4.61	1.49					-
Urban	n.a	27.97	5.05					-
Benishangul-Gumuz	46.8	17.74	17.92	430	0.363	0.178	0.055	0.199
Rural	46.5	13.85	13.54					-
Urban	51.6	60.67	75.79					-
SENNP	48.6	24.44	22.89	430	0.393	0.239	0.055	0.229
Rural	48.3	21.09	16.9					-
Urban	54.0	67.31	76.21					-
Gambella	54.2	29.33	36.77	430	0.487	0.318	0.055	0.298
Rural	54.7	21.24	26.57					-
Urban	51.4	67.95	95.61					-
Harrari	51.4	54.54	65.76	430	0.440	0.583	0.055	0.359
Rural	48.6	12.16	10.47					-
Urban	57.2	79.61	110.39					-
Addis Ababa	58.4	82.52	90.06	430	0.557	0.850	0.055	0.487
Rural	51.7	36.91	30.78					-
Urban	58.6	83.06	90.85					-
Dire Dawa	51.1	51.53	53.49	430	0.435	0.522	0.055	0.337
Rural	53.3	4.99	2.0					-
Urban	49.9	70.26	82.76					-
Ethiopia	50.7	23.35	20.5	430	0.428	0.224	0.055	0.236

Source: UNDP, Human Development Report 1998 Ethiopia UNDP, Addis Ababa. Appendix 2:71

^a National figure is taken for all regions due to lack of regional data

^b Figures for Afar Region are backward projected from July 1996 to October 1994.

^c Figures for Somali Region are backward projected from September 1997 to October 1994.

Table IV.4
Incidence of Poverty in 1992/1993 (millions)

Source	year	Area	Population	Poverty index	Number of poor
World Bank	1992	Rural	42.9	53.6	23.0
		Urban	6.9	58.0	4.0
Government		Rural	42.9	51.7	22.2
		Urban	7.6	63.0	4.8

Source: Getahun 1998: 4.

Such an extreme poverty arises from either lack of something and/or occurrences. The lack of something refers to lack of asset, employment opportunities, income, skill, education, health etc. The occurrence dimension refers to land degradation, deforestation, drought, civil war, etc. It is either one or some combination thereof that renders people poor.

3. EXPLAINING THE LOW LEVEL OF HUMAN DEVELOPMENT IN ETHIOPIA

As pointed out earlier, the HDI is derived from the three indicators of real GDP per capita (PPP\$), life expectancy and literacy. The fact of low HDI reflects the low level of these indicators, and this poses the greatest challenge to policy makers. This is very much appreciated by the Ethiopian government. In his forward to the recently released report on the poverty situation in the country, H.E. Ato Girma Birru, The Minister for Economic Development and Cooperation, stated that "for developing countries, development mainly constitutes... poverty reduction. Accordingly, the development policies and strategies of the [Ethiopia] government have accorded priority focus to the improvement of the people's well being, especially of those who live in rural areas". This sensitivity of the Minister is reflected in the economic policies and more so in the agriculture development led industrialization (ADLI) policy of the government, a framework that is critically examined in the later chapter of this report.

The three components of HDI are low on account of low levels of economic, education and health indicators. These would be looked into briefly in this chapter, although each of them will be discussed in later chapters in more detail.

3.1. Economic Conditions

According to the recently issued report on the poverty situation in Ethiopia, a new per capita income in Ethiopia² is estimated at Birr 1088 or US\$167 per annum for 1995/96.

Table IV.5
Per Capita Income/Expenditure by Area of Residence 1995/96

Area	In Birr	In US \$
Urban	1,411	217
Rural	1,035	159
National	1,088	167

Source: MEDaC, Poverty Situation in Ethiopia. February, 1999 table 2.

Urban residents' per capita income exceeds rural per capita income by 27% and the national average by 23%.

Disaggregation of the national average into its regional constituencies provides interesting insights as shown in the following table.

According to these figures, Tigray is the poorest region in the country with per capita income of Birr 904 or 83% of the national average, while Addis Ababa is the richest with a per capita income of Birr 1569 which is 44% higher than the national average. In fact all the urban based entities i.e. Addis Ababa, Dire Dawa and Harrari have per capita income exceeding the national average.

A rather surprising statistics is the per capita income of Gambella which has the highest of the non-city-based regions and 13% higher than the national average.

The four regions of Tigray, Amhara, SENNP and Benishangul and Gumuz accounting for 52% of the population have a per capita income less than the national average.

² Ministry of Economic Development and Cooperation, Poverty Situation in Ethiopia (Addis Ababa) February 1999.

Table IV.6
Geographic Profile of Per Capita Income/Expenditure 1995/96

Region	Per Capita income/Expenditure	
	In Birr	In US \$
Tigray	903.6	139.0
Amhara	917.2	141.1
Southern Region	945.5	145.5
Benishangul Gumuz	1026.8	158.0
Afar	1105.6	170.1
Somali	1166.4	179.4
Oromiya	1184.0	182.1
Gambella	1223.5	188.2
Dire Dawa	1397.1	214.9
Harrari	1459.7	224.6
Addis Ababa	1569.0	241.4
National	1087.8	167.4

Source: MEDaC 1999 Table 23.

3.2. Patterns of Expenditure

Investigation on the patterns of expenditure evidence wide variations. The MEDaC Report on Poverty situation in Ethiopia indicates that 60% of income is spent on food at the national level (Table IV.7). The World Bank³ estimates the proportion of income expended on food in the rural areas at 75% of income.

Table IV.7
Per Capita Food Expenditure

Area	Per Capita Food Expenditure	%	Implied Per Capita Income	Reported Per Capita Income
Rural	576.8	60.2	958.14	1035.0
Urban	789.7	56.1	1407.66	1411
National	606.6	59.5	1017.79	1088

Source: MEDaC 1999 Table 2.2 p. 9. The Implied per capita income is authors' calculation and is obtained calculating by 100% income using the percentage and actual expenditure on food out of total income while reported income is from MEDaC 1999 table 2.1 p. 9.

³ World Bank, Ethiopia: Social Sector Study (World Bank, Washington D.C.) 1998.

Despite the different environment on which these studies reflect, both source confirm the very large share of expenditure on food, a typical pattern in poor countries and confirming Engle's law which establishes an inverse relationship between income levels and expenditure on food.

Furthermore, and the high proportion of expenditure on food notwithstanding, both reports confirm the less than the minimum necessary average calorie intake of Ethiopians. The MEDaC Report (p.11) estimates a daily calorie intake of 1938 Joules per day or 90 per cent of the required minimum, while the corresponding figures for the urban and national are 2050 and 1954 respectively.

The World Bank (1998) report provides information that depicts the stark realities of poverty in rural Ethiopia. Of the 75 per cent of the expenditure spent on food in the rural milieu, more than half (53%) of the food consumed is obtained by cash purchase, while the balance comes from subsistence production. The remaining 25% of income/expenditure is spent on seven rural household items of clothing (8%), ceremonial and contributions (6%), medical expenses (2%), schooling (less than 1%), transport (2%), household durable and building (2%) and other expenditures (4%) (p.20).

Two features of the findings that warrant commentary on the pattern of expenditure are the proportion of food sourced from own production and the relatively high proportion of expenditure on ceremonials and contributions.

The fact that rural residents in Ethiopia accounting for no less than 85 per cent of the population and mainly, if not exclusively, engaged in agriculture depend on own production for 47 per cent of their food requirements and purchase the remaining 53 per cent, is indicative of the very low level of agricultural productivity and the importance of non-farm activities as a major source of income. In other words the peasant farmers cannot, on average meet even half of their food requirements let alone feed the nation and provide resources for the development of the non-agricultural sector, and more so the manufacturing industries.

These findings have important policy implication. If poverty is to be reduced and national development is to be stimulated, the country has no option but to focus on agricultural development. The government's policy of agriculture-led industrial development (ALID) strategy is endorsable to the extent that its execution will lead to the development of the rural sector through increased agricultural productivity and thereby reduce poverty of the rural population. Despite the rhetoric, the success of this approach remains questionable, not because the idea is not appropriate but mainly because of institutional (such as the land issue) constraints, its failure to curtail the participation of the peasantry,

and mechanistic implementations (such as insistence on the use fertilizers, improved seeds etc. that are in any case too small to make a difference, even if appropriate). The weaknesses of the ADLI strategy will be discussed in a later chapter.

The relatively high expenditure (6% of household expenditure) on ceremonies may be suggestive of an inappropriate use of income and more so when compared to expenditure on education (less than 1 percent) and medical expenses (2 per cent). While one should not discount the heavy weight tradition and culture impose on the lives of rural Ethiopians, a rational behavior born of terrible episodes of disruptions in normalcy due mainly to drought, and the need to maintain healthy body as well as investment in the education of their children, such a relatively heavy outlay on ceremonies, nevertheless, seem to require rectification.

3.3. Non-Economic Indicators of Quality of Life⁴

While economic parameters are important indicators of the quality of life in a country, they are nevertheless insufficient to provide the whole picture on the stance and status of the level of human development. Two additional indicators required for this purpose are literacy and health. These two variables impact significantly on human development through their effects on productivity, sustainability and empowerment. This section would look at the balance sheet of these two important components of human development in Ethiopia, a topic that would be dealt with in more detail in the next chapter.

3.3.1. Literacy

Literacy is one of the indicators of human development since it is a means by and through which members of a society are enabled and empowered to effectively participate in the development process. Extensive (covering a larger proportion of the population) and intensive education correlates with higher incomes, and higher qualities of life including better health, longer life span, lower mortality etc. Although a society acquires its literacy and skills through various means, including adult literacy drives and the regular educational system catering to its younger population, the former has been marginalized under the current regime, rendering the latter the more and only significant source of formal knowledge and know-how.

⁴ This section draws heavily from World Bank, Ethiopia: Social Sector Review (World Bank, Washington D.C.) 1998.

Despite the introduction of a new educational system based on (Ministry of Education 1996)⁵ the kindergarten; eight years of primary; and two cycles of secondary, each of two years duration and diversified tertiary levels; the discussions in this section would be based on the partly discarded set-up of the kindergarten (4-6 years), six years of primary, two years of junior secondary, 4 years of senior secondary and the tertiary system.

According to the findings of the World Bank which reviewed the status, achievements and shortcomings of education in Ethiopia, the gross enrollment ratio in 1996/97 was 29% at the primary level (which was less than half the Sub-Saharan average of 72%), 19% at the junior secondary level, 9% at the senior secondary level and less than 1% at the tertiary level.

There are significant rural and urban differences; primary education is almost universal in Addis Ababa and other urban areas while gross primary enrollment in rural areas is only 18 percent.

Regional disparities in enrollment are extremely wide: Gross primary enrollment in Afar region is 9.1 percent. At the other extreme, it is 53 percent in Tigray (greater in its cities) and 90 per cent in Addis Ababa.

Gender bias is marked. Only 24 per cent of girls are at primary school level compared with 33 per cent of boys.

Adult illiteracy is very high at approximately 65 per cent of adults above 15 years, compared with 53 per cent for all of Sub-Saharan Africa.

Household expenditures on education have very low elasticity, ranging between 0.1 and 0.4 (compared with 1.1 in South Korea, for example).

Internal efficiency of the educational system is low; the drop-out rate between grades 1 and 3 is 22 per cent, the average repetition rate for all primary grades is 11 per cent.

The teacher-student ratio is low at 1:33, but varies substantially by region, ranging from 1:21 in the Somali region to 1:51 in Addis Ababa.

⁵ Source: Ministry of Education, Education Sector Development Program (1997-2001) Addis Ababa, Ethiopia, October 1996.

Facilities and equipment in surveyed schools are in poor condition or nonexistent: only 24 per cent of surveyed schools have desks in good condition; only half have library facilities.

Rural household responses in a sub-sample survey conducted by Addis Ababa University revealed that⁶

The primary reason (46 per cent of respondents) for not enrolling rural children 6-12 years old is that parents and teachers consider them "too young". Since age in years is not a commonly used concept in rural areas, this response probably means that children are considered too small to walk to the nearest school, reflecting the stunted physical stature of more than 60 per cent of Ethiopia's children caused by mal-nutrition in early childhood.

The second most important reason given (nearly 30 per cent) for not enrolling children 6-12 years of age was that children are needed for farm work (for boys) or housework (for girls). This was the primary reason given by 55 per cent of respondents concerning children 13-18 years old.

Education is perceived to be worthwhile only if the child can go to secondary school and ultimately gain formal sector employment in a city. The value of education in the traditional farm setting is not high, since less than half of the respondents agreed that boys who go to school are better farmers than boys who do not.

There is mixed evidence on the impact of the direct cost of education and of distance to school on enrollment. Respondents did not list either as a primary reason. However, when combined with other determinants of schooling in the statistical analysis, distance to school is correlated with low enrollment in rural areas (where the average distance to primary school is 2 kilometers and to a secondary school is 20 kilometers). Long distances also cut into the time that children are required to spend on house and farm work. Also, although government schools do not charge tuition fees, parents spent, on average Birr 24 per year per child (excluding clothing) in rural areas. While this is not high compared with other countries in the region, many low-income families with an average of 4-5 children in each household may find it difficult if not impossible to send all of their children to school at the same time.

⁶T. Teferra, M. Gebreselassie, Z. Fekadu, and A. Ahmed (1996), *Access to and Supply of Education Facilities and Services*. Institute of Educational Research (IER), Addis Ababa University.

It is expected that the rapid population growth will thwart the government's efforts to close the gap between boys and girls school enrolment. Moreover, the limited supply of teachers will prevent the immediate enrolment of all school-aged children at the primary level. The low enrolment ratios at the secondary and higher levels will have a profound impact on the quality of the labor force in the country.

To the extent that the young and the adolescents do not go to school and gain the necessary knowledge, progress in human development will be slow. In particular and when the school non-attendance is accompanied by poverty, unemployment, and overcrowding, an increasing trend in the level of illiteracy would have a negative impact on the productive capacity of the people and significantly broaden and deepen the vicious circle of poverty.

3.3.2. Health¹

The nation's health profile does not paint a rosy picture. The briefs in this section and the details in Chapter 3 depict the reality.

Ethiopia has a heavy burden of disease but a low rate of self-reported illness and low health facility coverage and utilization.

Of 1.90 million children born each year, 230,000 (12 per cent) die before reaching their first birthday; another 160,000 (8 per cent) die before their fifth birthday.

Major causes of death in infancy and early childhood are acute respiratory infection (ARI), diarrhea, nutritional deficiencies and measles. These account for 80 per cent of deaths of children under age 5.

The total burden of disease in Ethiopia is 350 discounted life years (DLY's) lost per 1,000 people, compared with 170 in Kenya and 230 in Tanzania.

The top 10 killers, which account for 75 percent of all deaths, include perinatal-maternal conditions (17 per cent), ARI (14 per cent), malaria (14 per cent), nutritional deficiency for children under 5 (8 per cent), diarrhea (8 per cent) AIDS (7 per cent), and tuberculosis (5 per cent).

¹ This section draws heavily from World Bank, Ethiopia: Social Sector Review *ibid*.

There is wide regional variation in the burden of disease: AIDS accounts for 18 per cent of DLYs lost in Addis Ababa but only 6 per cent in Amhara region; ARI accounts for 17 per cent of DLYs lost in Oromia but only 6 per cent in Dire Dawa; malaria accounts for 11 per cent in Benishangul but only 3 per cent in Dire Dawa.

ARI, diarrhea, measles, and nutritional deficiencies are the major childhood diseases, while malaria, tuberculosis and AIDS are the major adult diseases. Nearly 17 per cent of deaths are women who die from pregnancy and childbirth related complications. In rural areas, for every three people who report illness, five people report chronic disability.

The rate of self-reported illness ranges between 18 days per year per person (episodic illness only) and 40 days per year per person (including chronic disability). The rate of episodic illness is low not only in comparison with other countries, but also in comparison to the situation in Ethiopia about 15 years ago, when, on average, reported illness was 30 days per person per year. It is highly unlikely that health status has improved in the last 15 years and this apparent decline may therefore be attributed to a phenomenon often observed in poor countries where people tend to report less sickness because, unfortunately, they are used to being sick.

Of those reporting illnesses, only about 50 per cent seek treatment. The rural survey cited high cost of treatment, distance to health providers, and poor quality and unavailability of drugs and trained providers as the most common reasons for not seeking treatment. The average number of visits to government health facilities is low; 0.25 per person per year compared with 1.0 for Sub-Saharan Africa.

A statistical analysis of the factors that determine whether a person seeks treatment ~~or~~ not indicates strongly that distance to a facility is an important factor, particularly in rural areas. A reduction of 1 kilometer in the distance to a facility would increase the probability of treatment by 2 per cent. In rural areas; nearly 80 percent of the population lives more than 4 kilometers from a health facility; about 50 per cent lives more than 11 kilometers away. Much of Ethiopia is characterized by rugged terrain and little or no public transportation, and therefore even a relatively short distance can be difficult to traverse.

There is only one health station for every 23,000 people (compared with 1 for every 8,000 for Sub-Saharan Africa) and one health center for nearly 300,000 people.

There is one doctor for every 35,000 people (compared with 1 for every 10,000 in Sub-Saharan Africa), 63 per cent of all doctors are located in Addis Ababa.

Poor facilities characterize the public health system. There is 1 hospital bed for every 5,000 people, 1 x-ray machine for every 500,000 people, and 1 HIV screening center for every 800,000 people. Of 89 hospitals only 41 have operating theaters, to serve a population of 54 million people.

The quality of services offered is poor. Surveys showed that about half the facilities had no supply of antibiotics (this is a measure of quality).

With distance and income being held constant in regression analysis, an individual's educational status has a strong influence on whether he or she seeks treatment. Both primary schooling and post primary education increase the probability of seeking treatment.

Overall, females tend to report a higher incidence of illnesses than did men, particularly those over 10 years of age. At the same time, however, mothers' education has a strong impact on whether treatment is sought. It also has a strong impact on whether a child is immunized and on the nutritional status of young children in general.

Ethiopians use a wide variety of health service providers, across income groups. Pharmacies and drug vendors, both predominantly privately owned are utilized by 25 percent of the poor and 11 to 18 per cent of the other income groups. Health posts, centers, stations, and hospitals, mostly government owned, are used by 52 per cent of the poor and about 50 per cent of the other income groups. Richer households tend to use hospitals more, while the poor use the lower-level facilities. About 14 per cent of the health stations are owned by NGOs, mainly religious missions, and about 5 per cent by other private owners.

Until recently, government health expenditures were biased toward hospital-based curative services in urban areas. Curative services constituted almost 80 per cent of total government health expenditures in 1994. As a result, coverage rates for most disease prevention and control programs have been low. In 1995, less than 20 per cent of pregnant women received antenatal care (compared with over 60 per cent in Sub-Saharan Africa). Only 25 to 30 per cent of children were immunized. Through most of the 1980s, the share of personnel costs in health costs increased, reaching 65 per cent of the health budget in 1990. This increase came at the expense of spending on drugs and facility maintenance.

Since 1992 there has been a gradual but significant reorientation of the government health budget toward facilities outside of Addis Ababa, away from hospitals, and toward increased purchases of supplies. A large share of the increased spending has gone to

drugs, and the proportion of salary costs has declined to 53 percent, yet, most facilities report shortages of supplies.

The high level of malnutrition in Ethiopia are among the most serious determinants of the well-being of the population; poor nutrition undermines child development, the cognitive abilities of schoolchildren, and the productivity of the workforce.

Rapid urbanization associated with the spread of slums and squatter force thousands of dwellers to live in overcrowded and unhygienic conditions. Such settlements are breeding grounds for infectious, respiratory as well as contagious diseases as they have acute shortage of clean water and sanitation.

The water and sanitation coverage in Ethiopia has been very low. Water coverage for urban areas is higher than that for rural. Sanitation coverage is worse in rural areas.

3.3.3. Nutrition

The serious malnutrition of the Ethiopian population are very well documented and are serious causes of concern. In part the high incidence of ill-health can be attributed to the very low levels of nutrition. The World Bank's study on the social sector summarizes its findings as follows.

Protein-energy malnutrition measured by stunting (low height compared with standard height for age) affects 5 million children under five years old.

Between 1983 to 1996 the rate of stunting rose from 60 per cent to 64 per cent.

The number of children currently affected by wasting (very low weight for height) is estimated at 470,000 and is responsible for the high infant mortality rate.

Nutritional deficiencies account for 7.8 per cent of all deaths (50 per cent under age 5), and 9.3 per cent of DLYs lost. Taking into account the interaction of nutritional deficiency with other childhood diseases like measles, ARI and diarrhea, the total and indirect contribution to mortality is 29 per cent.

In terms of micro nutrient deficiencies, findings are as follows:

- Iodine deficiency disorder (IDD) affect 10 million people. 71 per cent in some regions and 31 per cent among schoolchildren. The deleterious effect of IDD on

pregnancy outcomes are severe: about 13,600 neonatal deaths yearly, 14,800 still births, and 20,000 miscarriages.

- Vitamin A deficiency, manifested in blindness (Bitot spot), affects 1 per cent of children under 5, compared with the 0.5 per cent level maximum set by the World Health Organization. Recent survey indicates that 5 million children under age 6 show subclinical manifestations of vitamin A deficiency, which could lead to blindness.
- Anemia affects two-thirds of women of reproductive age and is partly responsible for the very high maternal mortality, ranging from 450 to 1,540 per 100,000 births.

The rural surveys show that protein-energy malnutrition (PEM) measured by low BMI (body mass index), affects 25 per cent of the adult working population. The impact on agricultural productivity is likely to be high since agriculture in Ethiopia is based on manual labor. Loss of agricultural output due to poor nutrition in the labor force is estimated at about 10 to 15 per cent of agricultural production.

These specific findings of the World Bank as well as studies by government departments and research institutions are instructive in the identification of the cause of low human development and are suggestive of the policies that are needed to emancipate the people from the poverty trap. This chapter has shown that the most important factors explaining low human developments are very low per capita income, low levels of education and health services; as well as poor nutrition. These would be discussed in more detail in the next chapter dealing with education and health.

EDUCATION AND HEALTH IN ETHIOPIA*

1. INTRODUCTION

If, from the inputs to growth and development that include capital, labour and land one is to pick the most critical factor of production, labour must, undoubtedly, head the list. It has long been accepted that a development policy and strategy that acknowledged physical capital as the most critical factor of growth and development was wrong and that countries such as Ethiopia that failed to pay heed to the development of their human resources are now paying heavy price. The need to focus on human capital as the most critical input in the development process would grow more acute in the knowledge driven economy of the 21st century. It is therefore necessary to have a well-focused and targeted human resource development strategy.

Simply stated, the era of cheap and unskilled labour endowing a country with a comparative advantage over those that lacked it is history and has in fact become a burden. The economic history of those countries that have successfully negotiated their way through the intricate path of development conclusively shows that human capital is the quintessential key to their transition from poverty and backwardness to affluence and the cutting edge of technology. While investment in physical capital is important, countries would need to have people who are healthy and sufficiently skilled to man it, repair it when it malfunctions, and adapt it to and develop an alternative and appropriate technology. Although some of these functions can be "learned by doing", skills of these nature are not powerful enough to endow the nation with dynamic and appropriate technological base to lead it through the difficult maze of development and locate it on a path of a self-sustained growth trajectory.

While the last chapter focused on the state of literacy (with emphasis on formal education) and health, this chapter would go over the same terrain from the institutional perspective. Accordingly the chapter looks at what the government and the private sector are doing to alleviate the problems and constraints facing these two important components of human development.

*The editors would like to express their indebtedness to Ato Getahun Tafesse's background paper on which this chapter is largely based

2. EDUCATION

Although modern education was introduced into the country about a century ago, it has yet to generate sufficient inertia to spearhead the nation's development. This failure is mainly due to capacity limitations to accommodate demand as well as the relevance of the curriculum to the realities and development problems of the country.

Recently a new and wide-ranging education policy has been drafted and put in practice. The changes and reforms undertaken include among others, the decentralization of the management of education, curriculum reform and changes in the educational structure. More over, the new paradigm acknowledges the importance of the private sector and invites their participation in the provision of educational services. Although the initiative of the government partnering with the private sector in the provision of this critical service is a move in the right direction, its effective implementation has been thwarted by constraints beyond the control of prospective investors.

The second area of reform is in educational administration. In the past education management had been highly centralised, with the Ministry of Education being involved to the lowest level in all parts of the country. The school system until recently was structured with primary education representing grades 1 to 6, junior secondary education grades 7 to 8 and senior secondary grades 9 to 12.

Many schools throughout the system are dilapidated because of long neglect and damage. Low and declining quality has been a problem leading to high dropout and repetition rates, especially for girls. The poor performance of primary schools was linked to the lack of adequate teaching materials, inadequate teacher training and motivation, and a curriculum that failed to distinguish between regional, cultural and linguistic diversities.

But the most critical issue and one that needs immediate attention is the conspicuous lack of purpose and objectives of education. With emphasis on academic training, the system has failed to produce graduates endowed with skill and knowledge to help them cope in the real world and render them useful to themselves and to the nation at large. We would want to reiterate the fact that the educational system in the country are developing into a major source of the unemployed and unemployable people.

2.1. Quantitative Indicators

The education sector in Ethiopia is beset by a number of problems, not least of which is capacity limitation. Indeed, access to education is very limited. According to MEDaC statistics¹, for example, only one out of four primary school age children are in primary school and that three-fourth of school age children do not go to school. Furthermore, secondary education is accessible to less than two out of ten youths, while tertiary education is open only to a small fraction of those who have completed secondary education. This is very alarming, especially considering the implications to the future manpower needs of the country and relative to the knowledge driven economy of the 21st century.²

This dismal picture of manpower development capacity is depicted in Table V.1 which shows trends in primary and secondary school enrollment over the period 1986/87 to 1994/95.

Primary school enrollment declined both in absolute terms and as percent of school age children continuously. In absolute terms it declined from a high of 2.9 million in 1987/88 to 1.9 million in 1992/93. The proportion of school age children attending school declined from 35 per cent to 18 per cent receptively. Starting in 1992/93 enrollment has reassumed the positive trend, although it has yet to catch up with and surpass the level achieved under the previous regime.

Table V.1
Trends in Primary and Secondary School Enrollment in Ethiopia,
1986/87-1994/95.

YEAR	PRIMARY ENROLLMENT		SECONDARY ENROLLMENT	
	LEVEL	RATE	LEVEL	RATE
1986/87	2,736,517		742,300	
1987/88	2,884,033	35	842,700	17.1
1991/92	2,063,635	20	775,200	11.2
1992/93	1,855,638	23	712,489	9.2
1993/94	2,283,638	29	714,145	15.4
1994/95	2,722,192		747,146	

Source: Compiled from MOE Annual Basic Education Statistics (various years)

¹ MEDaC 1997. A Report on Human Development in Ethiopia (MEDaC, Addis Ababa)

² World Bank 1998. World Development Report (Oxford University Press for the World Bank)

As shown in Table V.2, the number of schools at different levels has generally been rising during the last decade. The slight decline in number of schools observed in 1992/93 is largely due to the exclusion of schools in Eritrea, which seceded from Ethiopia in 1992. Although the number of schools have increased right through the last years of the past regime a significant number, and particularly those in the proximity of active war zone, were not operational. This partly explains why enrollment declined during this period.

Table V.2

Number of Schools (Government & Non-government) by Level of Schooling

	1986/87	1987/88	1991/92	1992/93	1993/94	1994/95
Primary	7839	8373	8434	8120	8674	9276
Junior Secondary	991	1064	1149	1099	1167	1230
Senior Secondary	258	272	284	279	303	330
Total	9088	9709	9867	9498	10144	10836

Source: Annual Education Statistics (MOE, 1994, 1995 & 1996)

On the other hand, school construction at different levels increased rapidly during and after the transition period, but this has not been matched by a similar growth in enrollment. Although anecdotal explanations abound, including the negative impact of the change to local language as the medium of instruction and disenchantment with education, particularly in the rural areas, the reasons for the slow growth in enrollment during the post transition period are not clear and need further investigation.

Other problems relating to the education sector include:

- a) Low Literacy Level: More than seventy-five per cent of the population are illiterate. The overall literacy rate in 1996 was 23 per cent³.
- b) High dropout and repetition rates: Both primary and secondary schooling have shown high drop out and repetition rates. Student drop out rates at primary level actually increased rising from 29.1 per cent in 1987 to 29.6 in 1991, declining to 26.5 in 1992 but jumped to 38.2 in 1993⁴. At a national level, 9.2 per cent of primary school students in 1994/95 were repeaters⁵.

³ MEDAC, Welfare Monitoring Unit, 1997.

⁴ MEDAC, 1997 Ibid.

⁵ PHRD, 1996.

- c) Limited access to tertiary level education: Although the priority concern in the country is on expanding basic education, the capacity at tertiary level is also worrisome. The annual pool of high school completers is very large compared to the capacity available at tertiary level. As a result, thousands of high school graduates annually become unemployed failing to continue their higher education or access productive employment. This is mainly because the national capacity at the tertiary level does not accommodate more than 10% of the student population that completes grade 12 annually.

The conclusion that emerges from this, albeit sketchy, statistics are that an educated and skilled manpower development capacity of the country is very inadequate and is distressing for a number of reasons: 1) The existing labour force is mainly unskilled and less productive and can hardly contribute to fast economic growth. 2) At the same time, the majority of children do not go to school and the future size of the illiterate labour force is likely to continue to grow proportionally. The human resource situation of the country is thus beset with short and long term problems

2.2. Quality of Education

In discussing education, it is important to look into its effect on production and its capacity of empowering the beneficiaries through acquisition of knowledge, sharpening their cognitive skills and the extent to which their motivation for achievement is nurtured. In turn this requires an analysis of the quality and relevance of education students are made to absorb in class relative to the pressing needs of the country.

As pointed out above, the education system in the country has for a long time been more a manufacturer of unemployed and unemployable cadre of students rather than skilled manpower. In the main the education that they are made to absorb in class are irrelevant and therefore unproductive. Some of the major factors behind this are elaborated on below.

Theory focused: The curriculum at all levels of schooling is loaded with theory and is not designed to link theoretical knowledge to practical real life problems. As in many developing countries, the students are getting general education when the need is for skill⁶. As Kirdar and Hag (1988) point out, this tendency is due to distorted priorities, and inculcating distaste for manual work and wrong incentives. Closely

⁶ Kirdar and Hag, 1988: Managing Human Development.

related to this, tutorial classes are not common. The linkage between the structure of education and the structure of the economy is also very poor.

Since the curriculum does not generate useful skills, enrollment even where schools are available tend to be low because households may prefer to keep their children on farms instead of sending them to school. However the low benefit and utility parents attribute to education is more a rural phenomenon. In the urban milieu, parents tend to consider education as perhaps the only escape mechanism from poverty and a means to a better future.

Lack of civic education: Civic education is not included in the education curriculum. Civic education is, however, required especially at primary level to bring up children who are well informed about their national identity, human rights, democratic issues, values and attitudes required to contribute to society's progress.

Lack of dynamism: The existing system of education lacks the capacity to develop openness, assertiveness and creativeness among students. A good example of this problem is reflected in teacher-student relationships, which tend to be stiff, paternalistic and fault-finding. In general, the schooling method is mainly a one-way instruction system allowing for little encouragement for the active participation of students.

Lack of Vocational and Technical Education: The level of competence of a country's workers and technicians is central to the flexibility and productivity of its labour force. Since the number of vocational and technical schools in the country is very low, productive manpower generation capacity is severely limited.

Other indicators of the low quality education are high pupil to teacher ratio, highly crowded classrooms and implementation of a shift system reducing time spent in schools and creating a burden on teachers. The average student-teacher ratios are 50:1 at primary and 40:1 at secondary levels with wide variations between regions⁷.

Apart from the limited availability of schools in terms of physical structure, a problem in the past has been a failure to address the needs of diverse ethnic, religious and linguistic groups in the country. Until recently, the language of instruction was Amharic which created some barriers to non-Amharic speakers. Students' achievement is hypothesized to be greatly enhanced when teaching is done in their mother-tongue as they are also more expressive and participate actively in the

⁷ PHRD 1996.

learning process when taught in a language they speak and understand properly. This problem has currently been addressed by adopting the local language as the medium of instruction. It however needs to be strengthened by the supply of adequate teaching and reading materials as well as teachers.

The limited expansion of the schooling system in the past was also due to near monopoly of the sector by the government. The suppression of the private sector in favor of cooperatives and socialization during the last regime prohibited the expansion of schools by private investors. Non-governmental schools mainly run by religious organizations are, however, better organized and provide a relatively better quality education, although they may not adequately address the diverse needs of students in the country. Missionary schools, for example, may not draw sufficient demand response in Muslim communities if their teaching includes morale and other Christian religion related topics.

The school calendar is also fixed throughout the country and may pose problems in some rural communities where farming activities coincide with the school calendar. For example, September, the beginning of the school year is an agriculturally intensive month in most rural communities, as a result of which parents may be pressed to keep children working on the farms.

Of the major problems identified above, the low level of enrollment rate and irrelevance as well as poor quality of education need to be urgently rectified if the sector is to serve as an agent and engine for social and economic development. ❖

2.3. The Regional Dimension

Low participation rates are further complicated by the prevalence of very big regional disparities. Although average national primary education participation has reportedly reached 26.4 per cent in 1996, actual distribution among and within the regions varies widely. More than half of the regions have enrollment figures far below the national average. Participation rates among the regions range from a high of 75 per cent in Addis Ababa to a low of 1.5 per cent in the Afar Region with wide difference's existing among zones and woredas within these extremes. In almost all cases, urban areas, and male students enjoy higher participation rates at all levels of the educational system.

2.4. Number of Teachers and Schools

The Education Sector Review produced by the PHRD project office in November 1996 underlines the urgent need to increase the number of teachers at all level of education. In 1994/95 there were 83,113 teachers in primary, 11,544 in junior secondary and 11,235 in senior secondary. Female teachers constituted 27% of the primary, 11.8% of the junior secondary and 8.5% of the senior secondary teaching force. Of the teachers deployed at the three levels, 6.3% of the primary, 11.6% of the junior secondary and 18.5% of the senior secondary school teachers were teaching in non-government schools.

However, the general impression is that the supply and demand for teachers in Ethiopia are often mismatched either in number, qualification or both indicating the lack of an appropriate education man power development strategy.

In terms of both enrollment and number of schools, primary schools constitute the largest component of the Ethiopian educational system. A total of 9276 schools catered for student enrollment that reached record level of 2.9 million in 1987/88, which declined to 1.9 million in 1992/93. This was mainly because of the intensified civil strife during the late 80's and more so in the early 90s. As the table below shows, the declining trend has been reversed since 1992/93. Primary school enrollment in 1994/95 reached 2.7 million, exceeding the 1991/92 figure by 21 per cent. The number of primary schools also increased at an average annual growth rate of about 7 per cent during this period.

Table V.3
Enrollment by School Level

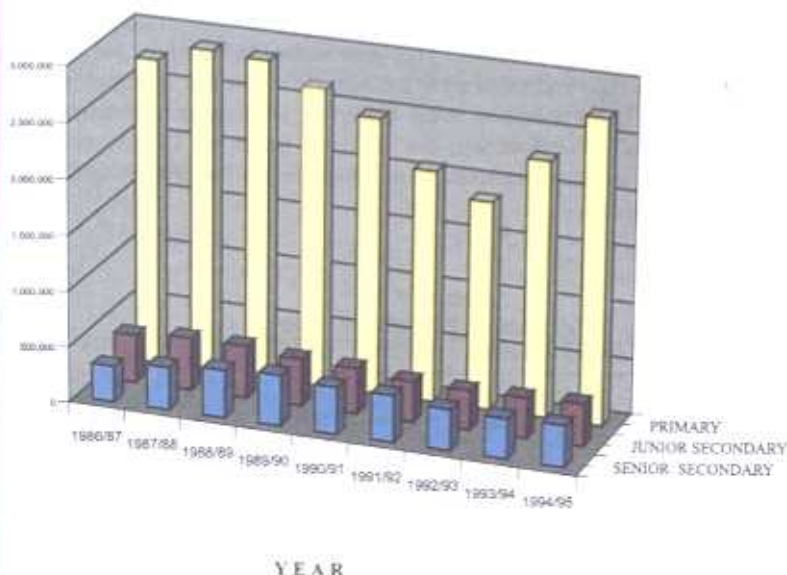
	1986/8	1987/8	1988/8	1989/9	1990/9	1991/9	1992/9	1993/9	1994/9
	7	8	9	0	1	2	3	4	5
Primary	2,736,517	2,884,033	2,855,130	2,952,214	2,456,454	2,063,635	1,855,638	2,283,838	2,722,192
Junior Secondary	424,046	464,016	464,463	415,496	404,861	359,111	348,803	357,428	376,230
Senior Secondary	316,305	378,734	426,413	451,766	416,062	416,062	363,686	357,194	370,916

Source: Welfare Monitoring Unit, MEDaC

There has been a favourable development in the share of school attendants, with primary school enrollment in the total school enrollment increasing from 73 per cent in 1991/92 to 79 per cent in 1994/95. Secondary school enrollment accounted for about 11 per cent of total school enrollment in 1994/95.

Level of enrollment at secondary level was the highest in 1988/89 reaching 890 thousand, but declined until 1992/93 when it reached a low level of 713 thousand. Since then enrollment has picked up although at a low rates of growth.

Fig. V.1 : ENROLLMENT BY SCHOOL LEVEL



2.5. School Enrollment Rates

In 1996 nearly 3.5 million students were enrolled in the education system, with 2.7 million in primary education and 747 in secondary education. There are gross disparities in these participation ratios among regions, among urban and rural areas, and across gender.

On the basis of this statistics, only one in four children of primary school age was enrolled at school. Less than one out of ten were enrolled in secondary education and one out of a hundred in tertiary education. The overall primary school net enrollment rate for the country was 21 per cent. Primary school enrollment rate for males was 24 per cent while females had an enrollment rate of only 18 per cent. The urban areas had a higher rate of enrollment level than rural areas. Overall primary school net enrollment for the urban areas was 68 per cent compared to 12 per cent for rural areas.

2.6. Repeaters

A study carried out by the Policy and Human Resource Development Project on the Education Sector Review in 1996 shows that country wide, rates of repetition in all grades ranged from 2 to 6 per cent. Repetition rates were higher in grades 1 – 3 and 7 – 8 than in other grades at 4 and 6 per cent respectively. Among the sexes more girls repeated grades 4 to 10 in both urban and rural residences. There were less girls repeating in grades 11 to 12 where the number of boys who were detained was almost four fold compared to that of girls in urban areas (see Table V.4 for details).

Repeaters at regional level and category reveal interesting insights. At the primary level, repeaters are higher in Afar, Benishangul and Amhara regions, with very high female proportion. At the junior secondary level Amhara, Oromia and Tigray top the list. At the senior secondary, Benishangul, and Harari have the highest proportion with heavy girl repeaters of as much as half and third respectively.

It is also interesting to note that the number of repeaters is positively correlated with advancement in class and category. Total repeaters increase from primary (lowest) to junior secondary and senior secondary (highest). For girl students the rate of increase is higher at all levels.

Table V.4
Repetition Rates by Rural/Urban Residence and Sex

Urban/Rural and Gender	Percentage of Students who Repeated Grades				
	Grade 1 - 3	Grade 4 - 6	Grade 7 - 8	Grade 9 - 10	Grade 11 - 12
Rural					
Male	4.24	1.29	5.54	-	-
Female	3.78	2.62	9.67	-	-
Total	4.11	1.67	6.95	-	-
Urban					
Male	3.44	2.22	4.21	2.71	5.09
Female	3.98	3.06	6.87	5.18	1.35
Total	3.71	2.66	5.68	3.99	3.07
Urban + Rural					
Male	3.96	1.80	4.64	2.25	3.76
Female	3.89	2.95	7.34	4.96	1.26
Total	3.93	2.30	5.99	3.56	2.55

Source: PHRD Study on the "Household Demand for Schooling" (PHRD 1996)

Table V.5
Regional Percentage of Repeaters by Level, 1994/95

Region	Primary			Junior Secondary			Senior Secondary		
	Boys	Girls	Total	Boys	Girls	Total	Boys	Girls	Total
Tigray	7.0	12.6	9.4	13.1	26.0	18.3	8.3	24.1	14.7
Afar	12.3	17.1	14.2	14.8	22.7	18.2	14.2	37.1	22.6
Amhara	9.6	12.7	11.2	16.4	25.7	20.9	11.8	24.5	17.7
Oromia	7.3	10.7	8.4	14.5	25.3	19.2	10.9	24.3	16.5
Somalia	8.2	12.6	9.4	12.0	26.7	16.4	11.3	27.7	14.6
Ben.-Gumuz	9.9	11.8	10.4	5.2	13.5	7.9	21.2	53.0	32.6
SENNP	6.0	8.0	6.6	11.6	19.9	14.2	10.4	20.2	13.8
Gambella	6.7	10.8	8.1	6.4	14.7	7.9	4.7	10.8	6.0
Haran	7.7	9.1	8.3	14.0	15.6	14.8	22.3	33.0	27.1
Addis Ababa	8.9	9.6	9.2	17.1	22.2	19.8	15.0	19.6	17.4
Dire Dawa	11.9	14.0	12.9	16.4	16.6	16.5	14.1	12.8	13.5
Total	7.5	10.8	8.7	14.6	23.5	18.5	12.2	22.3	16.6

Source: Ministry of Education, 1996

2.7. Dropouts

The same study reveals that a large number of students dropout from school for various reasons. Out of those who discontinued education, the majority (about 22 per cent) did so mainly due to opportunity cost of schooling, i.e. because they were tied up with work. This was followed by failing in exams (21 per cent), unable to afford going to school (6 per cent), because of perceived low utility of education (2 per cent) school too far (1 per cent).

Table V.6
Drop-out Rates by Rural/Urban Residence and Sex

Urban/Rural and Gender	Percentage of Students who Repeated Grades				
	Grade 1 - 3	Grade 4 - 6	Grade 7 - 8	Grade 9 - 10	Grade 11 - 12
Rural					
Male	31.18	18.90	25.33	13.03	22.01
Female	29.58	10.94	22.08	21.49	32.74
Total	30.72	16.64	24.23	16.03	24.08
Urban					
Male	9.46	7.14	14.44	16.97	10.40
Female	10.84	13.86	11.96	19.14	11.11
Total	10.17	10.63	13.07	18.10	10.78
Urban + Rural					
Male	23.55	12.52	17.98	14.23	13.45
Female	18.61	13.17	13.66	19.24	12.56
Total	21.65	12.80	15.82	16.65	13.02

Source: PHRD Study on the "Household Demand for Schooling" (PHRD 1996)

An important feature of the high rate of early departure from the system is that nearly half the number of children who enroll in grade one do not continue to grade two. This low rate of retention makes it hard to assess net annual increases in enrollments, which appear in some areas to be very high.

2.8. New Education Policies and Strategies

Following a change of government in 1991, a new education and training policy and strategy has been introduced and implemented. Elements of focus under the new policy and strategy are as follows:

- *Universal primary education: the expansion of the overall education system is stressed with particular emphasis on attainment of basic education for all;
- *Emphasis on civic education: Orientation of the schooling system is stressed to bring up citizens who respect human rights, equality, justice and peace, endowed with a democratic culture and discipline;
- *Focus on skill formation: the policy is designed to promote relevant and appropriate primary education and training to all, including the disabled, through formal and non-formal programmes to meet the demand for skilled labour;
- *Language of instruction: the policy recognizes the rights of nations and nationalities to be educated in their languages, while providing languages for national and international communication;
- *Orientation to development: emphasis is made to make education a supportive tool for developing traditional technology and for utilizing modern technology;

These restructuring and reforms of the educational system are necessary and welcome step to making it more responsive and appropriate to the needs of the nation. Most of the quantitative and qualitative problems discussed earlier seem to have been recognized and addressed in the new policy and strategy. However, policy intent and strategy formulation are the first and necessary measures but these need to be vigorously implemented if their intended impact is to be realized.

Some positive achievements made since the transition period are as follows:

Resource allocation: a singular signal of the government's commitment to the sector is an increase in public resource allocation. The share of expenditure on education relative to the total government expenditure increased from 9 per cent in 1990/91 to

14 per cent in 1995/96 and is expected to continue on the same trend in the years ahead.

Construction of primary schools: Mainly due to increased resource allocation to the sector encouraging results have been scored in the number of schools newly established in the last few years. On average, 550 new schools have been constructed on yearly basis since 1991. Only about 300 schools were constructed annually for a long period under the previous regime.

However, the construction of new schools has yet to be matched by teacher training facilities and the preparation of books and other training materials.

Salary adjustment and establishment of career hierarchy: The salary of teachers at different levels of the schooling system has been adjusted upwards. In addition, unlike in the past, different levels of promotional career that reflect teachers experience and capacity have been created which provide additional incentive to the teaching profession. These measures are likely to improve the morale of teachers and are expected to contribute to the improvement of the quality of education.

Curriculum upgrading: In line with the overall policy intent of making education relevant for practical development needs and formation of the right attitudes and values, new curriculum has been developed and is being tested on pilot phases. While the actual benefit and success of this measure can only be seen over the long-term, it is, however, a step in the right direction.

Addressing language barrier: As pointed out earlier, the medium of instruction at primary level has adopted local language throughout the country. This measure is likely to boost the morale of children and enhance their participation and knowledge formation.

Decentralized administrative structure: To this end the management and administration of education has been undergoing far-reaching changes. The management structure of education is being decentralized with the central government ceding more power and responsibility to regional governments. Educational institutions are expected to be autonomous and accountable to beneficiaries and society at large. Furthermore, the private sector is being invited to take part in the education sector, and is increasingly taking up the challenge.

Box V.1**Strategy Highlights**

- ❖ Curriculum preparation, implementation and evaluation based on Integration of education, research and development;
- ❖ Integration of education, research and development;
- ❖ Nationality language to be the media of instruction at primary level;
- ❖ Teaching of Amharic as a language of countrywide communication;
- ❖ Restructuring of education organization and administration in line with the decentralization measure and regionalization measures;
- ❖ Community participation in the management of schools;
- ❖ Autonomous functioning of educational institutions, especially at the tertiary level;
- ❖ Introduction of cost-sharing mechanisms;
- ❖ Special privileges to those who have been deprived of educational opportunities, and for women.

2.9. Major Problems that Still Need to be Addressed

*Extremely low participation rate: Seventy-five per cent of the children in the country are not attending primary school. The current level of primary school enrollment remains more or less at the same low level of enrollment achieved ten years ago.

*Newly created language barriers: The measure to introduce local nationality language as the language of instruction at primary schools is not, for example, matched by availability of teachers who are very well conversant with the newly adopted medium. There is also a conspicuous dearth of teaching aid, including books, to accommodate the new medium of instruction.

Ethnic minorities who do not speak the local language i.e. children whose mother tongue is different from the locally spoken language have engendered problems which requires attention. This has important implications for migration and diffusion of the population.

*Political intervention: Interference and interventions by local governments and political cadres in the administration and management of education are rampant and are likely to impact negatively on the teaching/learning processes. In particular the politically biased implementation of the incentive structure is very inimical to effective and active educational administration.

*Barriers to continuity of education: School drops out rates remain high especially for girls. In addition, high repetition rates are common features for both boys and girls especially at lower grade levels. This problem needs to be focused on.

The problem of continuing education at tertiary level is very grave. The capacity of universities and colleges are very low compared to the needs of the country and potential students who could join these institutions. Only a small percent of high school graduates are able to join tertiary level of education. The majority of the students, tens of thousands annually, discontinue their education and join the ranks of the unemployed not because they don't have the academic capability to study at tertiary levels but simply because the institutions do not have the capacity to admit them.

2.10. Structure and Curriculum

Up to 1994 the structure of the educational system comprised six years of primary, two years of junior secondary and four years of senior secondary. A new structure has been developed which is in the process of being introduced with the following set-up:⁸

- kindergarten for children aged 4 – 6;
- 8 years of primary education divided into two cycles of basic education (grades 1-4) and general education grades 5-8;
- general secondary education grades 9-10;
- senior secondary education grades 11-12;
- a technical and vocational stream, grades 11-12;
- higher education of 1-2 years for diploma and 3-5 years for undergraduate study.
- In addition a system of technical and vocational training parallel to the school education system are envisaged;
- adult education
- special education and
- distance learning.

⁸ Transitional Government of Ethiopia, 1994:14.

To change the curriculum from "academic" to "practical", the government has embarked on a program of reform, with the intention of expanding vocational and technical education.

2.11. Educational Resources

The government has introduced a new program of action, the Education Sector Development (ESD). Generally, overall ESD Program emphasizes improvements in the quality of education, and promotes a more equitable distribution of educational opportunities through out the country. It presents a five-year sector strategy and expenditure program and is designed to expand educational opportunities and is envisaged as a first step to achieving universal primary education by the year 2015. The program is set within the educational reforms (Education Sector Strategy) adopted in September 1994.

While recognising the need for a balanced development in the sector in order to achieve its goals, the emphasis for the immediate future has been placed on primary education. However, this approach requires extreme caution. In particular all the good work done at the primary level could be placed at risk if the graduates from this sector are not provided with follow-up and skill enhancing opportunities. Furthermore, the authorities must be very much aware of the danger of relapsing into illiteracy and therefor ensure a continuum of training and education.

2.12. Trends in Public Expenditure on Education

A shift in the pattern of public expenditure on education can be observed, reflecting the government's strong commitment to human resources development. There has been a notable increase in government expenditure on education since 1991/92. Total public expenditure on education more than tripled during the past decade, increasing from Birr 416.3 million in 1986/87 to Birr 1.34 billion during 1995/96. Although the education sector share of expenditure in GDP has risen from 2.8 percent in 1986/87 to 3.5 percent in 1995/96, it is still lower than most Sub-Saharan African countries, which allocate more than 5 per cent of GDP to the sector.

A breakdown of expenditure on education shows that current and capital expenditure claimed 84.2 per cent and 15.8 per cent respectively during 1986/87. This share changed significantly after a decade into 71 per cent current, and 29 per cent capital expenditure during 1995/96. Although both recurrent and capital expenditures on

education were generally increasing during the past decade, the share of capital expenditure in total education expenditure went up from 8.8 per cent in 1990/91 to 24 per cent in 1994/95 and nearly 30 per cent in 1995/96.

The Share of education expenditure in both total expenditure and GDP went down from 10.1 and 2.7 per cent, respectively, in 1986/87 to 9.2 and 2.5 per cent, respectively in 1990/91 due to the government's priority of financing the war. The shares was increased during recent fiscal years and rising to 15.0 per cent of government total expenditure and 3.5 per cent of GDP.

Another feature of the shifts in the pattern of expenditure in education is that recurrent expenditure on education has increased during the past five fiscal years, from Birr 443.8 million in 1990/91 to Birr 910.1 million in 1995/96. This is understandable and expected since investment in new educational facilities engenders running costs. It is also gratifying to note that while recurrent expenditure increased two-fold, capital expenditure over the same period increased more than ten-fold to address the urgent need to rehabilitate and reconstruct physical infrastructure which deteriorated badly during the civil war years as well as expand the educational infrastructure.

Table V.7
Education Expenditure as Percentage of Total Government Expenditure and GDP

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
EFY	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
As % of Total Government Expenditure	10.1	8.8	8.2	9.2	9.9	12.5	13	13.8	12.4	15.0
As % of GDP at m.p.	2.7	2.8	2.9	2.7	2.5	2.6	2.7	3.6	3.2	3.5

Source: Welfare Monitoring Unit, MEDaC

The total government budget for higher education more than tripled during the last five fiscal years, increasing from Birr 64.8 million in 1990/91 to Birr 201.4 million in 1995/96 in nominal terms. In real terms (deflated by using consumer price index at 1990/91 prices) the increase amounts to more than twice the 1990/91 allocation.

2.13. Key Recommendations in the Education Sector

While the intent and direction of the reforms the government has instituted is laudable and is on the right track, more needs to be done not only to expand the opportunities but further fine tune the curriculum such that it produces people with marketable skills at all levels-primary and particularly at the secondary levels.

Secondly, these intentions and reforms need to be translated into practice. This is the most difficult but necessary task, requiring resources, organizational and institutional capacity and dedication, attributes that seem to be in short supply.

One way to reduce the pressure on public resources is to open the sector to private investors at all levels of the educational stream – kindergarten to university. In this initiative the government should set minimum standard and ensure full compliance by practionaries. The current requirements are too stringent and are not met by any of the government schools. Second and equally important is the issue of getting land for building schools. Although the government promised to provide land for this purpose outside the lease system and on favorable terms and conditions, this has not obtained in practice. The two requirements of license and land acquisition are major constraints limiting private sector participation.

Thirdly the government must rethink its commitment to charge fees as a modality for cost sharing. This is critical in view of the poverty of the large mass of population and therefore affordability. The need to build up a minimum critical mass of highly trained manpower to kick-start and sustain a robust national development would have over-ride any cost consideration. In particular the expansion of private suppliers of education at all levels means that those who remain in the public institutions are those that cannot afford to join the high fees.

3. HEALTH

The government is major provider of health care in the country. Government involvement in the health sector is justified for various reasons, including limited information in and lack of health markets, externalities, non-existence of health insurance, and distributional concerns. Since both public and private sectors are involved, decisions have to be taken about public provision, public financing and regulation of the private sector to ensure efficient and equitable services to the population.

Available data indicate that the majority of ill health in Ethiopia is related to potentially preventable, communicable diseases and nutritional disorders. Low socio-economic status, poor environmental conditions and poor coverage of health and other social services have contributed to high morbidity and mortality profile. The low health status of the people is reflected in high infant mortality rate, which is estimated at 111 per 1000 live births and a life expectancy of the population of 52.8 years.

The governments a new health policy aims at decentralisation, of power, and development of an equitable, preventive and acceptable standard of health. The participation of the private sector and non-governmental organisations in the provision of health care services are also promoted and encouraged.

3.1. Health Profile

Some indicators of the generally poor health status prevailing in Ethiopia are presented in the Table V.8.

Table V.8
Major Indicators of Health Status in Ethiopia and Sub-Saharan Africa

Indicators	Sub-Saharan Africa	Ethiopia
Infant Mortality Rate	97/1000	111/1000
Child Mortality Rate	114/1000	161/1000
Maternal Mortality Rate	7/1000	10/1000
Life Expectancy	50	48
Access to Safe Water	51%	25%

Source: UNDP, 1997 Human Development Report and MEDaC, WMU, 1997, Human Development Report for Ethiopia

Some of the root causes of the poor health status of the population can be traced to:

- Lack of access to clean water: Rivers/lakes remain the most important source of water for the majority of the population. Fifty four per cent of the population in rural areas use this source of water for drinking, cooking and sanitation purposes. Since such waters are largely unsafe, it constitutes a major risk to health. Given that only 26 per cent of the rural population and 75 per cent of the urban

population have access to clean water, water borne diseases like malaria, diarrhea, etc. are, therefore, common health problems in Ethiopia.

- Lack of adequate nutrition: Various studies have confirmed that malnutrition is rampant in the country and is among the highest in the world. A nutritional survey conducted in 1992 revealed that half of children aged under five in Ethiopia are malnourished. The same study showed that about 64 and 8 per cent of the children are stunted and wasted respectively.

Malnutrition arise mainly due to the fact that Ethiopia has not yet managed to attain food self sufficiency and food security. Malnutrition is also due to poor knowledge about nutritional requirements and dietary habits which sometimes act as a barrier to adequate nutrition. A good example of this relates to the case of fish which, though abundant, and available at a reasonable price, is not consumed much, except during fasting periods.

The combined problems of poor health and inadequate nutrition are likely to have a life-long effect on children making them physically unfit, unproductive, mentally inactive and less dynamic.

- Lack of health services: Health services and facilities which are largely concentrated in urban areas are available only to about 60 per cent of the population. Specific problems that exist in the health care system are discussed below.

3.2. Health Coverage

The health care infrastructure of the country had been crippled by three decades of civil war, underfunding and neglect. The number of health facilities, the geographical distribution and the quality of service are all sub-standard. Total health services coverage in Ethiopia until recently was estimated between 38 and 47 per cent of the population. The system was underfunded and there were too few health personnel mostly with inappropriate training. Furthermore resources were not used optimally. Available resources were also unevenly distributed both on geographic and on care basis. More than 50 per cent of the health facilities were located in urban areas, most of them in Addis Ababa. There was also a relative emphasis on curative, hospital – based care than a preventive and community based health care system.

The ratio of the national population per hospital bed was about 6000. This figure is significantly higher than any population/bed ratio listed in the World Bank review of health services in African countries, and is nearly four times greater than the average for Sub-Saharan Africa of 1,600 people per hospital bed³. Given the facts that about 17 per cent of hospital beds were in specialised hospitals, and that about 35 per cent of all hospital beds were located in Addis Ababa, access to general hospital facilities for Ethiopians living outside Addis Ababa was extremely thin.

The population to health centers ratio is 306,283 and 21,992 people per primary health care facility if the number of health centers and health stations are combined. This is nearly 3 times higher than the average for Sub-Saharan Africa of 8,046 people per primary health care facility.

Table V.9
Distribution of Health Facilities by Region

No	Region	Hospitals	Beds	Health centers	Health Stations
1	Tigray	12	860	14	141
2	Afar	2	60	4	34
3	Amhara	11	1289	45	444
4	Oromia	25	2293	63	845
5	Somali	3	255	7	66
6	Benishangul	2	254	4	69
7	SENNP	9	816	34	424
8	Gambella	1	95	3	34
9	Harari	5	735	-	5
10	Dire Dawa	3	247	1	18
11	Addis Ababa	16	3016	16	390
	Total	89	9920	191	2470

Source: Policy and Human Resource Development Project, Ethiopia Social Sector Study.
Access to and supply of Health Facilities and Services, Addis Ababa September 1996.

³ World Bank 1994.

Table V.10
Urban/Rural Distribution of Health personnel

Personnel category	Addis Ababa	Total urban	Rural	Total	Urban as % of total
Medical Doctor	1020	1189	469	1658	72
Health Officer*	79	84	10	94	89
Nurse	1646	2076	1499	3575	58
Health Assistant	3460	4473	5572	10045	45
Sanitarian	196	221	168	389	57
Pharmacist	275	296	81	377	79
Pharmacy Technician	152	170	113	283	60
Laboratory Technician	323	468	125	593	79
Radiographer	127	158	80	238	66

Source: MOH, 1995

*The training of health officers has been phased out since 1978.

Table V.10 reveals significant urban/rural disparities in personnel levels. In a country where less than 15 per cent of the population are urban dwellers, the urban areas are served by 72 per cent, 89 per cent and 58 per cent of all medical doctors, health officers and nurses, respectively. Another significant disparity in the distribution of health personnel is that 62 per cent of nurses are located in Addis Ababa where less than 5 per cent of the population live.

3.3. Government Investment on Health

- Total government budget allocation for the health sector increased at an annual average rate of about 33 per cent during the 1992-95 fiscal years. The budget tripled from the 1991/92 level and reached Birr 500 million for the fiscal year 1995/96.
- Per capita health spending more than doubled over the period 1986/87 to 1995/96.
- Health expenditure as a percentage of total expenditure increased steadily from 3.5 per cent in 1986/87 to 4.9 per cent in 1995/96.
- Health expenditure as a per cent of GDP increased from 1.0 per cent in 1990/91 to 1.5 per cent in 1995/96.

- The recurrent health share as a percentage of total recurrent expenditure decreased between 1986/87 to 1991/92 after which the share increased to 5.7 in 1995/96.
- The share of capital expenditure on health as percentage of total capital expenditure by government remained fairly constant from 1986/87 to 1990/91, after which the share more than doubled.

Table V.11
Health Expenditure, 1986/87 – 1995/96

	1986/87	1987/88	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97
Recurrent	111.2	117.6	125.9	132.6	128.4	151.5	169.2	280.7	303.4	304.5
Capital	35.5	37.0	43.7	43.0	34.8	38.9	66.6	68.5	99.3	140.6
Total	170.5	154.6	169.6	175.6	163.2	190.6	255.8	349.2	402.7	445.1

Provisional Estimates

Source: Ministry of Finance and WMU Computations

Table V.11 shows that more capital investment has been directed to the health sector since 1991. There has also been a shift in focus from the previous distribution between Addis Ababa and the regions. The current expenditure on hospitals and clinics in Addis Ababa, which constituted 26.5 per cent in 1991/92, decreased to 17.4 per cent in 1995/96.

3.4. Other Health Correlates

In addition to health services other factors affect health. Primary education is particularly crucial and clean water supply is critically important. The provision of education is at least as important for the nation's health in the long run as the provision of health care. There is also a link between transport policy and health; the building of roads makes it easier to provide services, but it also increases the spread of disease. This essentially means that the challenges of improving the health condition in the country requires an integrated rather than an isolated approach.

3.5. The Private Sector

Private sector investment in health services is increasing rapidly in urban areas, mostly in Addis Ababa, but also in regional cities. Private clinics can be classified in 3 categories: (1) specialised clinics (for ophthalmology, gynaecology, etc.); (2) the higher level clinics (bringing together several general practitioners and specialists), and (3) general practice clinics (which are staffed by a GP and/or health officers). There are also private dispensaries, staffed by nurses and health assistants, who can perform small-scale services (apply dressings, make injections, etc.).

Some 130 private clinics are registered at present in Addis Ababa. In Awasa, a city with 100,000 inhabitants and a regional capital of the SENNP there are five operational private clinics.

The drug sector (imports, production and distribution) is probably the sector that has been privatised the most so far. Private entrepreneurs own and manage 92 pharmacies (out of a total of 142), 101 drug shops (out of 118), and 1113 rural drug vending facilities. Parallel with the PHARMID, a state enterprise, 27 importers and/or wholesalers are established in Addis Ababa. With regard to the pharmaceutical industry one should mention that a large privately owned production unit in Adigrat (Tigray) had started manufacturing drugs, supplementing that of the publicly owned firm located in Addis Ababa.

Finally, traditional medicine is evidently private and plays a major role, including both traditional healers, self-medication by collecting herbs, and the use of religious facilities and rituals for medical purposes.

3.6. Expenditures on Health Care

Three major sources finance the expansion and maintenance of health care in the country: government, donors and the private sector. Government expenditure on health care source from its own resources or are counterpart funds. While the central government allocates these resources among the regions, actual spending decisions are made by the regional governments. Under this arrangement the regions submit a budget to the central government and on approval the resources are released.

Second, there is a significant volume of spending that is financed by donors actualized through the central government, or directly expended by them or through NGOs. Part of this is on the capital budget, a large but unknown proportion is extra-

budgetary targeting specific purposes such as the purchase of medicine or equipment.

Private sector expenditure on health care span the gamut of investment on buildings, equipment, purchase of drugs and running costs.

3.6.1. The Share of Health in Total Expenditure

The share of health in the recurrent budget was falling until the end of the civil war and recovered over the next few years to levels not seen since the early 1970s. It now appears to have stabilised. The share of health in the capital budget has also risen, but this has not so far been matched by an actual spending. A much smaller share of the budgeted resources are utilized.

3.6.2. Private Expenditure on Health

Private expenditures in Ethiopia include fees paid at public and private facilities, as well as the funding of private facilities by NGOs. Survey evidence indicate that these amounts are substantial but are also inefficient. Per capita annual expenditure is estimated through household survey at about 18 Birr in 1992/3, of which more than 70% is on drugs. 55% of visits are to government facilities and spending per visit is approximately equal for government facilities and other sectors. This implies that the private sector spends about 10 Birr per capita, 550 million Birr per year in aggregate in government facilities. This is far higher than budgeted receipts from fees and charge for two reasons. Firstly people use the public services for diagnosis and then go to private dispensaries to buy drugs. Secondly most of the public receipts at the time of the survey were probably on ERRP drugs which are accounted for off-budget.

The private sector also spends in private clinics, private dispensaries and traditional healers. The evidence suggests that private dispensaries are particularly important for the poor, who are likely to bypass the advice of a clinician and go straight to a dispensary for treatment. This has important policy implications, which are discussed below.

3.7. The Availability of Facilities

As pointed out earlier, a large number of health care facilities are concentrated in urban centers. For example, Addis Ababa has one hospital bed for 774 inhabitants (compared to the national average of 1/5886), and one HC for 129,677 inhabitants (against the national average of 1/304,554). The situation is far less favourable in the interior of the country. Large regions, such as Oromia, Amhara and SENNP have a very limited health care infrastructure while, the Afar and Somali regions are the least equipped.

According to MOH statistics, the potential service coverage was 45% in 1995 (for a population living within a 10-km radius around a health facility). The real coverage by operational health care structures is more likely to be between 25 and 30%, compared to 26% in Zaire, 49% in Uganda, 51% in Sudan, and 77% in Kenya.

A progressive improvement in coverage is to be expected in the near future, if the increase in the investment budget (40% of the total health care budget) are actualized. The development of physical infrastructure need to be matched with commensurate increase in the budget to make them operational and maintain them in good order. The current outlay (for example only 3.5% of the 95/96 recurrent budget) seems to be grossly insufficient for maintenance and repair of buildings, of equipment and vehicles.

Table V.12
Distribution of Existing Government and NGO Health Facilities (1995)

REGION	POPULATION	HOSPITAL BEDS		HEALTH CENTRES		HEALTH STATIONS	
		N	INH/HC	N	INH/HC	N	INH/HC
TIGRAY	3817158	640	5964	18	212064	142	26881
AFAR	1072205	68	15768	3	357402	33	32491
AMHARA	14511035	1289	112558	42	345501	476	30485
OROMIYA	19080141	2293	8321	81	312789	836	22823
SOMALI	2667472	221	12070	6	444579	66	40416
BENSH & GUMUZ	937519	254	3691	4	234380	69	13587
SENNP	12082527	817	14789	31	389759	373	32393
GAMBELLA	156809	95	1651	3	52270	32	4900
HARARI	172550	735	235	0		5	34510
ADDIS ABABA	2334178	3016	774	18	129677	159	14680
DIRE DAWA	120000	247	486	1	120000	17	7059
TOTAL	56951594	9675	5886	187	304554	2208	25793

Source: Getahun Tefesse 1998

The distribution of health agents, as frequently happens, favours urban at the cost of rural areas both in terms of quantity and quality. Although the average national ratio of health professionals is 1/3131 inhabitants, this varies between 1/462 in Dire Dawa, and 1/4941 in Afar. The ratio is 1/858 in Addis Ababa. From the qualitative viewpoint the structure of the health personnel favours the capital, where the best-trained professionals can be found. Doctors represent 12% of the total health care personnel working in Addis Ababa, 6% in Tigray, and 3% Amhara, and 5% in Afar. Health assistants, with only a basic qualification, represent 38% of the health care personnel in Addis Ababa and 73% in the Amhara and Afar regions.

3.8. Health Problems

Major health problems in Ethiopia can be classified as follows:

Illnesses determined by poverty (under nourishment), lack of clean water, unhealthy environment, deficient habitat, promiscuity, and limited access to education and health care

Diseases related to beliefs, behaviours and traditional practices having a negative effect on the health status, especially for women and children are rampant in the country. Due to preference given to male children school attendance rates for girls is low, circumcision and infibulation, early marriage, sterility as a reason for divorce, marital instability, insufficient participation of women in the decision-making process, etc., as well as low value of children in relation to adults are the sources and results of traditional beliefs.

An additional factor in the causation of disease in Ethiopia is mobility. People who were moved during the settlement schemes of the 1980s reported that their health had deteriorated even though they were provided with better health facilities. A major reason is probably that people who had little immunity to malaria were moved into areas where malaria is endemic. Similarly, AIDS has spread everywhere, with high density along truck routes, and medical research in Uganda (Steely et. al 1994) has shown that AIDS-prevalence is higher among those who travel.

3.9. Health Issues that Need Immediate and Continued Attention

The public expenditure program of the government has given increased emphasis to the expansion of social services. In terms of budgetary allocation, public budget on

health has increased significantly in the last few years beginning from the transition period.

Increased resource allocation to the social sectors will not, however, guarantee by itself the country's human resource development, for the following reasons:-

First of all, the fact that the government health and education budget tripled and quadrupled in the last few years should be taken with caution due to the devaluation of the local currency which makes the importation of drugs, medical equipment, teaching material, etc. very expensive.

Given increased resource availability, efficient utilization of the resource and its implementation need also to be seen in context. Efficiency requires spending on the most appropriate form of service provision like primary health care and primary education.

Neither the budgetary allocation nor its effective recurrent expenditure are too small to stem the tide of physical dilapidation and very poor service delivery. On the other hand the budget for capital expenditure is high but are not fully utilized. This needs to be rectified on the basis of capacity and need.

Although a new health sector strategy has been developed and implemented since the transition period, the cornerstone of which is built around principles of decentralization, prevention and development of an equitable and acceptable standard of health there is need for its effective implementation. The priorities of the strategy include the following:

- Preventive measures: Development of health awareness is planned through the promotion of information exchange and education. Particular emphasis is placed on the control of communicable diseases, epidemics, diseases related to malnutrition and poor living conditions. Special focus is to be given to the construction of basic health facilities.
- Targeted communities: Special attention is given to the health needs of the family, those in the front - line of productivity and the hitherto neglected regions and segments of the population including rural inhabitants, pastoralists, the urban poor and national minorities.
- Development of an appropriate health service management system: The revision and upgrading of existing public health laws and regulations and the introduction

of new rules and regulations is emphasized. Effective administration and management systems are to be established through restructuring and rational use of human and material resources. Management boards are to be established in national hospitals, institutions and organizations. Strict implementation of the referral health service system is also in effect.

- Strengthening research: Priority is placed on promoting applied and other research, especially major health problems prevailing in the country. Improvements in the research capabilities of national and regional health institutions are also planned.

The translation of these laudable intentions to reality requires:

- Particular emphasis on the control of communicable and epidemics, diseases related to malnutrition and poor living conditions; rehabilitation of the health structure, maintaining of environmental health, and the development of appropriate health service management systems.
- Support needs to be provided to the curative and rehabilitative components of health services. Provision of essential medicines, medical supplies and equipment will be strengthened.
- Technical skills of health professionals need to be upgraded. Applied health research addressing the major health problems shall also be emphasised.
- Financing of the health services must be through public, private and intersectional sources among which raising taxes and revenues, formal contributions or insurance by public employees of the private sector, individual or group insurance, and voluntary contributions will be the major components.

In particular, the government does not seem to be aware of the HIV/AIDS pandemic. This is becoming a serious health hazard and has inflicted heavy economic and social damages on the society and wiped out much of the gains of the previous years. As a result of this disease, death rate, particularly among the most productive group, has increased, life expectancy is lowered. Government must help fight this threat to the nation survival.

In the 21st century, human capital is not a means for increasing neither productivity nor accumulation of knowledge but a means of survival. In a world of push-button technology and knowledge based production system, in a world that has shaded off

the idea of interdependence to one of intense competition, skill and healthy body and mind are the only means of survival. The nation faces challenges and opportunities. Building human capacity and capability is an urgent and demanding task.

As shown above, both the educational stream and the health situation are in critical condition both qualitatively and quantitatively. The government is very much aware of the problem and has developed appropriate policy framework and the initial steps are encouraging. Nevertheless more needs to be done.

ETHIOPIAN AGRICULTURE

1. INTRODUCTION

As can be seen from the previous chapters, the great majority of the Ethiopian population resides in rural areas engaged in some form of agricultural activity. It is also in this sector that the overwhelming majority of the poor reside. A close look at the performance of the Ethiopian macroeconomy also reveals its close correlation with the performance of the agricultural sector. In the years that nature generously provided the rains in the appropriate times, we also see a reasonably good overall macroeconomic performance. Even if we ignore the potential role of agriculture to the overall development of the country that various theories of economic development have been advocating and we also discount the important role agricultural development played in the experiences of the successful countries of East Asia, the sheer number of people involved in agriculture and the requirement of poverty alleviation necessitates that we take a close look at this sector. Accordingly, this chapter is dedicated to the structure and performance of the agriculture sector of Ethiopia. The chapter proceeds as follows: We will first start with a section describing the structure and performance of the sector by particularly looking at crop production and livestock. This is followed by a section outlining the major constraints to the development of agriculture in Ethiopia. The last section discusses the policy challenges ahead of us to develop the country's agricultural sector.

2. STRUCTURE AND PERFORMANCE OF ETHIOPIAN AGRICULTURE.¹

2.1. Agroecological Zones

Broadly presented, Ethiopia has traditionally been characterized by two major agro-ecological zones – the highlands and the lowlands. The highlands, which constitute about 35-40% of the country's land area, are areas found above 1500 meters while the lowlands, which take up over 60% of the land area, consist of areas mostly (85-90%) below 1500 meters. A more detailed classification that is more appropriate for our purpose here divides the zones into five categories. These are *wurch*, *dega*, *weyna dega*, *kolla*, and *bereha*. The major factor in delineating these zones is altitude which is a major determinant of rainfall, temperature, cropping pattern and vegetation cover. Accordingly, *wurch* and *dega* zones refer to highland areas with an altitude of over 2300 meters above sea level, while *weyna dega* represents mid-highlands with an elevation of 1500 to 2300 meters. Lowland areas are known as either *kolla* or *bereha* and have an altitude of less than 1500 meters.

The *wurch* zones are areas of extreme high altitude (over 3200 meters above sea level) with low temperatures and short growing seasons with barley as the dominant crop. Cattle and sheep husbandry constitute an important means of livelihood for the inhabitants of the area. *Wurch* zones are confined to small areas of Wollo, Gondar, and Gojjam zones of the Amhara regions, and Arssi and Bale zones of Oromia.

The *dega* agroecological zone refers to highland areas with altitudes ranging between 2300 and 3200 meters and rainfall between 900 and 1500 mm per year and mean temperature of less than 16°C on the average. Historically, human settlement has concentrated in the *dega* areas because of the relatively good rainfall reliability and cool temperature, which is suitable for a variety of small cereals such as barley and wheat. *Dega* areas are also free of malaria and trypanosomiasis (animal disease). Consequently, the zone has been intensively cultivated with high rates of soil loss throughout the region. Overgrazing has further exacerbated the problem of soil erosion in the region. *Dega* areas are chiefly found in Wollo and North Shoa of the Amhara region and some central parts of Oromia, mainly Arssi and Northwest Shoa.

¹Unless otherwise noted, most of the data and analysis of this section comes from two papers written for this report and is separately available for the interested reader. The first is by Mular Demeke entitled "The Structure and Performance of Ethiopian Agriculture," 1999, and the second entitled "Livestock," by Addis Anteneh. For issues related to land policy and its effect on Ethiopian Agriculture, we have gotten detailed comments from Dessalegn Kalimato and used his paper "Land and Rural Poverty in Ethiopia", 1999.

While some of the moist areas can support two growing periods per year under rainfed conditions, rainfall in many parts of the *dega* areas has recently become erratic perhaps because of the extreme deforestation and land degradation. This, together with the declining soil fertility, has resulted in increased dependence on food aid by inhabitants in many *dega* areas.

Most of Ethiopia's agricultural land is classified as *weyna dega*, mid-highland areas with an altitude of 1500 to 2300 meters. It is characterized by temperatures ranging from 16 to 29 °C and rainfall varying from 300 to 1400 mm. Some areas receive as much as 1400 mm and are sometimes referred to as wet *weyna dega*. Other areas receive 900 to 1400 mm of rain and are known as moist *weyna dega*. Most of the country's food crops such as teff, maize, wheat, and pulses as well as coffee are grown in this wet and moist mid-highland zone. The main surplus grain producing zones of the country, including most parts of Shoa, Arssi, Gojam, and some parts of Gondar, as well as coffee growing areas such as Sidamo, the former Kaffa administrative zone, Wollega and Ilubabor are classified as *weyna dega*. The production of *enset*, staple food crop in the Southern Region, is also concentrated in this agroclimatic zone. Two growing periods (under rainfed conditions) per year are possible in some of the rainy areas. Nonetheless, extensive land use has resulted in high degree of erosion and sharply reduced forest and grass cover. The annual rainfall in the drier part of *weyna dega* is 300 to 900 mm and the main crop is sorghum. Other crops such as wheat and oilseeds are also grown. A good part of Tigray, Gondar and Wollo is known to have dry *weyna dega* climate. Drought and severe degradation have become a major constraint to production and most of the relief assistance in the country is directed to these areas in recent years.

Lowland areas, which are classified as *kolla*, are located between 500 and 1500 meters. The temperature is hot, over 27° C, and the weather is dry with less than 450 mm of rainfall. The growing period is very short and can only support a few drought-resistant crops such as special varieties of sorghum. These areas are populated mainly by semi-pastoralists. Lowlands, which lie below 500 meters, are known as *bereha* or desert. These areas are sparsely populated with nomadic herders. Crop production can only be carried out through irrigation mainly from rivers flowing out of the highland areas. *Kolla* and *bereha* areas are chiefly concentrated in the Afar and Somali regions and the Borena zone of the Oromia region.

2.2. Resource Base, Land Use and Potentials for Expanding Area under Cultivation and Livestock

Ethiopia has a total land area of about 113,000,000 hectares. There is no comprehensive survey of land use pattern in the country but some estimates suggest that about 12.6 million hectares, 10.3% of the total area, is intensively cultivated, and a further 15.3 million hectare (12.5%) is moderately cultivated (Table VI.1). High forest and woodland areas account for 6.9%, while grassland for 30.5% of the total area.

Most of the vertisols in Ethiopia suffer from water logging and poor workability. Only about 2 million ha of the vertisols are estimated to be currently under cultivation. A large part of the vertisol areas in the highlands are used as grazing land. Lowland vertisols support native vegetation of grasses, shrubs and sometimes trees. Vertisol areas in the western lowlands are infested with trypanosomiasis, thus constraining opportunities for mixed farming.

Accepting the estimate that some 27.9 million-hectare of land is already cultivated (intensively and moderately), *the possibilities for expanding land under rain-fed agriculture is not very high.* More importantly, new land that can be brought under cultivation may be offset or even outstripped by land which needs to be withdrawn from cultivation because it is severely eroded or degraded. It should be noted that CSA's estimate of cropped area is small - only 8.8 million ha was reported to be under temporary and permanent crops in 1996/97. This may give the impression that opportunities for expansion are greater. However, the CSA figures do not include land devoted to housing, woodland, gardens, grazing, fallowing and other built up areas.

It is often suggested that the size of additional land that can be brought under rain-fed cultivation is limited to the 100 km wide strip of land stretching from Gambella, bordering Sudan to Humera in the north. But this claim must be taken cautiously since the tropical rain forests in the western parts of the country are highly fragile and incapable of supporting permanent cultivation. It also requires heavy investment in infrastructure and machinery to cultivate the land while animal husbandry is affected by trypanosomiasis.

Expansion into much of the non-arable lowland areas is constrained by moisture stress. But these areas are drained by major river basins and are suitable for irrigation. It is estimated that the major river basins of the country can irrigate about 3.5 million-hectare of land. At present only about 161,010 ha or 4.6% is irrigated

around the major river basins. Besides opening up new land for cultivation, irrigation allows to cultivate two or three crops each year instead of a single crop most common under dry farming. It also enables farmers to grow high value crops, especially fruits and vegetables. Nonetheless, the amount of investment required to expand irrigated agriculture around the major basins is often considerable.

In terms of livestock resources, Ethiopia has quite a substantial, albeit largely unutilized potential to benefit from its livestock resources. There are various estimates that are based on divergent methods ranging from agricultural sample surveys of the CSA, to estimates based on the number of hides and skins collected/sold in the local markets and exported and an assumed offtake rate applied to the different species. Despite the different counts that result from these divergent methodologies, however, there is consensus about the extensive size of Ethiopia's livestock population. Recent estimates that run between 30-35 million Tropical Livestock Unit (TLU) confirms the claim that Ethiopia has the largest livestock population in Africa.

TABLE VI. 1
Distribution of Land Put to Various Uses

	Area in hectares	Percentage total area of the country
Intensively cultivated land	12596900	10.3
Moderately cultivated land	15287500	12.5
Afro-alpine and sub-afroalpine vegetation, too cold for cultivation	244600	0.2
High forest	5381200	4.4
Woodland	3057500	2.5
Riparian woodland and shrubland	733800	0.6
Bushland and shrubland	26172200	21.4
Grassland	37301500	30.5
Waterbodies	611500	0.5
Others	20913300	17.1
Total²	122300000	100.0

Source: Environmental Protection Authority in collaboration with Economic Development and Cooperation. The Conservation of Ethiopia -volume 1: The Resource Base, Its Utilization and Planning for Sustainability. April 1997. Addis Ababa, Ethiopia

² Estimates for the total land area for Ethiopia and Eritrea vary between 122 and 125 million

The distribution of the livestock population in terms of agroecological zones and administrative regions reveal that about 75-80% of the cattle and sheep and 30% of the goat population are estimated to be found in the highland zone while 20-25% of the cattle and sheep, 70% of the goat and 100% of the camel population are found in the lowlands. On average, more than 90% of the livestock population in TLU terms is found in the three regions of Oromia, Amhara and SENNP, almost 50% of this being found in Oromia. On the basis of current human population estimates, there would be 0.67, 0.55, 0.44 TLU per caput in the three regions respectively. Per caput holdings for the less densely populated Afar Region and Somali, where livestock are central to the livelihood of the nomadic/pastoral population is much higher.

2.3. Farming Systems

Ethiopia's varied climate and soils have created a large diversity of cultivated plants and natural vegetation. Ethiopia's plateaux exhibit, depending on altitude, contrasting climate in which autumn, summer, spring and winter, or tropical, subtropical and temperate climates, are separated by only a few hours of journey (up or down the hills) by foot. Farmers in Ethiopia have developed complex farming systems and cropping patterns in response to this climatic diversity.

Various attempts have been made to classify the different farming systems in Ethiopia. For the purpose of this report, we have taken a synthesis of these classifications and identified the following five major farming systems:

1. Highland mixed farming systems
2. Lowland mixed agriculture
3. Pastoral systems
4. Shifting cultivation
5. Commercial agriculture

2.3.1. Highland Mixed Farming Systems

The highland areas (above 1500 meters) constitute around 45% of the total area and are inhabited by four-fifths of the population. The predominant agro-ecological zones are *dega* and *weyna dega*. A major characteristic of the farming activities is the integration of crop and livestock production. Oxen are the principal means of draft power and equines provide the main means of transport. Livestock husbandry constitutes an important source of food, cash income and insurance against crop

failure. A number of different cultivation methods are found in the highland agricultural systems. The major sub-components of the highland mixed farming complex are the grain-plough complex and horticulture-hoe complex.

2.3.1.1. The Grain-Plough Complex

The grain-plough complex is practiced in the central and northern parts of the country. Farmers rely on cereals which are grown along with pulses and oil crops. Over 80% of the production is destined for home consumption. Barley and wheat dominate in the grain-plough complex of Arssi and Bale, while *teff* is the single most important crop in the central and northern highlands including most parts of Shoa and Gojjam. Permanent crops such as coffee, *enset* and *chat* are largely unknown in most parts of the central and northern highlands.

Throughout this system, the land is ploughed with the help of a crude wooden plow which is fitted with iron tips to penetrate (mainly scratch) the soil. Ploughing is carried out several times (more than 4 times for cereals) before planting. Seeds are broadcast on the soil surface and then ploughed in with the same plough. Livestock husbandry is based on unimproved native pasture supplemented by crop residues.

Sustainable agriculture in the grain plough complex is adversely affected by drought, high degree of soil erosion and by the practice of removing crop residues for feeding animals and using animal dung for fuel. Terracing and other conservation techniques are scarcely used. *Since little or no organic matter is added to the soil under normal circumstances and conservation-based farming practices are rare, declining fertility has necessitated shifts in cropping pattern and increased application of inorganic fertilizer to maintain yield levels.* One of the coping mechanisms to loss of soil fertility, for instance, is a shift towards growing *sinar* or wild oats (a weed plant common in barley and wheat fields) as a food crop. This is increasingly observed in many *dega* areas of north and northwest Shoa, Gojjam and Wollo. In some areas like Jidda (North West Shoa zone of Oromiya), *sinar* is the dominant crop. Farmers are attracted by its yield which is 2 to 3 times higher than other cereals grown in the area, its tolerance to drought and adaptation to marginal or poor soils, although they agree that *sinar* has low nutritional value (Tsehay, 1996).

The most convenient mechanism of coping with declining soil fertility is the use of inorganic fertilizer. Indeed, the use of fertilizer has significantly increased in recent years (see section 6 below). Fertilizer use is believed to have mitigated the effect of rapidly declining soil fertility.

2.3.1.2. The Horticulture-Hoe Complex

The horticulture-hoe system of agriculture, also known as the horticulture-livestock complex, is primarily found in the high rainfall humid regions of southern and southwestern parts of the country. The land is cultivated with hoe (human power) in the case of horticultural crops. Both draft animals and hoe are commonly used for the cultivation of field crops. The major crops grown include *enset*, coffee, *chat*, and various other horticultural crops. Maize in the humid southern and southwestern regions is the major cereal crop grown by farmers. Production is favorable and less variable than in the grain-plough complex system. But high population density has resulted in extreme scarcity of land and land degradation. In the more humid areas, pests and disease remain the most important constraints to sustainable farming.

The eastern highlands of Hararghe are also classified as part of the horticulture-hoe complex. Here, sorghum, the staple food crop, is often intercropped with crops such as *chat* and sweet potatoes. Oxen power is commonly utilized along with hoe cultivation in Hararghe. Compared to the humid southern and southwestern highlands, the eastern highlands are dry and vulnerable to drought.

Livestock, mostly cattle, form an integral part of the horticulture-hoe system of farming. With growing population pressure and scarcity of farm land, stall feeding has become a common method of keeping animals in most areas. In the *enset*-growing areas, farmers make intensive use of animal dung. Nonetheless, the spread of the tsetse fly and other diseases in the region has threatened livestock husbandry.

2.3.2. Lowland Mixed Agriculture

Lowland agriculture is practiced in the mountain foothills and in the lower valleys at elevations below 1500 meters. The climate is hot and dry with rainfall ranging from 450 to 800 mm. The soils are shallow and have problems of compaction and surface crusting which lead to poor water infiltration and run-off.

Lowland agriculture is common in the Rift Valley and northern areas of the Awash river. Drought-tolerant varieties of sorghum, maize, wheat and *teff* are grown. A number of oil crops and lowland pulses are also grown. Livestock are raised on common grazing lands and crop residues. The land is ploughed with a pair of oxen as in the highland mixed agricultural system.

In response to the shortage and variability of rainfall, farmers in the lowland areas often diversify their cropping patterns by growing several types of crops and varieties. They grow up to 10 different varieties/types of sorghum and maize. At times of drought, the farmers in the central Rift Valley shift to early maturing crop varieties and short-cycle crops such as drought tolerant varieties of *teff* as an alternative to long maturing crops such as sorghum and maize. High seed rate, more than double the recommended rate, is used to get animal feed through thinning (Tilahun, 1995).

When all crops fail because of serious drought, livestock are relied upon for economic survival. Other important sources of income in the lowlands include sale of firewood and charcoal and off-farm employment opportunities. Much of the land in the Rift Valley has been highly degraded due to loss of vegetation cover, overcropping and overgrazing.

2.3.3. Pastoral Complex

The pastoral complex is mainly practiced by pastoral nomads living in the lowlands of Afar and Somali regions and the Borena zone of Oromiya and the lowland areas of the Southern region. Cattle production is the main economic activity in these sparsely populated dry and vast areas. Camels are an integral part of the pastoral system, serving, in addition to being sources of food, as the single most important means of transport. Sheep and goats are also kept by most nomads. In some areas, lowland varieties of maize, sorghum and other cereals are cultivated on flood plains and riverbanks or as a rain-fed crop.

Pastoral areas account for about 60% of the country's land area, and provide livelihood for an estimated 10% of the population. About 20% of the national cattle herd, one quarter of the sheep, and almost three quarters of the goats are raised by the pastoral communities. Over 90% of the live animals exported come from the pastoral areas (FDRE, 1996).

A major constraint to livestock husbandry in the pastoral areas is shortage of water, especially during the long dry season. At times of drought, not only a large number of animals die, but recovery from drought takes much longer in the pastoral economy than in the farming areas. It has been estimated that during the 1983-85 drought years, many Borana pastoralists lost 30-35% of their animals. In addition, they were forced to sell some 20% of their herd to buy the food they need to survive (FDRE, 1996). Obviously, it would take several years to fully recover from drought that resulted in over 50% loss of animals.

Pastoralists have a vested interest in the sustainability of their forage resources. But increasing population and failure to develop new regulatory mechanisms have threatened pastoral farming. Overgrazing has reduced the quantity, quality, accessibility, and stability of the resource base from its previous conditions. Sustainable pastoral farming is at risk owing to the rapidly expanding desertification. Encroachment by highlanders searching for farm land and a growing switch to dryland cultivation by nomads themselves have also contributed to degradation and restrained grazing opportunities. Because of the lower fertility and thickness of topsoil, range ecosystems are often referred to as more fragile than highland areas.

2.3.4. Shifting Cultivation

There is very little information on shifting cultivation in Ethiopia. According to Westphal (1975), Shifting is practiced by some ethnic groups living in the western and south-western fringes of the Ethiopian highlands and in the lowlands (among the Gumuz, the Berta, the Kaffa, the Gimirra-Maji groups, and possibly the Mekan-Surma group). These groups are now (under the new administrative setup) found in the Benshangul-Gumuz, Gambella and Southern regions. Population density is low and livestock rearing is limited in some areas because of tsetse fly infestation.

Farm plots are cultivated for one or two years and then left idle for several years to be covered with woodland. The land is cleared during the dry months (January and February), set on fire in March and planted when the rains come. Various crops including sorghum, millet, sesame, cotton and ginger are grown by the Gumuz.

Settlement schemes were established in some of the traditional areas of shifting cultivation under the former government. The size of the indigenous population is believed to have increased over the years. It is not clear how the traditional farming system has evolved as a result of the population pressure.

2.3.5. Commercial Agriculture

Commercial agriculture was introduced in the 1960s when the Haile Sellassie Government decided to enhance the role of commercial farms to meet the growing demand for food in the urban areas and agricultural raw materials for industry. Between 1958/59 and 1969/70, the number of commercial farms rose from 32 to

2,626 and the total land area mechanically cultivated increased from 6,244 to 481,659 hectares. Mechanized farms were concentrated in the Awash Valley, Arssi, Southern Shoa, and Setit-Humera areas in those days (Mulatu and Yohannes, 1988). After the 1975 Land Reform Proclamation, many of the commercial farms were nationalized and converted into state (government owned) farms. New coffee and tea farms were also created by the former military government.

The size and role of state farms diminished sharply after 1992 as the new government decided to hand over some of the state farms to nearby farmers and privatize some of them. At present there are only 13 state farm enterprises (down from 26) producing mainly wheat, maize, cotton coffee and tea on an area of only 136,040 hectares.

The economic reform introduced after the overthrow of the military government has allowed the participation of the private sector in large-scale commercial farming. Investment permits are issued by the Ethiopian Investment Authority (EIA) as well as regional investment offices. Between 1992/93 and 1997/98, of the total 4,246 projects licensed by the EIA, only 1,140 (26.8%) were in agriculture (both crop and livestock sub-sectors). Within agriculture only 508 projects became operational during the period under consideration. The number of agricultural projects (approved or commenced operation) has also declined since 1995/96.

The main problem faced by investors in agriculture is access to land. Existing regulations prescribe that land be free of other users to be leased to an investor by a regional government. To a large extent, investors need to go to low, hot, disease-ridden areas of the south and west to find 'unoccupied' land. Lack of infrastructure is a major barrier to any profit-motivated commercial farmer in this case. What is more, often there are a few communities even in these remote areas who claim that the land belongs to them and they have been using it for grazing or occasional farming. The absence of farming in a given area does not imply that the land is unoccupied (Gavian and Gemechu, 1994). Conflict with local inhabitants is not a conducive environment for investment.

Box VI.1**Agriculture and Economic Development**

Development economists have been accused of an "urban bias" during the 1970s as they strongly pushed the development of industry as the key to overall economic development. The problems encountered to sustainable industrial development in developing countries coupled with the inability to alleviate the poverty of the majority of the population residing in rural areas has forced many students of development to look back at the issue of agriculture and its role in the overall development project. It is now a well established fact that the success stories of East Asia began their drive towards industrialization by first developing their agricultural sector. Although the need for rapid industrialization for sustainable long term development is still valid, there is a clear consensus that this strategy can only be successful if agricultural productivity and income are significantly increased in the initial phase of industrialization.

This consensus emerges as a result of thorough theoretical and empirical research on the potential contribution of agriculture to the industrialization effort. First, it is believed that a productive agriculture implies higher levels of income to the large rural population which then generates a large demand for manufactured goods that enables manufacturers to produce at a scale that allows them to exploit efficiency gains from scale economies. The increase in demand comes in the form of both manufactured consumer goods and agricultural inputs allowing industrial expansions in these sectors. Second, a higher income for the rural population means higher potential rural savings which, provided that there are adequate financial institutions, can be geared towards investment in the industrial sector that is constrained by lack of capital. Third, highly productive agriculture means relatively cheap food to the urban population which eases the pressure on wages in the urban sector and thus enable higher profits in industry and thus higher savings and investment in the industrial sector. The high profits will also materialize as the cost of agricultural products used as input to the industrial sector is reduced owing to increased productivity in agriculture. Finally, increases in labor productivity in agriculture would necessarily mean a decrease in the marginal productivity of labor in the excess population residing in rural areas leading to migration to the cities. This in turn will increase the supply of labor to industry significantly easing the pressure on urban wages.

It is all these presumed economic benefits that come in the way of industry from a growing and productive agriculture, coupled with the immediate concern of alleviating rural poverty that recommended re-focusing on agriculture as the initial force that pulls the wheels of industrialization till it gathers momentum to spin by its own energy.

3. RECENT TRENDS IN THE PERFORMANCE OF AGRICULTURE

As can be seen from the foregoing, Ethiopian agriculture is predominantly characterized by traditional methods of farming with very little change in farming practices over the past few centuries. The continuous use of such farming practices over a long period of time with little or no soil conservation measures have significantly eroded the fertility of the soil and have made agricultural output highly susceptible to minor climatic changes. This very process of imprudent use of natural resources, particularly the continuous loss of forests owing to the cutting of trees for purposes of domestic energy and construction as well as the expansion of agricultural land to marginal areas with the increase in agricultural population has led to severe climatic changes particularly in the increased frequency of droughts in many parts of the country. With very little surplus output even during the best of years and very little irrigated agriculture, drought at any time usually leads to severe food shortages and famine to a large segment of the agricultural population whose survival is now increasingly dependent on the food aid it receives from international donors. As can be seen in the following pages, agricultural output in the past few decades has been characterized by wide fluctuations whose variance is usually associated with the vagaries of nature. In the following section we will first briefly look at the overall performance of agriculture followed by a more detailed treatment of crop and livestock production.



3.1. Overall Performance

As suggested earlier, agricultural production in Ethiopia is characterized by severe fluctuations usually following the fluctuations in the rains. What is also very clear from the table below is that the overall performance of the economy is highly correlated to the performance of agriculture. This is not surprising since agriculture's share in GDP is quite high averaging about 53% during the Derge and 51.2% under EPRDF. The highest rate of growth in agriculture during the period under consideration was achieved in 1986/87 when it grew by 18.8% while the lowest was achieved during the drought year of 1984/85 where it declined by about 21%. The average growth rate in agriculture during the last ten years of the Derge period was a mere 2% which is significantly lower than the rate of growth of population. The food deficit in the country increases during this period.

TABLE VI. 2
Sectoral Growth and Contribution to GDP (1980/81-90/91)

Year	Growth Rate of Real GDP	AGRICULTURE		Growth Rate of Per capita GDP
		As % of GDP	Growth Rate	
1980/81	-	58.1	-	-
1981/82	0.51	55.7	-3.6	-2.4
1982/83	10.1	57.5	13.8	6.9
1983/84	-6.3	53.7	-12.5	-9
1984/85	-9.7	47.0	-20.9	-12.4
1985/86	9.9	49.6	16.0	6.4
1986/87	14.0	51.7	18.8	10.4
1987/88	-0.1	50.3	-2.8	-3
1988/89	0.3	50.6	1.0	-2.7
1989/90	4.1	51.2	5.3	0.9
1990/91	-4.2	56.3	5.2	-7.2
Average	1.9	52.9	2.0	-1.2
1991/92	-3.7	56.5	-2.7	-6.7
1992/93	12.0	53.5	6.1	9.0
1993/94	1.7	51.7	-3.7	-1.5
1994/95	5.4	49.7	3.4	2.3
1995/96	10.6	51.5	14.7	7.5
1996/97	5.2	50.7	3.4	2.1
1997/98	-0.5	45.7	-10.3	-3.5
Average	4.4*	51.2	1.6	1.3

*The average growth rate of real GDP for the years 1992/93-97/98 (i.e. excluding the year 1991/92 which was a year of political instability) is 5.8% and the corresponding per capita GDP growth rate is about 2.6%.

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

Interestingly, despite massive efforts by the government to improve the sector's performance, agricultural production under EPRDF did not show as significant improvement over the Derge Years. In fact if we include the politically unstable first year of EPRDF, the sector's performance was worse under EPRDF compared with the last ten years average of the Derge. Even when we discount the first year, the average rate of growth of agriculture under EPRDF was 2.27% per annum; not a significant improvement over the 2% achieved under the Derge. In any case, the rate of growth is much lower than the growth of population and its fluctuation with the rain is unabated.

Indeed, it was the better performance in the other sections particularly industry and services that arrested the decline in per capita income and generated a modest 1.3% growth of PCI under EPRDF.

As we can see in the detailed discussion on crop and livestock performance below, the key constraints to the poor performance of Ethiopian agriculture, particularly the problem of diminishing farm size and lack of tenure security are serious structural constraints without the resolution of which we can not expect significant improvement in the sector in the foreseeable future.

3.2. Performance of Food Crops

3.2.1. Cereals, Pulses and Oilseeds

Two sets of data, CSA and FAO, were used to analyze the structure and trends in the production of cereals, pulses and oilseeds in Ethiopia for the period 1980 to 1996. Area and production figures of cereals are quite different for the two sets, with FAO data being up to 28 - 31% higher in some years. However, the directions of change are similar for the most part. FAO's estimates appear more consistent with the larger estimates of area under cultivation given by other sources (section II above). Differences in yield figures are much less pronounced between the two sets, except for the years 1995 and 1996 (Figure VI.1).³

Cereal production averaged 6.6 million tons during the period under consideration. On the average, 5.4 million ha of land was cultivated to grow cereals, giving a yield level of 12.2 quintals or 1.2 tons per hectare⁴. Annual pulse production amounted to 807,168 tons, compared to 55,226 tons in the case of oilseeds. Only 930,560 and 145,930 ha of land was allocated to the production of pulses and oilseeds. Yield levels were also low, averaging 8.7 quintals for pulses and 3.8 for oilseeds (Table VI.3 below). Given the average rural population for this period, the average output per labor was very low.

Cereal output increased by 1.4% (significant at less than 1 per cent) per annum during the period 1980-1996.⁵ On the other hand, no significant growth rates were recorded for pulses and oilseeds respectively. Overall, the performance of field crops remained very poor, especially when compared to the rapid population growth. In particular,

³ FAO data sets were used for the discussion on production, area and yield of cereals, pulses and oilseeds. In addition to the larger area, year to year variability is less pronounced in the case of FAO data. Some unbelievable fluctuations were observed in the case of CSA data (e.g. 1990/91 pulse and oilseed output and area figures). CSA data are used with respect to individual crops, as FAO data set does not include important crops such as *teff*.

⁴ One ton is equal to 10 quintals.

⁵ Annual growth rates were computed using the least square method. The log-linear growth rate was estimated by regressing the logarithmic values of output, area or yield against time.

production stagnated during the seventeen years tenure of the Derge. Cereal production, for instance, fluctuated between 62 and 65 million quintals during the period 1986 to 1991 (immediately after the drought years of 1983-85). Area under cereal production also stayed at around 5.2 million hectares over the same period. Annual production of pulses and oilseeds in 1986-91 was lower than the level attained in 1980.

The performance of field crops improved after 1991 owing to improved policy environment, increased availability of inputs such as fertilizer and the relatively good weather. The period from 1994 until 1996/97 has been particularly favorable: cereal production rose to 110.6 million quintals, while area harvested jumped to 8.8 million hectares in 1996. While a similar positive trend was observed with respect to pulses, the performance of oilseeds remained poor even after 1994.

Cereals are by far the most dominant among the field crops, accounting for 88.3% and 83.2% of the total production and cultivated area, respectively, for the period 1980 to 1996. The share of pulses and oil seeds was 10.9 and 0.8% in the total production and 14.5 and 2.3% in the total area harvested. It is important to note that the share of cereals increased over time. Farmers seem to allocate a larger proportion of their land to the staple cereal crop mainly due to decline in farm size. Reduced share of pulses and oilseeds implies less crop rotation with leguminous crops, hence decline in the levels of organic matter. Weed and insect infestation are also expected to intensify under continuous cereal cropping. Moreover, the nutritional status of the rural community can be adversely affected by the shortage of plant protein (pulses) and oilseeds.

As shown on Table VI.3, the trends in yield levels are of greater concern. Cereal yield increased by only 0.5% per annum between 1980 and 1996.⁶ Yields remained unchanged in the case of pulses and oilseeds. What is more worrying is the observation that there is no indication that yields have improved since 1994. Cereal yields in 1996 (the year of record harvest) were not any better than earlier years. The recent increase in production is largely attributed to increase in cultivated area. Area under cereals and pulses increased by 0.9 and 0.8% per annum, respectively, between 1980 and 1996. It should be mentioned that the area expansion was achieved through cultivation of hillsides with high slopes, reducing or eliminating fallow land, and converting pasture, woodland and forest areas into farmland, with obvious negative implications for sustainable farming.

⁶ The coefficient of time in a simple regression of yield against time is also significant.

FIGURE VI.1 NATION WIDE CEREALS YIELD (1980-1996) LINE PLOT COMPARISON OF CSA VS FAO DATA

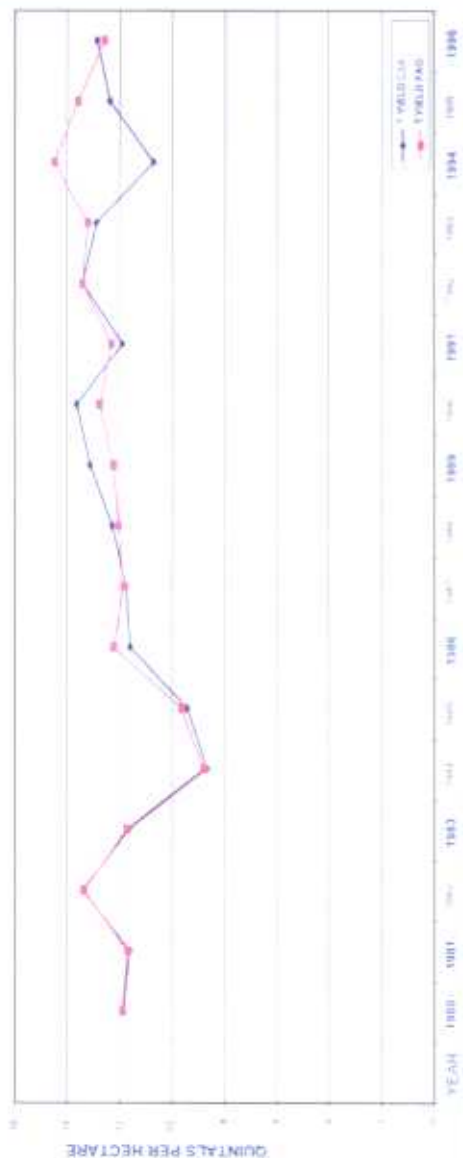


TABLE VI.3. Nation Wide Total Production, Area Cultivated and Yield of Cereals, Pulses and Oil Seeds.

YEAR	Cereals			Pulses			Oil Seeds		
	Quintals ('000)	Area ('000' ha.)	Yield (Qt/ha.)	Quintals ('000)	Area ('000' ha.)	Yield (Qt/ha.)	Quintals	Area ('000' ha.)	Yield (Qt/ha.)
1980	56118.610	4711.850	11.910	9194.090	867.710	10.596	641.270	123.550	5.190
1981	54057.710	4825.770	11.686	9143.220	902.770	10.128	503.400	151.310	3.327
1982	67182.800	5029.220	13.358	10272.770	936.040	10.975	789.300	172.600	4.573
1983	56268.190	4715.580	11.720	7987.280	867.810	9.204	589.160	154.710	3.808
1984	42398.470	4814.680	8.806	6012.390	862.500	6.971	618.200	181.130	3.413
1985	48198.870	4991.570	9.656	5389.270	858.960	6.274	595.420	167.170	3.562
1986	65040.000	5304.860	12.260	6470.140	791.870	8.171	476.540	139.580	3.414
1987	61950.000	5237.000	11.829	6109.420	871.810	7.008	440.000	116.300	3.783
1988	63840.000	5300.000	12.045	6111.370	854.240	7.154	423.520	115.450	3.668
1989	63550.000	5180.000	12.268	6242.690	753.990	8.280	407.720	129.540	3.147
1990	84570.000	5060.000	12.761	7108.430	808.340	6.794	423.940	132.490	3.200
1991	63050.000	5120.000	12.314	8244.550	939.000	8.780	600.000	159.000	3.774
1992	70700.000	5265.000	13.428	8150.000	925.000	8.811	600.000	159.000	3.774
1993	69060.000	5217.000	13.237	8723.000	978.500	8.915	570.000	144.000	3.958
1994	72760.000	5023.000	14.485	9550.000	1078.000	8.859	560.000	144.000	3.889
1995	91670.000	6737.000	13.607	11130.000	1247.000	8.925	570.000	145.000	3.931
1996	110600.000	8771.000	12.610	1138.000	1276.000	0.892	580.000	146.000	3.973
Average	65893.274	5399.481	12.23	7361.408	934.489	8.16	548.700	147.330	3.79

Source: FAO

3.2.2. The Performance of Major Food Crops

a) Teff

Teff is endemic to Ethiopia and its cultivation as human food is unknown outside the country. Many landraces with considerable genetic and phenotypic variability are grown by farmers. Teff is generally considered as the most important cereal crop in Ethiopia. It is grown at an optimum altitude range of 1800 to 2200 meters. It is better adapted to heavy clay soils with poor drainage than most other cereal crops.

Teff flour is favored above all other grain flours for making the local flat bread, *enjera*. It is a staple food in the central and northern parts of the country as well as the urban areas. Teff straw is an extremely valuable fodder for livestock. It is also widely used for construction purposes as it is often mixed with soil to plaster wooden walls. Consequently, the straw is completely removed from the field to meet not only the feed and construction demand of the household but also to sale surplus in the market place. This practice is believed to have depleted the nutrient and organic matter in the soil.

Annual teff production averaged 1.3 million ton between 1980/81 and 1996/97 and registered a growth rate of 1.9% per annum. The recovery of output after 1991/92 was very strong except in 1993/94. Teff production increased (over the previous year) by 29% in 1995/96 and 14% in 1996/97 (Table VI.4).

About 23% of the total cereal production is made up of teff, making it the second most important crop after maize. However, given its high price, which is often up to 2 to 3 times higher than maize, teff remains the single most important cereal crop in the country in value terms.

The dominance of teff is more clearly shown if area cultivated is considered. On the average, about 1.5 million hectare was allocated to teff production during the period 1980/81 to 1996/97 (Table VI.4). Its share in the total cereal area varied between 28 and 35 and averaged 31%. With a coverage of nearly one third of the total cereal area, teff is by far the most important crop. The next most important crop, maize, accounted for only one-fifth of the total cereal area. Teff area increased by 1.0% per annum between 1980 and 1996.

Teff yield showed no significant increase during the period under consideration (Table VI.4). The average teff yield was also low, 8.9 quintals per hectare, compared with 11.9 and 12.21 quintal per hectare for barley and wheat, respectively. Teff yield was 26 to 28% lower than other small cereals such as barley or wheat. Nonetheless, the

market price of teff is often up to 100% higher, indicating that the return from teff can be superior (assuming differences in costs of production are not significant).

Teff accounts for the highest share in the total fertilizer consumed by the peasant sector. In 1996/97, for instance, it absorbed 45.2% of the total fertilizer applied in the peasant sector or 49.3% of the fertilizer applied on cereals. About 54.2% of the teff area was fertilized and the rate of application (taking all teff area) was 54 kg per ha. The rate of application for fertilized area was 99 kg per hectare (Table VI.5). *Nevertheless, the relatively higher rate of fertilizer application failed to bring a significant yield increase.* One of the problems is limited use of improved seeds: only 1.7% of the teff area was covered with improved seeds in 1996/97. Fertilizer was applied along with local seeds, hence reducing its effectiveness. A breakthrough in developing high-yielding varieties of teff remain the biggest challenge of agricultural research in Ethiopia. The tendency to lodge under higher rate of fertilizer application is also a major problem in the cultivation of teff. In general, higher dose of fertilizer application has only helped prevent yield decline due to the rapidly falling soil fertility.

b) Wheat

Ethiopia is a primary gene center for durum (macaroni) type which accounts for more than two-thirds of the total wheat cultivated. Most wheat utilized by farmers are landraces of a mixture of different genotypes and species. The major wheat-producing areas lie between 1500 and 2500 meters. Arssi and Shoa are the principal producers of wheat in the country. Wheat straw is important as feed for animals and as roof cover in the rural areas.

Wheat flour is used for making home-made bread at household level or commercial bread by bakeries in the urban areas. The number of flour mills relying on locally produced and imported wheat is growing rapidly. It is believed that per capita consumption of wheat has risen sharply during the last 15 or 20 years due to large quantities of wheat coming from abroad in the form of food aid and commercial imports and increasing domestic production.

Average annual wheat production amounted to 0.75 million tons between 1980/1 and 1996/97 (Table VI.4). Annual production exceeded 1 million ton for the first time after 1994/95. On the average, around 615,280 ha is used for wheat cultivation. The share of wheat in the total cereal area and cereal production averaged 13%, the least share among the five major cereal crops (Table VI. 4).

TABLE VI.4: Nation Wide Total Production of Five Major Crops

YEAR	TEFF			BARLEY			WHEAT			MAIZE			SORGHUM		
	Quinn (000)	Area (000 ha.)	Yield (q/ha.)	Quinn (000)	Area (000 ha.)	Yield (q/ha.)	Quinn (000)	Area (000 ha.)	Yield (q/ha.)	Quinn (000)	Area (000 ha.)	Yield (q/ha.)	Quinn (000)	Area (000 ha.)	Yield (q/ha.)
1980/81	1333/033	1385 058	9 629	9810 535	743 213	13 200	5105 561	462 266	11 045	8354 752	671 150	12 374	14194 174	973 355	12 374
1981/82	11018 784	1354 439	8 136	8677 272	727 800	11 923	5640 938	592 085	10 034	10437 236	582 953	17 904	12165 042	831 493	17 904
1982/83	13971 542	1423 515	9 815	10706 322	814 675	13 142	7593 912	632 485	12 639	14583 625	732 965	19 897	13786 945	897 140	19 897
1983/84	14258 100	1300 461	6 275	8541 165	816 710	10 213	6036 428	580 246	10 403	14796 310	799 087	18 511	12398 144	929 958	18 511
1984/85	9057 145	1339 876	6 760	7721 935	741 411	10 415	6050 425	592 102	9 885	35598 818	847 723	11 323	5058 100	754 460	11 323
1985/86	9575 638	1291 891	7 412	8070 445	821 423	9 825	6571 585	696 113	9 578	8825 754	784 255	11 254	9005 503	843 451	11 254
1986/87	10031 100	1277 081	8 090	8938 709	707 956	11 202	6511 271	587 306	11 067	15411 037	932 107	10 534	9670 375	752 862	10 534
1987/88	10180 100	1246 824	8 166	8225 751	676 546	12 151	6817 894	592 630	11 504	16309 647	856 351	19 046	8914 035	773 395	19 046
1988/89	12507 469	1367 677	8 630	7415 359	648 812	11 429	6884 102	561 347	12 264	14550 749	788 807	18 447	8423 507	607 512	18 447
1989/90	10475 012	1219 328	8 696	7982 000	605 268	13 753	6936 530	540 029	12 845	17243 365	880 210	19 569	9646 936	723 100	19 569
1990/91	10455 543	1267 913	14 291	7266 000	561 673	12 919	7135 277	497 148	14 352	11821 127	926 843	12 754	6940 273	498 831	12 754
1991/92	11905 184	1378 173	8 696	7982 000	605 268	12 526	7595 573	549 279	13 830	12591 656	766 132	16 435	5588 621	429 695	16 435
1992/93	14007 170	1395 738	10 036	8090 559	612 962	13 199	8860 351	556 279	15 929	14374 712	775 897	18 527	6456 870	435 172	18 527
1993/94	12960 225	1433 428	9 064	9000 736	604 078	15 351	7885 096	572 832	13 741	13820 300	835 564	16 539	7246 082	458 549	16 539
1994/95	13542 197	1923 042	7 042	8841 356	916 974	9 642	10679 423	862 422	13 309	17435 497	1152 203	15 146	11701 553	924 108	15 146
1995/96	17623 760	2007 400	8 385	8725 760	825 540	10 570	10763 040	882 060	12 202	25392 920	1290 980	19 828	17226 520	1252 410	19 828
1996/97	20018 930	2167 770	9 235	7423 850	697 670	10 641	10315 900	772 230	12 970	25320 030	1316 870	19 227	20073 460	1300 950	19 227
Average	13926 586	1467 497	8 040	8407 215	717 156	11 877	7504 897	615 280	12 212	14754 914	878 229	16 867	10488 008	793 265	16 867

Source: FAO

TABLE VI.5: Nation Wide Total Production of Cereals, Pulses and Oil Seeds

YEAR	CEREALS			PULSES			OIL SEEDS		
	(000' QUINTALS)	A.GROWTH	% SHARE	(000' QUINTALS)	A.GROWTH	% SHARE	(000' QUINTALS)	A.GROWTH	% SHARE
1980	56118.610	-0.037	85.05%	9184.090	-0.006	13.94%	541.270	-0.215	0.97%
1981	54057.710	-0.243	84.86%	9143.220	0.124	14.35%	503.400	0.568	0.75%
1982	67182.800	-0.177	85.95%	10272.770	-0.222	13.13%	789.300	-0.254	1.01%
1983	55258.190	-0.233	86.57%	7987.280	-0.247	12.51%	589.160	0.049	0.92%
1984	42368.470	0.137	86.48%	6012.390	-0.104	17.26%	618.200	-0.037	1.20%
1985	48199.870	0.349	88.95%	5389.270	0.201	9.85%	595.420	0.200	1.10%
1986	65080.000	-0.048	90.35%	6470.140	-0.065	8.96%	476.540	-0.077	0.60%
1987	61950.000	-0.031	90.44%	6109.420	0.000	11.92%	440.000	-0.037	0.94%
1988	63040.000	-0.005	90.71%	6111.370	0.021	8.68%	423.520	0.040	0.60%
1989	63550.000	-0.016	89.55%	6242.690	0.163	8.89%	407.720	0.037	0.50%
1990	64570.000	-0.024	87.70%	7108.430	0.011	9.86%	423.940	0.415	0.59%
1991	70700.000	0.121	88.59%	8244.550	-0.011	11.47%	660.000	0.000	0.83%
1992	69060.000	-0.023	88.14%	8150.000	0.070	10.25%	600.000	-0.060	0.76%
1993	72760.000	0.054	87.80%	8723.000	0.095	11.13%	570.000	-0.018	0.73%
1994	91670.000	0.260	89.68%	9560.000	0.185	11.52%	560.000	0.018	0.69%
1995	110600.000	20.050	90.24%	11330.000	2.250	10.77%	570.000	1.750	0.55%
1996	110600.000	1.332	88.49%	1138.000	0.161	9.29%	580.000	0.120	0.47%
Average	65883.274	1.440		7381.408	0.620	16.75%	546.760	-0.270	0.76%
Growth rate in Log-linear (%)		8.100			0.231			0.491	
Level of sign									

A. GROWTH - Annual growth.

Source: FAO

Wheat production and area increased by 1.6% and 0.7% per annum, respectively, during the period 1980/81 to 1996/97. The average yield level for wheat is 12.2 quintals per ha. Among field crops, a statistically significant yield levels increase of 0.9% per annum was observed only in the case of wheat (Table VI.4). Such performance was made possible by the relatively higher rate of input utilization. Wheat area covered with improved seeds in 1996/97 was the largest (6.5%) among cereals (Table VI.5). The actual area is believed to be higher since farmers often refer to seeds saved from previous harvest or obtained from other farmers as own or local seeds although these were improved seeds originally. Wheat is also the most fertilized among all crops. Nearly 58% of the wheat area was fertilized in 1996/97 and the rate of application was 74 kg per ha. In fact, the rate of fertilizer application rose to 128 kg per ha for fertilized area.⁷ (Table VI.5). Pesticide was also more commonly applied on wheat than on any other crop.

Given the high level of modern input application, the performance of wheat yield is not encouraging. The yield gap between well-managed research or extension plots and farmers' field is very wide (over 40 quintals per ha has been reported by the latter). Low average yields at farm level may be attributed to poor quality of local and improved seeds and frequent attack by insect/ disease. Lack of wide adaptation and resistance to wheat rusts have plagued high yielding exotic durum lines introduced from external sources into Ethiopia and interest is gradually shifting toward the use of indigenous germplasm in breeding programs (Cladwell, 1992).

c) Barley

Ethiopian highlands have the highest endemic percentage among the genetic centers of barley. It is the most important crop in the cooler highland areas. Barley cultivation is rare under 1900 meters. It is also the most widely cultivated *belg* crop. Apart from household consumption, barley is made into a local beverage in most parts of the country. Beverage industry in the country also purchase some 10,000 tons of barley per annum to prepare malt for breweries (Kuma and Mekonnen, 1994). The main surplus barley producing areas are Arssi and Bale. The straw of barley is highly valued as animal feed.

Between 1980/81 and 1986/97, annual production of barley averaged 0.84 million tons and accounted for 15% of the cereal production. The level of output remained unchanged after 1992/93, but its share declined to 12.4%. On the average, a total of

⁷ These figures seem to be on the high side but the favorable position of wheat is unquestionable.

717,160 ha, 15.2% of cereal area was devoted to barley production and yield averaged 11.9 quintals per ha. (Table VI.4).

Barley is the only crop among the cereals whose production declined by 0.4% per annum. Both yield and area under barley tended to decline during the period under consideration. The reasons behind the poor performance of barley are not known. However, there are some indications of rapidly declining soil fertility in traditional barley-growing areas (Tsehay, 1996). A shift towards the cultivation of 'sinar' is mainly motivated by the poor yield of barley on the degraded highland areas. The level of fertilizer may also have been too low to prevent the declining trend. Only 30% of the barley area was fertilized and the rate of fertilizer application was much lower than wheat (25 kg vs. 74 kg/ha) in 1996/97. Improved seeds were used in only 0.1% of the total area cultivated (Table VI.5).

d) Maize

Maize was reportedly introduced into Ethiopia by the Portuguese in the 16th or 17th century. It is mainly grown in medium altitudes of the *woina dega* regions. Lowland types grow well below 1600 meters in the *kola* regions. Maize is grown under a variety of cultural practices, including both short and long season rainfed cultivation and short-season irrigation. It is often the dominant cereal crop in most areas of the Southern region and western parts of Oromiya.

Maize is a staple food in the areas where it is grown. It is also thought that maize consumption has significantly increased over the years, as maize is the cheapest grain for farmers in food deficit rural areas and low-income households in the urban areas. Its use in home-made beverages is also believed to have increased. Maize stalk is valuable as animal feed, fuel and construction material.

Mean annual maize output which amounted to nearly 1.5 million between 1980/81 and 1996/97 increased to 1.9 million ton, denoting the largest share (28.4%) among cereals, in 1992/93 - 1996/97 (Table VI.4). Maize output increased by nearly 2% per annum during 1980/81 - 1996/97. In the last two years reported, maize output has reached a record level of 2.5 million tons and is expected to increase even more. This growth rate is explained mainly by expansion of area which increased by 1.4% per annum. Yield also increased by 0.5% per annum but it was not statistically significant. Area under maize rapidly expanded after the reform, increasing from 835,590 ha in 1993/94 to over 1.3 million in 1996/97.

Maize production is not characterized by high rate of fertilizer application. Only 33.8% of the maize area was fertilized and the average rate of application was 24 kg per ha in 1996/97, well below the average for cereal (35 kg/ha). However, the percentage of maize area covered with improved seeds was the second largest, 4.6%, (next to wheat) in 1996/97 (Table VI.5). Improved seeds other than hybrid seeds are expected to be multiplied by farmers and used as local seeds. According to CSA, maize is the most important crop fertilized with organic matter (manure).⁸

The main pest and diseases of maize are earworms, birds, smut and rust. But storage is perhaps the major problem in producing maize. Storage losses can be substantial if maize is stored for more than 4 or 5 months without the use of insecticides against weevils. As farmers are forced to sell their maize soon after harvest, prices tend to show extreme seasonal as well as yearly variations.

e) Sorghum

Sorghum is reported to be domesticated in Ethiopia over 5,000 years ago. It has developed into many local landraces and spread out of Ethiopia to different parts of Africa (Cladwell, 1992). It now grows in the highlands, as well as in the lowlands, where rainfall is short and erratic. It is produced and serves as a staple food mainly in Hararghe, Wollo, and in many parts of Shoa.

The stalk is the main fuel and construction material in areas where sorghum is grown. Sorghum is commonly planted at high density with the aim of thinning, a major source of animal feed during the growing season. After harvest, softer parts of the stalk and the leaves are used as hay for animals.

Sorghum is the third most important crop, after teff and maize. On the average, it accounted for some 18% of the total cereal production and 15% of the total area between 1980/81 and 1996/97. Output, area and yield of sorghum showed no significant increase over the same period. However, the trend in recent years has been encouraging as production increased from 0.7 million tons in 1993/94 to 2.0 million tons in 1996/97. This is mainly due to the unprecedented increase in area under cultivation, jumping from 458,550 ha to 1.4 million ha over the same period.

The factors behind the recent improved performance of sorghum are not clear. But the evidence shows that technological factors are not among the reasons. For instance, the proportion of fertilized area was only 7.7%, and the rate of application

⁸ See for instance, CSA, Statistical Abstract, 1997.

just 5 kg per ha in 1996/97. One possible explanation is the favorable weather which the country experienced over the last few years. When faced with drought, farmers often replant sorghum fields with small cereals. It appears this has not happened in recent years, at least in most cases.

Among the major problems of sorghum cultivation are striga (parasitic weed) and birds. It has been reported that birds can easily reduce yields by half (Caldwell, 1992). Serious insect problems have also been reported very recently. As in the case of maize, sorghum is easily attacked by weevils under storage.

f) Root and Tuber Crops

Root and tuber crops are an important part of the Ethiopian diet. Among the most important root and tuber crops are *enset*, sweet potatoes, Irish potato, yams and cassava. Cassava and sweet potato are grown in the high rainfall south and south-western parts of the country, while sweet potatoes are adapted to the drier eastern highlands.

Enset is by far the most important tuber crops grown in Ethiopia. Over 10 million people are said to depend on *enset* as their staple food (Bizuayehu, 1995). It is an integral part of the culture in most parts of the Southern region. The fiber and food from pseudostem, corm and rhizome (underground stem) are extracted and decorticated using locally made bamboo sticks. Although primarily grown as a food crop, other parts of the plant are used for making fiber and twine and the leaves are fed to animals in dry season.

Statistical information on area and production has recently been published by the Central Statistical Authority. The total area under *enset* was 167,900 hectares in 1997. Over 68% of the total area is found in the SENNP region and 32% in Oromiya. A total of 1,813,600 households or 9,822,900 people are estimated to be engaged in the production of *enset*.

Enset provides more amount of foodstuff per unit area than most cereals. Only 40 to 50 *enset* plants occupying 160 to 240 sq. meters can provide enough food for a family of 5 to 6 people. (Shiferaw, 1996)

Cultural practices in the production of *enset* have not shown significant improvement. It is estimated that only 1.2 kg of chemical fertilizer is applied per ha of *enset* land. *Enset* has lately come under attack from bacterial wilt. A survey in Marka woreda, Southern region, showed that 88% of the farmers have been affected by the problem

(Shiferaw, 1996). Yield is declining as farmers are forced to harvest prior to maturity for fear of the disease. Declining soil fertility has also contributed to the low *enset* yield. There are no new technologies such as improved or resistant varieties to modernize the production of *enset*. The crop is largely neglected by the research and extension system of the county.

3.2.3. Performance of Major Cash Crops

a) Coffee

Ethiopia produces one of the best highland coffee in the world. The country is known to be the original home of coffee arabica, mainly produces sun-dried unwashed coffee types known in the world market for their flavor. It is estimated that around 15 million people depend on coffee production, processing, trade and transport. Over 60% of the country's foreign exchange also comes from coffee export.

There is no reliable estimate of area, production and yield of coffee. The former Ministry of Coffee and Tea Development (MCTD), recently renamed the Coffee and Tea Authority (CTA), estimated the total area under coffee at 321,048 hectares producing around 151,565 tones on the average.⁹ Yields are estimated at 4.7 quintals per hectare, according to CTA, perhaps one of the lowest in the world. Research findings have shown that over 20 quintal per hectare can be produced¹⁰.

Coffee export has recovered from the disastrous performance in 1991/92. The economic reform which devalued the domestic currency and allowed the private sector to participate in marketing has contributed to the recovery.

Over 96% of the coffee production in Ethiopia comes from smallholder farmers. No more than 4% is produced by the government owned farms such as Teppii, Bebekka, Arbagugu and Limmu State Enterprises (Taye, 1997). The main coffee producing regions are Oromia and the Southern region. But the ongoing extension effort attempts to introduce coffee to other regions as well including Amhara, Benishangul, Tigray and Gambella. According to CTA, the number of woredas to be covered by the extension program over the three-year period of 1997 to 1999 is 27 in Amhara, 9 in Benishangul, 4 in Tigray, and 1 in Gambella. The corresponding number in Oromia

⁹ CSA, on the other hand, estimated total area as 191,630 ha (Table V.5). If only this size of land is under coffee, the yield of coffee rises to more than 10 qt/ha, given the annual level of production in the country.

¹⁰ Coffee and Tea Authority, *Coffee and Tea*, 4th year, No. 7, August 1998 (Amharic report)

and the South was given as 40 and 43, respectively¹¹. The regional bureaus of agriculture are responsible for the implementation of the extension program which mainly includes establishment of nursery sites, dissemination of seedlings, rehabilitation of old coffee trees and improved management of existing coffee trees. The extension effort is assisted by the Coffee and Tea Authority which offers training and introduces the extension package to the regional bureaus. The Jimma Research Center is given the mandate of monitoring the adoption of the technology and transfers new technology to the Coffee and Tea Authority.

The main threat to increasing coffee production is infestation by Coffee Berry Disease and other diseases (CBD). The annual loss due to CBD is estimated at 20 to 30% of the total annual production (Tefsitwold, 1994).

b) Cotton

Cotton farms in Ethiopia are of two types: large-scale state farms and traditional peasant farms. Large-scale cotton cultivation is concentrated in the Awash Valley (Afar Region and in three other areas, namely North Omo (Southern Region), Ababo (Gambella Region) and Gode (Somali Region). Cotton is grown with the help of irrigation in all cases but Ababo.

State farms cultivated 35,741 hectares and produced 85,143 tons of seed cotton in 1985 for consumption by domestic textile firms which employ between 37 and 40% of the manufacturing labor force. However, the trend has been one of declining in recent years, with cultivated area and production falling to 34,350 hectares and 44,000 tons respectively in 1990. Cotton land under state farms measured only 16,573 and 13,288 hectares in 1991 and 1992, respectively, due to the new economic policy which gave back farm land to local farmers. Lack of improved seeds and inadequate pest control have also contributed to low yield and poor quality of lint (Mulat and Bente, 1994).

The declining importance of state farms is not a problem so long as the number of commercial farms growing cotton is expanding. Indeed, several investors did try to establish cotton farms in places where state farms used to operate after the 1992 economic reform. However, lack of clear land policy resulted in confusion over ownership of land (e.g. Afar Region) and many investors have reportedly abandoned their farms. Depressed demand for locally manufactured textile products has also reduced demand for cotton. Peasant cotton production is found in most parts of the

¹¹ Coffee and Tea Authority, *Coffee and Tea*, 4th year, No. 7, August 1998 (Amharic report)

country. It is estimated that peasant producers cultivate around 16,210 hectares of land. Almost all cotton produced by the peasant sector is used by the craft industry.

A major constraint of cotton farming in Ethiopia is the absence of institutional framework to initiate and implement development programs. The Ministry of Agriculture, which is largely concerned with food crops, has no capacity to handle the complex problems of cotton farming. Given its economic importance and the country's high potential (in growing cotton), an agency responsible for the development of cotton, similar to Coffee and Tea Authority, needs to be established. The agency or department within the Ministry of Agriculture must have the capacity to formulate and implement policies and programs aimed at removing production, marketing and export constraints.

c) Sugar

Sugar cane is produced by three sugar factories, namely Wonji, Wonji Shoa, Methara and more recently Fincha. Nearly 15 thousand hectares of land was cultivated by the three state-owned farms in 1989/90. Sugar cane is also produced by outgrowers living around these farms and other farmers living in different parts of the country. The latter supply sugar cane which is chewed as a sweet. The total area under peasant holding is estimated to lie between 8 and 10 thousand hectares.¹² Lack of processing facilities (e.g. jaggary) is a major constraint to expanding sugar cane cultivation.

Total domestic production of sugar varied between 123,000 and 186,000 tons during the period 1980/81 to 1995/96. Sugar output declined by 0.6% per annum over the same period. Export of sugar and molasses also decreased substantially in recent years due to declining soil fertility and problem of flood. On the average, 92% of the total production is locally consumed, while the balance is exported.

d) Tea

Tea is commercially grown on state farms located at Gumaro and Wushwush in the south-western parts of the country. The total cultivated area is only 1,951 hectares. Tea production expanded from 44.9 tons in 1980/81 to 3,701.3 tons in 1997/98. It is widely believed that Ethiopia could become self-sufficient in tea and foreign exchange savings from import substitution can be substantial. A concerted effort is required to

¹² CSA, Statistical Abstract, 1995 and 1997

promote tea production by small holders (as outgrowers) and by large-scale commercial farmers. Nevertheless, tea plantation, which has an economic life of 50 to 100 years and requires 9 to 12 years to give optimum harvest, is not attractive to investors, especially in situations where the land policy is not clear. A more favorable land policy and government institution charged with research and development responsibilities may be needed to enhance tea production.

e) Tobacco

Tobacco is traditionally grown as a garden crop in many parts of the country. Native tobacco has been used for snuffing, chewing and for pipe smoking ('gaya'). As a commercial crop, tobacco is grown by some state-owned farms and outgrowers around them. The National Tobacco Enterprise has been given the mandate to organize tobacco production and processing in the country.

The principal tobacco cultivation areas have been Sidamo, Wollaita, North Shoa and Hararghe. Commercial production is concentrated in Shoa Robit (North Shoa), Bilate and Awassa (Sidamo) and Nura-Era (Hararghe). State farms in these areas produce about 500 - 900 tons of cured leaves annually from about 2,000 hectares of land. The area cultivated by small farmers was estimated at 2,090 hectares in 1996/97.

The production by the state farms together with that of outgrowers fulfills 60 to 70 percent of the demand of the cigarette manufacturing firm in Addis Ababa. About 200 to 1,200 tons of Tobacco is imported every year (Debebe, et al., 1993)

f) Chat

Chat is mainly grown in Hararghe, Sidama, Jimma, Kembata and Gurage zones. The area under chat cultivation was estimated at 81,230 hectares in 1996/97. Owing to its high price, farmers in many areas are giving more attention to chat and are reportedly replacing coffee trees with chat seedlings in some areas. The young leaves are chewed for their stimulant effect. Chewing chat is one of the popular means of recreation among the youth in many urban areas. Chat is exported to neighboring countries such as Djibouti, Yemen and Somalia. Export prices have been rising since the mid-1970s (Ezekiel Gebissa, 1994). Both legal and illegal channels are used in the export trade. The volume of chat export (official) increased from 2,931 tons in 1986/87 to 3,699 ton in 1995/96. Chat is now the third major export earner of the country, after coffee and hides and skins.

g) Horticultural Crops

Horticultural crops, mainly fruits, vegetables and cut flowers are grown on state farms and small private farms. State horticultural farms are organized under the Horticultural Development Corporation recently renamed as the Horticultural Development Enterprise (HDE) which cultivates about 6,600 hectares of irrigated land in the Awash Valley. Small producers of horticultural crops are concentrated near the major cities where streams and rivers can be diverted for irrigation, Awash Valley and other Rift Valley areas. There are no reliable estimates of the total area allocated to horticultural crops by small farmers. Vegetables and fruits are the major crops grown on the small-scale irrigation schemes recently constructed as part of the food security strategy launched by the EPRDF Government. Export of fruits and vegetables increased from 6,051 tons in 1992/93 to 19,003 tons in 1995/96. The major constraint to expanding the export of horticultural crops is lack of a clear land policy.

3.3. Livestock

Livestock have diverse functions in the production systems described above. Food production in the form of meat, milk and other livestock food products constitute a major group of livestock outputs. In the smallholder mixed farming systems, 26% of livestock output is used for food; in pastoral systems the proportion used for food increases to almost 2.5 times at 61%. Non-food commodities such as draft power, manure and transport services are important outputs that also serve as inputs to food crop production. Hides and skins as well as wool and hair are important outputs which mostly are considered as byproducts.

A study carried out in the mid 1980s estimated the imputed value of draft output to constitute 43% of the total value of livestock output (61% for cattle), while the shares of meat and milk were 34% and 14%, respectively. About 70% of the total value of livestock output was contributed by cattle, 14% by sheep and goats, 13% by poultry and the balance by camels (Addis Anteneh, 1992, using AACM, 1984 data). These proportions are unlikely to have changed significantly over the past decade.

Livestock are a source of cash income for smallholder mixed farming and pastoral households by whom up to 24% and 31% of livestock output are sold for cash, respectively. It has been estimated that over 85% and 90% of farm cash and pastoral unit income are generated by cash income from livestock. In the highland systems, up to 42% of livestock output is used as on-farm inputs in the form of draft power,

manure and the transport of farm produce and feed (ILCA, Livestock Policy Analysis Manual, 1994, using field study data by ILCA Programs).

Livestock contribute an estimated 30 - 35% to agricultural GDP and between 13 - 16% to overall GDP. These figures are considered an underestimate since they exclude the value of manure (both as fertilizer and household fuel) and transport (Survey of Agricultural Sector, MEDaC, February 1997). In 1987/88 livestock and livestock products contributed 23% and 21% of the value of agricultural and total exports, respectively. Since then these shares have gradually declined as shown in Table 6 below. Almost all of the value of livestock exports was contributed by hides and skins between 1992/93 and 1995/96. The contribution of hides and skins has remained high, partly because of the reduction in the export of other livestock products, including live animals, as well as the increase in the export price of hides and skins during the period.

Table VI.6 A. Share of Livestock in Agricultural and Total Exports (Percent)

	1987/88	1992/93	1993/94	1994/95	1995/96
Share in Agricultural Exports	23.4	17.6	15.9	14.8	13.9
Share in Total Exports	21.3	16.6	15.1	14.2	12.9

Table VI.6 B. Share of Hides and Skins in Livestock, Agricultural and Total Exports

Share of Hides and Skins in Livestock Exports	79.2	98.8	94.9	96.3	96.1
Share of Hides and Skins in Agricultural Exports	18.6	17.4	15.2	14.2	13.4
Share of Hides and Skins in Total Exports	16.9	16.4	14.4	13.7	12.4

Source: MEDaC, Survey of Agricultural Sector, February 1997, quoting data from Department of Industry and Trade.

3.3.1. Past Performance of Livestock

Compared to sub-Saharan Africa (SSA) as a whole and to countries such as neighboring Kenya, the performance in the production of the main commodity outputs from Ethiopian livestock has not been satisfactory, particularly in more recent years. Table 7 presents annual growth rates for the main livestock food commodities for Ethiopia, East Africa (EA) and SSA during 1975-87 and volume and growth rates for Ethiopia for more recent periods.

Offtake from the national cattle herds and small ruminant flocks has remained low. In cattle it has ranged from 7-10% depending on the production system. The large number of draft oxen that need to be maintained in the mixed cereal-livestock farming systems of the highlands have influenced cattle offtake rates (implying the need to keep a relatively large number of breeding females to produce replacements and the young stock until they are ready for the draft function). Much higher offtake rates for sheep and goats have been estimated in the past - 25-26% for sheep and 27-28% for goats. More recent estimates have lowered these figures to 19% and 25% for sheep and goats, respectively (NLDP, January 1998, *op. cit.*).

Mortality rates have remained high at average rates of 8-10% for cattle, 14-16% for sheep and 11-13% for goats. These rates are much higher for the younger animals in each species. Young cattle mortality can go up to 13% for one-year old calves; mortality rates for one-year-old sheep and goats can range from 15-18%.

Table VI.7.

Ethiopia: Average Annual Growth Rates of Major Livestock Food Commodities

Product	1987			1975-87			1980-90		1991-97	
	Volume ('000 MT)			Growth (% p.a.)			Ethiopia		Ethiopia	
	SSA	EA	ETH	SSA	EA	ETH	Av. Vol. (MT)	Growth (% PA)	Av. Vol. (MT)	Growth (% PA)
Beef	2011	860	246	1.5	0.9	1.6	226		236	
Mutton	426	265	82	2.7	2.7	1.2	83		80	
Goat Meat	495	199	66	2.0	1.5	2.1	64		64	
Poultry Meat	872	186	72	5.9	3.4	2.0	72		74	
Total Meat	4948	1836	591	2.5	1.8	1.8	456	0.89	466	-0.65
Milk	9782	7323	960	3.3	3.9	2.4	891	1.30	969	-5.6
Egg	738	235	78	5.2	4.6	1.0	76	-0.32	75	-1.25

Source: FAO Agricultural Database, FAO 1990-1997.

4. THE PROBLEMS AND PROSPECTS OF FOOD SECURITY

One of the consequences of the poor performance of Ethiopian agriculture is widespread food insecurity. An estimated 50 to 60 percent of the country's population is food insecure, or lives below the poverty line. The major cause of food insecurity is drought and resource degradation which is a consequence of ill advised rural policies of successive governments. The number of drought-affected population between 1981 and 1995 ranged from a minimum of 2.53 million in 1987 to 7.85 million in 1992.¹³ The major drought affected areas are Tigray, Wollo, North Gondar and Hararghe. Food aid accounted for as much as 11% of the domestic production during the period 1985 to 1996. Owing to the good harvest, the share of food aid declined to about 3% in 1996.

Domestic food supply has failed to meet the basic food requirements of the country. Based on the recommended food intake of 2100 kcal per person per day (equivalent to 225 kg/head of cereals per annum), the annual deficit increased from 0.75 million tons in 1979/80 to over 5 million tons in 1993/94, more than a 6 fold increase in just 14 years. The situation appeared to have improved after 1994/95, but the food gap remained over 2.6 million tons even in the year with a record harvest (1995/96).

Food insecurity is often classified into two types: chronic and transitory food insecurity. Chronic food insecurity in the rural areas refers to land scarcity which consists of more than one third of the households who farm less than 0.5 hectares which under rainfed agriculture is inadequate to meet subsistence requirements. Where the land is marginal and fertilizer use is unknown, households farming less than 1 ha can be classified as chronically food insecure. Households experiencing shortage of draft animals and cash to buy seed and fertilizer may also be added to the group. Landless, elderly, disabled, female-headed, poor pastoral, non-farming and newly established households also suffer from chronic food insecurity.

Transitory food insecurity arises from drought, displacement of people and refugee inflows. In areas with frequent drought, the problem of food can be semi-structural and quasi-chronic. Pastoralists in general suffer from transitory food insecurity.

A concerted extension effort combined with good rains has helped increase cereal production since 1995. However, there is no evidence of the type of yield increase

¹³ See for instance IDRL, Food Security Strategy, Prepared for the Consultative Group Meeting of December 11/12, Addis Ababa, 1996.

needed to feed a national population that is growing at 3% per annum. Given the average farm size of about 1 hectare for a family of approximately 5 persons, cereal yields of less than 13 quintals are, at best, barely adequate to meet the household requirements. The observed decreasing tendency of the average farm size in the past few decades is one of the serious threats to the prevalence of food security in the country.

One of the Government strategies to eliminate famine and food insecurity, has been designing a National Disaster Prevention and Management Policy (NDPMP). The former Relief and Rehabilitation Commission has also been reorganized as the Disaster Preparedness and Prevention Commission (DPPC), the underlying idea being to direct development towards reducing vulnerability, and relief towards enhancing long-term development. The main goal of NDPMP is to strengthen the society's capability to face the challenge of such disasters in the future. The DPPC has also been attempting to build its disaster preparedness capabilities by strengthening the Food Security Reserve Administration. The aim is to increase the reserve to a level required to supply food to an average of 4.5 million people at any one time.

Although increasing agricultural production will both add to food availability and increase income over the medium term, it will not be enough in itself to ensure access to sufficient food for everyone. Beyond boosting food and agricultural production, unfavorable price fluctuations and storage losses need to be arrested to overcome the food security problems of the country. Emphasis should also be placed on employment generation schemes to increase the purchasing power of the low income group. Improving entitlement through employment/income support schemes, targeted programs, and nutrition/health interventions are needed if the agricultural development effort is to have a positive impact on food security.

5. EXPLAINING THE POOR PERFORMANCE OF AGRICULTURE

As in any productive sector, effective agricultural production requires the availability and efficient utilization of factors of production such as land, labor, capital and knowledge. Considering the percapita arable land availability in the country¹⁴ and the number of people employed in agriculture, lack of land and labor resources could not

¹⁴ According to the most recent World Bank World Development Report, (1999-2000) Ethiopia has 0.2 hectares per capita while Egypt has 0.05, Congo 0.16, Japan 0.03, with much higher production and productivity than Ethiopia.

be the main factors explaining the poor performance of Ethiopian agriculture although their inefficient utilization certainly is. The latter two factors, namely capital and knowledge are certainly in short supply in Ethiopian agriculture. However, the shortage of capital and knowledge or the lack of flow of these two factors in sufficient quantity to Ethiopian agriculture are functions of the institutional arrangements that guide resource allocation in agriculture. We will therefore concentrate on institutions influencing the sector for detailed treatment in the next section.

Among the major factors behind the poor performance of Ethiopian agriculture are diminishing farm size and subsistence farming, soil degradation, inadequate and variable rainfall, tenure insecurity, weak agricultural research base and extension system, lack of financial services, imperfect agricultural markets and poor infrastructure. Some of the factors raised above are pretty much out of the control of policy makers. However, most of the causes of the poor performance are directly or indirectly related to the policies pursued by different governments in Ethiopia over the past three decades or so. In the first part of this section we will briefly examine each of the constraints mentioned above. In the conclusions and policy challenges section of this chapter, we will look at the policy issues much more carefully.

5.1 Declining Farm Size and Subsistence Farming

The growing population pressure in rural Ethiopia and the limited possibility of expanding the total land area has generally led to a reduction in the per capita land size available for farming. The very limited possibility of migration owing to the land policy that made the possession of land plots conditional upon residence in the *Kebelles* since the land reform proclamation of the Derge, has led to periodic redistribution and the leveling down of holdings over the past twenty five years. Accordingly, the average farm size has declined to just 1 ha for the country as a whole. It has fallen to less than 1 ha in 7 of the 11 regions, or 62% of the households cultivate less than 1 ha. Over one-third (36%) of the holdings are less than 0.5 ha.

Households with small plots seldom produce enough grain to meet their family's consumption requirements. Subsistence and survival are their overriding concern. Nearly all farm produce as well as any non-farm income obtained is devoted to food. There is no surplus for investment and for input purchase. It has also been confirmed that the quantity of fertilizer used per hectare is directly related to farm size (Mulat et al, 1998). A similar relationship was also observed for improved seeds (Wolday, 1998).

The finding that non-users of fertilizer and improved seeds cultivate smaller land than users seem inconsistent with the general expectation that intensification is higher on smaller farms to compensate for land shortages. It could be that farm sizes in Ethiopia have already fallen below the critical threshold, implying that the inverse relationship between farm size and productivity (commonly reported for Asian and other countries) cannot be observed. There are indications of growing marginalization similar to what some authors referred to as 'agricultural involution' in the literature.¹⁵ Farmers with very small holdings lack not only the cash to buy commercial inputs but also oxen for land preparation. Often they participate in off-farm employment in order to meet their subsistence requirements.

Declining farm size would not translate into poverty provided the non-farm sector is able to provide employment for the growing rural population. Non-farm activities provide employment in their own right and also supplement agricultural incomes. According to a Ministry of Labor and Social Affairs survey, around 44% of the rural households reported non-farm income in 1996.¹⁶ Among the five regions covered by the survey, the highest rate of participation was observed in Amhara (54.2%) followed by Oromia (41.2%), Southern regions (38.9%), Tigray (31.7%) and Afar (6.8%) in that order. On the average, non-agricultural income accounted for 10% of household income. The share for Tigray and Amhara was above the national average, 17% and 11% respectively. However, low productivity, limited market opportunities, lack of credit and the absence of policy and institutional support, among others, have constrained the prospect of absorbing new entrants into the labor force in the non-farm sector. Opportunities for wage employment are limited owing to the small number of commercial farms in the country. Participation in the off-farm sector is induced by the need to supplement low agricultural incomes. Wage employment or non-farm activities rarely provide full-time employment in the rural areas. Rural income and employment problems as well as the declining farm size that is one of the major causes of poverty in rural areas can only be addressed if and only if sufficient attention is given to non-farm and wage employment. In other words, the problems of the agricultural sector can only be addressed in tandem with the issue of industrialization.

¹⁵ This is a process in which too much labor is involved in production with the aim of sharing out of the available work among those wanting agricultural employment. Man-land ratio drops and per capita income falls below requirements for sustainable agricultural development (Booth and Sundrum, 1985).

¹⁶ Ministry of Labor and Social Affairs, Rural Non-Farm Activities and Agricultural Wage Employment, Addis Ababa, 1996.

5.2 Soil Degradation

Farm and grazing lands in Ethiopia have suffered from massive land degradation. The serious shortage of good land in the highland areas coupled with population pressure have forced cultivation of a large part of the steep hillsides, especially in areas of heavy land pressure. Areas with steep and moderate slopes are highly degraded because of soil erosion. The seriousness of the problem becomes apparent when one considers the fact that nearly 70% of the Ethiopian highlands have slopes in excess of 30°. Compounding the problem of degradation on such terrain is the current farming practice, which rarely includes terracing and other soil conservation techniques.

According to the Ethiopian Highland Reclamation Study, around half of the highlands or 27 million ha are already significantly eroded, of which 14 million ha of agricultural land is seriously eroded. Areas most severely eroded include Tigray and densely cultivated and cropped areas of Gondar, Wollo and northern Shoa (Caldwell, 1992). Studies predict the erosion problem to worsen over the years. For instance, one study (Stahl, 1990 in Caldwell) suggested that between 1985 and 2010, soil erosion will increase the land area incapable of being cropped from 2 million hectares to 10 million hectares - an area covering approximately 17 per cent of the highlands.

Land degradation in Ethiopia is also exacerbated by centuries of crop production without fertilizer which have resulted in net outflows of vital nutrients from the soil. Traditional farming practices have ignored the importance of replenishing the soil as animal manure is used for fuel instead of putting it back on the land. The soil in many areas have lost some biological productivity and physical properties needed for optimal plant growth, and in particular moisture retention has been adversely affected (FDRE, 1996). The problem of land degradation is mainly caused by lack of investment on the land which in turn is largely explained by lack of tenure security as discussed below.

5.3 Tenure Insecurity

A secure and fair system of land tenure is essential to the growth of agricultural production. Tenure security to cultivating farmers increases medium- and long-term improvements and investment on the land. Before 1975, tenants operating in the central and southern parts of the country under the *Gult* system lived under the constant threat of eviction and were required to cede a large percentage of their production to the landlords. In the northern areas with communal or 'rist' system,

frequent redistribution of land within the lineage group encouraged cultivation practices which gave little or no concern to the protection of the soil, trees and other resources, thereby accentuating land degradation. Land productivity steadily declined as farmers adopted no measure to arrest the soil erosion and depletion of plant nutrients.

The March 1975 land reform legislation of the former military government abolished all forms of private ownership of land and put land under state control. Farmers were given only usufruct right over the land they cultivate. Since every one above age 18 years was entitled to have a farm land which was allocated by peasant association officials, frequent redistributions of land were carried out to accommodate the growing population. Peasants were also forced into collectivization and resettlement which further exacerbated the problem of tenure insecurity (Dessalegn, 1994). Unprecedented levels of land degradation and deforestation took place as neither the government nor the community nor the individual was responsible to ensure sustainable use of the land. The policy of the Derge government also led to further fragmentation and reduced holding size which often fell below the minimum subsistence requirement of farmers as discussed above.

The 1991 economic policy document of the Transitional Government of Ethiopia declared collectivization and resettlement as undesirable and intended to put a stop to further redistribution of land. Although the document stated that a national referendum will be held on whether the land should remain under public ownership or given as a freehold private property, the EPRDF government conveniently pushed the issue out of reasoned public debate by inserting land policy in the constitution. Accordingly the December 1994 Constitution of the Federal Democratic Republic of Ethiopia proclaimed that land remains vested in the State:

'... the right to ownership of rural and urban land, as well as of all natural resources is exclusively vested in the state and in the peoples of Ethiopia. Land is a common property of the nations, nationalities and Peoples of Ethiopia and shall not be subject to sale or to other means of transfer.'

The promise to halt redistribution of land was also abandoned as the landless group, which included the youth, returnee ex-soldiers and settlers, increased considerably. In 1996, the Amhara region carried out land redistribution which gave land to the landless by reducing the holdings of farmers who were reportedly associated with the Derge and Haile Selassie governments. The other mechanisms which were commonly employed to cope with the growing new claimants of land was conversion

of the communal grazing land into farms. Hillsides with extreme slopes were cleared and brought under cultivation. Many landless or near landless groups resorted to selling charcoal and firewood wherever some trees are left.

In spite of the ongoing effort to promote soil conservation and afforestation programs, there is a consensus that the problem of land degradation and deforestation has worsened in most parts of the country and is expected to get worse in the future as long as the current land holding system continues. Incentive to invest on land improvement, under the present as well as the old system, are non-existent. And this is no mere theoretical postulation or ideas concocted by the "unaffected" petty bourgeoisie. There is ample empirical proof that peasants are seriously worried about insecurity and are willing to pay money to obtain secured tenure.¹⁷ More seriously, the average farm size is currently about 1 ha, well below the economic size required to ensure efficient use of agricultural resources. Further decline in holding size is unavoidable in turn leading to the unfortunate conversion of smallholder agriculture to micro-agriculture exacerbated by the existing land policy and by the limited employment opportunity outside agriculture. As Dessalegn correctly observed, "such systems have no where to go but down, i.e., they can only deteriorate because they are not capable of producing wealth but survive by consuming their meager assets. [they] are fragile systems: they collapse easily under minor pressures such as rainfall variability or moderate environmental distress" (Dessalegn, 1999).

5.4 Inadequate and Variable Rainfall

Although the weather has been better in recent years, lack of adequate rainfall combined with variability in the onset and duration of rains has remained a major threat to agricultural production in Ethiopia. The fact that Ethiopia can expect dry conditions for agriculture in perhaps three years out of every ten underscores the formidable challenge facing the agricultural sector. As shown in Table VI.22, the wettest provinces (according to the old administrative classification) are Keffa, Illubabor, Wollega and Gojjam while the driest provinces are Hararghe and Tigray. The average rainfall figures in the driest regions are not only substantially below the average for the whole country, but quite low compared to requirements for most

¹⁷ A very interesting recent dissertation by Tekie Alemu, which conducted surveys in five sites in three regions of the country (Tigray, Amhara and Oromia) clearly indicated the relationship between tenure security, investment in agriculture and soil conservation. Asking peasants whether or not they are willing to pay for tenure security and how much to illicit response about peasants attitude towards tenure security, the research found that most peasants are indeed willing to pay to gain secure rights to land. See Tekie Alemu, "Land Tenure and Soil conservation: Evidence from Ethiopia." Unpublished Ph.D. dissertation, Göteborg University, 1999.

crops. Rainfall variability, as measured by the coefficient of variation, is also very high in these regions. The rains in Bale (now part of Oromia) and Gamo Gofa (now North and South Omo) are also low and highly variable.

Average annual figures for large areas conceal shortages and delays in the onset of rains, especially where weather stations are few in number and unevenly distributed. A case in point is Wollo which has suffered from repeated droughts but the average rainfall figures are not so low. Bad weather in many parts of Wollo is known to have resulted in frequent crop failures.

The rainfall problem in the country is not expected to improve so long as environmental degradation continues unabated. A strategy to cope with the weather problem should be based on multidimensional considerations including the promotion of conservation-based farming systems, introduction of an effective land use plan, a secure tenure system and expansion of irrigated farming. In this regard, the focus on enhancing the use of fertilizer in the extension package may be considered only as a short-term measure.

5.5 Weak Agricultural Research and Extension Systems

5.5.1. Research

Agricultural research was started in the 1950s with the establishment of agricultural education institutions, namely Ambo and Jimma agricultural schools and the Alemaya College of Agriculture. Simple experiments were carried out by the staff of the institutions with limited academic interest. The Institute of Agricultural Research (IAR) was established in 1966 with the mandate to formulate national agricultural research policy guidelines and undertake crop and livestock research.

The national agricultural research system (NARS) in the country is today made up of organizations whose primary function is research and those that undertake research as a supplementary function. In the former category are included IAR, recently renamed the Ethiopia Agricultural Research Organization (EARO), Regional Research Centers (RRCs) and the Biodiversity Institute. In the latter category are higher learning institutions such as the Alemaya University of Agriculture (formerly Alemaya College of Agriculture), Awassa College of Agriculture, Jimma College of Agriculture, and Ambo College of Agriculture. The Ministry of Agriculture also conducts some adaptive research as part of its extension program.

Since the beginning of agricultural research in Ethiopia, over 250 improved crop varieties, animal breeds, farm implements and various other technologies have been developed. The highest number of technologies are generated for field crops (mainly wheat and maize) followed by horticultural crops and livestock. However, the benefit from these technologies has been limited. As indicated above, only less than 2% of the farmers in the country reported using improved seeds in 1996/97. The problem is related to inefficient distribution systems and the quality of the seeds. Most of the improved seeds are adapted to the few localities and agro-ecological conditions in which they were generated. Those that are released for use are not replaced on time, hence many of the available seed varieties have become outdated.

Agricultural research is constrained by a number of factors, but the most critical ones are shortage of resources and inappropriate policies and institutional deficiencies. Agricultural research is a long-term effort which require highly trained manpower and research centers with adequate facilities. Expenditure on research remained far below the level required to provide adequate incentives for researchers and ensure proper research facilities. The average expenditure was only about 15 million birr for the period 1966 to 1997 although it has shown an increasing trend over time. The average expenditure for the last ten years of the Derge was about 19 million while the average for the EPRDF government jumped to 32 million reaching a record high of 55 million budgeted for 1998. The World Bank has called for a target of 2% of the agricultural GDP to be invested in agricultural research.¹⁸ Research investments have traditionally produced high levels of returns, compared with investments in other areas. However, expenditure on agricultural research in Ethiopia, say in 1993/94, amounted to just 0.2% of the agricultural GDP.¹⁹ Budgetary constraints have also limited the number of research sites to a few locations, leaving most regions and farming systems of the country without any research service. The sector has also been a victim of brain drain as many senior researchers have left the country over the last one or two decades mainly in search of better salaries and working conditions, which maintained, among others, high standard laboratories and other facilities. Often research projects had to be terminated before completion because of the high staff turnover.

The Ethiopian NARS lacked clear national research policy to guide it and provide framework on its governance, coordination, follow-up and evaluation system. For the most part, research is carried out by individuals with no coordination, focus and

¹⁸ See for instance, ISNAR, 1988, *Role of Research in Transforming Traditional Agriculture: An Emerging Perspective*, The Hague, International Service for National Agricultural Research.

¹⁹ In 1994, investment in agricultural research amounted to Birr 26.59 million. Agricultural GDP for the same year (in nominal prices) was roughly 14 billion (National Bank of Ethiopia, Quarterly Bulletin).

consideration about final results and continuity. Inter-institutional research collaboration, functional and purposeful linkages between technology generation and the delivery system has remained weak. Since research programs are initiated and developed by researchers to reflect their own interest and institutional priority, the needs of the farmers are usually neglected (Goshu, 1995).

5.5.2. Extension

In the past, attempts to increase crop yields included the comprehensive and minimum package projects initiated in the late 1960s and 1970s with massive external support. It was thought that concentrating resources on the most promising regions would yield better results than spreading resources thinly over a larger area. A 'package' consisting of mainly improved seeds, fertilizer and chemicals, together with measures aimed at developing physical and social infrastructure, was introduced in the high potential areas (e.g. CADU in Arssi, WADU in Wolaita and TAHDU in Tigray) chosen for the comprehensive approach. Other high potential areas came under the influence of the minimum package and benefited from the agricultural package only. Although some progress was reported in increasing yield in these areas, the development effort was halted as the socialist-oriented military government, which took power in 1974, claimed that the main beneficiaries of the projects were rich farmers.

In the 1980s, a project known as the Peasant Agricultural Development Program (PADEP) was launched with the assistance of the World Bank and other donors. The aim was to cover most of the cultivating households using more or less a comprehensive approach which emphasized distribution of inputs, promotion of cooperatives and creation of awareness of the importance of soil and water conservation. The training-and-visit (T & V) approach, which required direct subject matter specialists participation was adopted to disseminate new technologies. No success was registered since the extension agents were required to spend most of their time assisting the fledgling producers cooperatives. Extension agents had no access to good information and did not generally have the incentive, training or the ability to adapt information to the farmers' situation (Mulugeta Mekuria, 1995).

Within the framework of the Agricultural Development-Led Industrialization (ADLI)²⁰, a new system of agricultural extension, known as the Participatory Demonstration and Training Extension System (PADETES), was launched in 1994/95. The system tries

²⁰ ADLI places emphasis on agriculture as the engine of growth, on account of its potentially superior growth linkages, surplus generation, market creation, and provision of raw materials and foreign exchange.

to merge the extension management principles of the T & V system with the technology diffusion experience of the SG 2000 program. The major elements of the extension package are fertilizer, improved seeds, pesticides and better cultural practices mainly for cereal crops (teff, wheat, maize, barley, sorghum and millet). Under the new extension system, the woreda offices of agriculture provide participating farmers with a package of inputs. Participants agree to allocate 1/4 to 1/2 ha of land for the demonstration plot and pay a 25 - 50% down payment on the input package at the time of planting with the balance due after harvest. The plots are managed by the farmers under the supervision of the extension agent. The number of such plots increased from 3,200 in 1994/95 to 600,000 in 1996/97. The plan for the 1997/98 season was to increase the number of participants to 2.9 million. Being convinced of the results obtained, the Government has given its full support to PADETES and is indeed at the center of the government's overall development strategy. Input packages have also been developed for wet areas, drier area, livestock and high value crops such as vegetables, pulses and oil seeds.

The new extension programs have increasingly been geared towards production rather than extension. Development agents are under pressure to work with as many farmers as possible. One agent may be required to supervise the demonstration plots of 200 farmers. With no adequate resources to back such rapidly expanding programs, it could be difficult to sustain the motivation of the development agents over a longer period. Administrative matters like credit disbursement and enforcing repayment have also absorbed much of their time.

At least three reasons are generally provided to question the sustainability of the current program. (Dessalegn, 1999) The first reason is the rising cost of fertilizer. Following the removal of subsidies in 1997, the cost of the package has significantly increased. There is a danger that this may result in a high rate of default, especially in bad years, and undermine the effectiveness of the program. The second problem is the inputs themselves. Both the seed varieties and the fertilizers that are being offered to farmers require a high level of moisture to be effective raising the risk of failure under conditions of high rainfall variability as in most parts of Ethiopia. The third reason is the problem of micro holdings discussed above. The package program is currently implemented on existing peasant farms with out any requirement of plot consolidation. The issue of micro farms raises two problems for peasants. A continuous increase in the price of fertilizers and other inputs while the size of farm plots continue to decrease. This is certain to generate quick collapse of the farming system even under moderate environmental distress. In short, under the conditions of micro-agriculture, there is no sufficient incentive for farmers for the continuous use of the package of inputs provided by the current program.

5.6 Underdeveloped Rural Financial Markets

The financial sector was highly regulated under the former government with interest rate ceilings and quantitative restrictions on operations of financial institutions. Public and cooperative enterprises were the main beneficiaries of the low-interest (which remained below 6% in the 1980s) credit supplied by the state-owned Agricultural and Industrial Development Bank (AIDB). Credit to the smallholder sector was restricted to financing fertilizer purchase and the interest rate charged was often higher.

Because of massive default, AIDB/DBE sharply reduced its supply of fertilizer loans in the early 1990s, resulting in a decline in fertilizer sales. In response, the Government took various measures to increase the supply of fertilizer loan. AIDB was restructured and renamed as Development Bank of Ethiopia (DBE) and its loss was absorbed by the state. The Government also revised the 1988 Rural Credit Policy which made input loans a close preserve of AIDB. In 1994, the Commercial Bank of Ethiopia (CBE) was instructed to participate in extending fertilizer credit along with the DBE. The regional governments were made responsible for loan disbursement and guarantee full settlement of the loan. The banks transferred all the money for the fertilizer loan to the regional states which in turn distributed to farmers. Credit disbursement and collection was carried out (entirely or mainly) by the regional administration for a minimal charge included in the interest paid by farmers. Unpaid loans were deducted from the regions' budget by the Federal Government and paid to the banks. This has significantly improved both credit access and loan recovery, but there is no guarantee that this will continue. Credit administration is taking too much time of the local authorities. Standard banking practices and procedures are often compromised when credit is handled by non-professionals or civil servants (working for local governments) with no training in banking or basic accounting (Mulat et al, 1998). In spite of the guarantee, there still exists a significant amount of unpaid or long overdue loans. The Commercial Bank of Ethiopia, for instance, reported long overdue loans of 37.4 million birr as of July 31, 1998.²¹

The capacity of the formal banking sector to serve the rural areas is limited. In 1997, the CBE and DBE had only 150 and 35 branches, respectively. Most of these branches are concentrated in the major urban areas. Only 21% of the woredas in the country have bank branches (Mulat et al, 1998). The newly established private banks

²¹ The regional distribution was given as 24.3 million in Oromia, 1.5 million in Amhara, 10.1 million in SENNP, 1.1 million in Addis Ababa and 0.3 in Tigray. See for instance, Fisseha Jima, Agricultural Credit for Fertilizers: Review of Performance in 1998 and Plan for 1999, paper presented to the Third Annual National Fertilizer Workshop, Sept. 30 - Oct. 2, 1998, Addis Ababa, Ethiopia.

are in their formative stages and are not expected to reach the rural areas in the near future.

Even where the formal banks are accessible, high collateral requirements, elaborate paper work and high transaction costs have meant that they serve only "big" business, not the poor rural or urban households. The poor have no collateral to qualify them for credit, although they may have viable investment ventures. Banks are generally perceived as institutions created for the rich traders or investors by farmers (Solomon, 1996). Demand for non-fertilizer credit in the rural areas is largely met through friends and relatives as well as money-lenders which often charge very high interest rates (up to 120% interest per annum).

Recognizing the need to improve the provision of financial services to small business and farm enterprises, the Government issued Proclamation No. 40/1996 to promote micro financing institutions. The Proclamation provides the legal basis for investing in medium and small banks, which specialize in catering the credit and savings needs of the urban and rural poor who are willing to undertake productive micro ventures. The minimum capital required to establish self-sustaining micro finance institution is Birr 200,000. Subsidized credit, which used to be provided by various NGOs in the country, has been disallowed by the Proclamation.

Interest to undertake microfinancing business has so far come mainly from domestic NGOs working closely with the regional governments. One of the first such schemes to be established was the Dedit Credit and Saving Institution. It was established in 1994 by the Relief Society of Tigray. The Amhara Credit and Saving Institution (ACSI) was formed in 1995 by the Amhara Development Association (1995). Similar microfinancing institutions have been organized in the Southern region (1996) and Oromia (1997). Lending required membership in a credit group of 5 to 7 members and a 12.5% interest charge (1997) in the case of ACSI. A total of 208 million birr was disbursed in Tigray, 15 million in Amhara, 8 million in the Southern region, and 1.2 million by Oromia in 1997/98 through these institutions.²² At the moment, the operation of the schemes is closely assisted by the regional and local governments. It remains to be seen whether the institutions become viable and whether other institutions will join to reach more households and make the rural financial markets competitive.

²² The figure for Tigray is high because, unlike the other regions a large part of the money was used to finance fertilizer purchase

5.7 Inadequate Transport Network

Transport and communication systems are poorly developed in Ethiopia. The whole country is served by a total of 4,109 km asphalt road, 9,287 gravel and 5,610 rural road (FAO report). An estimated 75% of farms are more than a half day walk from an all-weather road. The average road density is estimated to be 21 km per 1,000 sq. km of land, or 0.43 km per one thousand population, one of the lowest road densities in Africa.

The rugged terrain has made building and maintaining roads difficult and expensive in Ethiopia. Much of the road infrastructure was also destroyed by the civil war which was waged to overthrow the former military government. Farmers' produce must be carried long distances by pack animals or by humans to locations where buyers are found. Consumer goods are either unavailable or sold at high prices in the rural areas. The poor state of roads is one of the major factors behind the unfavorable terms of trade faced by farmers.

The road sector development program aims at increasing the road network from 0.43 to 0.54 km per one thousand population within ten years (1997-2007). Over 15,000 km of new regional roads are planned to be constructed and more than 8,000 km roads rehabilitated. The program, expected to cost US\$3.9 billion, will require substantial financial assistance from foreign sources. A number of donors including the World Bank and the EU have pledged support to the program. Some of the pledges have also started to materialize. But donations need to be matched with sufficient budgetary allocations which in turn depend largely on the performance of the economy, especially the agricultural sector. The challenge of tackling the transport bottleneck, one of the critical constraints to the development of Ethiopia, is not expected to be an easy one.

5.8 Imperfect Agricultural Markets

5.8.1. Output Market

Prior to 1974, the prices of agricultural products were largely determined by market forces with little or no government intervention. In the post-1974 period, the military government adopted a policy of direct intervention to keep prices low. Farmers were required to sell a significant proportion of their output (quota) at fixed prices to the state-owned Agricultural Marketing Corporation (AMC), established in 1976. Private traders were restricted from transporting grain from one region to another.

Under pressure from donors, the former government adopted the March 1990 'Mixed Economic Policy' which removed the AMC quota system of grain delivery, restrictions on grain movement and the system of fixed pricing for farm produce. The TGE initiated further liberalization of the grain market and limited the role of AMC to wholesale trade primarily for regulatory purposes and stabilization of markets. In 1992, the AMC was restructured to create the Ethiopian Grain Trade Enterprise (EGTE). EGTE was expected to function and survive as a free competitor in the grain market which entails market operations based on rational calculation of profitability.

Grain market liberalization has obviously raised output price for farmers in major surplus-producing areas. Average cereal distribution margins declined following the liberalization measures. However, the marketing system still suffers from a number of constraints. The limited number of large inter-regional traders and their constrained access to working capital and storage and poor road conditions have resulted in geographical pockets of agricultural surplus facing low prices and deficit areas with high prices. Small traders have limited capacity of holding large quantities for longer duration. With no sufficient stock in storage, the volume of grain marketed falls sharply in years of poor harvest and prices rise considerably. Under high price instability farmers may be reluctant to make important investments such as the use of fertilizers.

Weak bargaining power of unorganized and illiterate farmers is another major constraint in grain marketing. Producer or farmgate prices are much lower as farmers are often cheated on the weighing scales and market prices offered by traders who commonly act in collusion. Independent farmers' own organizations like service cooperatives have yet to recover from the disastrous socialist-oriented collectivization experience of the past government.

Handling and transportation costs of wholesalers are high in Ethiopia partly due to the absence of cereal grading and standards. Grain has to be unbagged and rebagged for quality inspection each time grain changes hands. Weak infrastructure, both within Ethiopia and between Ethiopia and neighboring countries, inflate transport costs and impede the viability of trade that would otherwise moderate extreme price fluctuations. The virtual absence of processing industries in the country has further dampened demand for agricultural products. It has been suggested that while some reforms have been critical to promote economic growth, they are insufficient by themselves to generate leaps in productivity growth and require associated improvements in key market institutions and infrastructure. A more efficient marketing system calls for a more timely and widely disseminated market information and removal of barriers that raise costs of moving grain from one region to another (Asfaw and Jayne, 1997).

5.8.2. Fertilizer Marketing

Until 1992, the fertilizer market was controlled by the state owned parastatal named the Agricultural Input Supply Corporation (AISCO). Fertilizer prices were regulated and remained low mainly due to the overvalued currency and subsidy (direct and indirect) under the former government. However, the distribution system was inefficient with serious problem of shortages and delays. Fertilizer was rationed in the high potential areas and mostly unavailable in other areas. The operation of AISCO required considerable amounts of budgetary allocations in the form of subsidy.

Consistent with the new economic policy, the Government designed the New Marketing System for fertilizer in 1992 with the main objective of liberalizing the fertilizer market and creating a multi-channel distribution system. AISCO was renamed as the Agricultural Input Supply Enterprise (AISE) and restructured to operate as a competitive firm with no subsidies from the government. In 1993, the Ethiopia Amalgamated Limited (EAL) became the first private company to import and set up its own fertilizer supply network. Ambassel Trading House Private Limited Company, owned by the EPRDF affiliated Amhara National Democratic Organization, became the second importer of fertilizer when it added importing operations in 1996 in addition to its wholesale and distribution network in the Amhara Region which began earlier in 1994. EAL and Ambassel together accounted for 35.3% of the total fertilizer import in 1996 (Mulat et al, 1998). The latest entrant is Fertiline Private Limited Company which started wholesale and import of fertilizer early in 1998. Between 1995 and 1997, three other firms known as distributors²³ (with a capacity to pick their supplies from the port) joined the fertilizer business. A number of small traders and service cooperatives were also given permission to engage in retailing and wholesaling of fertilizer. But retail and wholesale operations are increasingly falling into the hands of the same importers and distributors since small traders are not permitted to sell using the credit arrangement currently in place. Small traders cannot rely on cash sales since over 80% of the fertilizer sales is financed through credit. At the same time, efficient and cost-effective fertilizer retailing cannot be achieved if import, distribution, wholesale and retail operations are carried by a single firm.

Fertilizer prices rose sharply due to the currency devaluation in 1992 and the Government was forced to introduce subsidy in order to cushion the effect of the devaluation and continued to set maximum retail prices with the pledge that these are only short-term measures. Indeed, subsidies were removed by 1997 and prices were decontrolled by 1998.

²³ These are Guna Trading Enterprise (Tigray), Dinsbo Trading Enterprise (Oromia) and Wondo Trading Enterprise (Southern Region).

It is true that access to fertilizer has improved as a result of the input market liberalization. This, combined with the new extension drive, has increased fertilizer consumption. However, the full benefit of the liberalization has not been realized because of various limitations in the marketing system. This is clearly reflected in the sizable stock of unsold fertilizer in recent years. For instance, only about 59 and 64% of the fertilizer made available for sale was sold in 1996 and 1997, respectively. The poor performance of sales is attributed mainly to high prices and inefficient distribution systems.

Apart from the devaluation of the domestic currency, high fertilizer prices in Ethiopia are caused by inefficient importation and distribution systems. Fertilizer is imported under conditions which do not allow gains from economies of scale in purchase and shipment, failure to adjust the time of purchase and administrative allocation of forex. Inefficient domestic transport, and uncompetitive wholesale and retail operations are also factors that adversely affected fertilizer price. The existing practice of importing in lots of 25,000 tons has significantly increased the cost of procurement and shipment. Because of the unwieldy conditions tied to disbursement of forex provided by donors, fertilizer is often imported from the least expensive sources. These and other related problems were estimated to have raised the cost of fertilizer to farmers by at least 13% in 1996 (Mulat et al, 1997). In addition to the high prices, fertilizer sales were adversely affected by lack of flexible and efficient retail and wholesale markets, as already noted above.

5.8.3. Improved Seeds

The production and distribution of improved seeds was under state control under the previous government. The Ethiopian Seed Corporation (ESC) was the sole distributor of seeds produced by itself or bought from state farms producing seeds (often at low prices). It either sold directly to state farms or channeled its sales through AISCO. Although the panterritorial prices were kept low, demand for improved seeds by the peasant sector remained low partly because of the low quality of the seeds and a cheaper substitute in the form of own seed saved from previous harvest.

The Corporation was restructured and renamed as the Ethiopian Seed Enterprise (ESE) after liberalization. Prices were deregulated and the private sector was allowed to participate in the production of improved seeds. For hybrid maize, price deregulation resulted in a 3.7 times increase in 1993, as compared to the pre-reform price of 1990/91. Pioneer Ethiopia was established in the early 1990s and started distribution of hybrid maize seeds in 1992. Some contract farmers have also joined

ESE in the production of improved seeds. Nonetheless, the market for improved seeds is still highly concentrated. Over 93% of the total commercial seed supply came from ESE in 1996/97 (Wolday, 1998).

Farmers' demand for improved seeds has remained low and continued to fall behind supply after the reform. Less than 2% of the cultivated area in the country was covered with improved seeds in 1996/97. Despite the strong extension effort, left-over stock of ESE increased from 9% in 1994/95 to 40% in 1995/96 and 58% in 1996/97. While supply has tended to increase, actual consumption rather declined. According to one survey (Wolday, 1998), the main reason for the depressed demand is the high price as reported by 64% of the respondents. For the small subsistence-oriented farmers, buying both fertilizer and improved seeds at high price is not affordable. But price is not the only reason. Some 57% of the sample households gave reasons which suggest that improved seeds are not superior to local seeds or they are susceptible to disease/pests.

Apart from loss of genetic quality (due to long period of repeated use), seed production under rain-fed condition has reduced quality. Unexpected rains during harvest often result in poor germination. Seed quality can only be ensured under irrigation. In general, a more competitive seed production and marketing is needed to lower the cost and improve the quality of improved seeds.

5.9 Constraints to Livestock Production

The poor performance in livestock production and productivity briefly described earlier resulted from several constraints. These could be categorized into technical and non-technical constraints. The main technical constraints include inadequate feed and nutrition, widespread diseases and poor animal health, and poor genetic structure. Many of the problems result from the interaction of the different constraints, technical as well as non-technical. For example, poorly fed animals develop low resistance to diseases and easily succumb to infections or other causes. The high mortality and morbidity caused by internal parasites is not only a result of deficient veterinary care, but probably to a larger extent of poor grazing management systems. Many disease constraints which affect production have been a consequence of inadequate budgetary allocations (for drugs, logistics, staff salaries and allowances, etc.) as well as policies that did not encourage sustainable financing schemes including cost recovery.

5.9.1. Technical Constraints

Feeds and Nutrition. Under-nutrition and malnutrition are among the major factors constraining ruminant livestock production in Ethiopia. Nutritional stress causes low growth rates, poor fertility and high mortality. In the highland zone, high population growth and increasing density are causing the shortage of natural grazing land on which smallholder livestock production depends. According to FAO, Ethiopia's permanent pastureland has decreased from 46 million hectares to only 20 million hectares, or by close to 60%, over the last three decades (MEDaC, Survey of Agriculture Sector, February 1997, *op. cit.*). In the lowland zones, the shortage of feed and water during the dry season continues to be a particularly critical factor, while increasing encroachment by bush (caused by overgrazing) and by crop cultivation is resulting in diminishing grazing resources. In both the mixed farming and pastoral systems, the overall poor quality of the available feed and particularly its deterioration during the dry season have contributed to the poor performance of the livestock sub-sector.

Animal Health. The major cause of economic losses and lowered productivity of livestock is the widespread prevalence of different diseases and parasites in all agro-ecological zones of the country. Although the major diseases which cause high mortality and morbidity have been known for a considerable length of time and appropriate preventive and curative measures available, animal health and disease problems persist as one of the major causes of poor performance. For example, Rinderpest is still endemic despite the successive efforts of the JP 15 campaign in the 1970's and the Pan African Rinderpest Campaigns (PARC). Although the main strains have been isolated, Foot and Mouth Disease is spread throughout the country. Huge economic losses are incurred through diseases caused by external and internal parasites, whose effects could be significantly reduced through improved management systems.

A major disease factor that affects livestock (as well as crop production) is the existence of tsetse and trypanosomiasis. Tsetse flies are estimated to infest some 130-200,000 km² of fertile land in the western and southwestern parts of the country and trypanosomiasis is present throughout the country, except for the dry eastern and northeastern areas (MoA, RLDS, May 1996, *op. cit.*). Livestock production is effectively precluded from this vast area of potentially productive land. The encroachment of the tsetse fly into the higher altitude zone which had been free previously has become a major factor in future livestock production strategies.

Genetic Structure. The genetic structure of the majority of Ethiopia's livestock species is believed to be an important factor for their low productivity in terms of

growth, yield and reproduction. This is believed to affect particularly their reproductive performance. The first calving age for most Ethiopian cattle breeds is normally not earlier than 4 years, while their calving intervals are far in between, on average two years. Productivity per animal is quite low. Carcass weights of adult slaughtered cattle are only around 110 kg, while milk production from local breeds averages 210 kg over a lactation period of a maximum of 200 days (NLDP, January 1998, *op. cit.*).

The reproductive performance of sheep and goats is well below optimum. The age at first calving for goats, which is said to be better than that for sheep is 18 months. Lambing and kidding intervals are long and range from 8-10 months for goats and even longer for sheep. Carcass weights of adult sheep and goats rarely go beyond 10 kg.

5.9.2. Non-Technical Constraints

Non-technical constraints mainly consist of economic, social and institutional factors which impede growth in production and market supply. A major constraint has been the inadequacy of capital and recurrent budget allocations to the livestock sector. Past experience has clearly demonstrated that the delivery of animal health services have declined due to severe budgetary constraints.

At the beginning of the 1980s, recurrent government expenditure on animal health services represented slightly more than 10% of the total recurrent expenditure on all agricultural services. On average, over 80% of the recurrent budget for livestock services were spent on staff salaries and wages²⁴. A large proportion of the government veterinary budget continues to be allocated to cover salary expenditures with very little left for operational costs. As a result animal health services have been maintained through donor assistance (MoA, RLDS, May 1996, *op. cit.*).

Poor infrastructure hinders the movement of livestock inputs and outputs, as well as their storage, preservation and processing. This inadequacy has resulted in high costs of transport. The extreme perishability of some livestock products such as raw milk and the inadequacy of the infrastructure have also discouraged surplus producing areas from supplying high demand distant markets. Poor infrastructure and the associated high transport cost has also contributed to inducing illegal cross border trade in live animals.

²⁴ Addis Anteneh, *The Financing and Staffing of Livestock Services in Sub-Saharan Africa: A Cross-Country Analysis*, ILCA, 1991

Land tenure remains an institutional constraint so long as the present system does not encourage farmers to make long-term investment in both crop and livestock production. The limited number of qualified manpower to conduct livestock research, to analyze and design appropriate livestock development programs continues to be an important factor for unsatisfactory performance.

6. POLICY CHALLENGES

From the foregoing presentation, it is abundantly clear that Ethiopian agriculture is in a very bad shape. A country once considered the bread basket of Africa has become an economic basket case. The situation in the agriculture sector has gotten from bad to worse as well intentioned, but ideologically driven policies with little practical relevance to our own conditions, were forcibly imposed on powerless peasants in the form of state policies.

It is true that the problem is multi dimensional. There are a number of factors that are completely out of the control of the policy maker such as the variability of the rainfall. But, although policy makers have little control over nature, both their effects and their frequency of occurrence can be mitigated with sound land management and prudent environmental policy. Of the more than dozen factors presented above to explain the poor performance of agriculture, the great majority of them are in one form or another a consequence of conscious or unconscious human action that can be addressed with sound policy and effective voluntary mobilization of the population. We will therefore devote the remaining pages of this chapter to the key policy challenges ahead of us if we are to reverse the decline in agriculture and put it on a more sustainable path.

The starting point is to give credit where it is due. The priority provided to agriculture in EPRDF's Agriculture Development Led Industrialization strategy (ADLI) is essentially correct simply because it is inconceivable to think of overall development in Ethiopia without fundamentally improving the sector that directly affect the life of the great majority of the population. The long term strategy of industrialization can not be effectively implemented without surplus production in agriculture to provide raw materials for industry, cheap food for urban labor, and increased income for the rural population which forms the necessary demand for manufactured goods. The various liberalization measures taken by the government as part of the package of this strategy is also commendable. The elimination of price controls, the abolition of quotas, the ability to hire labor in agriculture are all measures that are tremendous improvements from the previous policy regime. The attempt by the government to

increase agricultural output and the productivity of land through an extensive introduction of improved technology via the extension packages have also increased yield per hectare in a number of crops indicating the possibilities in the future although there are questions about its sustainability in the long term.

The disagreements about current agricultural policy largely rest on two key areas. First there is the issue of the policy's concentration on improving land productivity rather than labor productivity. The second problem relates to the institutional framework utilized by the government to implement its strategy in general and the issue of land policy in particular.

The attempt to increase land productivity, as we said earlier, is laudable. However, without significantly improving labor productivity the desired objective of transforming agriculture will not materialize. A cursory look at productivity differentials in agriculture between Ethiopia and a selected number of countries reveal that the sector's major weakness and its future potential for improvement lies much more in labor productivity than land productivity.

As can be seen from Table VI.7 below except for Egypt, in all the countries involved, labor productivity is much higher than land productivity indicating that the total productivity in the sector is more influenced by labor than land. Ethiopia's land productivity is close to twice better than the average SSA country, about three times better than Zimbabwe and South Africa and reasonably close to such highly productive countries as Canada. Ethiopia's agricultural labor productivity on the other hand is by far the lowest compared with the other countries in the table and one of the lowest in the world. Labor in the most productive country in the group is 228 times more productive than Ethiopia and the average SSA country is over twice more productive. Higher land productivity could not translate into higher labor productivity because of continuously declining farm size. Apart from technological changes, an increase in the area cultivated per agricultural worker is one of the essential conditions of an increase in productivity. It is therefore crucial that a policy designed to improve Ethiopian agriculture needs to put very high emphasis in improving labor productivity along with land productivity in which the current policy almost exclusively concentrates.

In relation to the second problem, as briefly discussed above, the government's strategy is already showing serious strains from the institutional constraints imposed by the government's land policy which not only simply accepted the policy of the previous regime, but more importantly virtually eliminated public discussion on the issue by incorporating it in the constitution without any meaningful debate. The

problems created by this ideologically driven land policy, as discussed above, have a number of direct and indirect consequences which together are sure to seriously threaten the success of the government's strategy in agriculture and with it its overall development strategy.

Table VI.8
Agricultural Productivity in Selected Countries 1994 - 96 (1987 dollars)

	Value added per agricultural worker	value added per hectar of agricultural land
Low income countries	397	183
SSA	392	68
Low and middle income	459	206
Ethiopia	181	116
Kenya	240	90
Egypt	1331	2990
Nigeria	684	150
Zimbabwe	266	41
South Africa	2870	49
Canada	30,202	154
Netherlands	41245	5932

Source: World Bank, World Development Report, 1998/99.

The first consequence of this land policy is the decrease in the size of the farm plot and the insecurity of tenure associated with it. The periodic redistribution of land (as has taken place in the Amhara region recently) meant that not only is the size getting too small to allow enough surplus for the family to venture into investing in yield improving technologies, but more importantly, even if there was any surplus, there is little incentive in investing in improving the land because, under such circumstances, there is no security of tenure. It was the fear that peasants will be forced to sell their land leading to concentration of ownership on the one hand and displacement of poor farmers on the other that seems to have informed the current government's decision to put land under state ownership. The actual result of this policy in the past decade and half was actually to make every one poorer with each re-division making family holdings progressively smaller. Furthermore, the legal prohibition of land transfers have made consolidation of holdings for more efficient farming literally impossible.

The second consequence of the land policy is the demographic pressure that it has created and is creating in rural Ethiopia. The existing land system has seriously discouraged migration since a sustained absence from the *Kebelle* could result in loss of one's holding. This has led to an enormous population pressure. The number of people estimated to be living in rural areas increased from 37.8 million in 1984 to 45.8 million in 1994 and is expected to reach 54 million by the year 2000. Without significant increases in yield and not much hope of expansion in the cultivable land area and without a meaningful possibility for migration to the urban areas, (or to less densely populated rural areas because of the ethnic divide in resource use) the current land policy is a sure recipe for a future Malthusian disaster.

Very closely related to the above problem is the decrease in pasture land and its effect on the country's livestock population. The need to accommodate the increasing population has required many *Kebelles*, particularly in the North to distribute grazing land for farming seriously reducing the already insufficient animal fodder. This in turn has reduced the number of cattle that a household can possibly support.

The land policy also has a negative impact on farm practices and environmental protection. Tenure insecurity and diminution of holdings has forced many peasants to abandon prudent traditional land management practices such as crop rotation, land fallowing, and usage of organic fertilizers for fear that they might lose the land that they so enriched. Instead, they concentrate on getting whatever they can now without looking into the future. The obvious effect of this is that land is continuously tilled without a break thus increasingly losing its important nutrients and eventually leading to soil exhaustion. Other environmental protection measures such as planting trees is now virtually abandoned because of insecurity (save for eucalyptus trees that can be planted and marketed fast) even when peasants are fully aware of the long term negative effect of such practice. Furthermore, the shortage of land has led to the allocation of increasingly marginal land, which is exposed to environmental hazard, for cultivation.

Finally, there is the social impact of the current land tenure system which seriously disadvantage the youth. More and more of the youth are becoming landless and dependent on their families even at late age. This in turn is creating generational tensions as the youth resent their parents whom they blame for their misfortunes. The virtual absence of differentiation in rural communities have also killed the incentive for entrepreneurship among the peasantry. As the state becomes the landlord that determines allotment, what has emerged in rural Ethiopia is a dominated and subservient peasantry rather than an independent peasantry with initiative and willing to take risks.

The conclusion that emerges from the foregoing is clear. Despite the many commendable initiatives of the government to improve the agriculture sector and with it the lives of the majority of the population, its ideological and inflexible position on land policy has made it very unlikely for the government to achieve its stated objectives. Furthermore, the effect of this land policy goes far beyond the issue of increasing output in the short run. The possible disasters that might visit Ethiopia's rural population in the future owing to this policy is a serious concern that any responsible government should take seriously and engage in a public debate in search of a suitable alternative.

ETHIOPIAN INDUSTRY

1. INTRODUCTION

Our discussion of the agriculture sector in the previous chapter made it clear that the fixed size of agricultural land and the depletion of agricultural resources in general along with the rapidly rising population has made it impossible for the sector to provide gainful employment and sufficient income to pull the majority of the rural population out of its miserable existence. If the expected rise in agricultural productivity and with it rural income is to materialize, the population pressure has to be lifted from rural Ethiopia. This means that the non agricultural sectors particularly the manufacturing sector need to expand rather rapidly not only to create demand for the unemployed urban labor force but also to be able to accommodate the expected migration from the rural areas.

This is not the only reason why the manufacturing sector in Ethiopia or in any other developing country for that matter, need to expand. As any student of the process of economic development surely knows and as the experience of the now developed countries attest, there can not exist an overall economic development with out some kind of industrialization. In fact, in every day language, development is synonymous with industrialization. So if Ethiopia is to alleviate the crippling poverty that most of its citizens find themselves in, to generate the desperately needed employment for its youth, to increase the income of its working people and to provide all this in a sustainable way, it has no choice but to find a way to significantly increase the size and the productivity of this crucial sector of the economy. This chapter is devoted to this sector. In the following pages, we will look at the current state of the manufacturing sector in Ethiopia. We will follow this by looking at the key constraints to the development of the sector and what need to be done to address these constraints and put the manufacturing sector in a rapid growth path.¹

¹ Most of the data and the basic analysis used for this section of the paper is from the paper commissioned for this report on the manufacturing sector. For detailed analysis and extensive data on the sector see; Admit Zerihun, "Manufacturing Industries in Ethiopia: A survey," 1999. Issues related to data sources and definitions of concepts related to manufacturing are covered in this survey. As in all the other sections, this survey is compiled in the form of "Working Paper" and separately available from the EEA office.

2. HISTORICAL BACKGROUND

The establishment of modern manufacturing in Ethiopia more or less developed with the emergence of a strong central government and the political stability that came with it towards the end of the 19th century. A number of factors contributed towards its development including the installation of the Ethio-Djibouti railways and the strengthening of Ethiopian foreign relations which created an appetite for modern manufactured goods among Ethiopia's elite. The increasing settlement of foreign citizens from Armenia, Greece, Italy and India also brought the entrepreneurial capacity to develop manufacturing industries locally. The increasing problem associated with transporting imported commodities like wood, clay, and printing products and the high cost of these imports provided the incentive for local manufacturing.

By 1927, about 25 factories were established in Addis Ababa, Dire Dawa, Asmara and Massawa which include 5 wood and clay factories, 2 tanneries, 5 soap and edible oil plants, 2 ammunition factories, 1 brewery, 2 tobacco processing plants, 1 cement factory, 1 grain mill, and 2 salt factories. Except the printing press and ammunition plants, all were established by private entrepreneurs. Holeta Grain Mill and Massawa Salt were set up in 1896 and 1904, respectively. All basic manufacturing commodities were supplied by local handicrafts, otherwise.

From 1928 – 1941, not less than ten manufacturing industries were set up, of which two of them (the Artistic Printing Press and Ambo Mineral Water Plant) were established before the Italian invasion. The rest were established during the Italian occupation. Moreover, except for Dire Dawa Cement, Dire Dawa Textiles factories (which were established by the Italian Government) and Ambo Mineral Water, the rest were set up by Armen and Greek settlers.

It was during the immediate post war period (1941-1950) that the manufacturing sector in Ethiopia increased rather rapidly partly as a result of the close relationship between the government and the United States and the United Kingdom. Even during this period, the rapid increase in the number of manufacturing industries was not the result of a conscious and deliberate industrial development policy and strategy. It was only after 1950 that a deliberate strategy to encourage the expansion of the industrial sector was formulated.

The "statement of policy for the encouragement of foreign capital investment in Ethiopia" was the important legal notice (Legal Notice number 10 of 1950) in this regard. A decree to provide for the encouragement of capital investment in Ethiopia (Decree number 51 of 1963), the revised investment proclamation of 1964, agricultural and industrial expansion (proclamation number 242 of 1966) were the important initiatives and refinements for the expansion of modern industries in Ethiopia. Moreover, Ethiopia started to develop five year plans to guide its economic policy. Three successive five-year plans were formulated and implemented during the Imperial era and a fourth five-year plan was under preparation on the eve of the February 1974 revolution.

Since then industrialization, with an inward looking orientation based on import substitution, was pursued as a matter of government policy. As a result, a good number of manufacturing enterprises were established including 80 factories mostly by private businessmen of foreign origin. Only eight of these eighty establishments were fully government owned while another five were joint ventures where the government had over 50% ownership. By 1974, of the total manufacturing enterprises only 26 were either fully or partially owned by the government on seven of which the government's stake was less than 50%. The great majority of the manufacturing concerns in Ethiopia before the 1974 revolution, especially the medium and large scale ones, were owned by foreigners. Out of 273 establishments, 178 or 65 percent were set up with the assistance of foreigners and 101 or 40 percent were totally owned by foreign nationals. In short, the industrial sector of Ethiopia by 1974 was small, characterized by production for the domestic market mainly to substitute imports, largely private and foreign owned. The role of government in the evolution of the Ethiopian manufacturing industries prior to 1974, at least as a direct producer, was very limited.

Although there was no major shift in the production and market structure of Ethiopian manufacturing, a profound change in the structure of ownership and management took place in 1975 when the Derge Regime, as part of its "socialist" project, nationalized virtually all medium and large scale industrial enterprises owned by Ethiopians and foreigners alike. Thereafter, the industrial sector was dominated by public manufacturing enterprises.

Following the general direction pursued by "socialist industrialization" the new government showed its intentions to move into production of intermediate and capital goods in its ten-year perspective plan. The plan had envisaged to build a strong self-reliant national economy with adequate inter-sectoral linkages. But this plan has not

gone beyond indicating ideologically determined intentions. No significant expansion has taken place in the sector under the Derge's tenure. What was successfully achieved was the total reorientation of the ownership structure and the management philosophy. The participation of the private sector was deliberately discouraged through the imposition of capital ceilings and preferences were given to government owned enterprises in the allocation of foreign exchange, market access, subsidies and the like. Government enterprises were organized into three hierarchically structured levels of management. At the top was the Ministry of Industry, followed by corporations set up to oversee the management of the group of enterprises. The day to day operation of the manufacturing enterprises were left to the General Managers. The managers of the enterprises were expected to operate in accordance with various guidelines prepared by the Ministry or the corporation without any amendment to their specific environment. This ownership and management structure remained in force until the overthrow of the Derge regime and the introduction of liberal economic reforms following the new government's New Economic Policy of 1991.

3. THE STATE OF INDUSTRY IN THE COUNTRY: 1975-1996

3.1. The Size of the Manufacturing Sector (Value Created by the Sector)

The contribution of manufacturing industries to Gross Domestic Product in Ethiopia is probably the lowest in the world. The data below provides an illustration of this fact, manufacturing industries in Ethiopia contributed only 3 per cent to GDP as compared to 27 per cent in low income economies, 13 per cent in low income economies excluding China and India, 15 per cent in Egypt and 11 per cent in Kenya.

This low level of industrialization is also observed in the broad industry category where the sector's contribution is significantly lower for Ethiopia even compared with comparable countries such as Kenya. Furthermore, the troublesome issue is that not only is the level of industrialization low, but there seemed to be a process of de-industrialization taking place in the country. The share of both manufacturing and the

broader category industry is lower in 1995 than it was in 1980.² The only saving grace in this area is that the sector has performed much better after the change of regime in 1991 than the ten years before that. According to the same source as the table above, the growth rate of value added in industry for Ethiopia was 1.8% per annum between 1980-90 while it grew by an annual average level of 4.1% between 1990-97. Furthermore, this performance was reasonably better than most of the comparators used in the table except for the LIE average and Egypt. Given the need for industrialization discussed earlier, this is in deed a worrisome development. We will come back to the issue of explaining why such a poor performance in general and the relatively better performance of the post 1991 period later. In what follows we will simply look at the nature of the existing industrial sector in relation to employment creation, level of technology and productivity etc. to give the reader a feel for what stands as the industrial sector of the country.

Table VII.1
Distribution of GDP in %

Countries	Manufacture		Industry		Agriculture		Service	
	1980	1995	1980	1995	1980	1995	1980	1995
World	23	21	38	33	7	5	53	63
Low income economies (LIE)	21	27	32	38	34	25	32	35
LIE without China & India	na	13	na	25	na	33	na	41
Ethiopia	6	3	12	10	56	57	31	33
Egypt	12	15	37	21	18	20	45	59
Nigeria	8	5	40	53	27	28	32	18
Kenya	13	11	21	17	33	29	47	54

Source: World Development Report, 1997

² Although the actual figures differ, in some cases substantially, this trend is confirmed by looking at the Ethiopian data from local sources. See for example the data compiled by the national accounts team of MEDaC, table 1.4, in Admit's Survey for this report.

3.1.1. Number and Growth of Establishments

The Central Statistical Authority (CSA) conducted surveys of manufacturing industries in 1995/96 for each of the four groupings. Surveys of small scale and cottage/handicraft manufacturing industries were conducted for the first time. The survey for manufacturing establishments with 10 and above employees has been conducted annually for about two decades. The survey on the informal sector which includes all sectors was conducted in collaboration with the Ministry of Labor and Social Affairs for the first time, as well. The manufacturing part is included in this report. Unfortunately, the 1997 survey is the most recent complete survey using data for 1995/96 and thus our report will be limited in terms of coverage to this period. We will, however, use more recent data whenever available and appropriate. According to these surveys, the number of establishments are reported in Table VII.2.

Table VII.2
Number of Establishments as of 1995/96

Groupings	Number	Share in %
10+	642	0.05
Small-scale	2731	0.23
Cottage /handicrafts	892,719	76.15
-Informal	276,287	23.57
Total	1,172,379	100.00

Source: CSA, Manufacturing and Urban Informal Sector surveys, Various Reports, 1997.

The total number of manufacturing establishments as of 1995/96 was 1,172,379 of which those manufacturing establishments which employ 10 and above persons and use power-driven machine are only 642. Manufacturing establishments which use power-driven machines regardless of number of employees are only 3373, accounting only for about 0.3 percent of the total. The majority of the establishments (about 76.1 per cent) are cottage/handicrafts. Clearly, just like Ethiopian agriculture is dominated by small peasants, Ethiopian manufacturing is dominated by cottage and handicraft manufacturing.

No adequate database is available to analyze the growth in the number of manufacturing establishments. It is only for the 10+ group that time series data is available. CSA conducted surveys of manufacturing industries for about 21 years from which number of private establishments that employ 10 and above workers are

reported. According to this survey, the number of manufacturing establishments with 10 and above employees in 1975/76 were 430. This number declined to 402 in 1985/86, a decline of 0.82 per cent per annum. It further declined to 273 in 1992/93, the lowest ever registered, eventually growing to 642 by the time of the survey in 1995/96.

There are several reasons that explain this decline. The first is the decrease in number of employees owing to low capacity utilization which in turn is caused by the then unfavorable government policies towards private activities to obtain foreign exchange (for raw materials, spare parts and replacements), credit and license. Therefore, some of the establishments might fall below the "ten and above" employee category. The way the number of establishments fluctuated year after year seem to prove this. Secondly, the possibility was high for establishments to cease operation for the obvious reasons of the period such as war, tedious regulations, and lack of foreign exchange. In deed, the then economic policy did not encourage bringing new establishments into operation. The third reason is the independence of Eritrea by 1991/92, which reduced the number by the amount that existed in Eritrea.

After 1992/93, the trend changed dramatically. The number of manufacturing establishments increased from 279 in 1992/93 to 477 in 1993/94, an increment of about 71 per cent. The number further increased to 501 in 1994/95 and 642 in 1995/96. In fact, the number of establishments grew by 34.71 per cent annually after 1992/93, reversing the declining trend that obtained previously. The primary reason for this upward trend of the number of manufacturing establishments is the improvement in the overall macroeconomic environment which alleviated some of the constraints mentioned above partly owing to the change in the policy regime. Most of the additional establishments recorded in the survey were not new but existing ones that have moved up the category owing to the alleviation of these constraints although there are some new ones created after 1992. Unfortunately the data does not isolate these two categories to identify the net increase in manufacturing establishments since the new policy came in to effect. Still, the growth in this category is relatively minuscule compared to that registered for the group employing below 10 persons, usually classified as small, handicrafts, cottage or informal. Data regarding these activities are limited, inconsistent, unreliable and incomplete. Thus, it is nearly impossible to fully assess the growth of the number of establishments. There are few surveys conducted on handicrafts and small-scale industries to give us some indication. These include the survey undertaken by HASIDA in 1989 and 1991 on private small-scale manufacturing establishments and the one conducted by CSA in 1997 on handicrafts/cottage and small-scale industries.

Table VII.3
Trend of Manufacturing Establishments (10+ group)

Year	Number	Average Annual Change
1975/76	430	-
1985/86	405	-0.82
1992/93	273	-4.62
1995/96	642	34.71
75/76 - 95/96		9.76

Source: CSO/CSA: Results of Surveys of Manufacturing Industries (1975/76 – 1995/96)

According to HASIDA, private small-scale manufacturing establishments are those which use manually operated machine or motor-driven machinery, which employ at least one person (not owner or families); and those with fixed asset not exceeding a million birr excluding land and building. Given this definition, the number of private small-scale manufacturing establishments were 7706 in 1985/86 and 7600 in 1986/87. These numbers dramatically changed during the 1997 CSA survey which registered 892,719 cottage/ handicrafts and 2731 small-scale industries. Clearly the main cause of this change is a change in the definition where the later survey included cottage and handicraft industries which were not included in the earlier survey. Still, a significant increase in these establishments owing to the more liberal economic policies of the new government can not be overruled since these are the first categories to quickly respond to changes in policy regimes.

3.2. Sectoral Structure of Establishments

It is impossible to present an accurate picture of the sectoral structure of informal manufacturing activities since the very survey itself did not include the sectoral dimension of the informal manufacturing sector. It is only for the other three groups that sectoral distribution can be presented. Number of establishments by sector is presented in Table VII.4.

Table VII.4
Number of Establishments by Sector, 1995/96.

Sectors	10+	Small Scale	Cottage/ Handicrafts	Total
Food and beverages	174	1090	356363	357627
Tobacco	1	-	54	55
Textiles	32	22	279759	279813
Weaving apparel	23	367	18230	18620
Leather	63	72	11753	11888
Wood	26	49	11927	12002
Paper and Printing	43	74	-	117
Chemicals	50	9	91	150
Non-metallic mineral	85	94	151267	151446
Metal	42	502	29749	30293
Others	103	452	33529	34084
Total	642	2731	892719	896092

Source: CSA survey.

According to the above table, the total number of establishments excluding the informal sector in 1995/96 was 896,092 of which more than two-fifth are food and beverage and almost one-third in textiles. Generally, the Ethiopian manufacturing establishments are engaged in the production of food, beverages, textiles and non-metallic mineral products for these sectors accounted for about 88 percent of the total establishments registered in 1995/96. The dominance of these sectors in the manufacturing activities of Ethiopia is mainly explained by the high local input content and the availability of a large local market for these products. This sectoral pattern, however, is not equally shared by all groups. The main four sectors and their importance in each group are listed in Table VII.5.

Table VII.5
List of Main Sectors in Each Group

10+		Small-Scale		Cottage/handicrafts	
Food and beverage	7.1%	Food & beverage	39.9%	Food & beverage	39.9%
Others	16.04%	Metal	18.3%	Textile	31.3%
Non-metal	13.24%	Non-metal	16.6%	Non-metal	16.9%
Leather	9.81%	Weaving apparel	13.4%	Others	3.8%

Source: Table VII.4

The common element these groups share is that the number of establishments of the food and beverage sector are dominant in all the groups though the size this sector accounted for in their respective group differed. The four dominant sectors that accounted for 88.04 per cent in cottage/handicraft manufacturing industries are food and beverage, textile, non-metallic mineral products and others (which mainly consists of furniture and fixture activities), each accounting respectively for 39.9, 31.3, 16.9 and 3.8 per cent of total number of cottage/handicraft manufacturing industries. The most plausible explanation for this concentration is their local base in both raw material and market.

On the contrary, the four dominant sectors that account for about 88 per cent in small scale industries are food and beverage, metal (mainly fabricated metal), others (particularly furniture and fixture) and weaving apparel, each accounting respectively for 39.9, 18.3, 16.6 and 13.4 per cent of the number of small scale industries in 1995/96. Thus, small-scale industries in Ethiopia are mainly engaged in the manufacture of food, fabricated metal products, furniture and weaving apparels.

In the 10+ group, sector concentration is less severe than the former two. This can be witnessed from the share of the major four sectors and from the number of sectors that accounted for about 90 per cent of the number of establishments. The four major sectors – food and beverage, others (mainly furniture and fixture), non-metallic mineral products and leather (particularly footwear) – accounted for only 66.19 percent of the total 10+ group establishments while that of the latter major four sectors accounted for about 90 per cent. Moreover, while only the four major sectors accounted for about 90 per cent of the number of establishments in small-scale and cottage/handicrafts group, it is eight sectors in the 10+ group. Herfindahl-Hirshman Index (HHI) which is the measure of extent of concentration revealed this fact as well. The higher HHI indicates the severity of the concentration.³ While HHI of the 10+ group is 0.126, it is 0.238 and 0.287 for small-scale and cottage/handicrafts groups respectively. Looking at the change in the sectoral distribution of manufacturing

³Note that (Ferguson and Ferguson, 1994: 41)

$$HHI = \sum_{i=1}^n S_i^2$$

Where: S_i^2 = the square of the share of the i^{th} sector, measured as that sector's number of establishment divided by total number of establishments in the group, n = the number of sectors in the measure (the major four sectors in each group in this case).

industries in the 10+ group for which data is available, we can see from the survey that the importance of food, beverage, textile, and wood sub sectors have declined since 1975/76 while that of footwear, furniture, non-metallic mineral products and fabricated metal has increased their share indicating some initial tendencies of structural shift towards a higher stage of industrial development such as manufacturing fabricated metal.

When compared with the total number of manufacturing establishments, the number of publicly owned firms seem insignificant. But in the more important 10+ group, where government ownership is exclusively concentrated, it accounted for more than a quarter of the number of establishments. The proportion of public manufacturing establishments was even higher in mid 1980's. According to the survey, the proportion of public to that of private manufacturing establishments was about 51.94 percent in 1975/76, which indicated that the number of public enterprises in 1975/76 was almost half of the total number of private manufacturing enterprises.

Table VII.6

Ownership Structure of Number of Manufacturing Establishments as of 1995/96

Group	Public	Private	Total
10+	169	473	642
Small Scale	-	2731	2731
Cottage/handicrafts	-	892719	892719
Informal	-	276287	276287
Total	169	1172210	1,172,379

Source: As indicated in Table VII.2.

This proportion increased to 93.81 per cent in 1980/81, to 102.01 per cent in 1985/86, to 114.50 per cent in 1990/91, reaching the maximum of 120.63 per cent in 1991/92 with 152 out of 279 enterprises owned by the government. The increase in public ownership after 1975 is mainly a result of the nationalization of medium and large private manufacturing establishments. The decrease in the number of employees in the private sector or the closure of some of them for reasons provided earlier might have reduced the number of private enterprises in the 10+ category. The capital ceiling imposed on private businesses also discouraged the formation of new ones during the Derge period. After 1992/93, the trend, however, changed dramatically. The ratio started to fall and reached 35.72 per cent in 1995/96 as the number of private establishments increased due to the change in the economic policy of the

country. Despite the increase in the private sector's share recently, however, there are still sectors that are either fully under state monopoly or dominated by it. Those sectors which are under the monopoly of government are tobacco, manufacture of industrial chemicals, glass and glass products and basic iron and steel products. Furthermore, beverage and tanneries are sectors in which the public sector dominates. Footwear, furniture and fixture, fabricated metals and printing are areas largely dominated by the private sector.

4. MANUFACTURING OUTPUT: STRUCTURE, GROWTH AND ITS SOURCE

4.1. Size and Trend of Manufacturing Output

There are different measurements and methodologies used to estimate the value of manufacturing output.⁴ For the purpose of this report we have used the three commonly used measurements namely Gross Value of Production (GVP), Value-Added at Market Price (VAMP) and Value-Added at Factor Cost (VAFC) to measure the size of manufacturing output in Ethiopia. The source is the survey conducted by CSA in 1995/96 for all groups, of which the summary is reported in the table below.

Table VII.7
Output of Manufacturing Sector as of 1995/96 (in thousand birr)

Output measure	10+	Small Scale	Cottage/ handicraft	Informal	Total
GVP	5,799,104	187,882	2,042,931	579,790	8,609,707
Share in %	67.36	2.18	23.73	6.73	100.00
VAMP	2,445,024	61,905	639,586	409,534	3,553,049
Share in %	68.81	1.17	18.00	11.53	100.00
VAFC	1,593,839	60,605	638,836	409,534	2,702,814
Share in %	58.97	2.24	23.64	15.15	100.00
VAMP/GVP in %	42.16	32.94	31.31	70.63	42.27
VAFC/GVP in %	27.75	32.26	31.13	70.63	31.14
VAFC/VAMP in %	65.19	97.90	99.88	100.00	76.07

Source: CSA survey

⁴ For the definitions used for the various concepts, see Admit, op.cit. section 3, p.14.

The total value of production of the manufacturing sector in 1995/96 was estimated to be birr 8.6 billion. The bulk of this value is created by the small number of medium and large scale manufacturing establishments noted as the 10+ group above whose number, as we saw earlier, accounted for less than half of one per cent of the total number of establishments. This group accounted for birr 5.8 billion or 67.4 per cent of the gross value of production. Cottage/handicrafts manufacturing activities while accounting for 76.1 per cent of the number of establishments, contributed only 23.7 per cent of the total gross value of production, followed by informal and small scale manufacturing activities, each accounting for 6.7 and 2.2 per cent respectively. Manufacturing value-added at market price in 1995/96 was birr 3.55 billion and value added at factor cost was birr 2.7 billion. Again the 10+ group was dominant accounting for close to 69% of the VAMP and about 59% of the V AFC.

The share of value-added to gross value of production of the manufacturing sector in 1995/96 was 42.27 per cent if it is at market price and 31.14 per cent if it is at factor cost. The ratio varied, however, across the groupings. The ratio of value-added at factor cost to gross value of production in the 10+ group was the least implying that the share of intermediate cost and indirect taxes to gross value of production is the highest. The extent of linkage may have a role to play in this difference across the four groupings. Higher linkage implies higher specialization and high intermediate input use and less value-added in the sector, and thus less value-added ratio. Higher levels of economic development, is usually associated with increased specialization in manufacturing resulting in an increased flow of intermediate goods between industries. Less value-added ratio in the 10+ group compared to others is thus an indicator that the linkage is high in this group compared with small-scale and cottage/handicrafts.

It is only for the 10+ group that time-series data exist to assess trends in the output of the manufacturing sector of Ethiopia. According to the CSA/CSO surveys conducted since 1975/76 for the 10+ group, unlike the number of establishments, output in the sector measured in terms of gross value of production or value-added generally showed a rising trend except for the last few years of the Derge period.

In 1975/76, gross value of production was Birr 1.01 billion growing to Birr 5.8 billion in 1995/96 which is a six fold increase compared with twenty years ago. Value-added at factor cost was Birr 287.8 million at the beginning of the survey and it became 1.59 billion in 1995/96 showing an increment of more than five fold. The lowest recorded in all cases was in 1991/92 where the conflict and foreign exchange constraint

reached its climax. Generally, both gross value and value-added grew on average by 9.13, 9.49 and 8.93 percent respectively between the period 1975/76 and 1995/96. The highest growth rates of manufacturing output, as expected, was registered after the Derge period which more than doubled the average growth rates achieved during the best of the Derge years. This healthy performance of the post-Derge period compares favorably even compared with the comparator countries discussed earlier in this chapter. With the exception of the average for Low Income Economies, the growth rate of value added in industry was higher for Ethiopia for the 1990-97 period compared with Nigeria and Kenya and as high as Egypt.⁵

Table VII.8.
Growth Rates of Manufacturing Output of 10+ group in %

Year	GVP	VAMP	VAFC
75/76 - 85/86	11.15	11.12	9.53
85/86 - 92/93	-1.20	2.26	-0.04
92/93 - 95/96	29.44	22.29	30.76
75/76 - 95/96	9.13	9.49	8.93

Source: CSA surveys

Regarding the share of intermediate cost and indirect taxes from gross value of production, one can clearly observe that both were increasing in the early periods. The share of intermediate cost reached 64 per cent in the early 1980's. The share of indirect taxes from value of production continuously rose from 8 per cent in 1976/77 to 26.2 per cent in 1991/92. Surprisingly, the ratios fluctuate year after year implying that there used to be no consistent management mechanism in procuring cost efficient quality raw materials, efficient conversion of inputs to output (consistent extraction rate) and proper handling of inputs. The tax restructuring measures taken by the government since 1991/92 has, however, an impact in reducing the ratio of indirect taxes from value of production. The ratio has been continuously declining since 1991/92 from 26.2 per cent to 14.68 per cent in 1995/96.

⁵ See World Bank, World Development Report, 1998/99.

4.2. Sectoral Distribution of Manufacturing Output

Because the informal manufacturing activities are not classified by sector, it is only the remaining three groups that are considered in the assessment of the sectoral distribution of output. According to the survey, sectoral distribution of output manifests concentration similar to the number of establishments. Manufacture of food and beverage, textile, non-metallic mineral and metal products dominated the manufacturing activities of Ethiopia for they accounted for about three-fourth of the manufacturing output. This sectoral lopsidedness, however, did not follow strictly identical pattern by each group. Each group tends to specialize in different areas. The 10+ group's main area of concern is manufacture of food and beverages, textiles, non-metallic mineral products and on tanning and dressing of leather. Small scale manufacturing, on the other hand, has concentrated on the manufacture of food and beverages, metal products, furniture and wearing apparels. The main activities under the domain of cottage/handicrafts is the manufacture of textile, food and beverages, non-metallic mineral and metal products.

The situation of structural change can only be assessed for the 10+ group by observing the direction of the change in the share of value-added of each sub-sector from the total. The share of value-added from the total for each sub-sector is computed in the table below. As the survey shows, structural shift did not seem to be remarkable in the case of output when compared to that of the number of establishments.

Unlike in the case of number of establishments where food and beverage dominate output of the manufacturing sector, the share of value-added has increased rather than tending to decline for almost all the sectors with a significant exception of the textile sector which declined from 31.3% in 1975/76 to a mere 9.8% by 1995/96. The highest increase was achieved for the non-metallic mineral products which increased from 1.7% in 1975/76 to 8.8% in 1995/96.

Table VII.9
Share of Value-Added from the Total for the 10+ group

Sectors	1975/76	1980/81	1985/86	1990/91	1995/96
Food	21.8	25.7	18.6	32.4	29.0
Beverage	9.9	8.8	11.4	13.3	12.1
Tobacco	6.3	4.8	3.5	10.9	4.8
Textiles	31.3	22.3	13.7	13.3	9.8
Leather	2.5	2.1	1.4	4.7	6.7
Printing	2.8	2.9	3.7	5.6	4.9
Paper	0.5	0.6	2.5	1.6	1.7
Non-metallic	1.7	0.9	2.1	2.9	8.8

Source: Computation from the survey.

4.3. Ownership Distribution of Manufacturing Output

Unlike the case of the number of establishments in which the public sector accounted for less than a per cent, public manufacturing enterprises accounted for more than half of the total value-added of the manufacturing sector of Ethiopia. The private manufacturing enterprises accounted only for 48.2 per cent of the value-added of the manufacturing sector in 1995/96.

Clearly what matters when it comes to value added is not numbers but the size and production capacity of the firm. In this regard the private sector contributed only for 12 per cent of the value-added of the 10+ manufacturing sector while it accounted for about 75 per cent of the number of establishments. Furthermore, this contribution was the highest of all the periods under review. It only accounted for 9.15 per cent of the value-added of the manufacturing sector in 1975/76 declining since then and reaching its lowest point of 3.5% in 1989/90. As in the early cases and for similar reasons the recovery started with the new economic policy after 1992/93.

Even if private manufacturing activities accounted only for 12 per cent of the total value added at factor cost of the large and medium scale manufacturing sector in 1995/96, there are sub-sectors in which either the private sector dominated the manufacturing output, as in the manufacture of furniture and fixture where it accounted over 82% of the total value added, or participated significantly as in the case of the manufacture of leather footwear, manufacture of other chemical products and fabricated metal where the share was 42.2, 38.0 and 28.9 per cent respectively.

On the other hand, the public sector monopolized the manufacture of food, beverage, tobacco, textile, wood, paper and other non metallic products where it accounted for over 90% of the value added.⁶

Table VII.10
Ownership Distribution of Manufacturing Value-Added.

Groups	Value-added at factor cost in '000' birr			
	Public	Private	Total	Private/Total
10+	1,400,585	193,254	1,593,838	12.12%
Small-scale	-	60,605	60,605	100%
Cottage/handicrafts	-	638,836	638,836	100%
Informal	-	409,534	409,534	100%
Total	1,400,585	1,302,229	2,702,814	48.18%

Source: CSA survey

4.4. Regional Distribution of Manufacturing Output

The discussion on regional distribution does not include informal manufacturing activities for which reliable data is not available. Classification of regions follow the current political and administrative structure of the country which has nine regional states and two city administrative councils. Those regions in which manufacturing value-added is not properly identified to the respective region including Tigray, Somali, Afar, Gambella and Benishangul Gumuz is grouped as "others".

As can be seen from Table VII.11, distribution of manufacturing value-added at factor cost appeared to be regionally skewed. Addis Ababa alone accounted for about 44.4 per cent followed by the Oromiya Regional State which accounted for 37.7 per cent. The two regions combined accounted for about 82.2 per cent of the manufacturing value-added of the country. The Amhara Regional State, the second populous region, accounted only for 7.6 per cent of the manufacturing value-added of the country and SNNP for only 4.9 per cent. The extent of skewness of regional distribution of manufacturing value-added, however, differed from one industrial group to the other and by ownership. The large and medium scale manufacturing

⁶ CSA Report on Large and Medium Scale Manufacturing and Electricity Industries Survey. Statistical Bulletin 178, June 1997.

industries are more skewed than the smaller ones. For instance, Addis Ababa and Oromia accounted for about 90 per cent of the value-added of the 10+ group, while the two accounted for only 70 per cent of value-added of small-scale and 63 per cent of cottage/handicrafts.

Cottage/handicrafts manufacturing activities seem better distributed across regions. Addis Ababa accounts only for 30 per cent of the value-added that emanated from cottage/handicrafts. Oromia, Amhara and SENNP Regional States accounted for 33.7, 15.6 and 12.3 per cent of the value-added of cottage/handicrafts, respectively.

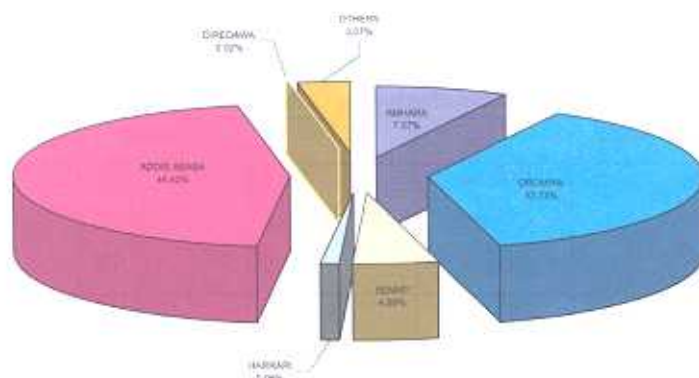
Table VII.11
Regional Distribution of Manufacturing Value-Added in 1995/96

Regions	Value-added at factor cost in '000' birr			
	10+ group	Small-scale	Cottage/ handicrafts.	Total
Amhara	65,266	8,528.7	99,747	173,542.7
Share	4.09%	14.07%	15.61%	7.57%
Oromia	637,084	4,649.1	215,441	865,212.5
Share	39.97%	20.93%	33.72%	37.73%
SENNP	29,067	4,649.1	78,530	112,246.1
Share	1.82%	7.67%	12.28%	4.89%
Harrari	17,359	747.7	3,843	21,949.7
Share	1.09%	1.23%	0.60%	0.96%
Addis Ababa	796,801	29,768.8	192,065	1,018,634.8
Share	49.99%	49.12%	30.06%	44.42%
Dire Dawa	27,919	1,063.7	2,379	31,361.7
Share	1.75%	1.76%	0.37%	0.02%
Others	20,343	3,159.6	46,833	70,335.6
Share	1.28%	5.21%	7.33%	3.07%
Total	1,593,839	60,605.1	638,838	2,293,282.1

Source: CSA surveys

If one sees the 10+ group activities in terms of ownership, value-added generated from those under private ownership are concentrated in Addis Ababa for it accounted for 80 per cent of the value-added. The public manufacturing activities seem better distributed across regions than the private 10+ group manufacturing activities.

Fig. VII.1: REGIONAL DISTRIBUTION OF MANUFACTURING VALUE-ADDED IN 1995/96



4.5. Source of Output Growth

For the purpose of this report, we have tried to identify the source of output growth using a general production function and calculating the respective contributions of the various factors.⁷ The change in output is decomposed into a change in output due to a movement along the production function (change in factor inputs) and the change in output due to a shift in the production function (due to disembodied technical change). Source of output growth is thus the sum of the combined factor input growths and the rate of technical change. Technical change here is used to include all forces that raise the combined productivity of all factors of production,

⁷ The assumptions employed and the equation used to derive these results is given in Admit, op.cit., p.21

growths and the rate of technical change. Technical change here is used to include all forces that raise the combined productivity of all factors of production, which enables to produce greater output with the same volume of inputs. The results of this exercise in identifying the source of output growth of the Ethiopian 10+ manufacturing sector for the period under review is computed and reported in Table VII.12.

Table VII.12
Source of Growth of Manufacturing Output for 1975/76 – 1995/96

Items		Public	Private	Total
Growth in %	Labour	2.61	3.97	2.35
	Capital	10.5	26.75	10.66
	Output	12.5	17.74	12.60
Factor Share	Labour	0.3645	0.5335	0.3722
	Capital	0.6355	0.4665	0.6278
Contribution to Growth	Labor	7.6%	11.9%	6.9%
	Capital	53.4%	70.3%	53.1%
	T.C	39.0%	17.7%	39.9%

Source: Computed from survey data.

As can be seen from the above table, the main source of output growth in the Ethiopian 10+ manufacturing group is capital (or investment). Almost half of the manufacturing output growth is ascribed to investment. Next to capital, technical change (T.C) accounted for about two fifth of the manufacturing output growth. Labor accounted for less than 10 per cent. If seen in terms of ownership, capital significantly accounted for the manufacturing output growth in the private sector when compared to the public ones. Capital accounted for 70 per cent of the manufacturing output growth in the private sector while it only accounted for 53.4 per cent in that of the public. Technical change, on the other hand, used to have less influence in the manufacturing output growth of the private sector since it only accounted for 17.7 percent in contrast to 39 per cent of the public manufacturing activities.

5. MANUFACTURING EMPLOYMENT: SIZE AND TREND

5.1. Trends in Manufacturing Employment and Regional Distribution of Employment

According to population projections based on the 1994 population census, the total population aged 15 - 64 in 1998 is estimated to be 30.8 million. Of these 24.3 million or 79 per cent are assumed to be economically active. The Ethiopian manufacturing sector employs a very small portion of this economically active population. This is not surprising since, as we discussed in the previous chapter, Ethiopia is a predominantly peasant society. As the table below exhibits, the size of employment in the industrial sector as a whole is nearly 1.8 million which is 7.3 per cent of the total economically active population of 1998. This work force is permanently employed in nearly 1.2 million establishments of different degrees of employing capacity in the sector, making the average labor-establishment ratio about 1.5 to 1. Obviously, the average number of workers per establishment is larger for the large and medium scale enterprises compared with the smaller ones. The average large and medium sized establishment employs about 142 workers while the small scale has 3.3 workers, cottage/handicrafts employ roughly 1.5 workers while the informal sector employs about 1.3 workers on average. Considering industrial groupings, 74.24% of the total industrial labor force are engaged in cottage/handicraft activities, while participants in the informal sector, medium and large scale industrial establishments, and small-scale industries constitute 20.09 %, 5.17 % and 0.5 % respectively.

In terms of regional distribution of employment, Addis Ababa has 55,320 or 60.6% of the workers engaged in 439 of the 10+ group industrial establishments followed by Oromia with 14,964 or 16.5% people in place in 71 similar enterprises and Amhara with 7,985 persons or 8.7% engaged in 41 establishments. This further confirms the regional imbalance in the distribution of manufacturing enterprises requiring a closer look by policy makers at the factors causing such a concentration. Parallel with this, Addis Ababa's leading role in small-scale industrial activities is reflected with 3721 or 41.7% workers engaged in 1173 establishments while Oromia and Amhara regions with their respective 625 and 386 establishments employed 1967 (22%) and 1291 (14.4%) workers.

The distribution of employment generation in manufacturing seems to have higher correlation with the regional size of the population with activities related to

cottage/handicrafts industry. In this sector 1,311,745 participants are either owning or running 892,719 establishments in the country. Of these employment Oromiya Region account for 465,194 people employed or self-employed in 348,673 establishments while in Amhara Region 334,124 persons are either employed or self-employed in 213,609 establishments and in the Southern Region 228,772 persons are either employed or self-employed in 155,394 establishments which is in line with their order of population size.

Table VII.13
Regional Distribution of Manufacturing Employment

Region	10+	Small Scale	Cottage	Informal	Total
Amhara	7985	1291	334124	81836	425236
Share in %	8.7	14.4	25.5	23.1	24.1
Oromia	14967	1967	465194	117492	599617
Share in %	16.5	22.0	35.6	37.6	33.9
SENNP	4257	919	228772	47304	281252
Share in %	4.7	10.3	17.4	13.3	15.9
Harrari	1210	182	1877	2187	5456
share in %	1.3	2.0	0.1	0.6	0.3
Addis Ababa	55320	3721	189163	53559	319393
Share in %	60.6	41.8	14.4	19.4	18.1
Dire Dawa	6397	203	2042	2176	10818
Share in %	7.0	2.3	0.1	0.6	0.6
Others	1129	646	90573	32721	125069
Share in %	1.2	7.2	6.9	9.2	7.1
Total	91262	8929	1311745	354905	1766841

Source: CSA survey.

5.2. Compensation

The available data on the total employed labor in man-year and the total amount of compensation paid for it in the manufacturing sector between 1975/76 and 1995/96 show that the former has been growing by about 2.3 per cent per year through out the period while the total wage paid for it grew by about 7.4 per cent per annum. The average wage grew by 5.3 per cent per annum during the whole period growing from

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birr 1795.5 in 1975/76 to 5075.7 by 1995/96. By the last year of the Derge regime, average wage in manufacturing was birr 3372.1 per annum.⁸

A closer look at remuneration made for labor with respect to ownership of establishments, man-year and the payment made for it over the period 1975/76 to 1995/96 in the surveyed public manufacturing establishments indicate average growth rates of 2.43 and 5.96 per cent respectively while the average annual wage increment is 5.06 per cent. For the privately owned enterprises the growth rates were 8.62 and 5.2 per cent respectively. The average annual wage increase in the privately owned manufacturing enterprises has been 6.03 per cent per annum.

Further scrutiny and comparison of the growth rates of the three variables between public and private establishments depicts that the difference between average wage and man-year for public enterprises is confined to 2.63 per cent while that of the private manufacturing establishments is 0.83 per cent demonstrating relatively higher annual increment of remuneration for labor in public establishments compared to that of the similar activities in the private sector. If we look at the performance of the sector in terms of employment creation after the change in the economic policy regime, it clearly shows that job creation has increased dramatically in the private sector after 1992/93 compared with the public sector. Private sector job creation grew by an average annual growth rate of 52% while the total wage in the sector grew by 42.8% on average. Average wage in the private sector remained stagnant, however, during this time. In the public sector, on the other hand, job creation slightly declined after the introduction of the new economic policy as can be expected while average wage grew by about 9.8% per annum on average between 1992/93 and 95/96.

6. EXPORT PERFORMANCE

6.1. Manufacturing Exports

As a predominantly agrarian economy, it is natural to expect the bulk of the country's exports to come from the agricultural sector. Still, albeit insignificant, the manufacturing sector contributes a little bit to the country's foreign exchange

* For complete data on Man-year, Wages and Average Wage Rate for the entire period, see CSO/CSA Results of Survey of Manufacturing Industries (Various Issues).

earnings. The exportable items from this sector, however, are very few in number, small in size and involve semi processed agricultural products. The overall trend in recent years show significant fluctuations in the country's export earnings with the exception of meat products which showed a consistent increase. As can be seen from the tables below, foreign exchange earnings from exports of semi-processed hides showed a 5.2% annual decline between 1994/95 and 1997/98 despite the increment of the volume of exports by 1.97 per cent over the same period.

Table VII.14
Manufacturing Exports in Quantity

ITEM	Unit	92/93	93/94	94/95	95/96	96/97	97/98
Semi-proc. Hides	Sq ft	11963	16901	2144	21588	15782	11057
Semi-proc. Skins	Dozen	787,023	1,064,377	990,318	909,241	1,183,397	1,384,208
Processed Meat	Ton	71	447	790	1,851	2,051	2,568
Petroleum	m ³	-	-	168,251	158,521	135,441	-

Table VII.15.
Manufacturing Exports in Value (Thousands birr)

ITEM	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Semi-processed hides	-	-	82374	89078	61242	65,900
Semi-processed Skins	-	-	316,312	293,647	362,406	345,115
Leather Products	2,742	2,041	4,645	1,941	658	1,518
Processed Meat	-	-	10,731	26,266	28,269	35,209
Textile	2,874	-	5,644.6	157,032	34,147	15,909
Petroleum	-	-	94,706	87,406	88,162	-

Source: Ministry of Trade and Industry

Export earnings from semi-processed skins showed an annual increment of 11.4 percent which is more or less equivalent to the growth rate in the volume of exports while the earnings from leather products indicated 1.4 per cent growth per annum over the same period. The export earnings from semi processed hides in 1997/98 exhibited growth over 1996/97 despite a decline in the volume of export by 30 per

cent, clearly indicating better international price for the product for that year. Export earnings from leather products has been fluctuating quite a bit. A nearly three-fold increment was observed in 1994/95 followed by a 58.5 and 66.1 per cent decline in the following two years recovering again in 1997/98 owing to the attractive price in the international market. As mentioned earlier, processed meat has been consistently increasing at an average growth rate of 44.2 per cent per annum between 1992/93 and 1997/98 while that of textile reached its apex of Birr 157 million in 1995/96 which was followed by a sharp decline (78.3%) in the following years.

6.2 Export Constraints

The overall underdeveloped nature of the Ethiopian economy confined the exportable items of the manufacturing sector to few commodities rendering the sector vulnerable to the vagaries of the international market. Not only is the quality of the manufactured export items too poor but also their small share in terms of volume has made manufacturing goods exporters simply price takers in the international market and victims of its fluctuations.

What is interesting regarding this sector comparing the two policy regimes is that Export of manufacturing products is worse after liberalization than before although most of the presumed constraints presented for the failure of manufacturing exports in Ethiopia such as overvalued exchange rate, lack of management autonomy, restricted private sector participation, price control, export subsidy and the like are now abolished. This puts the crux of the problem not on those broad policy issues related to liberalizing foreign trade, but on the capabilities of firms to go through the necessary processes of technological change to achieve a sufficient level of productivity increment in order to be competitive in the international market, on the one hand, and a concerted country wide strategy to encourage the development of such firms geared towards the promotion of manufactured exports on the other. The absence of a clear strategy towards the manufacturing sector and the orientation of the existing manufacturing sector towards meeting the consumption requirement of the domestic market, has meant that little attention has been paid to improve the efficiency of firms and the quality of their products to enable them to export at the desired level. The prevalent export incentive structure and the recently established export promotion agency are likely to play a limited role in encouraging manufactured exports in the near future as they are concentrating more towards promoting the country's traditional, agriculture based exports.

7. PRODUCTIVITY IN THE MANUFACTURING SECTOR

There are various concepts and measurements of productivity used to essentially identify the relationship between inputs and outputs in the production process. According to Fabricant (1968: 523-524) the concept refers to a class of empirical output-input ratios. According to the purpose of the analysis for which the concept is deployed, productivity could measure the fruitfulness of human labor under varying circumstances or the efficiency with which resources as a whole, including capital and labor, are employed in production or it could be used to measure the forces that underline the trends in real wages. It can also be utilized to determine proportion of labor or capital requirements in production. Productivity appears as a comparison of an output with one or more inputs; that is, as a comparison of an output with the services of one or more of the resources used in producing the output. Because the output-input ratio of a particular time and place has limited significance, it is compared with the corresponding ratio of another time or place to estimate changes. For the purpose of this report, we will look at labor productivity and total factor productivity in the manufacturing sector.

7.1 Labor Productivity

In order to calculate average labor productivity for this report, output is measured by value-added at factor cost. Value-added is chosen simply because it makes aggregation across sectors and sub-sectors possible and avoids double counting. Labor is represented by total number of employees both permanent and temporary, the latter converted to the equivalent man-year. The wage bill is used as the best measure of labor input to make labor homogenous. Man-year is not a good measure of labor inputs in production, as the number of hours worked may differ among enterprises and vary from period to period. Thus, value-added per man-year (Q/L) and per wage bill (Q/W) are computed for each of the groupings. Table VII.16 presents these ratios.

Table VII.16
Labor Productivity in the Manufacturing Sector in 1995/96

Items	10+	Small Scale	Cottage/ Handicraft	Informal	Total
Value-added	1,593,839	60,605	638,836	409,534	2,702,814
Wages	457,007	8,592	42,524	13,135	521,258
Employee	90,039	8,929	1,311,745	354,905	1,765,618
Q/L	17,701.6	6,787.4	487.0	1,153.9	1,530.8
Q/W	3.5	7.1	15.0	31.2	5.2
W/L	5,075.7	962.2	32.4	37.0	295.2

Source: Computed from the various surveys.

As can be seen from the above table, value-added per man-year is about Birr 1530.8 in 1995/96 implying that an average labor had generated this amount of value-added at factor cost. This, however, is different across industrial groups. In the 10+ group, an average labor produced Birr 17,701.6 while it produced 6787.4 in small-scale, 487.0 in cottage/handicraft and 1153.9 in informal manufacturing groups. The lowest value produced by an average man-year was in cottage/handicrafts which is 36 times lower than the value created by the average worker in the 10+ group or 14 fold lower compared to that of small-scale. On the other hand, labor worth a birr in the manufacturing sector has generated birr 5.2 worth of value in the same year. Contrary to the average labor productivity, value-added per wage bill in the 10+ group is the lowest in 1995/96, being only birr 3.5 while it was 31.2 in informal manufacturing activities, and 15.0 in cottage/handicrafts manufacturing activities. Labor worth a birr in the informal sector, or in the cottage/handicraft groups, in this case, is more productive than that of the 10+ group. This clearly is a result of the relatively higher wages paid per unit of labor (probably owing to higher levels of skill) in the 10+ group compared with the others as indicated in the variation in the average wage (W/L). While average wage in the 10+ group is birr 5075.7 in 1995/96, it was only 32.4 in cottage/handicrafts, 37 in informal operators, almost 140 times lower than that obtained in the medium and large scale sector. Furthermore, apprentices, working proprietors, active partners and unpaid family workers constitute a large proportion in informal or cottage/handicraft manufacturing activities as compared to that of the 10+ group. To give us more insight about the change in labor productivity over time, we looked at the 10+ manufacturing sector for which time series data for productivity is available. The same procedure is applied to calculate productivity over time and the result is reported in Table.VII.17.

The growth in labor productivity in the 10+ group is generally good compared to the trends in the number of establishments, output or employment. Value-added per man-year in the group was Birr 4859.4, and despite the fact that the number of establishments were declining, it revealed an increasing trend overtime (except in the late 1980's and early 1990's). In 1985/86 it reached Birr 7873.2, about 62% greater than that of the year 1975/76.

The same labor was producing birr 17701.7 in 1995/96, almost 3.7 fold greater than that of 1975/76 and over 94% more than the highest level registered under the Derge in 1986/87. Generally, labor productivity registered an annual growth rate of 9.72 per cent in the period under review. This fact revealed the efficiency at which labor input utilization was improving. Specially the improvement was significant after 1991/92. This happened without any disparity between ownership. Both public and private manufacturing activities registered an increase in labor productivity although the one for the private manufacturing activities is consistently lower in magnitude than the public one over the period under review. However, the rate at which labor productivity increased seem higher for the private than the public ones.

Table VII.17
Labor Productivity in 10+ group Manufacturing Sector

Year	Private		Public		Total	
	Q/L	Q/W	Q/L	Q/W	Q/L	Q/W
1975/76	2452.5	2.29	5392.1	2.70	4859.4	2.71
1980/81	3497.5	1.63	8363.3	3.61	7880.3	3.50
1985/86	5605.4	1.68	8035.4	2.91	7873.2	2.81
1990/91	4637.0	1.36	5529.7	1.76	5466.2	1.73
1995/96	14597.3	4.31	18032.7	3.40	17701.7	3.49
Growth Rate (1975/76-95/96)	10.71%	5.07%	9.57%	3.23%	9.72%	3.38%

Source: Own computation

The story, however, was quite different when it comes to the change in the value added per wage paid. Labor worth a birr in 1975/76 in the 10+ group was producing a value-added worth of birr 2.71. The same labor was producing only birr 1.97 in 1989/90 and 1.21 in 1991/92. It was only in 1993/94 that value-added per wage bill rose to 2.98 and 3.49 in 1995/96. This trend can also be observed from the growth rate registered. Value-added per wage bill increased only by 3.38 per cent annually

in the period under review, and even this positive growth rate was the result of a very rapid growth in recent years. The growth rate, however, seem better in the private sector than the public manufacturing activities. The "socialists," after all, were not exploiting their workers as wages were growing along with productivity.

7.2 Total Factor Productivity

Changes in each partial measure may have its origin in changes in other inputs. Separate partial indices still provide a confusing picture since, for example, we may know that labor productivity and capital productivity has increased while energy and material productivity have fallen. The combined effect of such flows on the firm is not known. Partial productivity ratios (like labor or capital productivity), while useful for measuring the savings in particular inputs achieved overtime, do not measure over-all changes in productive efficiency, since they are affected by changes in the composition of inputs, that is, by factor substitutions. Thus, measuring total productivity is essential. It is a productivity measure that compares output not only with labor input but also with tangible capital, each weighted by market value of its services. Total productivity can be presented via the expression:

$$A = \frac{Q}{aL + bK} \quad (1)$$

Where A= total Factor Productivity, Q= Value-added at factor cost, L= Labor input (man-year or wage bill), K= Capital input (net fixed assets) and a and b are respectively labor and capital income shares.

The above expression is computed for the Ethiopian manufacturing activities using man-year and wage bill alternatively for labor inputs. Factor income shares are represented by the current wage-value-added ratios. The result is reported in Table VII.18.

Total factor productivity in the Ethiopian manufacturing sector in 1995/96 is 0.6129 when case 1 is considered or 0.6482 for case 2. This by itself, nevertheless, tells little unless seen in comparative terms. What is important, in this particular case, is to look at the difference in total factor productivity registered in the different

manufacturing groupings. Two issues stand out in this comparison. The first is that total factor productivity in the 10+ group in 1995/96 is higher than other groups. While it is 0.9755 in 10+ group, it is only 0.4243 in cottage/handicrafts and 0.354 in informal manufacturing activities. This implies that labor and capital are more efficiently utilized in the 10+-manufacturing group than the other groups. The second related feature is that total factor productivity is consistently low as the scale of operation of the manufacturing group declines. Scale of operation become low when one moves from 10+ group to small scale, cottage/handicrafts and informal. This confirms the widely accepted view that there are efficiency gains associated with scale economies. The larger the size of manufacturing the more cost efficient the production.

Table VII.18
Total Factor Productivity of the Manufacturing Sector in 1995/96

Items	10+	Small-Scale	Cottage	Informal	Total
Value-added	1,593,839	60,605	638,836	409,534	2,702,814
Wages	457,007	8,592	42,524	13,135	521,258
Employee	90,039	8,929	1,311,745	354,905	1,765,618
Capital	2,254,498	84,512	1,519,355	1,183,408	5,041,774
Case 1	0.9755	0.8212	0.4243	0.3540	0.6129
Case 2	0.9165	0.8218	0.4495	0.3574	0.6482

Case 1 is the case where labor input is represented by man-year and case 2 by wage bill.

What is even more interesting is to look at factor productivity over time to see the learning process that has taken place in the manufacturing sector of Ethiopia and whether efficiency in resource use in the Ethiopian manufacturing sector was declining or increasing overtime. For this purpose, total factor productivity for the 10+ manufacturing activities (for which time series information for about 21 years are available) for the 1975/76 – 1995/96 period is computed. Two assumptions are employed in order to calculate total factor productivity. First, the wage–value-added ratio is used to represent labor income share (or labor elasticity of output). Second to avoid the undue influence of extreme values, geometric average income share (rather than current, initial or arithmetic average income share) is used to represent factor income share for the period under review. Labor input is represented by man-year (case 1) and wage bill (case 2) as before. The result of this computation for selected years is provided in Table VII.19.

Table VII.19

Total Factor Productivity in the 10+ Manufacturing Activities: Selected Years.

Year	Private		Public		Total	
	Case 1	Case 2	Case 1	Case 2	Case 1	Case 2
1975/76	1.2222	1.2002	1.1823	1.0984	1.5771	1.0987
1980/81	1.9543	1.4585	2.1380	1.9046	2.1318	1.8938
1985/86	2.5033	1.6084	1.4684	1.3140	1.5041	1.3333
1990/91	1.8292	1.2121	0.6666	0.6091	0.6971	0.6321
1995/96	1.0777	0.9851	1.1421	1.0388	1.1000	1.0053
Growth	0.86%	0.04%	2.64%	2.37%	2.28%	2.02%

Source: Computed

The trend of total factor productivity, regardless of ownership and which ever way labor input is represented, used to be disappointing especially starting from 1985/86 onwards and the situation did not change even after 1991/92 when labor productivity starts to increase dramatically although in the public sector there was some recovery for two years after 1992/93 only to decline again in 1995/96. Total factor productivity in 1995/96, regardless of ownership and type of labor input, was less than what it was before 21 years. The sector proved itself to be unlearning for the efficiency in resource use was deteriorating specially after 1985/86. The unlearning process could mainly be due to the poor efforts of firms in developing their own technological capabilities which, among other factors, include:

- the search for available alternative technologies and selection of the most appropriate technology;
- the mastering of technology, that is, its successful use in production;
- the adoption of technology in order to suite specific production conditions;
- further development of the technology as a result of minor innovations; and
- lack of basic research.

These are capabilities involved in know-how and know-why. The process of acquiring technological capabilities could encompass the social organization of the labor process, and the knowledge embodied in hardware, software, people, practices or procedures. Lacking these capabilities (mainly due to external factors) will have an impact on the changes in the transformation of inputs into outputs. Incorporating changes in the way in which inputs are transformed into outputs, including changes in the quality of output, is what signifies technological change and what enhances total

factor productivity growth. It is lack of these changes (the unlearning process) that contributed to the deterioration of the efficiency in resource use in the Ethiopian manufacturing sector. This requires a tangible firm level and government efforts which will be discussed in the "policy issue" section later.

Developing production capability is thus extremely essential for the manufacturing enterprises to achieve a level of international competitiveness. At the firm level production capability includes production management - ability to oversee and improve operations; production engineering - ability to obtain information (about systems of raw material control, production scheduling, quality control) and act to optimize operations; trouble-shooting to overcome problems and adapting process and products to increase productivity and repair and maintenance of physical capital. These capabilities can be gained from gathering and interpreting information from the production system, from adaptations and modifications, from understanding why some processes work and others don't, and from keeping records to preserve such information. It entails continuous systematic efforts and resources. Further more, the issue of the size of production needs serious attention. If Ethiopian manufacturing is to achieve competitiveness, it need to benefit from economies of scale, which in turn raises the crucial issue of expansion of markets, local as well as international, for domestically manufactured products.

8. IMPORT INTENSITY

Import intensity here is defined as the ratio of total cost of imported raw material to total cost of raw material required for the production of goods and services. It is a technical coefficient which measures the share or the magnitude of imported intermediate goods required to satisfy the direct and indirect input requirements induced by a sector to produce a unit of final product. Import intensity then shows import dependency of a given sector. The coefficient of import intensity takes the value between 0 and 1 and as it approaches 1, the level of dependency or the amount of import required approaches to unity. In this survey, to present the picture of import dependency of the manufacturing sector, the simple ratio of imported raw materials to total raw materials consumed is employed. Data on cost of raw materials consumed, both domestic and imported, for each sub-sector are collected and then the ratio computed.

The total raw material consumed by the manufacturing sector has been growing over time as a logical result of the expansion of manufacturing establishments. The increasing value of the raw materials consumed can also be partly explained by the rise of the cost of raw materials. According to the CSA surveys mentioned above, the total value of raw materials consumed in 1975/76 was valued at Birr 486.1 million which rose nearly to 2.3 billion by 1994/95. The proportion of locally produced raw materials to imported ones in the same period increased from 0.82:1 to 1.18:1, indicating an increase in the use of local raw materials. This is a positive development towards speeding up the industrialization process and reducing the import dependence of the manufacturing sector. The proportion of the cost of imported raw materials to the total cost of raw materials was 52 per cent in 1975/76 which declined to 45.9 per cent by 1994/95.

Looking at the sub-sectoral differences in the intensity of imports, we find that food and beverage sub-sectors have the lowest proportion of raw materials imported compared to iron and steel and fabricated metal product sub-sectors whose use of imported raw materials is almost 100 per cent. The degree of dependency on imported raw materials is relatively higher in chemical, metal, rubber and plastic, and paper and printing sub-sectors. In general the import intensity of the Ethiopian manufacturing sector on average is more or less 50 per cent. This is generally unsatisfactory in terms of the low level of linkage between the various sectors and the degree to which the country is not tapping the locally available raw materials.

9. INSTITUTIONAL ARRANGEMENTS AND THE POLICY REGIME

As discussed earlier, the level of industrialization in Ethiopia was at an incipient stage during the imperial period. A conscious drive towards developing a modern industrial sector did not start till the 1950s. The main agents for the expansion of the industrial sector during this period were foreign nationals residing in Ethiopia. It was believed that the settlement of foreigners and the expansion of commercial farms would continue to give impetus to the growth and expansion of the industrial sector. As discussed at the beginning of this chapter, a number of proclamations were decreed to pursue this objective during the imperial era including a legal notice (no.10, 1950) to encourage foreign investment and a revised investment proclamation in 1964. The thinking among policy makers of the period did not expect the incipient local capitalist

class to engage in industrial activity. Accordingly, there was no policy especially designed to encourage domestic entrepreneurs to involve in industry.

Partly as a result of the enabling environment created during the later years of the imperial era, a number of manufacturing establishments were created during this period. By the end of the imperial period, there were some 430 manufacturing establishments with a value added at market price of about 398.5 million birr in 1974/75 and a very low level of employment creation. These industries were designed to satisfy the limited domestic market and were seriously handicapped by poor infra-structural facilities and lack of clearly articulated government economic policy towards the development of the sector.

Although the trend was mildly encouraging in the last few years of the imperial government, the actual level of manufacturing activity and its employment creation was too low compared with other developing countries and even more ominously for the regime, compared with the expectations of the young and educated sector of the population. This group believed that the country's backwardness was a result of what it dubbed as the feudo-bourgeois regime of Haile Selassie and its policies. The policies that they considered inimical to the country's industrialization was the reliance on foreign "imperialists" who, they thought, would have no interest in the country's industrialization but more interested in "exploiting" the country's raw materials, cheap labor and above all the market for its industrial manufactured products. So, they envisioned very little progress towards industrialization without a fundamental change in government and a reorientation of the country's development strategy along socialist lines.

Accordingly, the military government, taking its direction from the then socialist intelligentsia, devised a policy that hoped to develop the country's industry with the state taking not only the lead but also the major ownership and management of the large and medium scale manufacturing sector. As a first step in this process, it nationalized almost all the medium and large-scale enterprises formerly owned by the private sector in 1975. It also imposed capital ceilings for private ownership to discourage any possible revival of the private sector in medium and large-scale manufacturing. Private ownership was mainly confined to small-scale industries and handicraft activities. As a logical consequence of the proclamation of the guidelines for the establishment of producers' cooperatives, there also emerged collective ownership of handicrafts⁹. These policies left the ownership of the industrial sector in

⁹ PMGSE, Ten-year Perspective Plan 1984/85 - 1993/94, (Addis Ababa, September 1984) P 63.

three groups, namely government, private and cooperatives. Before 1991 government ownership in the sector both in terms of capital and output accounted for 94.5 per cent.

The state took the responsibility in developing and managing the medium and large-scale industrial sector. The broad policy framework for the sector hopes to emphasize industries with wide linkages and capital goods producing industries that can be used to develop other manufacturing industries. The prevailing economic management policy had created three hierarchies in the industrial sector. Putting the Ministry of Industry at the top, and followed by corporations established to supervise the management of the group of enterprises. The general managers had the responsibility of supervising the day to day operations of the industrial enterprises in accordance with guidelines prepared by the ministry without much consideration to the specific situation of the enterprise in question.

The government sought to attract investment in this sector through the help it hoped to get from the then socialist countries. Although some investment in this area has been materialized, it certainly was not close to what the socialist industrializers hoped to achieve. Furthermore, the efficiency of these enterprises was compromised because of the management structure which was so intrusive that sales and purchase of outputs and inputs were decided by government corporations. Accordingly, producing enterprises had weak link with market forces which did not permit them to have the necessary feedback so as to be more competitive in the market. In short, the industrial policy of the Derge regime has stifled the speedy development of the sector which had resulted basically from too much government intervention and limited participation of the private sector.

To support small scale industrial entities, the government established Handicrafts and Small-scale Industrial Development Agency (HASIDA) in 1975. But this did not help much in achieving the required pace of growth in the small-scale industrial sector. This may be ascribed to the lack of concomitant measures that should have been implemented by the government. In this area, the major focus under the Derge was supporting cooperatives in line with socialist principles without simultaneous assistance to the private sector.

Following the collapse of state socialism in Eastern Europe and later in the former Soviet Union, and the increasing economic and political difficulties it faced, the regime tried to introduce some economic liberalization by way of introducing a mixed economic policy. A number of constraints for private sector development were

reconsidered. For instance, the restriction of capital ceiling was relaxed. However, Several of these encouraging measures were not materialized as the civil war reached its climax and diverted government resources towards resolving security problems. In the end, these measures proved to be too little too late to do any good for the survival of the regime.

9.1. The Post-Derge Era

Following the collapse of state socialism, the only choice that developing countries have in terms of devising their development strategy was capitalism. There was no rational left to pursue socialist development policy when the countries that supposedly show the future of these developing countries have abandoned the socialist project mainly as a result of economic failures. Even the Derge started abandoning its extreme socialist policies in 1990, albeit grudgingly, and a little too late to do them any good. For the victorious EPRDF, despite the leadership's firm belief in the truth of the socialist ideology, socialism, given the existing international economic and political reality, was no more seen as a realistic objective or even a guide to policy making to countries such as Ethiopia. Accordingly, the transitional government of Ethiopia, which took power from the Derge, announced an economic policy whose basic elements can be characterized as "cautious capitalism". Believing that the overall macroeconomic environment has to be conducive for investment, the government accepted structural adjustment program albeit with some reservations. The policy accepted market allocation of economic resources although it left a large area of economic activity to the government and was not willing to forgo with some of the policies of the previous regime including the policy on land.

The industrial sector policy of the TGE indicated that the role of the state would be limited to areas of large-scale engineering, metallurgical, communications, power and pharmaceutical industries which the private sector may not be able to undertake. A new investment code was proclaimed in 1992 with a hope to attract private investment particularly foreign direct investment in areas of the economy destined for the private sector. Domestic investors were also given special privileges in terms of demarcating certain areas of the economy (usually small-scale trade and service activities) only for the local private sector. In general these policies were designed with the long-term objective of raising the share of the industrial sector in the economy both in terms of output and employment creation and enhancing the development of strategic industries which were expected to have multiplier effect on the expansion and development of other economic activities. Laws were enacted to

give enterprises management autonomy, a more flexible labor code was proclaimed. Prices were largely decontrolled, foreign trade and financial institutions including the foreign exchange market were partially liberalized. A number of measures were also taken to encourage private sector participation in the economy including providing guarantee to private investment.

The government of the EPRDF led Federal Democratic Republic of Ethiopia, which took over from the transitional government indicated its intentions about the future of the Ethiopian economy by outlining the ruling party's broad five year development program it dubbed the peace democracy and development program. The gist of the economic part of the program is a rural centered development with utmost emphasis on the agriculture sector as a springboard for expanding the development of the other sectors. This strategy is named Agricultural Development Led Industrialization (ADLI). According to this strategy, agriculture is to be the primary focus of development in short and medium terms and its production will be expanded through increased availability of modern inputs such as fertilizers, improved seeds, pesticides and improved extension services. This is, of course, expected to increase the income of the rural people which will in turn raise the purchasing power of the larger proportion of the population. This will consequently augment the demand for industrial goods. Agriculture would thus become a source of domestic market demand and a reliable raw material base. This strategy is further anticipated to strengthen the intersectoral linkage between agriculture and industry. While this strategy is being implemented and a separate industrial policy is prepared, the industrial sector is expected to continue its modest growth through private sector activity particularly through foreign direct investment encouraged by the various incentives provided by the investment code, which underwent two more revisions including the most recent one in 1998, to make it more attractive to foreign as well as domestic private investors.¹⁰

As mentioned above, the country's policy geared towards the industrial sector is under preparation and looking at the unofficial document, several measures were incorporated to enhance the development of the sector. Key among these measures is the establishment and strengthening of institutions necessary to promote industrialization. The policy further hoped to create a conducive environment for

¹⁰ For details on the various incentives provided by the investment code, see Council of Ministers Regulation No 36/1998.

industrial development by developing infrastructure and expanding national technological capability. It intends to promote inter- and intra-sectoral linkages, create an appropriate financial environment, encourage balanced regional industrial development and strengthen the linkages between industry and other sectors. In addition to the expanding domestic market for industrial products from the rural population as its income increases as a result of the ADLI strategy, the government's policy hopes to promote industrial exports.

9.2. Impacts

The various liberal legislative and policy measures coupled with the improvement in the overall business atmosphere not only removed the main barriers to entry (many areas are open to the private sector) but also provided incentives to attract private investors. As a result, the participation of the private sector in manufacturing activities has increased since 1992. These can be observed from the number of licenses issued which increased rapidly following the change in policy. However, as can be seen from the tables below, the enthusiasm seem to have started to ebb as seen in the decrease in the number of licenses issued after 1995/96.

Looking at the nature of investment since 1991, it is important to make a distinction between investments requiring capital below Birr 250,000 and those requiring a larger amount. In the former category of investment, licenses used to be issued for years but its rate has become significantly high since 1991/92. In 1991/92, 4076 temporary manufacturing licenses were issued to investors which was expected to create 50939 job opportunities and employ about Birr 936 million capital. Compared to licenses issued a year earlier, it is higher by almost 77 per cent. In the same manner, the number of permanent licenses issued by 1991/92 were 645 which, when compared to 1990/91, was greater by 280 or 56.6 per cent. In 1992/93, 2711 temporary and 464 permanent licenses were issued. In general the number of licenses issued, the number of job opportunities created and the capital employed for the last 7 years according to the licensing bureaus is presented in Table VII 20.

Table VII.20
Number of Licenses, Job Opportunities and Capital to be Invested

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97
Temporary Licenses						
• Number	4,076	2,711	2,159	2,497	2,738	1,884
• Employment	50,939	24,040	15,383	11,279	11,725	17,275
• Capital('000 Birr)	936,794	300,659	1,211,100	293,499	222,005	194,000
Permanent Licenses						
• Number	645	464	1,499	2,335	5,675	5,037
• Employment	6,437	4,380	6,242	7,996	12,434	17,324
• Capital('000 Birr)	88,216	62,258	83,308	164,716	243,781	327,402

Source : Regional Bureaus

Investments requiring capital above birr 250,000 was legally prohibited by policy guidelines during the Derge Regime. Even the introduction of mixed economic policy in 1990 did not bring about a significant change in this category of industrial investment before the fall of the Derge regime. These categories of investment were also given special attention and provided with a number of incentives along with the formation of an investment authority that issues licenses and facilitate their activity. According to the data from this office, from July 1992 to October 1997, almost 1628 manufacturing projects with estimated investment capital of birr 11 billion creating employment opportunities for 67,739 were approved. However, during the same time only 228 manufacturing projects started production with birr 908.3 million capital investment and 4766 employment opportunities and a further 296 manufacturing projects with 1.8 billion investment capital and 13,219 employment opportunities were under implementation phase.

Table VII.21
Industrial Investment Certificates Issued (July 1992 – October 1997).

Status	Number of Projects	Job Opportunities	Capital (in 000 Birr)
Total project	1,628	67,739	10,972,452
Started production	228	4,766	908,263
Under implementation	296	13,219	1,828,642

Source: Ethiopian Investment Authority

As can be seen from the above table, projects which started production and which are under implementation are very small in number compared to the total number of projects approved during the period. For instance, it is only 14 per cent of these projects approved that started production and only 18.2 per cent are under the implementation phase. Generally, it is only 32.2 per cent of the total manufacturing projects approved that are either under implementation or operation phase indicating the existence of a serious problem in the process of actualizing planned projects.

10. MAIN FINDINGS AND POLICY ISSUES

10.1 Main Findings

From this survey, six main results can be identified. First, the contribution of manufacturing industries to the GDP of Ethiopia is not only low but its trend has also declined or stagnated. Second, the distribution of the manufacturing sector (both in number of establishments or output) is lopsided with respect to sectoral, regional and ownership patterns. The majority of the manufacturing establishments are cottage, handicrafts and informal in nature and are engaged in the production of food, beverages, textiles and non-metallic mineral products. The government still dominates the manufacturing value added accounting for more than 50 per cent and manufacturing activities are concentrated in Addis Ababa and few cities of Oromia. Third, structural shift of the manufacturing industries did not seem remarkable. Fourth, technical change have little influence in the manufacturing output growth, and from the measure of total factor productivity, the sector proved to be unlearning and the efficiency in resource use had even deteriorated. Fifth, linkages to each other (among the manufacturing sub-sectors) or among other sectors is minimal. Finally, despite the recent enabling legislative and policy environment towards the private sector, the process of actualizing industrial projects into operation is still slow. Given these findings, what are the main constraints that prohibit the growth and development of this sector? That is the topic that we now return.

10.2 Constraints to the Development of the Manufacturing Sector in Ethiopia

There are a number of inter-related problems that have affected the growth and dynamism of the manufacturing sector. Some of these problems are internal to the firm while others are external to it. For the purpose of this exercise, we look at these constraints by dividing them into seven groups. These are technology-related problems, market, finance, policy issues, inputs supply, human resources constraints and the overall political environment.

Technology related problems: Lack of sufficient information on appropriate technology is a serious handicap to both existing firms and to those investors wishing to invest in the sector. In most cases, firms depend on informal sources of information in evaluating the suitability of different technologies. The decision to acquire a given technology is not based on empirical analysis and tests of its suitability to the quality of raw materials, the level of skill of the work force and other local conditions. In most cases, firms simply acquire technologies which are in use by others in the same line of business. Lack of support for technology is a problem associated with the low level of development and the limited number of industries within the nation. It is also a reflection of the low capacity of the nation to absorb new technology. The limited number of industries within the country makes the provision of on-site support services uneconomical and unattractive to foreign suppliers of technology. The market size is not big enough for suppliers to warrant the type of support they provide to larger markets. Local technical know-how is not developed enough to provide technological support services to industries. With out this local skill, imported technologies will not be meaningfully absorbed. Efforts of firms to acquire technological capabilities are also limited. This problem of technology has significantly reduced the efficiency of existing firms and is bound to do so to the upcoming ones. This is an issue that any investor has to confront and the government to think about in devising an overall industrial strategy

Market: The demand for manufacturing products in Ethiopia are very small compared with the size of the population because of the low level of income of the majority of the population. Furthermore, since most of the existing enterprises are import substituting types, the products they produce are tradable products and thus have to compete with imports. Since the recent foreign trade liberalization measures and the significant reduction in tariffs on most of these imports, local manufacturing enterprises are facing difficulty in competing with cheap imports and judge the

competition they face from imports as unfair. Over-concentration of business in the same industry, which is a clear indication of the limited entrepreneurial scope and risk aversion due to the inability to see beyond what is familiar, have made the situation worse. Lack of information on export markets, protectionism from potential export markets such as the European Union, and the poor quality of products has been a serious problem for not gearing production for export markets. A consumer bias against local products is also a real problem despite the availability of comparable or even better local products.

Finance: The problems related to high collateral requirements are manifestation of the almost monopolistic position of lenders within the formal financial sector of the economy. Without any competition in the field until recently, banks adopted a take-it-or-leave-it approach towards borrowers and required a high level of collateral before extending loans to private industries. The land use policy did not allow the use of the plant's land as mortgage. Recently, a procedure has been introduced to accept as mortgageable collateral the paid installments of the land bought on lease, but the system has some flaws and it is not yet fully operational. Another limiting factor is the restriction on the type of assets accepted by banks as collateral only to those for which the borrower can produce ownership license. This practice excludes valuable properties from being pledged by the borrower. This problem has made it almost impossible for new entrants to business particularly in industry even when they have good business ideas as they are usually short of assets they can use as collateral.

Policy issues and the bureaucracy: Probably the key policy related problem that businessmen often complain about is the policy on land. Since the implementation of the lease system, acquiring land for investment is not only very difficult and tedious, but also very expensive. It is probably one of the most important issues that the government need to address both in terms of policy and implementation. Customs duty and tariffs are also subject to many complaints. The tax levied on imported unprocessed raw materials is often higher than the tax on the imported finished products which uses the same raw materials as an input. Under such situations local products which use the highly taxed imported inputs will lose their competitive edge to imports. Unfair and arbitrary tax assessment procedures and practices is another serious problem on which firms express strong opinion, claiming that sales tax proclamation is unrealistic and the rate of 12% unfairly high. The Inland Revenue Authority does not accept financial reports prepared by firms for the purpose of taxation. This lack of trust is said to encourage businessmen to be involved in corrupt practices. In general, lack of a clear and long-term strategy

towards the development of the industrial sector has seriously limited the growth and development of the sector.

Input related problems: High cost of land will inhibit expansion projects by existing firms and can also act as a barrier to entry of new entrepreneurs. This may continue to be the case until the market settles down and bidders learn to be more realistic in assessing the value of land. The high cost of imported inputs could be taken as a consequence of the continuous devaluation of the birr. But, it could equally be attributed to high custom duty and tariffs on imported inputs. The unreliability of domestic sources of inputs and their poor quality also acts as a bottleneck to local manufactures in their effort to exploit export markets.

Human resources: Lack of skilled manpower has been a serious problem for industrial firms. Graduates from technical schools do not have sufficient training to prepare them to handle technical jobs immediately after their graduation. This may be explained partly by the inadequacy of the curriculum in such schools and the absence of practical training and overall deterioration of education in the country. Furthermore, most technical students that attend evening classes do not have enough time for laboratory work because of tight schedules. The absence of industrial discipline and work ethic, on the other hand, is a result of various socio-cultural factors including the misappropriation of socialist ideology which weakened management's ability to enforce work discipline. It must be noted that the labor force is of agricultural background and is not equipped with the high level of discipline and work ethic that a modern industrial sector requires. Most often, workers acquire their skills through apprenticeship. This means the rigors of formal training which would broaden the scope of workers beyond performing a specific job and help them to appreciate the value of work as a source of personal development is missing.

Socio-political factors: The current regionalization scheme, which is based primarily on ethnicity, does not encourage the free mobility of capital and entrepreneurial skills across regional borders. Regional administrations often have conflicting policies that are not consistent with those of the federal government and difference in policies are inevitable under a political system where regional administrations have a wide latitude to formulate their own policies.

The various problems mentioned above were also problems encountered by informal handicrafts/cottage and small scale manufacturing activities during start up or at the operational stage. So much was confirmed by the survey conducted to identify the main difficulties facing this group. To alleviate these problems, manufacturers

suggested in this survey that the government assist them in obtaining a plot of land or rented building, better access to bank loan, easing of government regulations and enforcement of property rights, better access to raw materials, improved technical training to workers, managers and owners and assistance in marketing.

10.3. Policy Challenges

From the foregoing, we saw that the objectives of enhancing Ethiopia's overall economic and social development requires a strong and dynamic industrial sector. However, like all sectors of the economy, the industrial sector of the country is not only at an infant stage but even more troubling, does not seem to be going any where. Not only is its contribution to GDP declining but also its productivity, and thus its competitiveness is seriously declining. Clearly, left by itself, it is not going to play the role required from it as key contributor to overall economic development. *It needs the helping hand of the state in a coherent, systematic and substantial way.* Resolving the constraints that are outlined above require a wide but focused long term strategy that brings the various stake holders in the sector, namely the state, the private sector and workers together for effective implementation. Such a strategy must begin by taking a thorough inventory of the country's resource endowment and identify sectors and specific projects that provide potential comparative advantage for the country. A joint effort by the three stake holders mentioned above can then address the problems that are internal and external to the firm by taking specific measures related to the problem either at the firm level or at the policy level by creating or strengthening the required institutions.

The starting place for addressing the constraint related to technology is to attain theoretical clarity about the process of industrial development in general and technology use in particular for "copying" countries such as Ethiopia. Unlike the neoclassical view of technology as a set of "blueprints" readily available to be used by technology importers, empirical evidence has started to reveal a different characteristics of technology. This include that it is tacit, that its imitation is not trivial in the sense that it demands considerable effort on the part of imitating firm, and that production experience is crucial (Herbert-Copley, 1990: 1459). This has important implications for late starters. First, accumulation of technological capabilities is not an automatic outcome of production experience though it is important. Second, learning does not occur in all firms. Third, the process of technical change is irregular both in its rhythm and direction. These findings correspond to the results arrived at in Ethiopia too.

The good news for Ethiopia is that the outcomes in the Ethiopian manufacturing sector shall not be frustrating since it happened almost everywhere in late industrializing countries. It only tells us that the right policy measures were not in place, which in turn alerts both manufacturing firms and government to further put an effort to attain a reasonable rate of progress. The firm should insist on building the necessary technological capabilities and the government should create a conducive macroeconomic environment and a well thought out industrial strategy which necessarily include a clear understanding of the country's comparative advantage and along with it installing the appropriate public goods, a package of incentives and strong implementing institutions.

10.3.1. Firm Level Efforts

Once the country's comparative advantage is clearly identified efficiency in production could be achieved through, inter alia, selection and effective use of appropriate technology. Acquiring technological knowledge required first experience in production and secondly investment on learning and those firms with these elements produce the required capability. Raut reported, "... while knowledge from private R & D capital spills over to create public domain knowledge, a firm must invest in private R & D to acquire the technical capability needed to make use of the public domain knowledge to enhance productivity" (Raut, 1995: 2). Utilizing public domain knowledge fruitfully has costs, but the cost will be minimal for those firms which have accumulated the stock of technological knowledge through considerable investment in R & D in the past (Raut, 1995).

This process is the deliberate effort of the firm to adapt technology to new conditions, to improve it slightly or very significantly, and this process might pass through three stages of capability: Production, investment and innovation (Lall, 1992; Dahlman et al, 1987). Production capability includes production management - ability to oversee and improve operations; production engineering - ability to obtain information (about systems of raw material control, production scheduling and quality control) and act to optimize Operations; trouble-shooting to overcome problems and adapting process and products to increase productivity; repair and maintenance of physical capital. These capabilities can be gained from gathering and interpreting information from the production system, from attempting adaptations and modifications, from understanding why some work and others do not, and from keeping records to preserve such information. And it entails a continuous systematic efforts and resources; it shall not just happen when shocked by changes in inputs or production

markets. The process may take up to 20 years to acquire its full range and accordingly, long term thinking and investment is required (Dahlman et al, 1987: 764-765; Lall, 1992: 168-169).

As Lall suggested, investment capabilities include the skills needed to identify, prepare, obtain technology for design, construct, equip, staff and commission an expansion which determines the capital cost, the appropriateness of the scale, product mix, technology and equipment selected which in turn affects the efficiency with which it will operate (Lall, 1992:168). Innovation capability consists of major and minor innovations including improvements in existing technology; and, acquiring the former two capabilities is the main impetus to develop some capabilities in innovation. These capabilities are important for diversification and change and every firm has to give due respect for efforts to attain these capabilities. A firm that fails to achieve these capabilities will fail to survive in today's internationalized competition. The pace of acquiring these capabilities by firms, however, depends on the level of development in which the economy is in, physical and human capital development, national technological efforts, incentives, institutions, government policies, etc., which are not the domain of individual firms, but the environment in which they operate.

10.3.2. Government Efforts

Firm level technical capabilities can be acquired only if there are sufficient entrepreneurial capabilities, deep industrial experiences, proper incentives and adequate institutions. And the government has to provide all these in sufficient magnitude.

Developing Capabilities: These capabilities include the launching of physical investment, the provision of human capital and the undertaking of technological efforts. Lall reported that "these three are strongly interlinked in ways that make it difficult to identify their separate contributions to national performance, but they do not always go together" (Lall, 1992:170). One without the other will not exert a sufficient impact, or the existence of one does not necessarily bring the other into existence. Of course, physical investment is a pre-requisite: for industry to exist, plants and equipment are necessary. The undertaking of physical investment in Ethiopia was hindered by lack of the domestic investment capabilities which in turn is caused by lack of entrepreneurial capability. The extent to which the private sector participates and the experience on industrial activities would have been important to enforce the development of entrepreneurial capabilities.

The size of the informal sector might give an impression that there is no shortage of entrepreneurial drive in Ethiopia. But the drive to profit from opportunity might not *per se* be the same as the entrepreneurial capability required to organize, set up and run modern industry, which requires larger scales, longer time perspectives, more advanced technologies and more complex organizations than traditional crafts or informal sector activities (Lall, 1992: 116). They rather favor rent seeking and trade activities which produces quick returns. The other point is that the private sector was stifled by wrong economic policy for about two decades that impedes its impact on physical investment. Even now, the process of actualizing industrial projects into operation has shown a sluggish character mainly for problems associated with land and finance, but also due to lack of good governance (long procedures, lack of transparency, difficult and inefficient bureaucracies).

There is some progress in recent years to encourage private sector development in Ethiopia but efforts should continue to be made by the government to increase the participation of the private sector (not only through privatization) and the process of learning entrepreneurial capabilities. This entails commitment beyond installing a favorable environment especially in identifying basic barriers to industrial entrepreneurial capability and initiating selective intervention on industrial activities. The other important element that government should focus on is education and training. Its primary importance is its impact on entrepreneurial capability; a person with high level formal education is better placed to adapt, understand, learn, use and create ideas. Entering into more demanding activities calls for increasing level of technical know how. Quality of education and its technical orientation (vocational training) is quite important and currently very inadequate both in quantity and quality in Ethiopia. Firm level training is crucial and efforts made at the firm level to create skills and train workers could make a difference on TFP but firms usually are reluctant to invest on training. The government may wish to provide incentives for such in house training. Regarding the importance of in-firm training and the role of government in providing it, Lall said

Since there is a serious risk of private underinvestment in training at the firm level when labor is mobile, (which is important to the diffusion of knowledge), human capital development requires measures to induce more investment to support employee training, by firms individually or collectively, or by governments where private agents consistently underinvests. These measures may be functional, applied to all activities, or they may be selective, targeting emerging sectors (Lall, 1992:181).

As to what measures need to be taken, when and to what extent, shall depend on individual cases. However, even if labor is trained and physical investment is made, these will only be productive when combined with technological efforts made by the government to guide firm level efforts and fill the gap whenever it is created.

Incentives: Incentives determine the efficiency with which capabilities are used. It affects the pace of accumulation of capital and skills; the type of capital purchased and the kinds of skills learned; and the extent to which existing endowments are exploited in production (Lall, 1992: 171). Competition is one mechanism through which incentives are channeled. Competition (domestic and external) would make price to reflect the relative scarcity of inputs used as well as the demand and cost of supplying the goods and services to be produced provided that there are no both product and factor market failures. But failures are likely in labor, human capital, capital, finance and product markets (World Bank, 1992:26-27). As a result, government has to intervene either to overcome market failure or to give promotional supports particularly to emerging industries. Where markets fail and enterprises under-invest, government should intervene so that enterprises internalize markets (for example, provide self-financing or subsidize training of workers) and to overcome the failures directly by providing finance (loans venture financing, R & D subsidies, etc.) to enterprises. This intervention could be functional as well as selective, but in countries like Ethiopia where resources are limited, selective intervention will be dominant in order to selectively promote activities which have greater linkages and externalities and that generate positive spill over effects, thereby produce the required capabilities sooner given the limited resources.

It is not only market failures but, in countries like Ethiopia, structural problems also need the attention of the government. The structure of production might give not only a wrong or irrelevant signal to price but also might not be totally responsive to prices at all. In this setting, "getting-prices-right" would lead a country with severe structural bottlenecks nowhere on the ladder of technological capabilities. The government has thus to intervene especially to protect or promote until some level of structural transformation is assumed. But care must be taken from intervening in wrong areas to support unviable enterprises. Moreover, though acquisition of technological capabilities require inward-looking trade policies, the dichotomy between inward and outward orientedness is irrelevant. In the first place, they are not mutually exclusive, they are rather complementary. Secondly, both can be used in phases; inward-oriented as a pre-requisite until the domestic economy becomes price-responsive. Or they can be used jointly, outward-looking for established industries and inward-looking for infant industries. There is already an empirical evidence for that. All

newly industrializing countries went through import-substitution phase before turning to export-orientation (Hellinier, 1986; Pack & Westphal, 1986; Fransman, 1984). What is relevant is not the dichotomy between being inward and outward looking, as both are important to bring about technological capability and technical progress sooner. A period of protracted import substitution is useful - perhaps even necessary - to build a base for launching successful export drive with associated positive rate of TFPG; opening up to international competition, as well, is essential to spur increases in domestic efficiency; export promotion is good and so is import liberalization to produce technical progress. What matters most is combining them together fruitfully with a clear and transparent strategy. Equally relevant is identifying the appropriate duration of protection or promotion policies, deciding whether the duration should be uniform across industries or whether it should differ from industry to industry. And, if there should be differences, which sectors should get priority. Industrial activities differ in their technological, organizational and linkage characteristics and accordingly may have different learning periods and hence, the duration of protection and promotion should be different accordingly. Although there are no clear-cut rules, TFPG (the extent of learning) can be used as a guideline in the selection of priority sectors and the duration of protection. "Input per unit of output must fall more rapidly in more protected industries if there is to be any rationale for infant industry protection" (Nishimizu & Robinson, 1986:307).

One always should note that technological capabilities may be enhanced under conditions of protection. Nevertheless, it does not necessarily follow that protection is always needed for the development of technological capability or that the granting of protection will be followed by improved technological capability (Fransman, 1984:21). Thus, there is a need always to contain the cost of protection or subsidy by introducing limits and safeguards through selectivity and flexibility. In this regard, it is said that "the best combination may be the selective and temporary protection of domestic markets, together with strong incentives for export activity and domestic competition" (Lall, 1992: 172). It is in this direction that the Ethiopian industrial strategy should follow. Industrialization is a must. We can not think about development without it. But the industrialization process should generate the domestic benefits or the exchange earning capacity soon to sustain its growth.

As part of its overall liberalization package, the government of Ethiopia has taken trade policy reforms. The reform has reduced the extent of protection in most firms and inter-firm variation of protection rate has decreased. Most enterprises are exposed to competition both from domestic (by encouraging private investment which was stifled deliberately) and imports (by liberalizing trade). While the broad policy

direction is laudable, its gross and indiscriminate nature misses the logic of selective protection and prudent industrial policy. Even conservatives such as Lall concur the use of selective and targeted intervention:

Given the inherent costs and duration involved in building up capabilities in new, complex industrial activities, and given the differences between technologies, there is no reason to argue that all industries should be protected equally... More difficult technologies call for higher protection, and activities which have high linkages with others call for broader protection to embrace related industries which are also undergoing learning. Similarly, activities that generate higher externalities need more support because investors cannot appropriate all the benefits.¹¹

The key lesson here is that competition is necessary but it is a double-edged sword. Too much competition can wipe out firms that cannot finance the costs of capability acquisition. Thus, the adjustment in Ethiopia must be selective and shall be armed with considerable data. Sectors must be identified on the basis of dynamic comparative advantage and supported and these sectors must have a good record on allocative efficiency and rate of TFPG. Otherwise, the reform might end up being self defeating at least in the key area of industrial expansion.

Institutions: Both incentives and capabilities operate within an institutional framework and these institutions - those entities established to facilitate the working of markets - sets rules. Institutional deficiencies are the main causes of inefficiency and underinvestment. Thus, the development of institutions that facilitate technological capabilities and industrialization require due consideration in industrial policy formulation and implementation. Institutions are important in the provision of finance, information, services, standards, expert assistance, etc. Successful industrialization entails systematically building institutions to support or supplant market forces. There must be industrial institutions to promote inter-firm linkages in production, technology or training, to provide support to smaller enterprises, to help firms to restructure and update. There must be technological institutions to remedy market failures especially in the area of information on sources of technology since technological information does not exist everywhere nor are the international markets free and competitive. One of the key weaknesses of the industrial sector in Ethiopia is its lack of supportive institutions. Even those that exist are either poorly staffed and managed or engulfed with conflicting objectives or starved of funds or stranded by bureaucracy and policies.

¹¹ Lall, 1992, op.cit., p.125.

In Ethiopia, there are no institutions that are set up to supply information about technology or markets. But, selecting appropriate technology - technology that is easy to adapt, assimilate and change to local conditions - rests upon information and the ability to use that information effectively. Because information, by its character, is a public good and characterized by large economies of scale in collecting and organizing information, the private sector underinvest in the area since it cannot appropriate all the benefits that emerge from it. This justifies the need for the government to subsidize the collection and dissemination of technological information or set up such institutions and provide to those in need at an affordable charge. Furthermore, in Ethiopia linkages between large and small firms are absent, and are not facilitated by appropriate institutional assistance to potential small suppliers or subcontractors. Yet, there are strong arguments for sub-contracting both for efficiency of large ones and expansion of small-scale activities (Schmitz, 1982; Anderson, 1982; Kashyap, 1988).

Supportive institutions are not adequate in Ethiopia for physical investment to grow faster and capabilities to expand. While "directed credit" is necessary to make sectoral preferences (through subsidized interest rate and easy access to credit) to shift the structure of the economy towards the productive sector which is more liable to generate spillover effects, no such scheme is practiced. Due to lack of collateral, but mainly due to failures on financial markets, good investments might not receive finance while some bad ones do. Creating specialized institutions, like Small Business Administration of USA, could finance industrial entrepreneurs stranded by these problems. Having such institutions not only help to increase capability but also improve incentives by encouraging domestic competition. Setting up industrial estates and export processing zones in Ethiopia in which capabilities and industrialization is at a stage of infancy could be an institutional mechanism to selectively intervene in order to overcome infrastructural, information and service deficiencies. Export processing zones help to meet the requirements of legal and regulatory environment favorable to entrepreneurs and exports. Industrial estates not only reduce the entrepreneurs' investment costs but also provide basic infrastructures and industrial services, which the market cannot supply and which are real bottlenecks to entrepreneurs to invest. Furthermore, installing these institutions can enhance capability development. Finally, all these elements have to be put together in a clear and transparent package that include building institutions, providing appropriate incentives and developing capabilities, along with good governance for clean, speedy and effective implementation.

VIII

EXTERNAL TRADE AND PAYMENTS

1. INTRODUCTION

One of the most remarkable outcomes in the policy domain of the change of government in Ethiopia in 1991 was the phenomenal shift in the trade policy regime. If, during its initial days the Transitional Government of Ethiopia (TGE) sought of pursuing the more or less protectionist regime it inherited from the Derge, albeit with minor adjustments, it soon changed (or was made to change) to a more relaxed and liberalized policy stance. The exchange rate changed its parity from Birr 2.07 per US dollar (which it maintained for 28 years) to Birr 5.00 per US dollar when it was devalued in 1992. Following this momentous policy shift the Birr was delinked from the US Dollar to which it was fixed for 48 years when it was semi-floated in 1993.

These significant exchange rate policy reforms were accompanied by extensive changes in trade policy. Quota imposed on imports were excised in favor of tariff, which were in turn drastically reduced. Export taxes were eliminated with the exception of that imposed on coffee. By so revising its trade and exchange rate regime, the country was adjusting its tune to the rest of the world, which was globalizing at a fast pace, and were in accord with the demands of the World Bank and the International Monetary Fund inspired and supported Structural Adjustment Program (SAP).

These measures contrast very conspicuously with the policy regime that ruled supreme since the end of the Second World War when economic and later ideologically driven policy stances very much defined the trade policy framework.

2. TRADE POLICY REGIME - POST AND PRE-REFORM ERA

2.1. Pre-Reform Era

The pre-reform trade regime in Ethiopia was characterized by one of protectionism, based at first on and deriving from a purely economic rationale but later expanded to include ideological objectives. The economic reasoning behind the trade policy of the

Imperial Regime was the classical goals of mobilizing government revenue by imposing taxes on exports and imports, maintaining the balance of payments at a sustainable level as well as providing the domestic economy with the degree of protection deemed necessary.

The revolution of 1974 went beyond the simple changing of the guards and elicited a novel *modus vivendi* as well as *modus operandi*. However, and despite the fundamental shift in ideological outlook, the trade regime maintained the policy it inherited from the Imperial government. The exchange rate policy and the exchange rate were left intact, as were the systems and institutions governing export and import.

What changed under the Military Regime was the purpose for which the instruments were used and the severity with which it was applied. To the three objectives of the Imperial Regime a fourth objective was imposed – the control and gradual extinction of the private sector and most importantly the socialization of economic activity. To enhance the process of socialization, the administration and utilization of foreign exchange was withdrawn from the National Bank of Ethiopia in favor of the Ministry of Planning and the institutions that preceded it. While the capital account remained tightly closed, as was the case under the previous regime, payments for current transactions were drastically curtailed.

There were also important institutional rearrangements with imports and exports. While private importers were driven out of business in favor of state trading enterprises, exporters were prohibited from exporting traditional export commodities which were taken over by public enterprises created for these purpose.

At the beginning of 1987 when our story begins, the following summarize the major policy packages governing external trade:

- a) fixed official exchange rate,
- b) restrictive foreign exchange licensing system for private use,
- c) 100% surrendering of foreign exchange obtained by Ethiopians and foreigners in private business regardless of how this was obtained,
- d) very high and escalating import tariff made up of several layers and categories with the maximum rate as high as 230% of its value,
- e) reference price schemes for exports, below which export was prohibited,
- f) government marketing channels for all imports and major exports.

These instruments and institutions created and nurtured strong bias against foreign trade and were certainly redundant and expensive. For example restrictive exchange control and the cumbersome import licenses were all used to limit the nature, volume

and value of imports. But these redundancies were so in terms of their effect rather than purpose.

Taxes on foreign trade were important sources of government revenue motivating high rates. Exchange control was used to maintain the balance of payments at a more sustainable level. The non-tariff barriers and particularly the quota system that included the complete banning of certain goods must have had the objectives of minimizing what the regime may have thought were "luxury" consumption as well as goods deemed to be dangerous or harmful to society, while at the same time casting a protective umbrella over domestic producers.

2.2. The Reform

The decade of the 90s coincided with major revolution both in the world and in Ethiopia. The dissolution of the Soviet Union eliminated the bipolar global political arrangements in favor of a unipolar world. The finalization of the Uruguay Round of Agreements produced a new set of regulations to govern international trade and institutionalized its management in the World Trade Organization (WTO).

At home, the Ethiopian People Democratic Front (EPRDF) ousted the Military Socialist Regime and inherited an economy which has been exhausted by inappropriate policies and devastated by civil war.

The imperatives of rebuilding the economy and political expediency dictated the revisiting and reforming of the policies of the ousted regime.

The reform which started with slow pace in the second half of 1991 and the first half 1992 gathered momentum towards the last quarter of 1992. The liberalization measures were initiated by the devaluation of Birr by 142 % (from Birr 2.07 per US dollar to Birr 5.00 per US dollar) which was soon followed by the streamlining of administrative controls as well as the reduction in tariff and elimination of export duties with the exception of that imposed on coffee.

The series of foreign trade related reforms undertaken by the government between 1991 and 1998 are summarized below.

- a) Liberalization of the foreign exchange control: Foreign exchange was to be made available to dually licensed importers through the auction market.
- b) Move towards a more market determined exchange rate with the introduction of the auction pricing system in mid 1993. Up to mid 1995 three exchange

rates ruled in the country – one at which foreign exchange was made available for government related transactions and the import of essential commodities including fertilizer and medicine; and the other at which foreign exchange was made available to the private sector and the third was the black market rate. These multiple rates were more or less unified beginning in mid 1995 eliminating the parallel market premium which was as high as 400% in 1991.

- c) The tariffication of those goods controlled through the quota system.
- d) The drastic reduction of customs duties from an average high of 230% to an average maximum of 50%.
- e) Elimination of duty on all exportables with the exception of coffee on which three different taxes – customs duty of Birr 15 per 100 kg; a 2 % transaction tax and a cess tax of Birr 5 per 100 kg were imposed.
- f) Introduction of foreign exchange retention scheme to exporters. These went through a series of modifications starting with the surrender of 50% of their foreign exchange earnings and retention of the balance, 40% of which was to be offered for sale within 21 days to the commercial banks or through auction. The remaining 10% were to be used by the exporter for the import of goods approved by the National Bank. In 1998 these were revised to an arrangement where exporters were to retain 10% permanently and sell the 90% over a 30-day period. Failure to sell within the specified period entailed the surrendering of the foreign exchange to the National Bank at the prevailing rate of exchange.

3. DEVELOPMENT IN FOREIGN TRADE: 1987/88 - 1997/98

The major purpose behind the reforms were ideas espoused by both the IMF and the World Bank whereby an open economy helps to increase and diversify exports, renders the domestic economy more efficient and competitive, and results in vigorous and sustained growth.

It may be too early to assess the impact of the trade liberalization on exports, imports, government revenue, the balance of payment and the improvement in the competitive

position of domestic firms producing import competing goods. Nonetheless a brief review of these developments seem to be in order, and would be made in this section.

3.1. Export Volume, Export Revenue and Structure of Exports

One basic justification behind trade-liberalization is its capacity to improve its competitiveness in the world market and bring about significant increase in the volume, diversity and export earnings. We will look at these serialim.

3.1.1. Volume of Exports

Volume of exports rose sharply during the post reform period relative to the pre-reform period. The volume of export of the 5 major exports items of coffee, oilseeds, pulses, hides and skins and fruits and vegetables, (which together account for more than 80% of the annual export earnings) increased by an average of 34 % between 1992/93 and 1997/98. The highest aggregate total export of these products during the Derge period in the late 80s was 136,420 tons of 1989/90. The highest volume of exports of these products since 1992 was the 242,374 tons of 1997/98. This is twice as much as the highest volume of these products exported during the post 1987 period of the Derge regime, (which was the 136,420 tons in 1989/90). The volume of other exports also increased in tandem.

Table VIII.1
Volume of Major Exports 1987/88 – 1997/98
(’000 Tons)

	1987/88	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98
Coffee	71.3	92.11	89.0	58.2	32.3	67.5	69.20	82.2	97.7	123.2	120.1
Oil Seeds	17.5	5.4	6.9	2.6	1.8	0.4	10.2	12.1	7.8	14.1	66.6
Hides & Skins	8.6	9.7	8.5	5.7	3.7	5.8	7.8	8.4	7.6	8.7	7.9
Pulses	12.5	11.2	23.4	14.8	1.4	1.5	9.8	25.8	29.0	30.5	30.9
Fruits & Vegetables	11.0	10.27	8.7	13.0	7.2	6.1	15.9	19.5	19.0	21.8	17.0

Source: NBE Quarterly Bulletin Vol. 13 No. 4 Table 31 p 81.

Looking at the same development on an index basis puts the picture in a better focus.

Table VIII.2
Indices of Volume of Major Exports 1986/87=100

	Coffee	Oil Seeds	Hides & Skins	Pulses	Fruits & Vegetables
1986/87	100	100	100	100	100.0
87/88	88.8	216.5	84.1	282.4	157.0
88/89	117.3	65.6	88.4	269.8	84.1
89/90	110.8	84.1	83.8	527.5	71.6
90/91	72.6	31.1	55.2	333.4	107.3
91/92	40.2	2.1	35.9	31.6	59.6
92/93	84.0	4.8	54.4	34.5	50.1
93/94	86.2	124.0	76.2	222.3	131.6
94/95	102.5	147.6	81.8	582.4	161.4
95/96	121.6	95.3	73.6	654.4	157.4
96/97	153.5	171.2	84.4	688.2	180.8
97/98	149.7	809.8	76.6	698.2	138.4

Source: Computed from Table 11 of NBE's 1995/96 Annual Report

It is clear from the table that there has on the whole been an increase in the volume of exports. Taking 1986/87 as the base year, the total volume of exports of these 5 major commodities, on an unweighted average basis, increased by nearly two fold, to 197.2 or by 97 per cent by 1997/98.

The increase in volume has been dramatic for some of these commodities. In particular, the volume of exports of oil seeds and pulses recorded an impressive resurgence.

It is also worth noting the conspicuous instability in the volume of exports. A steady and fast decline is observed towards the end of the decade, bottoming out in 91/92. The reasons behind these precipitous declines were the intensification of the civil war as well as the weather out-turn which is the major determinant of the output of these products.

3.1.2. Foreign Exchange Earnings

Foreign exchange earnings from exports of goods and services, by and large, reflected the behavior of volume of exports. From 1987/88 to 1991/92 it declined

precipitously and then started to recover. The value of exports in dollar terms increased more than 3 fold under the current government from US \$ 170 million in 1991/92 to US \$ 557 million in 1996/97. It should be kept in mind that 1991/92 was an abnormal year in that the civil war was in its most intensive stage and drawing closer to the capital city, the effect of which is reflected in the decline in the volume and therefore foreign exchange earnings.

Earnings from service export were steady throughout the period under observation relative to earnings from merchandise exports. From 1987/88 it was on the rise reaching its apex at US\$ 305 million in 1989/90 but declined to US\$ 268 million in 1990/91 and 91/92. Since then export of services increased continuously to US\$ 391 million in 1996/97, which was 46% higher than its low point in 1991/92.

Table VIII.3
Export Earnings 1987/88 – 1997/98
(Millions of US\$)

	Goods (1)	Services (gross) (2)	Total (3)	As % of GDP		
				Goods	Services	Total
1987/88	400	272	672	5.5	4.4	9.9
88/89	444	289	733	5.8	3.8	9.6
89/90	292	305	597	3.6	3.8	7.3
90/91	168	268	436	1.8	2.9	4.7
91/92	170	268	438	1.7	2.7	4.4
92/93	199	277	476	3.7	5.2	8.9
93/94	372	295	567	7.2	5.1	12.3
94/95	423	345	768	7.7	6.3	14.0
95/96	438	377	815	7.4	6.4	13.8
96/97	557	391	948	9.0	6.3	15.3

Sources: Calculated from IMF, International Financial Statistics 1998 Year Book and NBE Quarterly Bulletin Vol. 13 no. 4.

Table VIII.3 is interesting for two reasons. The first is the close correspondence between the increase in volume and value. An important observation here is that, although both volume and earnings increased, growth in revenue was not only unstable but also failed to match the increase in volume. This aberration is explained by the unstable but predominantly declining trend in world commodity prices. The second point to note is the share of GDP that is exported. The point of interest in this regard is the increase in the share of exports in GDP since the reforms of 1991/92. The highest share of the post-reform period share of GDP exported (i.e. 1996/97) is

55 per cent higher than the pre-reform high (i.e. 1987/88) of GDP. Despite this impressive growth in the share of GDP exported, it is very small compared to all standards. Measured against domestic output, commodity exports, at less than 10 per cent at its highest, strongly suggests that the country produces more for domestic consumption rather than for exports.

3.1.3. Structure of Exports

The structure of exports had remained the same during the two periods both in kind and nature. Not only does the country export the same products but a limited number account for a disproportionate share. During both periods, five products – coffee, hides and skins (including leather and leather products), oil seeds, pulses and fruits and vegetables accounted 75% of the export earnings. Coffee alone averaged nearly two-thirds of the export earnings during the two periods under review.

Export of manufactured goods were insignificant under the Derge Regime, contributing no more than 7% at its highest but then declined thereafter as shown in the last column of Table VIII.4.

Table VIII. 4
Share of Major Export Commodities 1987/88

	Coffee	Hides & Skins	Oil Seeds	Pulses	Fruits and Vegetables	Total of 5	Industrial Products ¹
1987/88	56.8	16.0	2.9	2.1	1.5	79.3	7.4
88/89	69.4	13.7	1.2	1.8	1.0	87.1	3.5
91/92	60.3	21.0	0.1	0.1	2.3	83.8	7.4
94/95	65.9	13.7	2.1	3.8	-	85.5	3.8
96/97	63.8	10.3	2.1	1.9	1.3	79.4	3.1

Source: Calculated from NBE, Quarterly Bulletin Vol. 13 no. 4 Table 25p. 75

Not only does the country's exports remain undifferentiated, there is a more or less matching market concentration. The OECD countries are, as have been in the past, the major markets for the country's exportable absorbing no less than 80% of its exports. Of the African countries only Djibouti is an important market with 11% share of the nation's exports.

¹ Industrial products include sugar & molasses, canned and frozen meat, oil seeds cake and petroleum products.

3.2. Import and Structure of Imports

As percent of GDP, post-reform import of goods registered an increase of 45%, from 15% to 22% relative to the pre-reform period. Under the previous regime, imports as a share of GDP claimed a high of 15 per cent of GDP but then declined to less than 10 per cent in 1991/92. During the post 1992 period, the value of imports as share of GDP increased continuously to about a fifth.

This increase in imports as a share of GDP is consistent with the two phenomenon of the post-1991 Ethiopian economy. The first is the growth in GDP. Empirical evidence have long established a positive correlation between GDP out-turn and imports. As the GDP increases the volume of imports tends to increase basically for two reasons. The first is the well established fact that as income (GDP) increases, consumption also increases and since the consumption bundle includes imported commodities, the value (reflecting the increase in the volume of imported consumables) also increases. The second factor driving imports are investment goods. An increase in GDP sends positive signals to investors who would purchase more investment goods from abroad. The combination of these two factors increases imports in tandem with GDP.

The second phenomenon that explains the growth in imports is the policy domain where the post 1991 period was one of liberalization. An increase in imports is a common and standard phenomenon under the IMF/World Bank inspired SAP because of the reduction of import barriers including the removal of quotas and the cut in tariff rates.

Despite the increase of imports as a share of GDP, their brake-down with respect to the purpose for which goods are imported have remained constant. Raw materials claim an average of 2% of total imports while capital goods and consumers goods absorb nearly two-third together. Semi-finished products and fuel account for nearly a third of total imports.

These statistics reveal important signals about the structure of the economy as well as being suggestive of policy direction with respect to imports.

The first is the consistency in the structure of the economy. Inputs in to the production process still claim a very small proportion of imports. This is revealed by the share of raw materials and semi-finished products in total imports, which has more or less remained the same during the last decade. A shift in the structure of the economy would have elicited an increase in the proportion of these imports.

The second point emerging from the structure of imports is the share of these goods that target agriculture, which is the source of all foreign exchange, the largest contributor to GDP and the largest employer. Whether to reduce poverty or kick-start structural transformation, this sector should have been accorded high priority. But this has not been so, neither under the Derge nor under the current government.

Table VIII.5
Imports by End Use as Percent of Total Imports

	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Raw materials	2.4	2.5	3.2	2.7	1.6	2.0	1.8	2.0	2.3	2.2	2.4
Semi-finished materials	14.4	16.9	17.6	11.1	8.8	9.0	15.3	17.0	16.4	19.2	18.6
Fertilizer	3.2	3.7	5.7	1.4	1.4	3.4	4.1	3.3	1.6	7.8	7.6
Fuel	9.5	10.1	12.3	9.9	13.8	22.7	15.3	15.2	12.1	16.5	17.6
Capital Goods	47.1	39.0	38.6	45.3	25.8	35.0	29.2	31.9	33.7	36.7	32.2
Transport	20.8	16.8	8.1	21.3	18.6	23.3	13.4	13.4	16.2	16.7	14.3
Agriculture	2.5	0.7	1.0	0.7	0.1	0.3	0.7	1.9	1.0	2.3	2.2
Industrial	23.7	21.5	29.5	23.3	7.1	11.4	15.1	16.5	16.6	17.8	15.7
Consumer Goods	26.3	30.8	28.1	30.2	29.6	31.3	35.1	32.5	31.6	23.0	27.1
Durable	8.6	9.5	12.1	10.0	7.5	7.2	10.0	8.7	9.3	8.5	6.2
Non-durable	17.6	21.3	16.1	20.2	22.1	24.1	25.4	23.8	22.3	14.5	18.8
Cereals	8.0	10.0	4.2	9.8	10.7	11.8	11.0	13.1	7.2	4.9	9.3
Imports as % of GDP	15.2	13.4	10.9	11.1	8.7	13.6	16.7	19.3	20.4	22.7	22.1

Source: NBE Quarterly Bulletin (Various Years) and IMF Database.

Consider the three categories of fertilizers, capital goods for agriculture and imports of cereals. The latter, i.e. import of cereals on own account (i.e. excluding external assistance) is a symptom of the malaise in agriculture. Because of insufficient production to satisfy domestic demand, the nation is obliged to allocate, on average, close to 10 per cent of the value of imports to the import of this commodity. Import of cereals could easily be reduced by increasing productivity in agriculture.

However the means by which the targeted productivity is to increase has not been forthcoming. Fertilizer imports as a proportion of total imports was very low until the last two years of 1997 and 1998 crop years when it increased by more than two fold. Although this is a welcome trend, note has to be taken of its gross insufficiency. The 300,000 tons of imported fertilizer for a farming household of between 5 and 6 million means 50 to 60 kg per farm or less than 10 kg per farmer is too small to have significant impact on output.

The government's policy of Agricultural Development Led Industrialization (ADLI) provides the nation with correct development strategy. But its success requires the support of modern inputs including capital goods. It is an area that needs to be focused upon.

3.3. Direction of Trade

The destination of exports and the origin of imports into the country has remained conspicuously loyal. Going as far back as 1980 and even further in time, the major trading partners remain Europe, Asia and the Americas (both North and Latin America).

Europe has retained its predominance as the destination for and source of exports and imports respectively, although its share in both has declined. The major markets however remain Germany, Italy, France and England which together account for no less than 85% of the European and about 40% of the total export. These four countries also dominate on the import side, claiming nearly 60% of the European share and a quarter of the total imports.

In the early 70s and even in the 1980s, America (and more so the USA) used to be the second most important destination of exports and the third ranked supplier of imports. While this region retained its position as the source imports, it has long ceded its 2nd place as the absorber of the nation's exports to Asia. Exports to the America, i.e. the US declined from 18% in the 1980s to a third later in the decade as a result of political and ideological differences between the two countries. Resurgence is in evidence in the 1990s, but it has to reclaim its lost position.

Table VIII.6
Direction of Trade 1970-1997
 (Percentage of Total)

	1980		1990		1995		1997	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Africa	13.2	2.0	12.6	3.6	12.4	6.6	13.2	
Europe	51.0	66.2	45.2	68.0	50.8	43.1	48.9	
America	18.1	8.4	13.6	6.5	6.8	13.4	12.0	
Asia	17.2	21.0	27.4	15.7	29.7	34.4	23.5	
Oceania	0.1	1.4	0.1	0.1	0.1	0.1	0.1	
Unspecified	0.4	1.0	1.1	6.1	0.2	2.4	2.3	

Source: Calculated from NBE, Quarterly Bulletin, Various Years.

The Asian market has increased its share both as supplier of imports and buyer of its exports. However these markets are concentrated in Japan and Saudi Arabia which together account for no less than 90% of Asia's share exports and more than 60% of imports.

In Africa the most important destination of the nation's exports is Djibouti which claims more than 95% of exports to Africa, while Kenya supplies 50% of the exports from the African region.

There is a need for diversification of our export out let and the country is strategically located to invade one of the richest markets in the world. The export related investment strategy should be based on targeting this market along with the comparative advantage that geography offers.

3.4. Government Revenue from International Trade

As pointed out earlier, one possible goal of trade policy is the mobilization of resources to finance government expenditure. It is usually argued that the liberalization of trade would entail increase in government revenue from taxes imposed on exports and more importantly imports as a result of the tariffication of non-

tariff barriers and increase in the volume of trade, notwithstanding the lower level of taxes.

It would be interesting to see the extent to which this hypothesis is born out by the Ethiopian experience.

As shown in Table VIII.7 the share of government revenue sourcing from international trade has been higher during the post reform period compared to the pre-reform period.

While the higher volume of revenue could possibly be attributed to the effect of liberalization, a number of factors that may partly, if not wholly, explain the increase need to be pointed out. One of these is the effect of devaluation which tends to inflate the Birr denominated tax revenue collected from imports. The devaluation and subsequent depreciation of the currency inflates the Birr value of imports and therefore the taxes collected from such imports. Such bias is inherent in an exercise that attempts to compare pre and post devaluation performances.

Table VIII.7
Government Revenue from International Trade

	<u>1987/88-1990/91</u>	<u>1992/93-96/97</u>
As % of GDP	3.1	4.2
As % of Govt. Exp.	10.2	19.8
As % of Govt. Rev.	13.3	23.6
Import tax as % of imports	20.0	21.6
Export tax as % of exports	11.9	4.3

Source: computed from NBE Annual Report and IMF Database

3.5. The Current Account Balance

The impact of trade liberalization is hypothesized to render the current account more sustainable relative to the repressed pre-liberalization era. This medium to long term scenario was to be supported by external assistance which were in turn conditional on implementing the full range of the policy package drawn by donors.

The general conclusion emerging from the Ethiopian experience does not bear out the optimistic impact of liberalization on the current account balance. On the contrary it confirms the deterioration that have been observed in other reforming countries. The tables below summarize the pre and post reform developments in the current account balance.

Start with the trade balance. The gap between the value of goods exported and imported as percentage of GDP widened by 58 per cent from an average of 8 per cent during the post reform period relative to 13 per cent of the post reform era. The deficit in the balance on goods and services also doubled during the post-reform compared to the pre-reform period, despite the favorable increase in the service balance. Private transfers also increased from less than one per cent during the pre-reform period compared to the post-reform period.

On account of these developments, the current account deficit increased from 6 per cent of GDP to 7 per cent.

Table VIII.8
Balance of Payment as % of GDP

	1987/88 – 1990/91	1992/93 – 1996/97
Trade balance	-8.0	-12.6
Service balance	0.3	0.7
Balance on goods & services	-5.8	-11.9
Private transfers	0.3	5.1
Current account	-5.5	-6.8

Source: IMF data bank

3.6. Financing the Deficit

As shown in Table VIII.9 the deficit in the current account was financed from the three major sources of public transfers, external borrowing and running down of reserves.

While public transfer were high and continued on an increasing trend, it was not so for external credit. For some years, net transfer was negative because payments on

interest and principle were in excess of disbursement of credit for that year, as was the case for 1991/92 and 1992/93 fiscal years.

Depletion of reserves were among the major sources of financing deficits during the last years of the 1980s. On the other hand, there was continued build up during the post 1991/92 periods.

In general the trend on current account deficit is one of unsustainability, leading to growth in indebtedness. As would be discussed in the next chapter, the debt burden is growing to be too much to bear on the economy. This is indicated by the annual increase in arrears-debt due for repayment but is not honored for lack of capacity.

The failure to honor our payment obligations imposes an unpalatable political cost on the country. In effect requiring creditor countries and institutions to either cancel or reschedule our debts. These not only are capitalized with punitive interest rates, but also lowers the credit worthiness of the country. The process of negotiation for debt relief are also fraught with conditions that impinge on and finally threaten our freedom and independence, including one of developing an appropriate development strategy of our own.

Table VIII. 9
Financing Current Account Deficit (millions of Birr)

	87/88	88/89	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98
C/A Deficit	1164	707	1206	811	1647	1513	1464	3861	1172	2068
Financing										
Public Transfer	389	433	604	894	1709	1448	2560	2474	1453	1793
External Loan(Net)	550	463	330	-238	-45	1233	187	-30	-785	751
Long-term	647	574	302	-27	514	961	309	422	1114	279
Short-term	-97	111	28	-211	559	272	-122	-452	-328	472
Net errors and D	-158	213	141	-271	-512	-527	-83	1141	-882	-4767
Over all balance	-383	-23	-131	-423	-499	641	1200	275	-1386	-155
Change in reserve*	383	23	-325	-136	-404	-1939	-2104	NA	NA	NA
Change in arrears	-	-	456	562	-372	962	536	781	763	360
Debt relief	-	-	-	-	1275	336	367	21	13	0.0
Cancellation	-	-	-	-	368	82	149	21	13	0.0
Rescheduling	-	-	-	-	907	255	219	-	-	-

*- is increase

Source: NBE

This underlines the need for concerted and proactive policy to contain the deficit. In the short run, the government needs to contain imports, use the foreign exchange in priority areas and build the productive capacity of the country. The longer run objective rests on increasing the volume and values of export.

In the process of increasing export earnings, points that need to be re-emphasized are the diversification both of products and markets. Since there is no future in primary commodities, government needs to initiate a process of industrialization, starting with import substitution and graduating to export promotion. After all we have to have the products to sell before we become competitive both at home and abroad.

4. TRADE AND DEVELOPMENT

The objective of economic management in a country is to see to it that the standard of living of the people improves over time. In the economic sphere this goal is operationalized through high rate of growth, increased employment opportunities, equitable income distribution, balanced inter-regional development, stable prices and sustainable balance of payment.

Foreign trade is one possible instrument and means to achieve these objectives. It is through this activity that a country acquires those goods and services that are essential to accommodate its current needs as well as build up its productive capacities but are not available from domestic sources. Among these goods and services are the broad ranges of consumer goods and services, ideas and knowledge, skills, capital goods, and raw materials.

The import of these items would need to be paid for, defining the imperatives for exports. In other words a country does not export goods and services for its own sake but to enable the acquisition of those goods and services it needs but cannot produce at home. In the words of Dani Rodrik of Harvard University, (1999: 24) "exports are the "price" an economy pays for having access to imports; they are means, not an end." This plainly means that a country exports not for its own sake but to enable it pay for the goods and services it imports.

What a country exports and imports are dictated by its comparative advantage. It will produce and export those goods and services that use its most abundant resources and are therefore relatively cheaper than those of its competitors, and import those goods and services that require inputs that it either does not have or are scarce. This

explains why Ethiopia exports primary agricultural commodities and imports industrial goods, including machines.

The important point about trade and trade policy is the dynamic nature of comparative advantage. The fact that Ethiopia has comparative advantage in tropical agriculture and comparative disadvantage in industrial goods is not an immutable law of nature but one that can and does change. The essence of trade policy, in conjunction with its overall development policies, is therefore to change this comparative advantage by importing investment goods and services to expand the industrial and agricultural sector, skills and knowledge to build up its human capital and concurrently strive to increase total factor productivity (TFP), thereby rendering the economy more competitive both in the home and the world markets.

The challenge that policy makers face in this regard is how to initiate and instill dynamic comparative advantage in the production process. The fact that Ethiopia continues to rely on and exports the same goods and services that it used to export 50 years ago and imports those goods and services it was importing half a century ago, testifies to the failure of past policies to initiate and sustain the development of dynamic comparative advantage. Over the last fifty years the Ethiopian economy remained static. The country produces and consumes the same goods, using more or less the same technology.

An example may underline the differences between an economy that remained static and one that initiated and nurtured dynamic transformation. In the 1950s, Ethiopia was rated higher and was reputed to have better potential for further development compared to the Republic of Korea. In the 1960s Korea transformed itself from exporter of raw materials to manufactured goods, while Ethiopia continued to export the same commodities it did a decade, and indeed centuries ago. In the 1990s Korea became a member of the Organization for Economic Cooperation and Development (OECD) countries- the rich countries club, while Ethiopia regressed to the least developed countries category- the club of the poorest of the poor. One is an example of a country that devoted itself to structural transformation while the other to that of stagnation.

Both trade and domestic economic policies must, of necessity, target structural transformation. It is important to reiterate and belabor an obvious point. A country exports those goods and services that it produces and nothing else. And for as long as Ethiopia continues to produce primary commodities, it will continue to export these primary commodities. But there is no future in primary commodity trade. Firstly the share of primary commodities in world trade has declined drastically. Secondly, the

prices of primary commodities have been and will continue to be on declining trend. Thirdly there is more value added in processed goods than in primary commodities and the higher the level of processing the better the value added.

These linkages between trade and development dictate the nature and purpose of trade policy. As much as possible, the country must first and foremost develop a realistic and doable industrial and agricultural development strategy, and define its trade policies accordingly. Trade should be used to further and enhance the development of the domestic economy and for this purpose needs to be managed and administered accordingly.

Structural transformation is knowledge based and driven. The backwardness of Ethiopia's agriculture testifies to the fact that no innovation has been introduced to this critical sector of our economy, despite the explosion of scientific discoveries. What attempts have been to expose the nation's agriculture to modern know-how has been rather at the margin and remained marginal, and excluded the greater majority of the peasantry.

New ideas and know-how need to be injected into the economy to bring about genuine transformation. This cannot be achieved without the build-up of human capital that is capable of learning not only to use and man the machines and new technologies that are imported into the country (which is easily acquired through learning by doing) but most importantly to develop the capacity to adopt and adapt, and eventually build machines that produce other machines. This is the first and most important goal of and means to change existing comparative advantage. Secondly, the drive to develop the human capability needs to be supported with an investment and trade strategies that are capable of transforming the economy and locate it on a transformative and dynamic trajectory.

This has been one of the major failing and weaknesses of all past governments, as a result of which the country remains trapped in its static comparative advantage and continues to rely on the same agriculture commodities as it did half a century ago as its source of foreign exchange.

The challenge of locating an economy on the path of accelerating growth and development is daunting in its own right. But this challenge is exacerbated by a hostile external environment. In a world that has abandoned the principle of interdependence and replaced it with one of intense competitions in which the winner takes all the benefits and pits the small against the large and the mighty against the

weak, what is at stake is the survival of the nation in all its glory, sovereignty and independence.

Ethiopia is too small to matter to the rest of the world. A review of its GDP, exports to and imports from the rest of the world shows that it is so insignificant that it will not be missed in the world market if it sinks and disappears from the face of the earth. Ethiopia's contribution to world trade as well as to the annual increase to global wealth is illustrated by the following statistics. In 1995 its exports to, imports from and total trade amounted to 0.8; 1.3 and 2.1 billion US dollars respectively, while its GDP is estimate at US \$ 6 billion in current prices. Table VIII.10 compares this to the revenue of some of the companies with which we are very well acquainted.

Table VIII.10
Ethiopia and Global Companies : A Comparison in 1995
(billions of US \$ where appropriate)

Sales of	Billions of US \$	ETHIOPIA'S			
		Exports	Imports	Total Trade	GDP
		US\$ 0.8 billion, as % of	US\$ 1.3 billion, as % of	US\$ 2.1 billion, as % of	US\$ 6 billion, as % of
Toyota	112	0.71	1.2	1.9	5.4
Shell	110	0.73	1.2	1.9	5.5
Mobil	73	1.1	1.8	2.9	8.2
Nissan	56	1.4	2.3	3.7	10.7
Sony	43	1.9	3.0	4.9	14.0
Fiat	41	2.0	3.2	5.2	14.6

Source: UNCTAD, World Investment Report 1998, table 1.7.29 for company revenue and IMF, International Financial Statistics, April 1999 for Ethiopian data.

Ethiopia's annual GDP is 15% of the annual sales of Fiat, while our total trade is 5% of its annual revenue. Compared to Toyota Motor company, the annual value of goods and services produced in the country is a mere 5% and our total trade is an insignificant 2% of this giant Japanese company's annual sales. Comparison with other companies tell the same story of our insignificance.

The import of this comparative statistics is to once again highlight the challenge facing the nation. If we are to initiate socio-economic transformation, we have to export more to enable the country import large quantities of developmental factors. If we are to get more value for our exports, we need to undertake the processing of our primary commodities.

The fundamental reason behind the increased marginalization of the country and one that constrained its annual foreign exchange earnings is the continued reliance on primary commodities. Continued dependence on these lines of production and exports does not have any future. As pointed out earlier, it has been incontrovertibly established through the Prebisch-Singer thesis, that the prices of primary commodities have been on declining trajectory and would remain so. The only question is how fast they would drop in international markets. The speed with which the prices of primary commodities would decline in the years ahead are likely to be at a pace much faster than it was in the past, for a number of reasons. The first is the continued advance in the technology of producing artificial substitutes for natural ingredients to serve as inputs in the production processes. Secondly advances in genetic engineering is a cause of concern as it may be used to produce some variant of tropical agricultural products such as coffee. Thirdly, the pressure on developing countries to acquire as much foreign exchange as possible would induce them to export more. This adding-up problem would, as it did in the past, increase supply in the world market and thereby exert downward pressure on prices. Fourthly, in a world where ideas much more than physical inputs are the basics of the 21st century economics (World Bank 1998), demand for primary commodities are likely to decline.

These, and no doubt, many other reasons underline the imperatives for adopting a policy that would initiate, nurture and drive the development of dynamic comparative advantage. An exit strategy should base itself on the development and implementation of an investment strategy that has the capability to initiate and sustain an industrial development.

The second policy and one that is closely related to the development of dynamic comparative advantage is the need to protect the domestic industry. There will be no structural transformation of the economy with out protection from external competition. Three reasons justify this position. The first is taken from the experience of the currently developed countries. Whether the celebrated North-East or South-East Asian countries or the currently mature developed countries, including the US, industrialization occurred with the protective support and assistance of their governments. It is important to keep in mind that the first modern country to have developed the argument that infant industries are not in a position to compete against mature industries and therefore need to be protected until they come of age was the US in the 18th century.²

² Fredric List is acknowledged as the father of modern protectionism. But he popularized the ideas of Alex Hamilton of the US.

Thirdly it has been established that openness does not endow countries with advantages, since it is not openness that makes an economy grow but that growth tends to increase the volume of trade of a country. Essentially this means that countries must have something to sell before they open their economies into an undifferentiated and indiscriminate competition from abroad. This requires the build-up of an efficient developmental infrastructure to be able to compete in the global market as well as in the home market.

Box VIII.1

Industrialization and Protection: The EU and Agro-Industry

In the 1990s, when talk of trade liberalization abound and developed countries repeatedly use trade liberalization as a condition for structural adjustment support to developing countries, it is entirely possible to believe that industrialized countries are advising this policy because they have learned its value from their own experiences. Accordingly one would assume (even when we know the history of protectionism in all developed countries at their early stages of development) that developed countries such as the European Union would pursue a relatively open trade policy with very little tariff or non-tariff barriers at least towards those poor countries that they preach the medicine of free trade incessantly as a panacea to their developmental problems. The truth of the matter is that these countries still practice protectionism with impunity when they decide that the survival of these industries are in their "national interest" or that there are powerful lobbying groups that politicians have to please. While we all know the issue of protection to the agricultural sector of both Europe and the United States, there are a number of other industrial sectors that they still protect with very high tariffs. One obscene example is that of agro-processing. The EU under article 168 of the Lome convention, agrees to import all products from ACP countries free of import duties. This article is followed by a sub article that exempts products included in the EU's Common Agricultural Policy (CAP) from this privilege. Apparently almost all agro-processed products accordingly pay very high duties. For example, if Ethiopia exports maize, rice, potatoes or any other similar products to the EU there will be no import duty. If Ethiopia, in her attempt to industrialize establishes a processing plant and tries to export starch or glucose syrup to the EU market, she has to pay an import duty of 193 Euro and 446 Euro per ton respectively. This roughly comes to about a 100% duty. Could Europe or the United States have any theoretical, practical or moral basis to tell us that protectionism is bad for us?

EXTERNAL DEBT

1. INTRODUCTION

The external debt is an accumulation of annual loans entered into between the Ethiopian government and creditor nations and lending institutions. The latter includes multilateral financial institutions and the private lenders.

The origin of external debt can be traced to the willingness of the debtor country to borrow and the lenders to lend. From the debtor country's perspective the need for external loan arises from the imbalance between domestic savings and investment, which is equal to the current account deficit. To fill the gap between the saving and investment (or broadly speaking export and imports of goods and services), countries have two options. The one is to totally rely on domestic savings to finance all investment (which is tantamount to limiting imports to the amount of foreign exchange generated by the country). The second option is to borrow externally and through it close the gap between desired investment and domestic saving. The benefit of long-term external credit is to increase investment above and beyond what the country can afford. Much more than the first option, the second alternative has been the more popular in countries that experience resource gap.

It is also important to keep in mind that external debt is driven not only by the needs of the borrowing country. The volume of indebtedness is also driven by the pressure and willingness of lenders to lend. There have been instances in the recent past, such as those immediately following the 1971/73 first oil price shock and the experience of the late 80s and early 90s. In the mid-70s commercial banks were awash with petro-dollar and needed an outlet for the massive deposits they amassed. These were liberally lent out and countries were encouraged to borrow, resulting in the debt crisis of the 80s. The world experienced similar shock in mid 1990 when the financial crisis in South East Asia, sourcing from high levels of debt, particularly of short-term nature triggered an instability that spill over into economic and social and in certain cases political instability in the emerging markets around the world. Although the shock was felt in the debtor countries but the cause was the massive credit flows from financial institutions of the developed countries who wanted to take advantage of the relatively higher interest rates under a system of fixed exchange

rates that obtained in the emerging markets compared to the low interest rates and floating exchange rates ruling in their major markets.

If this pressure is directed to the middle and high-income countries, the least developed countries such as Ethiopia have not been spared of the exhortation and extortion. In the case of these countries the pressure comes from and through multilateral institutions, particularly the IMF and the World Bank, who are their major sources of financial assistance through their conditionalities to pave the way and provide the resources.

The history of foreign debt of Ethiopia goes back to the early post II World War years when the country was among the first to apply for a loan from the newly created IMF in 1947¹.

Given the resource endowment and the huge gap between foreign exchange supply and demand, neither the Imperial, nor the Derge regimes as well as the current government entertained the illusion of developing the country by solely relying on domestic resources. Consequently they have been and continue to seek external resources.

The important point about external debt is that it poses no danger if it is used wisely and in ways that would lead to high rates of growth such that the increase in goods and services exceed the rate at which the loans are contracted.

2. DIMENSION OF EXTERNAL DEBT

All the outstanding debt of Ethiopia is held by the public sector or is guaranteed by the government regardless of the borrower. There are no non-guaranteed debts.

Excluding military related Russian debt (estimated at US\$ 5 billion) the external debt of Ethiopia in 1987/88 was Birr 6.2 billion or 41% of GDP. By 1996/97 (the latest year for which official data is available) it has risen to Birr 27 billion or 65 % of GDP. Three factors explain the phenomenal growth over a period of a decade.

¹ Ethiopia was the first country to apply for a credit of US \$900,000. The application was withdrawn when IMF requested for justification, see de vries et al 1969 p.386.

The first and most significant factor is the devaluation of the currency on October 1, 1992 which inflated the Birr denominated external debt by the same proportion as the devaluation. While the US dollar denominated debt increased from US\$ 4.3 billion to 4.7 billion between 1992 and 1993 fiscal years, the Birr denominated debt increased from Birr 6.6 billion to Birr 18.8 billion, much more than US\$ 300 million in new debt. The nearly three fold increase in the Birr denominated debt stock was mainly due to the devaluation of the currency.

The second factor is newly contracted debt entered into by the Ethiopian government. Every year, the government gets new loans, which go to increase the debt stock.

The third factors due to arrears that are capitalized. The arrears arise when the country fails to repay its debt (principal and/or interest). For a long time, the country honored its external debt obligations. Arrears started appearing in the Ethiopia's external balance sheet since 1989/90 when the country, for the first time in its history, failed to meet its obligation on debt. Thereafter, arrears have become a common and increasing feature. By the end of fiscal year 1995 total outstanding arrears, excluding military related debt to Russia, were estimated at US\$691 million increasing to US\$649 million at the end of 1996/97 fiscal year.²

2.1. Types of Credit

Ethiopia has entered into both short and medium to long-term debts. The short-term debts are those that are to be paid back within a maximum period of one year. Fortunately for the country, the stock of its short-term debt is very minimal, amounting to no more than 10 percent at its highest.

Short-term debt source from the private sector, usually suppliers, carry high rate of interest. They also carry the disadvantage of being repaid in a rather short period of time. The fact that short-term debt is very low is of great advantage since it reduces the exceptional repayment pressure it exerts on the country.

² Ethiopian Government, Policy Framework Paper, Sept. 1998. Table 4 p.36.

Table IX.1
External Debt 1987/88 – 1997/98 (Millions of US\$)

	1987/88	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96	96/97
External Debt (LOD)	6176	6491	7257	7497	6551	18779	25722	27732	27088	26510
In US \$	3274	3489	3909	4198	4343	4661	5001	5221	-	-
Disbursement	1061	969	975	927	566	1283	2379	1568	1611	1206
Amortization										
- actual	414	431	310	296	127	319	400	432	489	1628
- due	414	431	654	625	650	769	1418	1259	1189	2319
Arrears	-		344	329	523	450	1018	827	700	691
Net flows in debt (actual)	647	538	665	631	439	964	1979	1136	1122	-422
(with no arrears)	647	538	321	3021	-84	514	961	309	422	-1113
Interest payments	159	179	166	161	188	377	415	501	525	400
Net transfers on debt (actual)	486	359	499	499	251	587	1564	635	597	-822
(with no arrears)	488	359	155	155	-272	137	546	-192	-103	-1513
LOD as % of GDP with no arrears	41	41	43	43	32	70	91	82	71	64
LOD as % of exports of G & S	44	39	59	59	83	53	57	37	35	41

Source: NBE Annual Report 1996/97, Table 9, p.67

2.2. Source of Credit

The major creditors of long-term debt to the country are official sources made up of governments and multilateral institutions. These two sources of credit on average provided 94% of the long-term debt outstanding (LDOD) while the balance was made up by private creditors.

Multilateral institution lending have been on the decline in the 1980 and started to increase only since 1991 and currently account for a little over a quarter of the entire debt stock. Bilateral creditors remain the most dominant source of lending as a consequence of which their claim on the debt stock amounts to about three fourth.

Table IX.2
External Debt by Lenders 1988/89 – 1995/96
(%)

	88/89	89/90	92/93	93/94	94/95	95/96
Official Creditor	92.3	93.2	92.4	93.2	93.9	96.3
Multilateral	15.2	16.0	21.4	23.9	25.5	27.2
Concessional	89.9	90.5	92.2	92.3	92.2	91.6
Bilateral	84.8	84.0	78.6	76.1	74.5	72.8
Concessional	96.5	96.2	96.2	96.0	95.9	96.6
Private Creditors	7.7	6.8	7.6	6.8	6.1	3.7
Commercial Banks	26.8	20.1	46.5	44.7	42.5	7.6
Other Private	73.2	79.9	53.4	55.3	57.5	92.4

Source: World Bank, Global Development Finance, 1997.

Private creditors are also becoming important sources of financing although they claim less than 10% of the resources and debt stock. There are two sources – private financial institutions and export credit providers. The former are usually banks that finance certain needs of the government while the latter are institutions that provide export credit and are either government affiliated institutions such as the Ex-Im bank of the US that provide public finance for the purchase of goods (ex. Air craft) from that country. Alternatively, export credit could also be provided by the companies themselves for the purchase of their own products. This latter modality depends very much on the credibility and credit-worthiness of the country.

2.3. Terms and Conditions

A proportion of the total debt exceeding 80% are concessional and 95% are of long term nature. As indicated in Table IX.2 above, more than 90% of the multilateral and 75% of bilateral debt were contracted on concessional basis. They are provided at less than market interest rates, have longer maturity and grace periods and the grant element is considerably higher. Private sector debt (including export credit in certain cases) are provided at market (LIBOR) rates while official creditors charge at fixed and low rates. The terms and conditions under which the country borrows are detailed in the following table.

Table IX.3
Average Terms of New Commitments

	1970	1980	1989	1990	1991	1992	1993	1994	1995	1996
ALL CREDITORS										
Interest (%)	4.4	3.8	3.2	6.6	4.7	1.0	1.7	1.1	1.0	1.6
Maturity (years)	31.8	19.2	21.6	21.8	20.3	40.1	40.7	40.4	36.3	35.4
Grace period (yrs.)	6.6	3.8	5.9	2.9	6.0	9.8	9.2	9.3	9.3	8.9
Grant element (%)	43.3	39.5	42.7	23.7	35.0	73.7	72.5	76.1	76.1	79.0
Official Creditors										
Interest (%)	4.2	2.4	3.0	1.9	4.5	1.0	1.7	1.0	1.0	0.9
Maturity (years)	37.7	24.0	22.2	32.9	21.4	40.7	40.7	36.3	36.3	38.3
Grace period (yrs.)	7.9	4.5	6.1	6.6	6.3	9.9	9.2	9.3	9.3	9.8
Grant element (%)	49.6	50.8	44.3	59.0	38.3	74.1	72.5	76.1	76.1	78.2
Private Creditors										
Interest (%)	4.9	6.3	6.9	9.8	7.8	0.0	0.0	0.0	0.0	7.5
Maturity (years)	6.9	8.3	8.4	14.1	5.7	12.4	0.0	0.0	0.0	10.4
Grace period (yrs.)	1.7	2.1	1.6	0.4	1.6	4.9	0.0	0.0	0.0	0.7
Grant element (%)	18.9	14.3	10.6	-0.4	5.6	55.2	0.0	0.0	0.0	9.0

3. EXTERNAL DEBT AND ECONOMIC GROWTH

A review of debt and economic performances in Ethiopia during the first four decades shows two conspicuous trends. During the Imperial Regime, the rate of growth exceeded the cost of borrowing and debt service obligations were honored without any strain on the economy or foreign exchange reserves (Befekadu 1992).

The story was, however, different for the Derge Regime: Excluding military related debt (then estimated at US\$ 2 billion in 1986) the growth to debt correlation turned negative. During the 1974–1986 period, external debt was piling up at four times the annual average rate of GDP growth (Befekadu 1992).

On the debt servicing side, the Derge continued to honor obligations relating to external debt until 1989 when the first arrears emerged. Thereafter, the debt service obligations have grown beyond the capacity of the country to manage, requiring the government to pursue and pressure for relief.

It is difficult to empirically ascertain the relationship between external debt and growth over the last decade nor make a comparative assessment of the benefits of debt under the Derge and the EPRDF regimes as the time is too short to provide sufficient data for that purpose. However, certain observations emerging from the data are:

- a) the debt burden has been on the increase at an increasing rate. The debt to GDP ratio increased from 41% in 1987/88 to 91% in 1993/94 thereafter falling to 64% in 1996/97. If the Russian Military Related Debt (RMRD) is included, the ratio of debt to GDP would be about 170% of GDP.
- b) Debt to export (excluding RMRD) increased from 513% to 855% in 1992/93 but stood at 412% in 1998/97. Again if the RMRD is included this ratio would have been 1225%.
- c) Effective or actual debt service burden as percent of GDP increased from 3.8 1987/88 to 4.9% in 1996/97. If arrears are taken into account the debt to GDP ratio would have been 6.7% in 1997/98.

- d) Actual debt service to exports of goods and services has however moderated from 48 percent in 1987/88 to 32% in 1996/97. Again, if the arrears were taken into accounts, it would have been as high as 57% in 1993/94.
- e) Post 1991/92 economic performance has been much more vigorous than the pre 1991 period. But the burden has also been unrelenting. The intuitive position is that growth would have been higher had it not been for the drainage of foreign exchange to service the debt.

Table IX.4
Some Indicators of Debt Burden³

	87/88	88/89	89/90	92/93	93/94	94/95	95/96	96/97
Debt Stock								
As % of GDP	41.3	41.2	43.1	70.4	90.8	81.8	71.4	63.9
As % of exports	512.5	456.2	560.4	844.8	798.1	571.6	545.9	411.6
Debt Service								
As % of GDP								
Actual	3.8	3.9	2.8	2.6	2.9	2.8	2.7	4.9
Due	3.8	3.9	4.9	4.3	6.5	5.2	4.5	6.6
As % of exports								
Actual	47.5	42.9	33.5	31.3	25.3	19.2	20.4	31.5
Due	47.6	42.9	57.6	51.5	56.9	36.3	34.5	42.2

3.1. Debt and Economic Growth – What are the Prospects?

The accumulation of external debt is a source of major problem in developing countries. The most important causality of the debt burden is economic growth. The literature traces the transmission mechanism from debt to growth to take various channels including the constraint it imposes on the government's fiscal balance, reducing investment by draining foreign exchange, reducing domestic saving which

³ Excludes Russian Military Debt.

may be channeled to debt servicing and the "debt overhang" which reduces current investment since all the gains from it may be transferred abroad to pay for the debt that was contracted in the past.

Further to the constraints debt imposes on economic activity, it also tends to impact negatively on the freedom and independence of a sovereign state. It has often been used to force countries to accept conditions that are harmful to their benefits and are inconsistent with their vested interest of improving the standard of living of their people.

Ethiopia has not been immune to these problems. The heroic efforts of the government may have protected the freedom to develop own policy but the threat remains real. Although as a least developed poor country with an external debt amounting to more than 250% (the outer limit) and 50% of its GDP, it should have been entitled to the Highly Indebted Poor Countries (HIPC) debt reduction benefits, it has been denied access because of the government's refusal to accede to demands of the IMF.

As the burden of external debt became more and more onerous, the government was forced to restructure and make it more amenable to its servicing capacity. At the same time, creditor countries and institutions also provided some debt relief as shown in Table IX.5.

Table IX.5
Debt Restructured and Forgiven 1990-96 (Millions of US \$)

	1990	1991	1992	1993	1994	1995	1996
Total debt rescheduled	-	-	134	66	47	28	-
Principal, of which	-	-	106	51	38	23	-
Official	-	-	38	25	19	12	-
Private	-	-	68	26	19	11	-
Interest of which	-	-	27	15	9	6	-
Official	-	-	15	8	3	2	-
Private	-	-	12	7	6	3	-
Debt forgiven of which	67	6	44	13	15	7	-
interest	-	-	7	2	3	1	19
Debt stock reduction of which	-	-	-	-	-	-	197
buyback	-	-	-	-	-	-	16

Source: NBE.

But these do not provide lasting solutions. The country seems to have reached a point where honoring its obligation is impossible. It should, along with other highly indebted poor countries, seek to have it cancelled. There seems to be no option to this. Creditor nations and institutions should translate their "understanding" of the huge burden that the debt imposes on poor countries like Ethiopia to an effective debt cancellation scheme.

The debt servicing burden i.e. the amount of foreign exchange required to repay external debt has grown enormously for the entire developing countries is self evident. In the case of Ethiopia, the World Bank (Global Development Finance, Volume II 1998) estimates that total debt service before debt relief for 1998 at US\$ 464.3 million. This is obviously an amount beyond the capacity of the country to meet, given the fact that the value of export of goods and services is only twice the required payment.

The creditor nations and countries understand the gravity of the problem and have initiated a mechanism for the debt relief of the poor countries such as Ethiopia. If the debt relief had been in place by mid-1998, the annual debt repayment would have been US\$ 111 million.

While the presumed debt relief mechanism (called the Highly Indebted Poor Countries Initiative- HIPC) affords some breathing space, it suffers from a number of weaknesses. The first is that it affords too little relief. For a poor country such as Ethiopia, where a large majority of its population suffer from lack of daily necessities and are vulnerable to life threatening and yet easily preventable causes of death and infirmity, an annual repayment of more than US\$ 100 million is too much of a burden. In effect the designed debt relief offers too little respite relative to the needs of the people.

But the second and most glaring failing of the HIPC initiative is the conditions attached to eligibility. For a country to be a candidate to HIPC initiative, it has to accede to the Enhanced Structural Adjustment Program (ESAP), an economic policy model inspired by and enforced on the poor countries by the International Monetary Fund and the World Bank. It has been conclusively shown and known for certain that these programs are neither pro-growth nor pro-poor but that it is a means for the further impoverishment of the poor countries.

The third and equally important failing of the initiative is the long time it takes. For a country to be candidate for debt relief, it must have satisfied the supreme requirement

of having entered into an agreement with the (IMF). Furthermore, the IMF must continuously validate the country's compliance to the agreement for a minimum of six years (three years to reach a decision point, i.e. a time when it is to be decided whether the country, on the basis of its past record of implementing the conditions imposed on it by IMF, has satisfied the requirements and is deemed worthy of being considered as a candidate for debt relief; another three to six years to reach the completion point, i.e. the time when the country is to be certified as having satisfied all the requirements and should, therefore, be rewarded with debt relief).

The fourth point of weakness is the size of the relief offered. Once this process is completed, the amount of debt relief provided may turn out to be insignificant. In this instance, the Ugandan experience is very instructive. After 12 years of a globally acknowledged performance, Uganda was offered a debt relief of US\$ 30 million. Taking stock of the benefit of the debt relief, the authorities acknowledged the fact that their external debt increased by a multiple of this amount when they were putting in place all that was required of them to satisfy the requirement, and that on balance they were worse off.

The bottom line in the debt/growth enigma are that a poor country like Ethiopia could benefit from external credit provided it is of quality and one geared to the needs of the economy and the people.

The second point is that although the country has the moral obligation to respect its commitments, this obligation must be shared by the creditors as well. It was under the encouragement and at times insistence of creditor countries and institutions that this country borrowed and used the resources. Many of the causes for which resources were borrowed are non-performing, as a result of which the country has problems servicing the debt. Take, for example, the debt contracted following the ESAP agreement with the IMF. The agreement was entered into more or less under duress, when everybody knew that the program would not benefit the country. But the IMF not only lent money to the government but also encouraged others to do so. Definitely, the IMF-inspired policy is a failure and there is likely to be a recognition of this one of these days. But then who is to pick up the pieces when this happens? The moral burden of sharing responsibility for past wrongs and misdeeds should drive debt relief.

This country needs the assistance and support of its development partners. But the assistance must be to assist the implementation of growth and development paradigm that is consistent with the needs and capabilities of the people.

THE FORMAL FINANCIAL SECTOR*

1. STRUCTURE OF THE FINANCIAL SYSTEM: PRE 1991

The military government nationalized private commercial banks, specialized financial institutions and insurance companies on January 1, 1975. The Addis Ababa Bank, Banco di Roma (Ethiopia) and Banco di Napoli (Ethiopia), which were formerly private banks, were merged into one bank known as Addis Bank. On July 1, 1980, Addis Bank and Commercial Bank of Ethiopia were merged to create a single commercial bank, which was named the Commercial Bank of Ethiopia. The Savings and Mortgage Corporation and Ethiopian Savings and Home Ownership Public Association were also merged into a new Housing and Savings Bank. The Agricultural and Industrial Development Bank continued as the government's principal agent for extending medium and longer-term credit.

Considerable overlapping existed during 1974/75-1991/92 in types of credit provided by various banks. Both CBE and AIDB were engaged in medium and short-term finance to the agricultural and industrial sectors. The HSB specialized in mortgage loans, but CBE was also extending such loans as well. CBE's the large branch net work also made to serve as an agent for the specialized banks in the different parts of the country.

Thirteen private insurance companies were nationalized in January 1975, and amalgamated to create the Ethiopian Insurance Corporation.

The Ethiopian financial system during this time also included Pension Social Security Authority (PSSA), Savings and Credit Cooperatives and the informal financial institutions such as Eqqub and Idir.

* The editors are grateful to Ato Ibrahim Abdullahi who provided the background paper and from which this chapter heavily draws.

At the apex of the banking system was the National Bank of Ethiopia (NBE), the country's central bank. The 1976 proclamation enhanced the power of NBE in the formulation and implementation of monetary and credit policies. The proclamation also allowed the bank to exercise exchange controls, allocate foreign exchange and determine interest rate administratively. The proclamation limited the NBE's lending to central government, banks and other financial institutions.

1.1. Allocation of Credit

Ethiopia practiced central planning from 1974/75-May 1991. Consequently the monetary and financial policy of the government were directed towards the fulfillment of the annual plans. The operational philosophy dictated that the annual plans were not to be constrained by lack of financial resources which the financial institutions were required to make available.

In the preparation of the annual plan, the Office of National Council of Central Planning (ONCCP) reconciled financing needs of public enterprises and cooperatives with the volume of financial resources available from financial institutions, government revenue and external sources. In this practice, banks had little power in their lending decisions as they were made to provide directed credit to the central government, public enterprises and cooperatives.

1.2. Loan collection

Loan collection performance of banks during this period was extremely poor. This was mainly due to the following reasons: (a) financing public enterprise through instruction which increased non-performing loan portfolio of the banks to be nearly 50 per cent, (b) diversion of loans from the intended purpose by many borrowers, (c) outstanding debts of nationalized enterprises were not assumed by government agencies that took over their properties, (d) it was not possible to recover bad debts of nationalized enterprises through legal proceedings because judgments obtained were normally not executable through auction sales of properties of public enterprises, (e) courts sometimes used to grant defaulters extended repayment periods which delayed collection of loans through legal proceeding.

1.3. Interest Rate Policy

The interest rate policy of the Derge Regime reflected the financial policy with which it was made consistent. Since the annual plans were not to remain unfulfilled, for lack of financial resources, they were not to be curtailed due to cost of credit. As a result both deposit and lending interest rates continued to be administered, as was the case during the Imperial Regime, with one major difference. While, by and large, interest rates on private deposits remained unchanged; the lending rates were significantly reduced. These are discussed in detail below.

1.3.1. Deposit Rates

As pointed out above, interest rates on private sector deposits remained at the level inherited from the Imperial Regime – 6% on deposits of up to Birr 100,000 and 2% in excess of this amount. Government organizations, financial institutions, cooperatives other than savings and credit associations, urban and peasant associations, professional associations, joint ventures and state enterprises were not allowed to maintain saving deposits.

Interest rates on time deposit were revised, differentiated on the basis of the source of funds. In general minimum interest rate were reduced to zero from 4% while the maximum was raised from 6% to 7.5%. Government and government related institutions saw their benefits deriving from interest rates on their time deposits lowered from 4 and 5% to zero on short term i.e. 6 months or less and from 6% to 5.5% on deposits of five years and over.

Interest rates on time deposit for the private sector were either retained at 6% (for one year) or raised to 7.5% per five-year deposit.

1.3.2. Lending Rates

The Derge Regime reduced lending rates to accord the cost of credit with the general principle of not imposing constraints on borrowing to finance the different economic and social activities. While interest rates were reduced for all categories of borrowers, (with the exception of personal loans, lending to the central government and imports of non-agriculture related goods which were unchanged), they were nevertheless discriminatory. In general, and irrespective of line of activity for which

credit is sought, cooperatives were the most favored of the clients followed by that of public enterprises. Loans to the private sector were less favored enjoying the lowest rate reduction.

Table X.1
Ethiopia: Structure of Deposit Interest Rates (In percent per annum)

	Through June 30, 1986	As of July 1, 1986
A. Deposit Rates		
1. Time deposits		
30 days' notice	4	—
3 months to less than 6 months	4	—
6 months to less than 12 months	5	—
1 year and over	6	1
Financial institutions (1 year)	6	1
Government-owned undertaking (1 year)		
Private organizations, cooperatives (except savings and credit cooperatives), urban dwellers and peasant associations, other mass organizations and professional associations, joint venture and partly state-owned companies:		
1 year	6	4
2 years	6	4.5
3 years	6	5
5 years	6	5.5
Individuals, savings and credit cooperatives, self-help organizations:		
1 years	6	6
2 years	6	6.5
3 years	6	7
5 years	6	7.5
2. Savings deposits		
Financial institutions, state organizations, cooperatives (except savings and credit cooperatives), urban dwellers and peasant associations, other mass organizations and professional associations, joint ventures, foreign and partly state-owned companies.	6	Not allowed to maintain savings deposit accounts
Individuals, savings and credit cooperatives, private and self-help organizations:		
Up to Birr100,000	6	6
In excess of Birr100,000	6	2
Others	6	To be determined by the bank

Source: National Bank of Ethiopia.

Table X.2
Structure of Lending Rates

	Through June 30, 1986	As of July 1, 1986		
		Cooper..	State	Private
B. <u>Lending Rates</u> (by CBE and specialized banks)				
<u>Sector</u>				
Agriculture	9-10.5	5	6	7
Industry, mining, power and water resources	9.5	6	8	9
Domestic trade	9.5	6	8	9.5
Transport and communications	9.5	6	8	8
Export trade	8.5	6	6	6
Import trade (agricultural inputs)	9.5	5	6	7
Import trade (other)	9.5	6	8	9.5
Hotels and tourism	9.5	6	8	9
Construction	9.5	6	8	9
Housing (1) purchase	10	6	6	8
(2) construction	9	4.5	4.5	7
Central Government	3-5	--	3-5	--
Banks and financial institutions	5-6.5	--	2.5-4	--
Personal loans	10	--	--	10

Source: National Bank of Ethiopia.

Thus interest rates served not only economic purposes but were also used to further the ideological intent of the government. The lending rate also reflected the priorities of the government by according exports and construction of houses the most favored status.

The Interest rate policy was reflective of the trade and development policy of the regime. Credit to finance imports favored agricultural inputs with among the lowest interest rate even for the private sector while other types of imports were charged the highest interest. The low interest on exports could also reflect the outward orientation policy of the government.

1.4. The Money Supply Process and Determinants

Money, narrowly defined to include currency outside banks and demand deposits averaged an annual growth rate of 10 per cent between 1972 and 1991.

Factors that affect developments in monetary aggregates comprise of claims on government (net), claims on other sectors, and net foreign assets (see Table X.3).

1.4.1. Claims on Central Government (net)

Claims on central government (net) grew on average by 13.0 per cent during 1974/75–1991/92. A significant increase was observed in 1982/83 and contributed to 31.7 per cent of growth in domestic liquidity. This sharp increase was the result of the government's decision to bring down the debt equity ratio of some of the public enterprises from high levels. This was achieved by providing for a substantial sale of bonds by the treasury to the banking system. When the recapitalization of public enterprises were completed during the 1984/85 - 1987/88 period, the contribution of this component to domestic liquidity declined to an average of 11.7 per cent during 1987/88 - 1991/92. The need of the treasury for credit from the banking system was particularly low in 1985/86, as a result of the drought relief levy and greater reliance on external sources. During 1987/88 - 1991/92 this line of credit as per cent of beginning money stock rose to nearly 12.0 per cent reflecting a return to greater reliance on domestic bank financing of government deficit.

1.4.2. Claims on Other Sectors

The change in claims on other sectors grew on average by 11.8 per cent between 1974/75–1991/92. It registered significant negative growth in 1982/83 due to the provision of additional equity to public enterprises, for settlement of their arrears to the banks. In 1984/85 the annual rate of growth of claims on other sectors was only 3.2 per cent and was the result of drought and the resulting decrease in economic activity. The rate of growth however, recovered in 1986/87 and 1987/88 as real GDP growth recovered. In 1989/90 and 1990/91, the rates of growth were 1.2 per cent and negative 1.2 per cent. This deceleration was due to the civil war which led to significant foreign exchange constraint and decline in economic activity.

1.4.3. Net Foreign Assets

Net foreign assets decreased significantly between 1977/78-1980/81. It, however, registered substantial increase in 1981/82 due to a sharp rise in net monetary capital reflecting unusually large disbursement from bilateral donors such as Libya. In 1982/83 and 1983/84 it again registered significant declines of 40 per cent and 41.3 per cent respectively. In 1984/85 and 1985/86 it showed substantial increases of 78.9 per cent and 146.9 per cent respectively due to large grants in aid and concessional foreign loans. During 1986/87-1991/92 significant continuous declines in net foreign assets were registered.

2. COMPOSITION OF BROAD MONEY

Currency outside banks, demand deposits, savings deposits and time deposits grew on average by 14.0 per cent, 18.0 per cent, 19.0 per cent and 0.4 per cent respectively between 1974/75 - 1991/92. During the period between 1974/75 - 1991/92 the composition of money supply indicated that on average 45.1 per cent, 27.2 per cent, 20.6 per cent and 7.1 per cent constituted currency outside banks, demand deposits (net) savings deposits and time deposits, respectively.

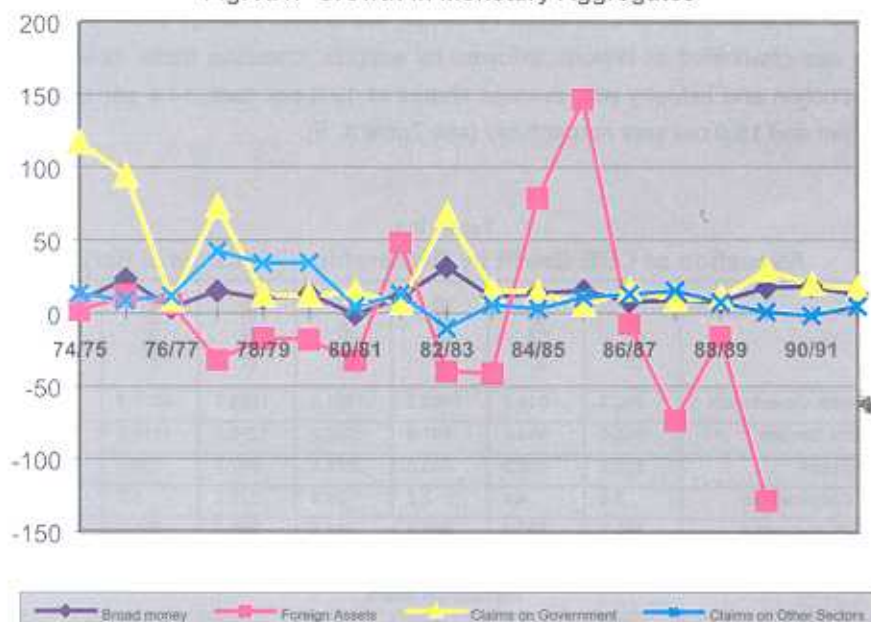
Table X.3
Development of Monetary Aggregates

	In millions of Birr			Percentage change over 12 months			Change as per cent of money stock at the beginning period		
	1974/75	1982/83	1991/92	74/75	82/83	91/92	74/75	82/83	91/92
Foreign Asset (net)	678.7	221.8	407.0	2.1	(40.0)	50.4	1.3	(5.4)	1.7
Domestic credit	741.4	3721.1	1067.7	30.3	19.1	13.0	15.2	25.8	14.7
Claims on government	209.6	1979.4	733.6	116.8	67.6	16.8	10.6	34.6	12.8
Claims on other sector	531.8	1741.7	3134.1	12.6	(10.4)	5.2	5.6	(8.8)	2.0
Broad Money	1150.9	3040.6	8992.1	7.9	31.7	13.3	7.9	31.7	13.3
Money	832.7	2180.4	6840.1	26.3	40.0	11.7	16.2	27.0	9.0
Currency outside banks	661.4	1258.2	4315.8	37.1	11.4	13.1	16.8	5.6	5.3
Demand deposit	171.3	922.2	2524.3	(3.2)	115.8	9.5	(1.5)	21.4	2.8
Quasi Money	318.2	860.2	2152.0	(21.9)	14.5	18.8	(8.3)	4.7	4.3
Savings Deposit	104.1	609.1	1999.1	(17.6)	15.3	19.2	(2.1)	3.5	4.1
Time Deposit	214.1	251.1	152.9	(23.8)	12.4	13.4	(6.3)	1.2	0.2
Other items (net)	40.1	902.3	1582.6	345.6	(23.9)	18.5	2.9	(12.3)	3.1

Source: National Bank of Ethiopia.

The share of quasi-money in total money stock followed a rising trend throughout the period. The shift from currency to demand deposits and to quasi-money, is attributed to the spread of rural banking facilities undertaken by the CBE as a deliberate policy.

Fig. X.1: Growth in Monetary Aggregates



3. COMMERCIAL BANK'S CREDIT ALLOCATION AND LIQUIDITY

3.1. Credit Allocation

The Commercial Bank of Ethiopia (CBE) extended loans to both the government and non-governmental sectors. During 1974/75-1991/92 the average share of CBE credit extended to public enterprises in total credit to non-government sector was 63.6 per cent; 35.5 per cent to the private sector and 0.9 per cent for cooperatives (see Table X.4 for breakdown of allocation of credit by CBE by ownership).

As regards breakdown of CBE credit by sector, the largest average share of 21.0 per cent was channeled to imports followed by exports, domestic trade, housing and construction and industry with average shares of 19.0 per cent, 14.4 per cent, 14.0 per cent and 15.0 per cent respectively (see Table X. 5).

Table X.4
Allocation of CBE Credit by Ownership (In millions of Birr)

	1980/81	1982/83	1984/85	1986/87	1988/89	1990/91	1991/92
Central Government	262.3	914.1	1460.2	1451.6	1868.7	6917.8	8062.8
Other Sectors	995.6	994.8	907.8	1067.0	1296.0	1116.6	1281.5
enterprises	628.2	598.2	543.8	655.6	907.7	725.0	857.9
Cooperatives	3.5	4.4	2.2	29.8	222.1	9.7	22.2
Private sector	363.9	392.2	361.8	381.6	366.2	381.9	401.4
Total	1257.9	1908.9	2368.0	2518.6	3164.7	8034.4	9344.3
Percentage Share							
Central Government	20.9	47.9	61.7	57.6	59.0	86.1	86.3
Other Sectors	79.1	52.1	38.3	42.4	41.0	13.9	13.7
Public enterprises	49.9	31.4	23.0	26.0	28.7	9.0	10.2
Cooperatives	0.3	0.2	0.1	1.2	0.7	0.1	0.2
Private sector	28.9	20.5	15.3	15.2	11.6	4.8	4.3

Source: National Bank of Ethiopia.

3.2. Liquidity Position

Ratio of loans and advances both to central and non-central government to deposits of CBE experienced significant decreases between 1974/75-1977/78 but surged in 1977/78-1979/80 due to substantial rise in demand for credit (see Table X.6).

This trend was reversed in 1980/81 and 1981/82 as loan deposit ratio decreased from 84.5 per cent in 1974/75 to 59 per cent in 1980/81 and 57 per cent in 1981/82. The decline reflected lower lending by CBE to the private sector. Reflecting these developments, the CBE's excess reserves rose from Birr 86.2 million in 1979/80 to Birr 313.8 million in 1980/81 and Birr 429.2 million in 1981/82. Significant increase in excess reserves were also recorded between 1987/88-1991/92 mainly due to reduced lending by CBE to both public enterprises and private sector during this period. The lower demand for credit by both private and public enterprises in the later part of 1980s emanated from the severe foreign exchange constraint.

Table X.5
Breakdown of outstanding Loans and Advances
by CBE by Sector 1984/85-1991/92 (Percentage Shares)

	1984/85	85/86	86/87	87/88	88/89	89/90	90/91	91/92
1. Agriculture	5.1	4.2	6.6	5.5	4.9	4.2	1.3	0.9
2. Industry	12.3	10.7	12.0	12.6	17.0	16.2	17.7	17.5
3. Domestic Trade	8.5	6.3	17.2	19.0	13.4	13.6	17.2	16.2
4. International Trade	43.9	50.5	38.0	37.3	36.5	40.3	33.3	36.6
Exports	19.2	33.9	14.2	12.0	16.2	14.9	17.2	20.6
Imports	24.7	16.5	23.8	25.3	22.3	25.4	16.1	16.0
5. Housing and Construction	17.2	15.5	15.0	13.7	16.0	16.8	—	7.0
6. Transport and Communication	9.4	7.4	7.2	9.1	7.3	6.9	—	—
7. Hotels and Tourism	0.9	0.8	1.2	0.8	1.0	1.0	—	—
8. Mines power & water resources	—	—	—	—	—	—	—	—
9. Personal	1.2	1.1	1.0	0.8	1.0	1.0	0.9	1.4
10. others	1.5	1.6	1.7	1.1	1.0	1.2	16.6	18.5

Source: National Bank of Ethiopia.

Table X.6

Reserve and Liquidity Position of Commercial Banks and Turnover of Deposits
(In millions of Birr, unless otherwise specified)

	1974/75	80/81	84/85	85/86	87/88	88/89	89/90	90/91	91/92
1. Reserve requirement	33.0	101.9	125.3	143.5	152.5	189.8	199.1	207.8	236.0
2. Actual reserves	102.4	415.7	579.1	898.2	1180.9	1043.3	1189.5	993.8	1425.6
3. Excess reserves (2-1)	69.4	313.8	453.8	754.7	1028.3	853.5	990.4	786.0	1189.6
4. Foreign assets	107.9	191.9	169.2	217.6	205.4	252.4	148.4	269.2	383.2
5. Foreign liabilities	39.6	72.3	103.7	87.8	107.1	102.9	71.5	116.5	68.6
6. Actual reserves plus net foreign assets	162.3	635.3	651.4	1132.3	1279.2	1192.8	1266.4	1146.5	1720.2
7. Liquidity ratio	94.7	92.3	48.8	71.3	51.3	63.1	56.2	49.5	68.0
8. Ratio of loans and advances to deposits	84.5	69.0	45.7	80.2	91.2	83.9	83.6	80.4	79.7
9. Debit balance	599.0	1447.0	1595.0	1902.2	2622.5	1664.0	1871.4	1139.1	1516.0
10. Turnover of deposits	2.6	1.8	1.1	0.64	0.82	0.83	0.5	0.46	0.5

- 1) Reserve requirement: 5% of total deposits with the commercial banks;
- 2) Actual reserves: Reserves with NBE, plus cash in hand (local currency);
- 3) Liquidity ratio: Actual reserves + Foreign assets (net) of short term liabilities, divided by demand deposits (net);
- 4) Ratio of loans and advances to deposits: Gross commercial bank loans and discounts plus credit to central government divided by gross demand deposits (of private and others) and demand deposit of domestic banks, time and savings deposits + government deposits with CBE;
- 5) Debit balance: Total debit balance less debit against the deposit of CBE;
- 6) Turnover of deposits: Debit balance divided by gross demand deposits of private and others and demand deposits of domestic banks and government deposits.

4. SPECIALIZED BANKS

The two specialized banks, namely AIDB and HSB, played significant role in providing particularly long-term loans since 1974/75. AIDB with its 16 branches and 15 sub-branches outside Addis Ababa provided short term credit for fertilizers, seeds etc., as well as long-term credit for investments. It was also providing medium and long-term lending to state enterprises, particularly state farms. The balance sheet as at end June 1991 indicate that its outstanding lending was Birr 3.0 billion of which 80.0 per cent was for state farms. The source of funds for financing state farms was

borrowing from NBE. Among its loans to state farms and public enterprises about 92 per cent and 38 per cent were non-performing at the end of 1990/91, respectively.

Table X.7
Consolidated Balance Sheet of Specialized Banks^{1/}

	1979/80	1983/84	1985/86	1988/89	1990/91	1991/92
1. Cash and balance with domestic banks	42.7	72.9	80.6	254.8	400.4	311.9
2. Foreign banks	4.4	0.9	2.1	-0.8	9.6	4.7
3. Claims on government	56.3	56.6	73.1	57.0	46.6	46.6
4. Other claims ^{2/}	991.9	1091.9	1663.7	2480.2	2673.8	2886.3
AIDB	(821.2)	(899.4)	(1398.5)	(2072.2)	(2234.3)	2442.2
HSB and predecessors	(170.7)	(192.5)	(265.2)	(408.0)	(439.5)	444.1
Assets=Liabilities	1095.3	1222.3	1819.5	2791.2	3130.4	3249.6
5. Time and Savings deposits ^{3/}	165.0	232.4	283.3	576.8	705.2	649.2
Credit from commercial bank	66.8	24.2	20.7	17.5	15.8	14.9
7. Credit from National Bank to AIDB	566.4	616.5	1311.9	1859.5	2072.8	2091.7
8. Credit from govt.	24.4	15.0	13.8	36.4	27.8	29.1
9. Foreign loans and advances	152.5	62.2	84.6	139.3	236.8	276.8
10. Capital account	118.7	84.2	110.3	159.7	116.7	-68.2
11. Other items (net)	1.5	-12.1	-5.1	2.0	-44.7	256.6

Source: NBE Quarterly Bulletin.

^{1/} AIDB and HSB.

^{2/} Claims on public enterprises, cooperatives and private business and individuals.

^{3/} Mainly fixed deposits with HSB, the Ethiopian Insurance Corporation and the Pension Commission.

Housing and Savings Bank which was established in 1975 provided loans for residential and commercial construction industries. It had 13 branches at the end of 1991/92. Its balance sheet at the end of June 1990 shows that its outstanding loan was Birr 452.3 million out of which claims on private sector represented 21.0 per cent, public enterprises 42.0 per cent and cooperatives 37.0 per cent. HSB was mobilizing time deposits, and accepted the deposits of Ethiopian Insurance Corporation and Pension and Social Security Authority (PSSA) as per the order of the

government. HSB was facing shortage of loanable funds due to the large mismatch between use of funds (mostly long-term) and source of funds (one-year deposits).

5. STRUCTURE AND BEHAVIOUR OF THE FINANCIAL SYSTEM AND MONETARY POLICY SINCE POST 1991

Monetary and financial sector policies are among key instruments in the management of macro-economic conditions. In the past regime financial sector was a pure government monopoly and interest rates were set administratively and were favouring the socialized sector. Credit was also largely channeled to social sector at preferential rates.

In January 1994, with the advent of economic reform program, the government issued two proclamations namely Monetary and Banking Proclamation, and the Licensing and Supervision of Banks and Insurance Companies. In the first proclamation, NBE was given increased autonomy and authority to supervise the banking system. The second proclamation allowed private sector to participate in banking and insurance business. In addition, in 1995 the Housing and Saving Bank and the Agricultural and Industrial Development Bank were restructured and renamed Construction and Business Bank and Development Bank of Ethiopia, respectively. The government also recapitalized government owned financial institutions. The treasury has also taken over non-performing loan portfolio of Development Bank of Ethiopia to state farms.

With the advent of the opening of the financial sector to private sector participation five new private banks namely, Awash International Bank, Dashen Bank, Bank of Abyssinia, Wegagen Bank, and United Bank, and eight insurance companies, namely, Nyala Insurance, Nile Insurance, Africa Insurance, National Insurance, Awash Insurance, United Insurance, Lion Insurance and Global Insurance, were established.

The network of bank branches in Ethiopia indicate that, as of December 1998, there were 254 bank branches throughout the country of which about 65.4 per cent were of CBE. The respective share of DBE, CBB, Awash International Bank and Dashen Bank, Wegagen Bank and Abyssinia were 12.6 per cent, 7.9 per cent, 5.1 per cent, 2.4 per cent and 1.6 per cent, respectively.

Following the proclamation which allows the establishment of micro-financing institutions issued on July 5, 1996, ten micro-financing institutions were established. These are discussed in Chapter XI.

Other important financial sector reform measures that were undertaken included: -

- Following the liberalization of entry into the banking sector, there was need for adequate supervision and regulation of the financial system. As a result, NBE established a Banking Supervision Department in early 1996;
- A proclamation which allows the establishment of micro-financing institutions was issued on July 5, 1996;
- In 1996/97 treasury bills of different maturities were introduced as a step towards using indirect monetary policy instruments;
- NBE was committed to ensure the positivity of real interest rates. Currently minimum interest rate (floor) is set for savings. The lending rate is however deregulated.

5.1. Interest Rate Policy

After the liberalization of interest rates, different banks charge different interest rates. For example, lending rates of Commercial Bank of Ethiopia, Construction and Business Bank, United Bank and Wegagen Bank are set at 10.5 per cent for all types of loans. On the other hand, Bank of Abyssinia and Awash International Bank have lending rates to 12.0 per cent per annum for short-, medium- and long-term loans as well as over draft and personal loans. Dashen Bank has differentiated rates ranging from 10.5 per cent for short term, 11.0 per cent for medium and overdraft loans, 11.5 per cent for long-term and 12.0 per cent for personal loans.

As regards deposit rates, no bank increased the minimum savings deposit rate, which was set at 6.0 per cent. Time deposit rates, however, differ from bank to bank ranging from 6-7 per cent depending on the maturity and the amount of money deposited.

5.2. Monetary Indicators

During 1991/92 - 1997/98, the average annual growth rate of broad money was 13.0 per cent. The monetary growth in each of the years was due to increases in net domestic assets and net foreign assets. The growth in credit to central government (net) declined from its peak of nearly 30 per cent in 1989/90 to 4.8 per cent in 1993/94. Net claims on government, and continued to decrease by 4.6 per cent, 1.9 per cent, and 8.5 per cent in 1994/95, 1995/96 and 1996/97 respectively. This was due to continued significant repayments by the government to the banking system. Claims on other sectors grew on the average by 27.4 per cent. Significant rises of 66.9 per cent and 42.1 per cent were registered in 1994/95 and 1995/96.

Net foreign assets grew on the average by 14.0 per cent. Significant increase was registered in 1994/95. This was partly the result of the coffee boom following the poor Brazilian harvest at the beginning of 1994 which increased the price of coffee, and its contribution to increased export earnings leading to a large accumulation of net foreign reserves.

Table X.8
Monetary Developments (1991/92 - 1997/98)

	Annual percentage changes						
	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
1. Broad Money	13.3	16.2	14.0	24.3	8.7	5.7	11.7
Currency outside banks	13.1	13.2	5.6	13.3	-2.6	-8.0	-9.9
Demand deposits (net)	9.5	11.9	18.5	13.1	-3.0	-8.5	30.0
Quasi-money	16.8	26.5	24.2	26.9	40.3	13.7	15.6
2. Claims on Govt. (net)	16.8	10.6	4.8	-4.6	-1.9	-8.5	6.5
3. Claims on other sectors	5.2	35.7	15.7	66.9	42.1	13.0	13.3
4. Net foreign assets	48.9	14.0	22.2	15.5	9.2	-9.8	2.5

5.3. Pattern of Financial Intermediation

5.3.1. Deposit mobilization

There has been steady real growth during 1991/92 - 1997/98 in demand, savings and time deposits. Total deposits increased annually on the average by 23.0 per cent.

Demand deposits increased from Birr 3.2 billion in 1992/93 to Birr 8.5 billion in 1997/98. Savings deposits increased from Birr 2.5 billion in 1992/93 to Birr 6.2 billion in 1997/98. Time deposits also rose from Birr 315.6 million in 1992/93 to Birr 1.1 billion in 1997/98.

Demand deposits at the end of 1997/98 claimed 54 per cent of total deposits. At the end of 1997/98, of the total demand deposits nearly 29.0 per cent were held by the private sector as compared to 25.0 per cent in 1992/93. The share of private sector savings and time deposits during 1992/93 - 1997/98 was nearly 95.0 per cent.

Table X.9
Deposits in Commercial Banks (1991/92 - 1997/98)
(In Millions of Birr)

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Demand deposits	2791.8	3193.6	3469.0	5529.1	6125.1	7310.1	8505.6
Private sector	704.0	799.4	1040.8	1439.2	1740.3	1880.6	2441.6
Cooperatives	230.2	235.0	231.0	210.4	270.3	343.3	295.4
Public enterprises	1278.4	1391.3	1341.1	1954.5	2060.7	2191.4	2483.8
Central government	243.3	342.2	439.6	589.0	117.6	548.9	1195.2
Others*	335.9	425.7	416.5	1336.0	1936.2	2119.6	2089.9
Savings deposits	1999.1	2450.5	2844.3	3869.0	5020.6	5698.6	6206.8
Private sector	1983.8	2432.0	2820.6	3800.1	4798.7	5587.7	6089.8
Cooperatives	15.3	18.5	23.7	30.4	78.1	87.4	87.0
Public enterprises	--	--	--	20.3	23.8	23.7	27.8
Others*	--	--	--	18.3	122.0	--	2.2
Time deposits	152.9	315.6	381.2	625.5	795.0	839.4	1094.3
Private sector	148.1	310.8	369.0	436.5	478.4	463.3	513.6
Cooperatives	4.2	4.2	4.4	1.5	1.4	10.9	21.5
Public enterprises	--	--	7.2	17.3	143.9	34.9	132.9
Domestic Banks & F.I.	--	--	--	161.1	64.6	322.7	419.1
Others*	0.6	0.6	0.6	9.0	106.7	7.6	7.2
Total deposits	4943.8	5959.7	6694.5	10023.6	11940.7	13622.0	15,806.9

Source: National Bank of Ethiopia, Quarterly Bulletins.

* Includes domestic banks and other financial agencies and non-transferable accounts of non-residents.

5.3.2. Lending

The most important trend during 1991/92 - 1997/98 has been the steady growth in lending to the private sector. Commercial banks significantly increased their loan portfolio to the private sector which increased from 10.3 per cent in 1992 to 63 per cent in 1997/98, whereas that of the public sector plummeted from 89 per cent in 1991/92 to 31.0 per cent in 1997/98 (see Table X.9).

Sectoral distribution of bank lending by economic sector as of June 1998 indicates that domestic trade and services was the largest borrowers with a share of 36.5 per cent of total lending at the end of 1997/98. Manufacturing, imports and exports, had shares of 8.0 per cent, 18.1 per cent and 10.0 per cent respectively during the same period (see Table X.11). The share of the agricultural sector was on the average about 3.0 per cent between 1992/99 - 1997/98.

Table X.10
Commercial Banks Domestic Credit Outstanding and Shares by Ownership
(Millions of Birr)

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
1. Government	2629.7	2617.4	2617.1	2573.7	2850.3	2136.9	2251.5
2. Non-financial public enterprises	843.6	1396.4	1521.2	1715.8	1755.8	1734.5	1786.2
3. Financial public enterprises	14.1	96.3	95.4	179.5	271.9	540.9	496.8
4. Private sector	401.4	976.4	1425.0	3363.7	5604.7	6788.6	8119.3
5. Cooperatives	22.2	33.0	65.7	266.6	241.7	337.5	286.6
6. Total credit outstanding	3911.2	5119.5	5724.4	5515.0	10724.4	11438.4	12940.4
Percentage Shares							
1. Government	67.2	51.1	45.7	34.5	26.5	19.0	17.4
2. Non-financial public enterprises	21.6	27.3	26.6	21.3	16.3	15.2	13.8
3. Financial public enterprises	0.4	1.9	1.7	2.4	2.5	4.7	3.8
4. Private sector	10.3	19.1	24.9	40.2	52.3	59.3	62.7
5. Cooperatives	0.6	0.6	1.1	1.4	2.3	2.1	2.2

Source: NBE Quarterly Bulletin

There was significant increase in the share of credit to manufacturing, particularly in 1992/93 due to increased capacity utilization and the relatively higher price increases for manufactured products. The reason for the high share of credit to imports are increased credit demand for raw materials and spare parts, the liberalization of the foreign exchange control and its allocation through foreign exchange auction and the improvement in the capacity utilization in the manufacturing sector.

Table X.11
Sectoral Breakdown of Commercial Banks Outstanding Claims
(Percentage shares)

	1993	1994	1995	1996	1997	1998
Agriculture	1.7	2.4	3.0	2.7	3.7	3.5
Manufacturing	21.9	15.6	8.2	7.3	8.1	8.0
Large scale industry	21.4	15.2	7.8	6.8	7.0	6.5
Small scale industry	0.5	0.4	0.4	0.5	1.1	1.5
Exports	16.5	17.9	13.2	12.0	10.1	9.6
Coffee	9.5	13.7	10.6	8.5	6.3	5.4
Non-coffee	7.0	4.2	2.7	3.4	3.8	4.3
Imports	21.6	15.5	14.9	13.8	16.8	18.1
Construction	8.3	7.2	16.7	14.4	14.7	13.2
Domestic Trade & services	24.8	35.0	39.1	38.3	39.0	36.5
Domestic Trade	17.2	24.7	22.6	21.9	23.1	21.3
Transport	5.4	7.2	8.9	10.8	10.4	8.6
Hotels and Tourism	1.8	2.3	3.2	2.0	2.1	2.0
Other services	0.5	0.8	4.4	3.5	3.4	4.7
Personal	0.7	0.4	0.2	0.2	0.2	0.2

Source: National Bank of Ethiopia.

1/ CBB and AIB are included beginning from March 1995, Dashen Bank (DB) beginning January 1996, Bank of Abyssinia beginning November 1996 and Wegagen Bank beginning December 1997.

2/ Excludes the accounts of the Djibouti branch of the Commercial Bank of Ethiopia, includes provisions for bad loans.

3/ Includes co-financing of projects, inter-bank lending and other loans.

5.4. Liquidity Position of Commercial Banks

The commercial banking system has consistently maintained excess reserves through out the period from 1992/93 - 1997/98. Excess reserves at the end of June 1998 was Birr 1,617.0 million, of which 95.0% was that of the Commercial Bank of Ethiopia. The liquidity ratio was also in excess of the required minimum of 20 per

cent. It was 51.4 per cent at the end of 1997/98 (see Table X.12). Excess reserve and liquidity position of commercial banks indicate that there is a monetary overhang in the economy.

Table X.12
Reserve and Liquidity Position of Commercial Banks: June 1993 - December 1998^{1/}

	1993	1994	1995	1996	1997	1998
	June 30					
	(In millions of Birr unless otherwise indicated)					
Net deposits ^{2/}	5575.9	6908.1	9423.3	11308.2	12843.1	16167.0
O/W CBE	5575.9	6908.1	8997.2	10506.5	11706.9	14651.2
Reserve requirement ^{3/}	278.8	345.4	471.2	565.4	842.2	808.4
O/W CBE	278.8	345.4	449.9	525.3	585.3	732.6
Actual reserve	1613.3	1909.6	1524.2	1985.2	1336.2	2425.3
O/W CBE	1613.3	1909.6	1500.9	1920.2	1235.6	2267.9
Excess reserves	1334.5	1564.2	1053.0	1419.8	694.0	1617.0
O/W CBE	1334.5	1564.2	1051.0	1394.9	650.3	1535.3
Actual reserve ratio (%)	28.9	27.6	16.2	17.6	10.4	15.0
O/W CBE	28.9	27.6	16.7	18.3	10.6	15.5
Net current deposits ^{4/}	5266.7	6526.9	8797.8	10547.6	11996.3	15092.2
O/W CBE	5266.7	6526.9	8552.7	9936.0	11160.2	13953.7
Liquidity requirement ^{5/}	1053.3	1305.4	1759.8	1582.1	1799.4	2263.8
O/W CBE	1053.3	1305.4	1710.5	1490.4	1674.0	2093.1
Actual liquid assets	2517.4	3723.4	4779.0	4124.2	5191.0	7755.1
O/W CBE	2517.4	3723.4	4676.6	3856.3	4788.6	7146.5
Actual liquidity ratio (%)	47.8	57.0	54.3	39.1	42.3	51.4
O/W CBE	47.8	57.0	54.7	38.8	42.9	51.2

Source: National Bank of Ethiopia.

^{1/} CBB and AIB are included beginning from March, 1995. Dashen Bank (DB) beginning January 1996, Bank of Abyssinia beginning Nov. 1996, and Wegagen Bank beginning Dec. 1997.

^{2/} Demand, Savings, and time deposits less uncleared checks paid, and uncleared effects-foreign.

^{3/} The requirement is 5 per cent of net deposits for all commercial banks, but 8% for CBE in 1996.

^{4/} Net deposits less deposits at notice (able to withdraw after 30 day's notice).

^{5/} Twenty per cent of net current deposits through August 1995, 15 per cent thereafter.

5.5. Weaknesses of the Current Financial System

The current financial system in Ethiopia is still encumbered with a number of problems. The main ones are the following:-

- a) Poor repayment performance by borrowers, particularly those owed to government owned banks. To alleviate this problem foreclosure law was promulgated in February, 1998 and banks are exerting every effort to recover their loans;
- b) The capital base of recently introduced private banks are low and therefore may need revision;
- c) Although all banks strive hard to develop various up to date systems of operations to effectively handle customer service activities, there is still much to be done regarding efficiency by introducing appropriate technology;
- d) There is lack of significant level of competition;
- e) The financial system remains highly undiversified;
- f) Shortage of technical skills related to financial operations and management are significant;
- g) Inadequate supervisory capacity, despite the Supervision Department of NBE which is exerting every effort to strengthen its capacity;
- h) The monetary overhang which is characterized by excess liquidity particularly of Commercial Bank of Ethiopia needs to be reduced;
- i) The absence of indirect monetary instruments and of an inter-bank money market which limits the capacity of NBE to conduct open market operations as a monetary policy instrument;
- j) Funding mis-match for Development Bank of Ethiopia (DBE) and Construction and Business Bank (CBB). These banks can only be sustained if their capacity to raise long-term funds is enhanced.

5.6. The Key Issues facing the Financial Sector in the years ahead

In Ethiopia, the financial system is still undeveloped, despite the fact that, there was significant improvement in financial Intermediation. The banking system is highly dominated by Commercial Bank of Ethiopia. The financial system is still undiversified and supervisory capacity of the National Bank of Ethiopia is still inadequate. Thus the challenges of financial sector reform in the years ahead include mainly the following:-

- Mobilization of domestic savings at a large scale;
- Diversification of financial institutions and financial instruments;
- Increasing efficiency and competition in banking;

- Strengthening the supervisory capacity of the National Bank of Ethiopia;
- provision of micro-finance on a sustainable basis.

6. DEVELOPMENTS IN EXCHANGE RATE

6.1. The Exchange Rate Situation in Ethiopia (1973/74-1991/92)

When Ethiopian Birr was issued in 1945, its value was set at 5.52 grains or 0.355745grams of fine gold equivalent to US \$ 0.4025 or an official exchange rate $2.48 = 1$ US dollar (Befekadu, 1993). A small change was made in 1964, which adjusted the rate to a more manageable Birr2.50 = 1 US dollar. In December 1971 when US dollar was floated and ceased its convertibility to gold, the Birr appreciated to a rate of Birr2.30 = 1 US dollar. The Birr again appreciated in February 1973, when the US dollar was further devaluated and became Birr2.07 = 1 US dollar. This exchange rate ruled for nearly two decades.

Despite the fact that the rate was fixed against the dollar, it was floating against all other major currencies, following the fluctuation of US dollar against these currencies. This implies that the exchange rate of the Birr against other major currencies was not determined by economic fundamentals in Ethiopia, but by relative economic conditions in US (Befekadu, 1991).

In order to determine whether the Ethiopian Birr was over-valued before the devaluation of October 1992, a study on Potential Exchange Rate Adjustment in Ethiopia was undertaken by the National Bank of Ethiopia. In the study different approaches were used, including the traditional approach, alternative approach and Purchasing Power Parity (PPP) theory approach.

The traditional approach tried to find a very simple solution to the problem of estimating the fundamental equilibrium exchange rate (FEER) in real effective terms. In this approach a base period was chosen during which exchange rate was at an "appropriate" level and real effective exchange rate (REER) at that period was regarded as fundamental equilibrium exchange rate (FEER). This procedure was widely criticized since the choice of the base period is arbitrary. To circumvent this problem, to some extent, average real effective exchange rate during 1972/73-1977/78 was used in the NBE study. This choice was made since the period was long enough to smooth out temporary deviations and the US dollar to which the Birr was pegged showed no secular trend in effective terms during that period.

Table X.13

Nominal Effective Exchange Rates (NEER) of the Ethiopian Birr (1973 - 1990)

Year	NEER 1 (1973 = 100)	NEER 2 (1973 = 100)
(2)	(3)	(4)
1973	100.00	100.00
1974	102.92	104.07
1975	100.77	103.8
1976	108.03	112.52
1977	104.16	111.21
1978	98.41	105.04
1979	90.66	99.97
1980	90.79	101.01
1981	106.01	119.37
1982	117.04	130.47
1983	124.63	140.75
1984	137.04	154.56
1985	142.39	161.04
1986	114.33	134.86
1987	101.38	121.15
1988	99.23	117.60
1989	104.86	122.62
1990	96.22	113.76

Source: Potential Exchange Rate Adjustment (PERP), October 1991

Note: NEER 1 is based on bilateral export weights whereas

NEER 2 is based on bilateral composite trade weights

Fig. X.2: Developments in Exchange Rates

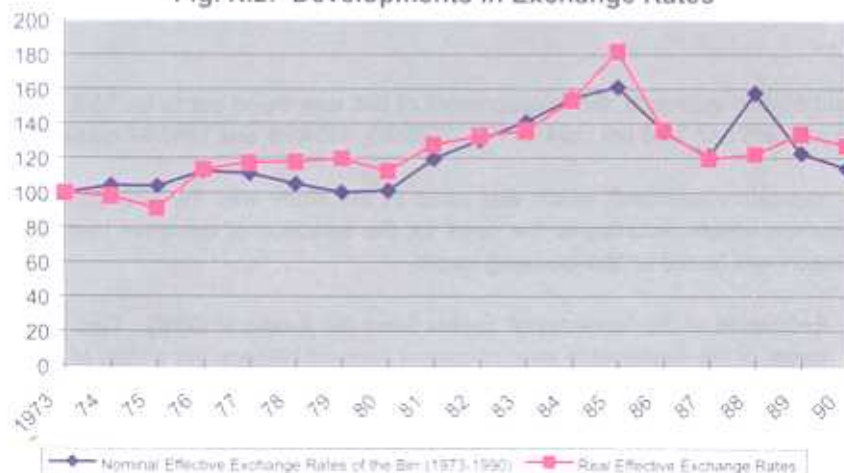


Table X.14
Real Effective Exchange Rates (REER)
of the Ethiopian Birr (1973 - 1990)

Year	REER 1	REER 2
1973	100.00	100.00
1974	98.37	97.72
1975	91.16	90.66
1976	115.23	113.41
1977	119.13	117.29
1978	118.66	117.63
1979	120.19	119.71
1980	114.05	112.28
1981	129.48	127.63
1982	138.04	132.73
1983	139.71	135.62
1984	158.84	153.30
1985	188.55	182.02
1986	133.22	136.08
1987	112.71	119.49
1988	114.68	122.15
1989	126.14	133.70
1990	115.60	127.25

Source: Potential Exchange Rate Adjustment..., ERPD, October 1991

Note: REER 1 is based on bilateral export weights whereas

REER 2 is based on third country competition export weights.

Based on this approach, the misalignment of Birr was found out to be 10.3 per cent, 78.4 per cent and 21.8 per cent for F.Y. 1979/80, 1984/85 and 1986/87 respectively.

The alternative approach which was used in the study was the one proposed by Williamson which circumvents the need for the selection of the base period. This approach was based on the following steps:-

- Estimation of the "underlying" capital flows (as a ratio of GDP). This gives the target or the sustainable level of current account balance (as a ratio of GDP) for the economy;
- Secondly, the relationship between actual current account balance (as a ratio of GDP) and the real effective exchange rate (REER) index was estimated using suitable econometric technique;

- c) Finally, using the estimated relationship, REER index was computed that would give the current account balance (as a ratio of GDP) equal to its targeted level. That level of the REER index could be expected to generate the current account balance equal to the "underlying" capital flows and hence, would represent the fundamental equilibrium exchange rate (FEER) for the economy.

The average of the long-term capital flows (net) as a percentage of GDP during the five-year period, 1979/80-1983/84 was chosen and it turned out to be 5.0 per cent. As a result the sustainable level of the current account deficit was placed as 5 per cent of GDP. According to this approach the estimated REER indices were found to capture as much as 80 per cent variation in the current account deficit.

In this approach the estimated degree of misalignment of the Birr's real effective exchange rate were 7.1 per cent for 1980, 73.3 per cent for 1985 and 18.3 per cent for 1987.

The other measure of the overvaluation of the Birr which was used by the study is the purchasing power parity (PPP) which takes into account domestic inflation relative to the trading partners. The study found out that the Ethiopian economy was inflating faster than her 17 trading partners to the extent of 0.81 per cent per annum on average over the period 1973-1987. Cumulatively, the price increase was about 11.0 per cent higher than her trading partners. This meant that the Ethiopian economy suffered 11 per cent more inflation, which would have required the depreciation of the same amount during the period. Instead, the currency appreciated during this period in real effective terms by about 18 to 22 per cent. From this the study concluded that the Ethiopian Birr was over-valued between 29 and 33 per cent in real effective terms compared to its fundamental equilibrium level.

The study also indicated that there was a downward bias in the estimated level of over-valuation due to the deficiency in the price data which were based on a dated basket of goods and was limited to Addis Ababa.

Another commonsense indicator of the overvaluation of the Birr during that period which is not indicated in the study could be obtained by comparing world prices and domestic prices of the country's major export products such as coffee during that time. For example, the domestic free price of coffee in June 1992 was Birr10 per kg. The world price including transportation was US246 cents per kg. The ratio of the two prices indicates an implicit exchange rate of around Birr 4 per US dollar.

Another indication of the overvaluation of the Birr was the exchange rate which was prevailing in the parallel market during that period which was around 8 Birr per US dollar. The major causes for the substantial depreciation of the Birr in the parallel market were the existence of excess liquidity in the economy; the deterioration in the country's balance of payments which led to shortage of foreign exchange in the official market; the rise in import demand, following the lifting of restrictions on franco valuta imports; high demand for forex to finance capital flight, due to uncertain domestic economic conditions and expansion of export and import contraband trade.

The overvaluation of the Birr had negative consequences on the economy of which the following can be singled out:-

- There was significant expansion of the parallel foreign exchange market. The high premium in the parallel market led to the shifting of foreign exchange from official channels to the parallel market;
- Exports were diverted to either contrabands or domestic market;
- Cheap official rates increased import demand, undermining the competitiveness of domestic producers;
- Over-valuation led economic activities to go underground and thus became a source of super profit for individuals with access to foreign exchange;
- There was considerable subsidies to government exporting organization which led to substantial burden on government budget;
- Discouraged official remittances from abroad.

6.2. Exchange Rate Developments after October 1992

After the introduction of structural adjustment program, the exchange rate of the Birr was devalued by 59 per cent on September 30, 1998 from Birr2.07/US\$ 1 to Birr5 = US\$1. The underlying reason for the massive devaluation of the Birr was to correct the overvaluation of the official exchange rate and to raise the competitiveness of the Ethiopian exports in the world market.

When foreign exchange auction was introduced in May 1993, three rates, namely the official exchange rate, marginal rate and the black market rate ruled. The introduction of forex auction was the first phase for introducing market determined exchange rates. With effect from October 1, 1992, the official rate was raised to Birr 5.00 = US\$1. Subsequently, it was raised to Birr 5.13 on April 1, 1994, to Birr 5.58 on May 16, 1994, to Birr 5.66 on June 1, 1994, to Birr 5.59 on July 1, 1994 and Birr 5.57

effective August 1, 1994. The official rate was applicable to the following foreign exchange transactions: imports of petroleum products, pharmaceuticals, fertilizers, as well as official debt service and government contributions to international organizations and its foreign offices. In order to avoid multiplicity of rates, the official and auction rates were unified as of July 25, 1995. To accommodate the growing demand for forex and promoting international trade transactions, the frequency of auction increased from fortnightly to weekly on August 3, 1996.

The auction was based on a Dutch auction system, with the successful bidders receiving an allocation of forex based on the exchange rate contained in their bid. The amount to be auctioned was always announced by NBE beforehand, but the amount disbursed may differ from the amount announced. The forex obtained in the auction market can only be used for imports not included in the negative list. Till September 1996, applicants were required to deposit 100 per cent of the Birr equivalent. This was reduced to 2.0 per cent as of September 1996. Successful bidders were required to utilize the foreign exchange within 30 days of the auction. Those bidders, who decline from utilizing the forex they won from the auction were penalized the 2.0 per cent deposits and also were disqualified from participation in subsequent auctions. The marginal rate from the auction was the rate used until the next auction for all transactions outside the auction except for transactions where official rate was applicable.

Since the introduction of forex auction market in May 1, 1993, up to August 31, 1998, the NBE has supplied a total sum of 3.3 billion US dollars to licensed importers which is lower than the total demand during the same period of about 4.4 billion US dollars. There was gradual depreciation of the marginal rate through out the period. This came as a result of higher demand for forex compared to the amount supplied. After the abolition of franco valuta, the amount of forex auctioned was gradually increased and there was a significant fall in the rates that was prevailing the parallel market. Detailed data on forex auction indicate that the auctions held between July, 1994 - June 1998, 66.4 per cent of the foreign exchange on the average went to the private bidders. The leading commodity categories in the auctions during this period were: machinery and equipment (19.3 per cent), spare parts (7.4 per cent), chemicals and raw materials (24.8 per cent) and consumer goods (13.8 per cent). The shares however, varied from auction to auction.

Table X.15
Supply and Demand Pattern for Forex in Forex Auction Market in Ethiopia
In US Dollars

Year	Total supply	Total demand	Average marginal rate
1992/93*	26.9	39.0	4.27
1993/94	261.7	442.3	5.77
1994/95	401.4	476.6	6.25
1995/96	697.6	780.7	6.32
1996/97	917.6	1364.0	6.50
1997/98	960.0	1279.0	6.88
Total	3265.2	4381.6	

Source: National Bank of Ethiopia.

* Covers the period from May 1 - June 1993

Table X.16
Selected Effective Exchange Rates, 1992/93-1996/97^{1/}

	1992/93	1993/94	1994/95	1995/96	1996/97 Est.
	(Trade weighted, period average, 1979/80=100)				
Effective exchange rates					
Nominal	184.0	151.7	138.3	136.0	138.2
Real	77.1	51.7	49.5	47.6	44.0
Memorandum items: ^{2/}					
Birr per U.S. dollar, end of period	5.100	6.220	6.320	6.320	6.881
Birr per U.S. dollar, period average	4.269	5.788	6.254	6.330	6.496
Birr per SDR, end of period	7.158	9.009	9.915	9.122	9.490
Birr per SDR, period average	6.025	7.133	8.796	9.370	9.210

Source: IMF, International Financial Statistics; and Fund staff estimates

^{1/} All data pertain to the period July 1 - June 30.

^{2/} Since May 1993, based on marginal rates at foreign exchange auctions.

Buying and selling rates for other currencies were set on the basis of the relevant rate for the US dollar and the previous day's closing rate of the currency concerned against the US dollar in London. The NBE does not deal with the public; its transactions in US dollars with authorized dealers takes place at the marginal rate. Authorized dealers must observe the marginal rate for the US dollar and the prescribed commission charges, which accrue to the NBE, of 0.5 per cent buying and 1.5 per cent selling; they are also authorized, but not obliged, to levy service charges

for their own account of up to 0.25 per cent buying and 0.75 per cent selling, and, for currencies other than the US dollar, to include the margin charges applied by the correspondents abroad.

Movements in the marginal rate from the auction since May 1993 indicate that the Ethiopian Birr was allowed to depreciate in the forex auction *vis-à-vis* the US dollar in nominal as well as in real effective terms (see Table X.16 above).

7. INFLATION IN ETHIOPIA

7.1. Trends in Inflation during 1974/75–1991/92

Ethiopia belongs to the group of African countries with relatively low rates of inflation for the period, from 1974/75–1989/90. In fact, the average rate of inflation during this period as measured by Addis Ababa retail price index (RPI), was 7.5 per cent. However, in 1990/91 the inflation rate jumped to 20.9 per cent.

The period between 1974/75 to 1976/77 was characterized by high rate of domestic inflation which resulted from excess demand for goods and raw materials which were in short supply during that time. During this period, the rate of inflation rose from 4.7 per cent per annum in 1974/75 to 22.0 per cent in 1976/77. This was mainly due to significant increase in food prices which account for 57.4 per cent of the weight. To contain the accelerating rate of inflation, the government introduced a system of price controls on domestic goods and maximum profit margin for certain imported goods. Farm gate, wholesale, retail prices of major grains, pulses and oilseeds were put under price control. Factory gate, whole sale and retail prices of domestic manufactured goods were also brought under the system of control. Commodities such as sugar, salt, edible oil, soap, baby foods, other manufactured items such as textiles etc. were distributed by the government.

The inflationary pressure was reduced during 1977/78–1983/84 period. The annual rate of increase in RPI declined from 21.9 per cent in 1976/77 to 1.9 per cent in 1980/81 and dropped further to -0.3 per cent per annum in 1983/84, triggered by the decline in food prices. During this period the government introduced compulsory

Table X.17
Level of Price Index and Inflation Rates Based on the
Retail Price Index for Addis Ababa

Ethiopian Fiscal Year Ending June 30		Average Annual General Index 1983=100	Inflation Rate
1973/74		154.4	10.7
1974/75		161.6	4.7
1975/76		192.2	18.9
1976/77		234.2	21.9
1977/78		277.7	18.6
1978/79		313.6	12.9
1979/80		352.9	12.5
1980/81		359.7	1.9
1981/82		385.9	7.3
1982/83		400.7	3.8
1983/84		399.7	-0.2
1984/85		473.1	18.4
1985/86		495.0	4.6
1986/87		448.2	-9.5
1987/88		457.9	2.2
1988/89		501.8	9.6
1989/90		527.7	5.2
1990/91		638.0	20.9
1991/92		771.9	21.0
1992/93		849.0	10.0
1993/94		858.9	1.2
1994/95		973.6	13.4
1995/96		982.6	0.9
1996/97		919.5	-8.4
1997/98	July	916.5	-6.3
	August	915.8	-5.7
	September	914.6	-5.2
	October	915.1	-4.5
	November	916.1	-4.0
	December	914.8	-3.7

Source: Central Statistical Authority, and NBE Staff Computation.

grain quota deliveries to the Agricultural Marketing Corporation at centrally fixed prices. This made the supply of food grains to urban areas regular. The price Department in the Office of National Council for Central Planning (ONCCP) was also set up to review costs and fix producer, wholesale and retail prices of major crops and basic domestic industrial goods. Retail prices were determined by percentage mark-ups.

Pricing decisions for state corporations were made by the ONCCP based on recommendations from the Ministry of Industry. *Kebele* and state enterprise shops were established to make official prices effective. The distribution of food grains at *kebele* shops were abandoned in 1989/90, during which agricultural marketing was liberalized. The liberalization of agricultural product market was, however, limited to private producers and crops produced by state farms continued under the price control regime.

During 1990/91 and 1991/92 inflation rates was above 20.0 per cent per annum. This was mainly the result of the civil war and the consequent severe foreign exchange constraint which led to the closure of some industries and the operation of some below capacity due to lack of imported raw materials and spare parts. As a result the supply of goods in the economy were significantly reduced.

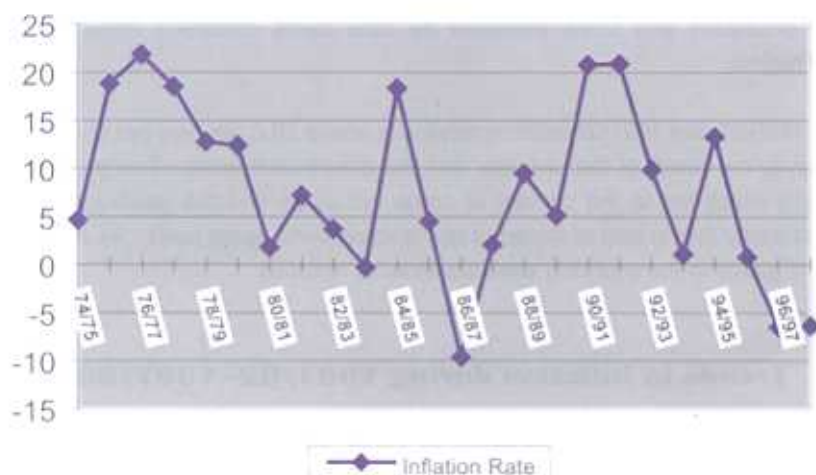
7.2. Trends in Inflation during 1991/92–1997/98

The post 1991 regime is one in which all prices are decontrolled and are market determined. During 1990/91 - 1991/92 the annual inflation rate averaged about 20.0 per cent, due to supply bottle necks and major macro-economic imbalances and disequilibrium engendered by the transition from war to peace and from one government to another. Annual inflation significantly decelerated in 1993/94, mainly as a result of the good harvest in 1992/93.

In 1994/95, there was an increase in inflation, due mainly to an expansionary monetary policy as a result of the coffee boom and the effect of the bad harvest in the preceding year.

During 1995/96 - 1997/98, the rate of inflation was significantly decelerating. In 1996/97 it was negative 6.4 per cent, a result of higher agricultural output which sharply lowered the price of food. Utility prices (electricity, water and telecommunications) were also adjusted significantly upward. In the first few years of structural adjustment program (SAP) there were controls on the retail and wholesale prices of fertilizer; petroleum and petroleum products, some pharmaceuticals and sugar for household consumption. But these were decontrolled subsequently.

Fig. X.3: Development in Consumer Prices



7.3. Factors Influencing Prices in Ethiopia

A study which was undertaken by Mistry (1991) on inflation in Ethiopia¹ indicate that critical determinants of inflation in Ethiopia are costs of food, housing and energy in both rural and urban areas. Transport costs (and bottlenecks) also play a key role in determining retail prices.

It is indicated in the study that in the last quarter of 1990, despite large quantities of food production in some regions, transport constraints emerged as a major factor discernible impact on food grain prices in urban areas. Physical constraints on distribution and marketing are also cited to have resulted in food grain prices

¹ Mistry P.S. "Inflation in Ethiopia: An Assessment of Inflationary Pressures and Prospects with Continued Economic Liberalization" April 1991, p.30.

increasing much more rapidly in urban and grain deficit areas, despite increased aggregate production and a relatively high level of food imports.

The study by Mistry further indicated that the effect of direct increases in construction costs were largely felt in 1990/91 by upper income urban groups which began to accelerate investment in urban property of residential occupation and for renting out. Construction and building material costs are however not included in the calculation of AARPI.

The other factor that influence prices is the depreciation of the currency. By increasing the prices of import goods and services it directly and indirectly impacts on food grain producer costs to the extent that imported inputs such as fuel, fertilizers etc. play a role in production. In the peasant sector the costs of food grains production are not likely to be affected by prices in imported fuel but will be significantly affected by the increase in the prices of fertilizers. Fuel price increases however could affect the production cost of commercial farming including state farms.

Apart from food grains, domestic prices for agricultural exportables in urban households could increase due to depreciation of the currency. As a result, domestic prices of exportables such as coffee, oilseeds, pulses, and meat may increase.

The effect of depreciation on manufactured items depend on what happens to capacity utilization, the aggregate supply of goods available to consumers and the extent of competitive behaviour of producing units. To the extent that these increases affect the cost of production, these are reflected in their prices.

A study conducted by IMF² estimated a causal relationship between money, prices, and other supply and demand side variables for the Ethiopia economy over the 30-year period extending from 1966 to 1995. The objective was to provide evidence on whether money supply affects prices or vice versa, and on whether other supply - side factors could affect the determination of prices and thus the monetary policy stance.

² IMF, Ethiopia "Selected Issues" SM/96/92 April 17, 1996.

The result indicated that both macro-economic policy and exogenous shocks are significant determinants of the price level with money growth having an almost instantaneous effect. Ethiopia being agricultural country the study also recognizes those, periodic droughts, pest infestations and changes in fertilizer availability could also have significant influences on price level.

8. FINANCIAL DEVELOPMENT

As noted by Goldsmith (1969:37) "financial development is – change in the financial structure" of a country. The structure refers to (Goldsmith 1969:26) "the presence, nature and relative size of financial instruments and financial institutions" in a country.

The degree of financial development in a country are important. Besides enhancing the mobilization of savings by first financializing it and channeling them through financial institutions, it also creates the basis for specialization. As pointed out by a large number of researches, non-monetized savings inhibits economic development. In this regard, the following, albeit lengthy quotations aptly underlines the imperative of financial development;

[from] a policy point of view, the path to economic development in a society of ... subsistence production units lies to a very large extent in increasing the level of participation in the monetary economy, for only with the catalysis of money do the full advantages of specialization, division of labor, and large-scale capital formation, upon which most economic development depends, becomes accessible. (Fisk 1975: 75-75)

Financial structure could be measured in a variety of ways including the ratio of financial assets to the national wealth; the distribution of financial assets and various financial instruments; the number of different types of financial institutions – banks, capital and money markets etc; the share of all financial institutions in the total financial assets; among others.

In general the higher the ratios and the number of differentiated instruments and institutions, the more developed is the financial sector. The table below provides an indicator of financial depth in an economy

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Table X.18
Ethiopia's Financial Structure: (as % of GDP)

	1970	1980	1990	1998
Currency	7	13	15	11
Demand Deposit	2	5	13	14
Money Supply (M1)	10	19	30	21
Quasi Money	4	7	11	19
Money Supply (M2)	14	26	40	39

Source: Calculated from NBE, Quarterly Bulletin, various years.

As a country's financial development advances, the currency ratio should decline while the other components increases, since more transactions are mediated through financial institutions, thus reducing the need for cash. In the Ethiopian case currency outside bank is very high, as shown in the table above.

A second indicator is the level of monetization in the economy. In Ethiopia, the share of the non-monetized sector to GDP is high estimated at 30% in recent years.

A third indicator of financial development is the size of the money multiplies. As financial institutions expand and banking tradition is well entrenched, the larger would be the share of deposits and credits in and through financial institutions. This behavior of the general non-banking public would increase the money-creating capacity of financial institutions thus increasing the money multiplies. In the Ethiopian case the money multiplies averages about 1.5 implying that the money creating capacity of the banking system is only 0.50 out of each Birr.

Yet another crude measure is the demand for currency in the economy, which averaged about 60% of narrow money and close to 50% of broad money.

Another indicator of financial underdevelopment is the near-absence of alternative instruments available to wealth owners. Although the treasury bills market has recently been opened to any person and lowered the portfolio to a minimum of 5000, people have no choice other than currency and bank deposits as a store of value.

The import of the discussion in this section is that the level of financial development is very low and needs focused and targeted drive to quicken the pace. The more the money that is outside the financial institutions and the lower the level of monetization the smaller the volume of savings mobilized to enhance investment.

SEMI-FORMAL AND FORMAL MICROFINANCE*

1. INTRODUCTION

In Ethiopia, semi-formal finance is mainly made up of services rendered by saving and credit associations (SCAs) or credit unions and credit schemes conducted by NGOs. The chapter will discuss these two types of semi-formal finance in the country.

2. SAVING AND CREDIT ASSOCIATIONS (SCAs) IN ETHIOPIA

2.1. Historical Background

The SCA movement was started in Ethiopia in 1964. The Ethiopian Airlines Workers' SCA was the first to be registered followed by those established by the employees of Ethiopian Roads Authority, and Telecommunications Agency.

The SCAs were granted legal status by the Cooperative Societies Proclamation Act No. 241/66 issued in 1966. The then Ministry of Community Development and Social Affairs was given the responsibility of registering SCAs while the Ethiopian Thrift and Credit Cooperative Society (ETCCS) was to promote the development of SCAs. The proclamation had a built-in provision of gradually building up and converting the SCAs into credit union banks. However, following the 1974 revolution, a number of changes were made to their status and operation. The 1976 Monetary and Banking Proclamation No. 99/76 and later the 1978 Cooperative Societies Proclamation No. 138/78 annulled the previous proclamation and created a new arrangement.

* Editors are grateful to Ato Mengistu Bediye who prepared the background paper for this chapter.

As per the latter proclamation, an organ responsible for promoting and registering SCAs was established under the National Bank of Ethiopia. This organ was named Savings and Credit Cooperatives Development Office (SACCCDO) and was to undertake activities such as providing model by-laws, auditing accounts of SCAs and overseeing that they operated as required by and in accordance with the proclamation and regulations issued by the National Bank of Ethiopia.

2.2. Role and Significance of SCAs

A credit union is defined as "a cooperative financial organization owned and operated on a not-for-profit basis by its members according to democratic principles". Its purpose is to encourage savings, to use pooled funds to make loans, and to provide other related services to members and their families. A credit union is part of a cooperative financial system and adheres to the operating principles of credit unions as set forth by the World Council of Credit Unions.

The 1978 proclamation indicates that thrift and credits cooperatives may be formed by individuals working in one undertaking or office for making regular savings and to provide credit for individual needs and for productive purpose.

To promote SCAs in the country in accordance with Proclamation 138/78, SACCCDO provided information on how to organize SCAs. SCAs are formed with a minimum of twenty persons having common occupation, residence or profession. A three person "Formation Committee" prepares the by-laws and invites a SACCCDO organizer to witness the formation of the SCA. Once organized the SCA gets official certificate of registration from SACCCDO after three months of probation and evaluation period.

How the SCAs are organized and managed determines their significance in terms of promoting thrift among the people. Their role and significance are also determined by the extent to which they adhere to international SCA operating principles which include:

- Democratic structure that involves open and voluntary membership, without non-discrimination.
- Service to members so that services and distribution of benefits to members and financial stability are achieved.
- Social goals which improve on-going education on saving, cooperation among cooperatives and social responsibility.

In addition to promoting thrift and hence serving as instruments of savings mobilization, they are expected to improve members' knowledge about the importance of banking services. By allowing members to have access to their credit services for purposes of economic significance, they also encourage the development of financial management skills and hence entrepreneurial skills.

Another major role SCAs are expected to play is the creation of linkages between formal and informal sectors. For instance, idirs have been observed to be linked to SCAs by depositing their funds with SCAs which in turn deposit same with banks (Dejene, 1993). Further, there are attempts by the formal sector to sell insurance policies to SCAs which try to create their own insurance system (Dejene, 1993). There is also a belief that SCAs can serve the growth of informal sector operators into the formal sector. Informal sector operators can benefit a lot if they try to mobilize saving and establish small enterprises by forming SCAs (Dejene, 1993).

2.3. The Spread of SCAs

SCAs in the country are dominantly spread over eight regions while there are also SCAs that SACCDO categorized as non-regional cooperatives. The available data for the categorization of SCAs by region are for the year 1996. Table XI.1 provides the spread of SCAs in the country.

What one can easily understand from Table XI.1 is that SCAs are highly concentrated in urban areas thus indicating the bias against rural areas hosting the majority of the country's population. More astonishingly, over half (53%) of the SCAs and about 72% (nearly $\frac{3}{4}$) of the SCA members were concentrated in Addis Ababa implying that the history of SCAs in Ethiopia is rather the history of SCAs in one city. Hence, future research work on SCAs in Ethiopia need to take into account such kind of anomaly and find ways and means in and through which they could be spread around the country.

TABLE XI.1

Statistical Position of SCA's affiliated with SACEDO by Region (as of June 30, 1996)

Region	Coops.	As % of Total	Members	As % of Total	Savings (Birr)	Loans (Birr)	Reserves (Birr)	Assets (Birr)
Tigray	5	0.87	485	0.38	158,537	123,781	2,810	155,833
Afar	8	1.38	1,110	0.88	488,732	311,245	12,517	553,663
Amhara	61	10.55	5,973	4.62	4,450,300	2,760,187	110,513	4,867,765
Oromia	94	16.20	20,238	15.68	12,580,133	8,710,935	303,698	14,797,147
Somalia	2	0.35	265	0.20	179,192	150,293	5,181	206,045
Southern Region	34	5.88	3,915	3.03	492,299	1,678,860	56,710	2,684,485
Haren	7	1.21	1,046	0.81	806,490	658,140	19,553	913,145
Addis Ababa	305	52.77	92,414	71.52	104,587,846	104,181,816	8,857,822	143,559,048
Sub-total	516	89.27	125,446	97.08	123,751,529	118,595,257	9,388,784	167,747,131
Non-Regional Coops	62	10.73	3,770	2.92	689,796	283,349	24,181	865,254
Total	578	100	129,216	100	124,441,325	11,887,806	9,392,965	168,612,385

Source: SACEDO, 1996 and own computation.

2.4. Performance of SCAs

The performance of SCAs is evaluated on the basis of growth in the number of cooperatives and members, saving size, reserve and total assets. Table XI.2 provides the detail. The data in Table XI.2 are divided into two groups: before reform (1985-1991) and after reform (1992-1998).

As could be observed from the table, the SCAs have been increasing in number, membership, mobilized resources, loans, reserves and total assets, savings per person has also been on the increase.

However, in terms of growth rates most of the indicators show that the performance of SCAs was more dynamic during the pre-reform period compared to their post-reform activities. For example, the average annual growth rate in the number of cooperatives was 13% before the reform while it is 7% after the reform. Average membership growth rate was 19% before the reform but 5% after the reform. Contributions and savings growth rate was 32% before the reform but 10% after the reform. Outstanding loans growth rate was 33% before the reform but 9% after the reform. Total assets growth rate was 29% before the reform but 10% after the reform. Saving per member growth rate was 10% before the reform but 5% after the reform. The reserve growth rate before the reform was 31% and 18% after the reform.

Various reasons could explain the better performance of SCAs before the reform. The reason for faster growth before the reform may be partly because it was mandatory to organize or join cooperatives. Secondly, the need to finance investments including housing may have encouraged people to join cooperatives and save to get access to bank credit. Moreover, microfinancing by NGOs were limited in number, and in the absence of alternative means of credit or saving, SCAs were popular. Furthermore, the activism of SACCDO may have also contributed to the mushrooming of SCAs.

After the reform most of these factors were either non-existent and/or none operative. Saving for building houses was drastically reduced due to the difficulty of acquiring land. The increase in the cost of living has also contributed to the diminution of individual savings. Retrenchment and privatization induced lay-offs may have negatively affected membership growth.

Furthermore, the dynamism of SACCDO has been significantly reduced due to limited manpower and resources. This inhibited the growth of SCAs.

Other problems are related to policy (lack of government assistance and appropriate policy) and structural (limited capacity to save) reasons. In an attempt to address the major problems inhibiting the development of SCAs in Ethiopia, the Government is currently working on a new draft proclamation providing for the establishment of cooperative societies. SACCDO has been actively participating in this process which is expected to replace Proclamation No. 138/78. The new proclamation is also expected to create a more conducive environment that can expedite the growth of SCAs in the country.

There is also need to strengthen SACCDO with resources and organizational capacity. In addition, efforts have to be geared towards transforming SCAs into formal financial institutions through such methods as pooling SCA funds to form credit union banks in the long run.

Box XI.1

HIGHLIGHTS OF SAVING AND CREDIT COOPERATIVES

About 53% of registered cooperatives were found to be those located in Addis Ababa Region in 1996. Further, about 72% of total cooperative members in the country were found to be members of cooperatives in Addis Ababa Region. This situation indicates how credit cooperative dispersion is extremely biased towards urban areas thus leaving the much more needy rural population unserved.

The performance of saving and credit cooperatives as measured by average growth in number of cooperatives, membership, savings, outstanding loans, reserve and total assets has been found to be weak after the reform as compared to the performance prior to reform. For instance, average growth in number of cooperatives and membership size dramatically slowed down after the reform. Annual growth in number of cooperatives fell from 13% before reform to 7% after reform while average growth of membership fell from 19% before reform to 5% after reform.

TABLE XI.2
SAVINGS AND CREDIT COOPERATIVES IN ETHIOPIA: 1 JULY, 1986 - 30 JUNE, 1998

Year	No. of Coops	Growth Rate (%)	Member- ship	Growth Rate (%)	Contributions & Savings (Birr)	Growth Rate (%)	Outstanding Loans (Birr)	Growth Rate (%)	Reserves (Birr)	Growth Rate (%)	Total Assets (Birr)	Growth Rate (%)	Savings Per Member	Growth of Savings Per Member
1985	218	-	38166	-	12 970 879	-	12 561 829	-	861 672	-	19 239 557	-	340	-
1986	264	21	56 885	49	22 925 673	77	23 511 531	81	1 738 320	97	29 887 557	55	403	16
1987	309	17	63 540	12	23 300 011	2	23 644 390	0.5	1 676 556	(4)	30 332 813	2	387	(9)
1988	371	20	68 366	8	30 845 399	32	33 375 253	41	2 146 308	28	42 053 667	39	451	23
1989	419	13	98 973	45	50 406 195	63	52 104 599	56	2 173 738	11	69 926 742	66	509	13
1990	484	16	116 037	19	68 959 446	37	69 834 856	34	4 019 213	85	90 781 491	30	584	15
1991	485	2	119 799	2	78 712 710	14	79 919 665	14	4 497 197	12	102 168 244	13	658	13
Average Growth	-	13	-	19	-	32	-	33	-	31	-	29	-	10
1992	420	-	109 231	-	87 035 927	-	89 200 462	-	5 097 756	-	109 756 427	-	796	-
1993	426	1	101 299	(7)	86 105 842	(1)	87 474 898	(2)	5 484 551	8	112 286 156	2	850	7
1994	497	17	112 664	11	90 767 864	16	100 304 074	15	7 396 189	35	135 371 088	21	868	4
1995	522	5	116 119	4	111 173 060	11	93 582 753	(7)	8 163 965	10	150 707 746	11	950	7
1996	578	11	129 316	11	124 441 325	12	116 878 006	27	9 392 965	15	168 612 385	12	965	2
1997	620	7	147 302	14	159 865 849	26	148 491 188	25	10 989 767	17	196 132 447	16	1 088	13
1998	670	8	150 468	2	167 056 812	5	155 173 291	5	15 539 636	41	207 900 393	6	1 114	2
Average Growth	-	7	-	5	-	10	-	9	-	18	-	10	-	5

Source: SACCCO, 1998 and own computation.

3. CREDIT SCHEMES CONDUCTED BY NON-GOVERNMENTAL ORGANISATIONS (NGOs)

NGOs and their activities in the country grew in the wake of drought and famine that repeatedly struck the country in the past two decades. With a view to bringing about stability and improvement in the lives of the victims, many NGOs included in their relief works schemes of saving and credit aimed at creating employment and generating income. A number of studies have been done on these schemes regarding the credit delivery model, performance, impact and sustainability. Some of them are reviewed in the paragraphs to follow.

3.1. Review of NGO Credit Schemes

United Nations Development Program was among the donors that provided for the initiation of NGO based credit scheme. Recently it sponsored a study on five credit and saving schemes sponsored by NGOs.

One of the studies was conducted in Channo Millie rural community, North Omo Zone, Arba Minch Zuria Woreda in SNNPR with the participation of the Regional Bureau of Agriculture. Very interesting findings were observed for example as originally planned, the credit delivery system was to have selected beneficiaries by the community credit management committee composed of peasant association representatives, development agents and elderly members of the community. However, the actual selection process was made by development agents indicating significant departure from the original design.

Although the scheme was planned to promote women's participation, their participation was found to be weak because of 25% start-up capital requirement, which was they were unable to raise and so limited their participation. The other observation of the study was that although Bureau of Agriculture helped in financial management, development agents were involved in loan collection, which created opportunities for fraud. In addition, although there was no loan ceiling, the level of loan (carrying 10.5% interest) made available was found to be inadequate.

The second case reviewed was the one conducted in Debre-Zeit in Oromiya Region by Bureau of Labour and Social Affairs. The scheme involved 62 beneficiaries the selection of whom was based on wealth ranking and behavioural assessment by

Kebles. The target beneficiaries were women. Here again, 25% start-up capital was required.

Loans (ranging between Birr 600 and 800) were granted interest free for one year. Compulsory as well as voluntary savings were involved. However, problems associated with the scheme abounded, the most important of which was its sustainability because no interest was charged on loans.

The third case was conducted in the Amhara Region, Arba Amba community by Bureau of Agriculture. Selection of beneficiaries was conducted by development agents. Loan size was up to Birr 20,000 to co-operatives and Birr 500 to individuals. Like the other schemes this scheme also had some drawbacks. To mention a few, no emphasis on women participation, low community participation because of 25% start-up capital requirement, no follow-up and enforcement of loan repayment, questionable sustainability because of lack of long-term plan and interest free loan granting.

The other case we have at hand is the one carried out in Amhara Region by the Amhara Rural Credit Society in Amba Ghiorgis Town. The selection process involved participation of the credit society and woreda and local government screening committee. The scheme gave preference to women and the poor i.e. those with one or no ox. Loans (ranging between Birr 100 to 500) were granted bearing interest rate set by the National Bank of Ethiopia. Community participation was found high in the selection process. High repayment performance was also observed. Because of professional management of the scheme, sustainability was reported to have a better chance.

The fifth case reviewed by the UNDP study was that of SOS Sahel (an international NGO) conducted in Dada Kari Community, Kindo Koisha Woreda in SNNPR. The scheme was run in collaboration with Farm Africa and was based on the guideline of SOS for operation. Selection was based on community participation and wealth ranking, the poor given preference. In addition, a 10% down payment was required for eligibility. Compulsory saving was in place while loans ranging from Birr 100-900 were granted at interest rates ranging between 3% and 10%. Since the scheme involved no long-term plan and was based on subsidy, its sustainability was found to be questionable.

A sixth study of NGO sponsored credit and saving schemes to be reviewed was conducted by Hailu Wondafrash (1994). Eighteen NGOs were approached for

information on their credit schemes. Ten were engaged in both urban and rural areas, two in rural areas only and six in urban areas only. Those in rural areas were to support agricultural productivity and those in urban areas directed their schemes at financing petty trade, services and production activities. Most gave priority to women and the poor. Though some used revolving credit facility and savings of the target group, loanable funds were dominantly dependent on donor funds and allocations by sponsoring NGOs. The sponsors included UNICEF, USAID, OXFAM-UK, German Technical Assistance (GTZ), Overseas Development Agency (ODA – UK), Swedish International Development Authority (SIDA), ACTIONAID-Ethiopia, Norwegian Save the Children (Redd Barna- Ethiopia), Concern, Swedish Save the Children (Radda Barnen), Christian Relief and Development Association and Agricultural Co-operative Development International.

Most of the NGOs implemented Grameen Bank credit delivery model. All used integrated approach in implementing their schemes that involved training, marketing and provision of new techniques. All used group pressure and sanction for enforcing loan repayment. A few required guarantor and provided credit guarantee schemes in addition. About 50% of the NGOs also benefited from the help of SACCDO in organizing their target groups.

The loan size extended by the NGOs varied greatly. The minimum was Birr 5 per month by Redd Barna – Ethiopia and the maximum was Birr 10,000 by CPAR, Ethiopian Women Entrepreneurs Association and ACTIONAID- Ethiopia. Most, however, ranged between Birr 500 by Redd-Barna-Ethiopia and Birr 5000 by Hope Enterprises.

Regarding the sustainability of their schemes, the NGOs gave varied answers. Very few were confident about the sustainability of their schemes while a large number (about nine) said there would be fair chance of sustainability if future support from SACCDO and Ministry of Agriculture would be strong. On the other hand, about five expressed their reservation about the sustainability of the schemes. Most of those optimistic about their future were local NGOs.

Another study that made an assessment of the performance of some NGO-sponsored credit schemes was conducted by Hadas Wolde Giorgis and Tadesse Abadi (1997). The study is based on schemes conducted by two NGOs, namely, Irish Aid and Redd Barna-Ethiopia.

Irish Aid sponsored credit schemes (starting from 1994) in East Tigray Zone, Gurage Zone and Sidama Zone. The credit delivery model used was Grameen Bank type which emphasised group pressure. As a result, default rate of loan granted at a rate of 15% was minimal. Repayment was 97% in Sidama Zone, 99% in Gurage Zone, 93% in Tigray. The fund was made available by Irish Aid but saving by beneficiaries was also encouraged. Before taking loans borrowers were required to deposit 10% for four weeks. The important point in this credit scheme is the decision by Irish Aid to help assist and transform it into a formal micro-financing institution.

The Redd-Barna credit schemes (started in 1988) lacked clear and standard set up of operations. Both group and individual membership were used. It sponsored credit schemes in Addis Ababa, Woreda 23, Kebele 16, Debre Brehan and Wolayita. The one in Addis Ababa was registered by SACCDO and prepared its own by-law. It had 98% repayment rate. The one in Wolayita was also successful. Saving was also encouraged by Redd Barna, paying 8% interest rate on savings while loans were charged 10.5% - 20%.

Both sponsors emphasized women empowerment, community participation, and poverty alleviation. There was, however, problem of sustainability in schemes run by Redd Barna because it decided to withdraw unexpectedly. For example, the scheme in Debre Berhan is on the verge of collapse because of the withdrawal of assistance.

On the other hand, Irish Aid's decision to transfer the scheme in Sidama to local people to form a micro financing institution with its help was commendable. Redd Barn has also accomplished one notable deed. It was a pioneer organizer (in 1994) of efforts to establish an independent micro-finance institution named Specialized Financial and Promotional Institution.

World Vision Ethiopia is also among the NGOs that have been conducting credit and saving schemes in the country. It introduced revolving loan scheme in 1989 for agricultural inputs and income generating activities. Peasant associations screen beneficiaries of loans which were mainly in kind and varying in value between Birr 50 and 2,500, while selection was by the general assembly of peasant associations. Saving was also encouraged before taking loans carrying interest set by National Bank of Ethiopia. Five percent of loan taken had to be saved. Assessment report on the scheme was not possible to obtain for inclusion in this study.

ACTIONAID-Ethiopia's credit scheme in Dalocha was another scheme that had been studied. The study was done by Abebe Shimeles (1998). Susan Johnson (1997)

also commented on the scheme. The scheme was in a community highly vulnerable to drought. Membership was mixed (both men and women) and selection was based on wealth ranking targeting the bottom poor which resulted in selecting totally destitute and physically incapacitated. Saving was compulsory and loan size varied between Birr 190 and Birr 900. The scheme had, however, problems. Repayment problem was serious (Johnson, 1997). Beneficiaries worried less to repay since the sponsor was an NGO which might leave the area any moment. Other reasons for weak repayment were that loans were granted before full recovery of previously disbursed ones, monitoring system was weak, borrowers were inadequately prepared for the loans (Berhanu Workineh, 1997). Sustainability of the scheme became difficult in such a situation.

The other notable credit scheme in the country is that sponsored by Relief Society of Tigray conducted under the name Rural Credit Schemes of Tigray. Ibrahim Abdullahi (1996) briefly reviewed the scheme. Loans granted under the scheme ranged between Birr 50 and Birr 2,500 and were short-term in nature. The credit delivery model employed was similar to the Grameen Bank. The scheme strongly encouraged local participation which also resulted in high loan recovery rate of 97%. This scheme has recently been transformed into a formal micro-financing institution.

3.2. Lessons Drawn and Problems Encountered

The review of the NGO sponsored schemes undoubtedly highlights major features of the schemes in terms of targeting, selection, performance and sustainability. Most of the schemes reviewed have common features. Most used Grameen Bank type of credit delivery and repayment enforcement (i.e., through group pressure). Most emphasized women empowerment, community participation to some extent, and proved that the poor could take care of their destiny successfully if given a chance through such methods as credit provision. They paved the way for transformation of simple credit and savings schemes into formal micro-financing institutions as witnessed by the recent formation of micro-financing institutions originally initiated and sponsored by NGOs previously.

As discussed in the preceding section, the schemes had some problems. Ibrahim (1996) outlines some of the major problems associated with the implementation of the schemes. They did not follow sound banking and business practice and some time distorted financial resource allocation and hence their sustainability became questionable. This was partially attributed to lack of professional staff capable of

providing business and marketing advises. In this regard, Fuglesang (1994) citing a Sri Lankan experience of savings and credit scheme underscores the need for restricting the job of NGOs to providing every support to the successful implementation of micro-financing institutions by leaving the actual banking job to professionals experienced in the field.

The other major problem of the schemes that NGOs themselves admit is that they lacked long-term objectives as a result of which their prospect for expansion turned out gloomy. As they heavily depended on donor funds and charged no interest or interest rates mostly below inflation rate (Ibrahim, 1996) their sustainability became questionable.

The success of the local NGO schemes is, however, commendable as witnessed by their transformation into formal micro-financing institutions. The efforts of some international NGOs are also commendable for contributing to the sustainability of their schemes by handing over to local people for transformation into formal micro-financing institutions.

4. FORMAL MICRO-FINANCING

4.1. The Ethiopian Micro-Financing Experience

Although providing credit to rural agricultural households for purchase of agricultural inputs and tools has been practised by the country's major state-owned banks (including Development Bank of Ethiopia (DBE) and Commercial Bank of Ethiopia), credit schemes targeted at the urban or rural poor were non-existent until recent years when NGOs started providing credit to poor households in some parts of the country.

It was obvious that this gap needed to be bridged with a new approach and initiatives started to flourish to this end in the 1990s. In 1990, an urban micro-financing scheme was initiated on a national scale with a credit agreement signed between the Government of Ethiopia and the International Development Association (IDA). The credit scheme aimed at financing the Market Towns Development Project, planned to improve infrastructure in

towns considered market and service centres for the agricultural hinterland and to alleviate poverty problems in selected urban areas of the country through employment generation and income enhancement. The employment generation and income enhancement component of the project was originally planned to be implemented in sixteen towns. The number of towns has currently grown to fifty-nine and is expected to increase in the future.

The experience from this pilot project is believed to provide evidence on the importance of credit provision to the poor using the group-based lending. The details of this project are discussed below.

4.2. The Pilot Credit Scheme

The credit scheme was first planned to be implemented by the Agricultural and Industrial Development Bank now called the DBE and Handicrafts and Small Scale Industries Development Agency. However, following change of government in 1992, the responsibility of the latter (which was dissolved as a result) was transferred to regional trade and industry bureaux. Because of the unfavourable environment that prevailed in the country during the early 1990s the actual implementation of the scheme was started in 1994. The first sixteen towns selected for implementation included Assela, Wolliso, Shashemene, Mizan Teferi, Goba-Robe, Arsi-Negele, Ambo, Zeway, Bahir Dar, Awassa, Debre Brehan, Bedele, Woldia, Assebe Tefed, Debre Tabor, and Arba Minch. Thereafter, the project towns have increased to fifty-nine.

4.3. The Credit Delivery Model

The model heavily draws on the experience of Grameen Bank. Targeting beneficiaries is based on the stipulations of the credit agreement signed between IDA and the Government. The agreement stipulates that at least 50% of the beneficiaries be women and households with a monthly income not exceeding Birr 50. However, the latter criterion had to be changed because of the devaluation that followed the reform in the country. As a result, households with monthly income below Birr 100 or 200 (depending on the situation in a specific town or region) were also included into the scheme.

The responsibility of screening, promoting, organizing and licensing micro-enterprise operators in co-operatives consisting of members not exceeding 30, rests with regional (with their respective zones and woredas) trade and industry bureaux. The bureaux have to prepare business plans for every member of the co-operatives. The DBE then extends loans to those organized accordingly. Individual borrowers are required to deposit 10% of loans received as part of credit guarantee and saving schemes. The maximum loan size grew from Birr 1000 at the beginning to Birr 5000 currently. For loans above Birr 2000, co-operative membership is required for eligibility and additional appraisal technique is used by the organizers.

4.4. Coverage and Performance

According to information from DBE, the scheme now covers four regions: namely, Amhara, Tigray, Oromiya, SNNPR. The fund is made available by the government and IDA. While the former contributes 20%, the latter covers 80% of a loan to a micro-entrepreneur. Accordingly, up to end of 1997, IDA made available Birr 13.8 million while DBE contributed Birr 3.5 million. In total Birr 17.3 million was made available. This fund is required to revolve. With the revolving size of fund, the total loan amount disbursed to over 34,000 beneficiaries from commencement of the scheme in 1994 up to December 31, 1997 amounted to Birr 50.2 million. 11.7% was disbursed to micro-enterprises in Tigray, 52.6% in Amhara, 21.8% in Oromiya, and 13.8% in SNNPR.

The reported recovery rate for 1996/97 was 92%. Over 65% of the beneficiaries are women. In addition to these good performance indicators, the scheme has also improved its outreach over the years and has increased the size of loan made available to an individual borrower from Birr 1000 to Birr 5000. The other important feature of the scheme is its success under a situation where two independent bodies (DBE and Regional Trade and Industry Bureaux) successfully co-operated to implement the scheme.

4.5. Project Impact

Kassa Wolde-Senbet (1998) conducted an impact assessment of the scheme in SNNPR covering 2,582 respondents. The scheme improved the beneficiaries' level of income, consumption of clean water, electric light and telephone, and provided

employment for family members. Medical expenses of one round borrowers, for example, increased by 39% and that of two round borrowers by 7%. The income level of one round borrowers grew on average by 53% p.a., that of two-round borrowers by 24% p.a., and that of three round borrowers by 14% p.a. In general, the scheme is said to have done a lot in contributing to the reduction of urban poverty in the project areas.

4.6. Lesson Drawn and Problems Encountered

The scheme has been successful on the main. It provides additional empirical evidence on the success of group based lending and on the promising prospect for a specialized micro-financing institution in Ethiopia. There have, however, been some minor problems related to co-ordination and organization of beneficiaries. Because of misunderstanding between the two implementing bodies in some project towns there were minor implementation problems that resulted in delayed disbursement and hence repayment inconvenience. Some organizers also happened to come up with weakly organized co-operatives. Most of the problems were related to lack of experience and training. Overall, the problems never got out of control. But in the future the scheme needs to be handed over to a specialized micro-financing institution in various regions to avoid the intricacies of co-ordinating two independent implementing agencies and thus reducing cost of implementation (Mengistu, 1998).

With the pilot credit scheme and others implemented by NGOs, the ideals of micro-financing seem to be taking root in the country as witnessed by the Government's issuance of the proclamation providing for the licensing and supervision of micro-financing institutions in 1996. As a result of this proclamation seven micro-financing institutions have been established up to Hamle 30, 1990 E.C. The institutions include:-

1. Amhara Credit and Savings Institution S.C.
2. Gasha Micro-Financing S.C.
3. Omo Micro-Finance S.C.
4. Oromia Credit and Saving S.C.
5. Specialized Financial and Promotional Institution S.C.
6. Dedebit Credit and Saving Institution S.C.
7. Wisdom Micro-Financing Institution S.C.

According to the proclamation, micro-financing institutions are established by

Ethiopian nationals as a share company. The minimum paid-up capital required is Birr 200,000. Based on group guarantee, the maximum loan extended to a borrower at one time shall not exceed Birr 5000 while the maximum loan repayment period shall not exceed twelve months. The Ministry of Finance is empowered to determine the period, manner and condition of exemption of micro-financing institutions from income tax.

It would have been interesting to include a review of the performances of these institutions. However, for lack of data at the time of writing, this critically important component has not been evaluated nor discussed in detail. Future reports and researches, with the cooperation of these and similar institutions, would hopefully appraise their operations with the objective of assisting their efficiency.

INFORMAL FINANCE*

1. INTRODUCTION

Informal finance, although difficult to define, refers to intermediations that take place outside the country's banking and financial institutions. This is in contradistinction to those that are governed, supervised and regulated by and through these regulations and referred to as the formal and semi-formal financial institutions.

The problem with the informal finance transcends the definitional realm and extends to the nature and characteristics of the market, organization and management and the volume of financial transaction it involves. What has been written on this sector often paints a partial picture and is based on speculation and guesses.

While the volume of transaction and decision making process may be difficult to gauge because much of it is based on interpersonal relationships, one cannot deny its crucial importance. Roughly speaking, its importance is inversely correlated with the density of the formal financial institutions and the ease and efficiency of getting credit from them. The smaller the density and/or the more difficult and time-consuming the process of acquiring credit from the formal institutions, the larger would be the informal sector.

In the Ethiopian context, the conjuncture is that informal finance is very important and that the volume of transaction exceeds that of the formal financial institutions. The justifications behind this proposition are the two factors identified above i.e. thinness of the formal financial institutions that has left out the vast majority of the population as well as the inefficiency inherent in the process of acquiring credit.

Transaction costs and policy do also impact on the vibrancy of the informal market. The former includes prohibitive formalities including written forms, pictures and the gamut of requirements.

*The editors are grateful to Ato Mengistu Bediye who prepared the background paper for this chapter.

Even the imposing bank buildings are found to be intimidating to the humble city dwellers let alone to rural residents. With respect to the latter, the exclusionary policies in terms of excessive collateral and the totality of government directives have important repercussions on the dynamism of the informal sector. For example, informal finance must have seen its most dynamic growth during the Derge Regime when the private sector was more or less excluded from the credit facilities of the formal financial institutions. Periods of draught, tight monetary policy, and rising unemployment also impinge on the operations of the informal financial institution.

2. ORIGINS OF INFORMAL FINANCIAL MARKETS

The literature on the origins of informal financial arrangements lays emphasis on two schools of thought—the financial repression school and the structuralist school. The financial repression school opines that informal financial markets evolved as a result of excessive regulations of the formal financial system. These regulations include use of directed credit, interest rate ceilings, and discriminatory credit allocations by government (Germidis, 1990). As a result, small savers and borrowers lose access to formal financial institutions, real interest rates are negative, too many and complex procedures, and insensitiveness to the deposit or credit needs of the small savers and borrowers. This creates the need for an alternative financial arrangement.

The structuralist school attributes the origin of informal financial arrangements to motives that transcend the purely economic factors (Hugo, 1990). According to this school, dualism in the financial markets is ascribed to the populations attachment to traditional models of behaviour.

Although both schools of thought do explain the origin and durability of informal financial systems in Ethiopia, the structuralist school seems to be closer to tracing the beginnings as well as its sustaining factors but neither provides a wholesome explanation.

The sustainability of the informal financial arrangement, other than its traditional and cultural base, owes a lot to the thinness of formal arrangements, their inefficiency relative to the informal and red tape as well as the general barrier they imposed between themselves and the general public.

3. INFORMAL FINANCIAL INSTITUTIONS IN ETHIOPIA

Although the participants in informal financial activities could be stretched from an individual marketing occasional loan or accepting deposits for safe keeping, the commonly observed and acknowledged market players are money-lenders, friends and relatives and traditional arrangements such as *iqqubs* and *idir*s.

3.1. Money-lenders

The two major forms of informal finance that attract attention in Ethiopia are *iqqub* and *idir*. They derive their importance from their capacity to meet the participants' social needs in addition to their significance in terms of saving mobilization and risk insurance. They overshadow the importance of other sources of informal financial arrangements including money-lenders. For instance, in the urban informal sector sample survey conducted by CSA (1996), only 1.3% of the respondents indicated that they obtained loans from money-lenders usually referred to as "*Arata Abedan*".

Though money-lenders have been the only sources of loans until the turn of the 20th century in the country, they have been held with disdain and contempt by the society, religious organisations and government and regarded as usurious (Dejene, 1993). Consequently, they carry out their activities under cover and secrecy. For example, no information on financial dealings are divulged neither on the rate of interest they charge nor on the volume of transaction they undertake (Dejene, 1993).

A recent survey by MoLSA (1997) on "Agricultural Wage Employment and Rural Non-Farm Employment in Ethiopia" has produced average interest rate paid by various types of lenders. Table XII.1 shows the survey results on interest rates paid by borrowers (respondents).

Although the information in Table XII.1 must be used with caution, interest rate charged by money-lenders varies from place to place and is the highest (57%) in Tigray and lowest (19%) in Amhara. The total average interest charged by money-lenders is not that much exorbitant as usually thought when compared with the other rates. For example, it is lower than that charged by lenders categorized under "others". Also, the difference between those charged by *idir* or local groups are not wide enough to label it excessive. However, Mauri (1987) found that interest rate

charged by money-lenders varied from 24% to 900% per annum.

Table XII.1
Average Interest Rate Paid Per Annum By Type of Lenders (%)

S No.	Lender	R e g i o n				Total
		Tigray	Amhara	Oromiya	SENNP*	
1	Money-Lenders	56.70	19.31	42.16	42.92	31.97
2	Friends/Relatives	6.67	7.93	6.69	19.49	11.25
3	NGOs	7.03	24.82	7.61	7.84	9.40
4	Idir or Local Groups	6.31	31.69	16.33	30.40	26.65
5	Banks	9.68	13.99	8.00	-	10.25
6	Others	2.00	34.61	-	5.31	32.49

*Southern Nations Nationalities and Peoples' Region

Source: Ministry of Labour and Social Affairs, 1997

Mauri (1987) also indicates that the activities of money-lenders managed to flourish in towns during the Derge regime. This is most probably due to the policy that severely restricted the private sector to access formal finance. This must have also been due to the money-lender's flexibility, simplicity and secrecy.

3.2. *Iqqub*

Iqqub is an Ethiopian name for ROSCA. Its origin is traced back to the period of the Italian occupation of 1936-41 during which people had to find their way out of war insecurity and intricacies of urbanization and to have a medium through which they could save money and raise resources (Pankhrust and Endreas, 1958; Alemayehu, 1969; Dejene, 1993). It is formed on the basis of pre-established social ties (Dejene, 1993). As is the case with ROSCAs in many developing countries, *Iqqubs* involve homogenous groups constituted by members either from the same workplace or same ethnic background or same profession, or same neighborhood (Dejene, 1993).

Iqqubs are not limited by level of income or wealth nor residences. They are found in both rural and urban areas. More surprisingly, people with access to formal bank credit also make use of *Iqqub*. The reasons for people's tendency to use *Iqqub* are outlined by Mauri (1987) and include easy access to credit, although there is an

implicit opportunity cost on those that have their turns far into the queue.

Iqqubs are not limited by income level and involve people from all walks of life. But this does not mean that people of various income levels and/or different social ties join the same *Iqqub*. It is unusual to expect a rural resident farmer to join the *Iqqub* of urban traders. Furthermore, there is conspicuous differentiation in the basis of wealth and income as well as profession. Dejene (1993), for instance, identifies small-traders' *Iqqubs* and big-traders' *Iqqubs* in Ethiopia. He observes that small-traders' *Iqqubs* are common for the informal sector while big-traders' *Iqqubs* are strongly related to banks. He further notes that big-traders' *Iqqubs* are market (business) oriented, more institutionalized (formalized) and hence involve higher transaction costs and have developed sophisticated ways of compensating late collectors of *Iqqub* fund, still maintaining cultural appropriateness.

In his study about informal and semi-formal financial sectors, Dejene (1993) also outlines the features of *Iqqubs*. They have written by-laws that define procedures and duties of participants (bringing two guarantors when they win the *Iqqub* fund). They have an organizer (chairperson) and a secretary. They also provide for setting conditions of getting priority in collecting *Iqqub* fund. For instance, making early collectors (without winning lot) pay premium or giving priority to those in trouble free of charge.

In addition to confirming that *Iqqubs* make economic sense, they are good starting points for savings mobilization in rural areas and are characterized by timeliness, flexibility, self-discipline and collective action. Dejene managed to come up with interesting findings. They include: steady economic growth (market economy) and employment contribute to *Iqqub* expansion; size of *Iqqub* is related to transaction costs (large size *Iqqub* involves increased transaction costs); large size *Iqqub* is strongly related with banking system (e.g. depositing *Iqqub* money with banks); economic importance and formalization of *Iqqub* improves with its size; participation in more than one cycle is common.

These findings throw light on the possibility of using *Iqqubs* as intermediaries for mobilizing funds from the formal financial institutions and take advantage of their first-hand knowledge about the quality and characteristics of their members. Besides, the segmented nature of financial markets may be improved when financial flow between the informal and formal financial sectors increases as growing *Iqqubs* make use of much of the banking system facilities. This needs to be emphasized since the size of funds mobilized by *Iqqubs* is not something to be ignored. For instance, a rough

estimate by National Bank of Ethiopia (1995) puts the size of *Iqqub* mobilized funds at 8-10% of GDP.

3.3. Idir

Idir is also one of the forms of informal finance in Ethiopia. Though mainly meant for the burial of the dead when first started during the Italian occupation of 1936-41, it is a kind of an insurance scheme that goes beyond the burial of the dead to assist the bereaved financially and materially.

Here again, the contribution of Dejene (1993) in enriching the little researched *idir* is worth-mentioning. He identified four types of *Idir*:

- Community *Idir* (territorial) – members living in the same area;
- Workplace or occupational;
- Friends' *Idir* – former schoolmates, close friends;
- Family *Idir* – blood relatives;

One type of *Idir* (which can be fifth type) seems to be missing from the above list or does not seem to be explicitly stated in the list. The missing type is that formed mainly based on ethnic basis. This type is usually observed in urban areas where people with various ethnic backgrounds reside.

In general, *Idir* members make regular contributions (weekly, bi-weekly or monthly) that can be used during mishap to a member. *Idir* members have also been observed to participate in development programs such as road construction, school construction and public utilities (Dejene, 1993).

Unlike most *Iqqubs*, *Idirs* have strong relations with banks for depositing their money. This is due to their nature. Unless a member or his relative (depending on the provision of their by-laws) dies or there is a program the *Idir* wants to execute, *Idir* money may not be needed for use. Until such time, the money is kept at a safe place which are the banks in urban areas. Only petty cash to cover minor expenses are held by the treasurers. This practice also helps *Idirs* to minimize the risks of embezzlement. In this regard, Dejene (1993) notes that bank deposits per *Idir* member has been increasing thus evidencing the increasing integration of *Idirs* with the formal sector. Some *Idirs* have also reached a stage of being transformed into a formal insurance enterprises (Dejene, 1993).

A major strength and advantage of *Idirs* is that they involve no barrier to entry as any one fulfilling the requirements of an *Idir* (e.g. belonging to same area of residence, workplace, ethnic group, etc.) can in most cases join, regardless of level of income or wealth. Furthermore, they are culturally appropriate, flexible, easily accessible and cost-effective (Dejene, 1993).

Despite their strong relation with banks, *Idirs* have shown reluctance to join the Ethiopian Insurance Corporation's effort to integrate them with the formal sector. Nonetheless, their importance as intermediaries for mobilizing financial resource has been growing. A number of NGO's have, for instance, been using them to provide credit to the needy. A case in point is an NGO called ACCORD which has been using *Idirs* in Dire Dawa and Addis Ababa to grant loans to the poor. As observed by a staff member of the organization in charge of this program, loan recovery had been very high, but a major constraint the program faced was that the non-member poor were excluded since participants were strictly drawn from *idir* members. Furthermore, *Idirs* started charging additional fee (leading to corruption) when the poor who were non-members applied for membership and access loans.

Overall, the *idir* has been appreciated by NGOs and other microfinanciers as a possible instrument to reach the poor for the purpose of extending them credit.

3.4. Other Types of Informal Finance

Informal lottery is one resource mobilizing scheme that can be mentioned while discussing informal finance. It has become popular among petty traders and employees of various organizations. During major religious holidays, it has become common to observe employees of an organization organize a lottery. The prize may be in cash or in kind or both so that it can be used for the holiday festivities. Petty traders are also keen in organizing lottery at market places such as "Merkato" in Addis Ababa and recreation places such as *tej* houses, bars, etc. Participants like lottery because it involves huge return with a small amount of cost in addition to satisfying their gambling desire.

The other type of informal finance that is usually observed in Ethiopia is installment buying. Workers and traders also use this type of informal finance in meeting their credit needs. Workers may buy consumer goods, durable or non-durable, from shopkeepers with a pledge to pay at a later date. Petty traders and micro-enterprise operators also may buy some goods or raw materials from big traders on credit. The

eligibility for such kind of credit depends on usual screening techniques applied by the informal financiers, i.e., presence of first-hand knowledge about the borrower and fulfillment of other requirements set by the creditors.

Many more types of informal finance can be raised. For example, dining (by workers with low level of monthly salary) in a hotel on credit or with partial payment, giving a domestic animal to another farmer (in rural areas) with agreement to share the products of the animal while the responsibility of taking care of the animal remains with the receiving farmer, joining *mahbers* (social clubs) that are helpful to participants in various ways.

But the most ubiquitous informal finance schemes, such as money-lenders, family members, etc. play significant role in the mobilization and dispensation of financial resources. As pointed out in the beginning of this chapter, their activities are shrouded in mystery. Research to uncover these activities is long overdue.

What all these add up to is that the majority of the population of the country considered to be poor and living predominantly in rural areas do not have access to formal financial facilities as a result of which a fail-back is made on devising informal ways of meeting financial needs.

3.5. Size of the Informal Financial Market in Ethiopia

Because of the multiplicity and secrecy that shroud and cover the operations of the informal financial markets, it is near to impossible to measure the volume of financial transactions undertaken by the different market operators. However, it could be postulated that it is as big, if not bigger than, the formal financial institutions in the country.

On a purely conjectural basis, assume that Birr 10 is transacted either in the form of deposit or credit per capita per month. On the basis of this supposition, informal financial transaction was about Birr 7.2 billion in 1998. This estimate may seem to be on the high side but considering the fact that "even people living in poor areas save" (Dejene 1993) and borrow, this estimate may not be outlandish. Almost everybody, everywhere in the country, either saves with or borrow from the informal market.

The size of the informal sector activities can also be measured using a crude indicator represented by the ratio of currency outside banks to narrow money. Table XII.2 shows the trend of the size of the informal sector by this measure.

As shown in Table XII.2, the ratio of currency outside banks to narrow money showed an increasing tendency during the period before reform (before 1992/93) while it decreased during the reform period. This measure may be indicative of the alienation of informal operators from the formal sector during the Derge Regime while after the reform the ratio started showing a declining tendency, although it still remains very high.

Table XII.2
Size of Informal Sector as Measured by Ratio of Currency
Outside Banks to Narrow Money

Year	Currency Outside Banks	Narrow Money (Million Birr)	Ratio (%)
1987/88	1908.3	3910.8	49
1988/89	2181.8	4174.4	52
1989/90	2736.3	4990.0	54
1990/91	3817.4	6131.7	62
1991/92	4315.6	6845.1	63
1992/93	4685.0	7711.9	63
1993/94	5158.9	8373.2	62
1994/95	5843.3	9909.0	59
1995/96	5692.3	9561.5	60
1996/97	5236.6	10073.9	52

Source: National Bank of Ethiopia, Quarterly Bulletin, Vol. 12, No. 4
Fourth Quarter, 1996/97 and own computation.

Although currencies outside banks are the only medium of exchange in a country where alternative means of payment do not exist, they may also give a crude indication of the size of the informal finance since these must also be saved and used. It should of course be born in mind that the size of the informal sector remains speculative. The only sure thing that we can definitely say is that it is large.

4. LINKING THE INFORMAL FINANCE WITH THE FORMAL FINANCE

4.1. Importance of and Possible Ways of Links

The Ethiopian credit market remains highly fragmented. As a result, financial flows between informal and formal sectors are restricted as each sector serves only a distinct group of the society. Financial resource allocation is, therefore, inefficient because there is limited chance of mobilizing financial resources from one market to another.

Each financial sector has its own advantages. The formal sector has the capacity of providing large amount of funds to non-informal sector borrowers. However, it is reluctant to provide loans to the informal sector because it involves high transaction costs and problems of screening and enforcement are immense. On the other hand, the informal financial sector has the capacity of reaching market niches not served by the formal sector. For efficient utilisation of financial resources which are very scarce in developing countries like Ethiopia, the need for linking the two sectors is considerable since there is a substantial benefit in making use of the advantages of both sectors for the better. Besides, the negative effect resulting from absence of a link between the two markets outweighs the benefits from specialisation (Aryeetey, 1997). By forging links, therefore, it is possible to reduce the size of money that stays out of the hands of banks and is immune to the influence of financial authorities.

A number of ways of linking the informal and the formal financial sectors have been proposed by economists and policy makers. One way is through channelling the surplus in the formal financial sector to the informal sector operators who have a comparative advantage of reaching the vast majority of potential borrowers. This could be functionalized by providing credit to the semi-formal sector (on wholesale basis) and through it to the informal sector. If possible, direct selling of credit to informal intermediaries such as village money-lenders should also be explored. For instance, in the Ethiopian case, *Iqqubs*, *Idirs* and other self-help associations and SCAs can be used for this purpose.

Innovative schemes and the devising of new formal financial instruments are needed to integrate the formal and the informal. One way to do so is to engage money-

lenders and institutions such as *iqqub* and *idir* not only to provide loans but also to collect deposits. Moving banks in the form of bank vans to cover rural areas are also possible means to reach the under-banked rural milieu.

To enhance the linking efforts, governments are also required to pave the way by enacting policies and procedures that create a conducive environment. To avoid problems of stiff regulation of informal institutions, Popiel (1994) recommends a proactive approach "consisting of providing legal, regulatory, and prudential framework that fosters, and when possible, accelerates financial market development. This framework supports the setting up of mechanisms, institutions and instruments that promote and facilitate this development as the economy grows and market functions expand".

Banks could also be required to open branches in the rural areas for every branch they open in the more profitable urban centers.

Informal intermediaries need to be allowed to grow so that their integration with the formal sector improves. As witnessed by Dejene (1993), for instance, *iqqubs'* relations with banks grow, when they grow, thus facilitating the integration process.

Government efforts can also be geared towards helping the integration through fiscal incentives. It may be of benefit if fiscal incentives are given to formal institutions that allocate wholesale credit through semi-formal and informal agents (Aryeetey, 1997).

The informal intermediaries such as *iqqub*, *idir* and other self-help associations are regarded by many as good starting points to enhance the link between the two sectors or having the potential to evolve into a modern bank (*iqqub*) or insurance company (*idir*). Some NGOs have made use of these arrangements in credit provision to the poor.

SCAs can also be transformed into formal financial institutions if allowed to form credit union banks by pooling their resources together.

The Government has recognised the importance of the informal sector and consequently has made a number of moves to promote the sector. Proclamation (No. 40/96) providing for the licensing and supervision of micro-financing institutions

is one example. The other is the strategy being worked out to promote micro- and small-scale enterprises. Taking advantage of the above proclamation, about seven micro-financing institutions have indicated their willingness to graduate themselves into banks. In addition to the above, the Agricultural Co-operative Societies Proclamation issued in 1994 and a proclamation being worked on to provide for other forms of co-operative societies including SCAs can be of immense assistance in improving the integration process.

But, as observed in many areas of economic activity, the government's expressed intentions and what is actually observed are inconsistent. What is needed is a proactive arrangement where by legislative intentions and measures are transformed into reality.

Box XII.1**INTEGRATION OF THE INFORMAL SECTOR WITH THE FORMAL SECTOR**

Using a crude indicator of the size of the informal sector, a positive integration trend has been witnessed after the reform. The size of the activity of the informal sector may be measured by the ratio of currency outside banks to narrow money.

The ratio showed an increasing tendency before reform while it showed a decreasing tendency after reform thus indicating less and less money is kept out of the formal sector which in other words means the informal sector is coming closer to the formal sector more and more. This is a good achievement that the reform has brought about.

PUBLIC FINANCE AND FISCAL POLICY

1. INTRODUCTION

We are living in a world of scarcity. If resources were not scarce, we won't have economics as a discipline nor would there be economic choice since by definition economic choice is constrained choice. Accordingly, the soundness of an economic policy is evaluated in relation to its alternatives given the constraints under which it operates. One area of economic policy where the wish to do a lot by governments is seriously constrained by the availability of financial resources is the area of fiscal policy. Because of that, governments are usually forced to make hard choices about where to spend the resources they raised and what instruments they use to raise the resources they need for their various programs. In fact, most politicians, almost always, but particularly during election times, find themselves promising a lot of programs to their constituencies only to break them during budget negotiations because they quickly learn that they cannot possibly fund all of these programs even if they are convinced of their value. That is why economists usually suggest that if one wants to really know where the heart of a politician lies, one need to look at where he/she stands on the budget. In countries such as Ethiopia, a careful look at the government's revenue and expenditure policy usually gives a better clue at the government's overall intentions and direction more than official pronouncements about policy directions.

There is another reason why we need to take a close look at public finance. Since the Keynesian revolution in macroeconomics and the expansion in the role of government in the economy, government expenditure has become an important element in aggregate demand with serious implications on the macroeconomy of a country. In the Keynesian framework, activist policies justified the intervention of government on a number of grounds. First, free markets under-provide 'public' goods such as national defense, law and order, primary education, basic health-care services, infrastructure, and research and development. Second, markets can over-produce goods that impose costs beyond those borne by the producer such as traffic congestion, pollution, the depletion of natural resources, and so on. Third, the existence of monopolies, the lack of fully-developed markets and gaps in the supply of information may result in inefficient resource allocation and yield savings and investment rates that are less than optimal. Under these situations, it was presumed

that the market mechanism, left by itself, will obviously fail to produce sufficient growth and macroeconomic stability. Thus government intervention through the provision of public goods and services and public investment using taxes, subsidies and other instruments was justified to correct market failures.

On top of these, the existing situation of developing countries further justify the active participation of government. Developing economies were and still are characterized by underdeveloped physical and social infrastructure, low levels of savings and investment. To foster economic growth and break the vicious cycle of poverty, therefore, government has to provide the above mentioned basic services which are under-produced or not produced at all by the private sector. This, in effect, provides a rationale for a rapid expansion of public finance in developing economies.

This expansion has also taken place in Ethiopia in the last four decades with a more dramatic expansion in public finance following the 1974 revolution, particularly after the nationalization of private property. As intimated in earlier chapters, the government took the responsibility for the micromanagement of the economy leading to the broadening of the public sector and its responsibilities even much beyond what is recommended by Keynesian or even traditional development theory.

The neo-classical counter-revolution in economics, the economic problems faced by "*dirigiste*" regimes all over the world, particularly the increasing fiscal and balance of payment deficits in most developing countries, coupled with the victory of conservative governments in the late 1970s and 1980s which tilted development policy in favor of economic conservatism in multilateral financial institutions, all combined to question the validity of the expansionist policies of the Keynesian era. The excessively expanded public sector was partly blamed for the economic problems of the Third World because of its inherent inefficiency and the collapse of the socialist bloc lead to the crowning of fiscal conservatism and limited government intervention as the most prudent economic policy to follow for developing countries.

Nevertheless, in Ethiopia, government is still a major player in the economy and is likely to remain so for some time to come. This is basically because of the apparent dearth of infrastructures like roads, social services such as health-care services, schooling, and so on that are at present less attractive for the private sector. Furthermore, the generalized weakness of the private sector to play its leading role in the foreseeable future necessitates a more active role for the government in the economy. For all these reasons, government will remain important in the Ethiopian economy and hence, the need to understand its finance. We have, therefore, devoted this chapter to carefully look at Ethiopia's public finance and its trend over

the past sixteen years (1982/83–1997/98), extending nine years into the 'Derge' regime and seven years into the present government.¹

In the following pages, we will first review the fiscal policy of the country including the recent fiscal decentralization and its effect on government finance. The second section will look at trends in government revenue and expenditure in the reporting period. The following section looks at the magnitude of the public deficit, various mechanisms of deficit finance and their effect on the macroeconomy. The fourth section discusses the structure and trends in public debt and debt servicing in Ethiopia and the final section concludes the chapter by looking at the policy issues and challenges facing the country in relation to public finance.

2. FISCAL POLICY

Government and the private sector share the responsibility of producing goods and services and the allocation of resources, though the share of these sectors might differ from country to country. To perform the duties it assigns itself, the government need to raise revenue through taxation, and other discretionary measures. Fiscal policy refers to the policy of the government employed to raise or mobilize the necessary revenue, from whom to raise this revenue, to determine the burden of this tax on different groups of the society and finally to decide how to spend the revenue thus raised more rationally. In short, fiscal policy is the policy of government on taxation and expenditure management.

Because of the large size of its pocket, the government can deliberately manipulate its revenue (more specifically taxation) and expenditure (budget) to influence aggregate demand to maintain growth and stability in output, employment and prices. A sound fiscal policy, therefore, helps to stimulate economic growth, allocate resources to the best possible uses in the economy, redistribute income and wealth, and enhance effective mobilization of resources.

¹ The data source for the paper is mainly from published and unpublished documents of Ministry of Finance. The data for government finances (revenue and expenditure) are entirely collected from the fourteen annually published accounts of Ministry of Finance, "Annual Budgetary Revenue and Expenditure". Regarding public debt the data are again obtained from unpublished documents of Ministry of Finance particularly Credit and Investment Department. These data are compiled and analyzed in a paper by Netsanet Walegn commissioned for this report entitled "Public Finance and Debt in Ethiopia". The complete text and data of that paper is available from the EEA secretariat.

2.1. Recent Developments in Government Revenue Policy

Since the overall orientation of the Ethiopian economy during the Derge period was geared to expand the state sector even in the minutest of productions and deliberately discouraged the private sector, it would be meaningless to evaluate the government's revenue policy in terms of its rationality and its contribution to economic growth and efficiency. The disincentive effect of its income tax policy on the economically active population (a marginal tax rate that goes as high as 85%) and the total corruption of the whole system that this brought about are too well known to repeat here. We, therefore, concentrate on the changes that took place since the overthrow of the Derge for detailed evaluation.

Since 1991/92 a number of amendments on existing tax structures (e.g. personal income tax, corporate tax, and sales and excise tax) and new tax laws (e.g. mining income tax, capital gains tax, and rental tax) have been introduced. In general terms, all these measures basically aim at rationalizing the tax structure, broadening the tax base and reducing the marginal tax rates¹. It is also the government's hope, as stated in Ministry of Economic Development and Cooperation (1997), that these measures will stimulate economic growth, overcome fiscal imbalance and avoid economic inefficiencies.

Two amendments on personal income tax have been effected since the last amendment of Proclamation 173/1961 by Proclamation 155/78 in the previous regime. The first is Proclamation no. 30/1992 and the second Proclamation 107/1994. The first amendment introduced a number of changes over the income tax law of the previous regime. First, the level of monthly income free from taxation rose from Birr 50 to Birr 105. Second, the income brackets were reduced from 16 to 9. An important rationalization worth noting is, starting from the second income bracket up to the eighth bracket, the marginal tax rate increased by 5% on every additional monthly income of Birr 300. Third, the maximum marginal tax rate was reduced to 50% from a previous high level of 85%. The second amendment, Proclamation 107/1994, raised the untaxable income level to Birr 120, squeezed the income brackets to only 5 and reduced the maximum marginal tax rate from 50% to only 40%².

¹ A marginal tax rate is the tax paid on additional or incremental income. By definition, it is the increase in taxes paid divided by the increase in income.

² Refer to Annex A Table 1 and 2 for details on both proclamations.

The amendments by these proclamations enabled tax-payers to have more disposable income compared to that of the previous regime. In essence, they are sort of incentives for hard work for employees, particularly for those who once had been surrendering 85% of their income as tax. On the government side the impact of these amendments are obviously contraction in government revenue.

Proclamation 107/1994 also amended business income tax and tax on other profits. The profit tax rate for any organization except mining has been reduced from 59% to 40% on annual profit. This has been further amended by Proclamation 36/1996 which reduced the rate of business income tax to 35%. The intention here is to encourage investment while at the same time to minimize the incidence of tax evasion through reduction of tax rates and broaden the tax base to raise tax revenue.

With the view of broadening the tax base and increasing its revenue, the government has also issued new tax laws namely mining income tax, capital gains tax, and tax on rental income. Proclamation 53/1993 set a mining income tax rates of 45% and 35% of the annual taxable income of large-scale and small-scale mining license holders, respectively. The Mining Income Tax Amendment Proclamation 23/1996 reduced the income tax from large-scale mining activity by setting a uniform rate of 35% irrespective of size. In both these proclamations, artisanal mining is exempted from payment of any tax.

Proclamation 108/1994 introduced a more controversial new tax called capital gains tax. This is a tax to be paid on gains realized from the increase in the value of capital assets such as shares, bonds, and urban houses at a rate of 30%. Regional governments are entitled to impose an additional 10% tax. Aggregate annual gains of less than Birr 10,000 is exempted from such a tax. It is a controversial tax that has affected business transactions particularly in relation to the purchase and sale of houses considerably. Critics argue that the evaluation mechanism used for assessing capital gains is flawed, arbitrary, and exorbitant. Typically, the government does not accept the claimed purchase price. Instead, it does its own evaluation first and takes the largest estimate between its own estimate and the claimed transaction price. There are reportedly lots of transactions that were not consummated after the agreement between buyers and sellers was completed because of sellers' reluctance to pay the capital gains tax requested by the government. In a country such as Ethiopia where the most commonly held asset by a large number of people are houses, this is sure to have a negative effect on overall economic activity and is not clear if the expected positive effect on government revenue will be that significant compared with its negative effect in limiting transactions in houses.

Proclamation 62/1993 re-introduced rental income tax which was repealed by the "Derge" regime following the nationalization of rented urban houses. Rental income tax is imposed on income generated from renting houses, buildings, materials, and goods. The law exempts the first Birr 1,200 annual rental income and imposes rental tax rates ranging from 10% to 45%, on annual rental income higher than Birr 1200. Here again there is a lot of ambivalence about the high rate of tax in this category. Critics believe that such a high tax has a strong disincentive effect particularly on real estate and through it the construction industry. In addition to the very high cost of urban land, particularly in Addis Ababa, very few people are expected to venture into this business if they have to surrender such a large amount of their gross rental income in the form of tax. Already, we have started hearing about diversion in the use of some new buildings in the city from their intended purpose most likely to avoid this tax. In a city known for its shortage of houses, this is certainly not going to help alleviate this critical problem.

Sales and Excise Tax Proclamation 68/1993 replaced the previous general sales tax. The proclamation divided the general sales tax into sales and excise taxes. These taxes are to be imposed on goods produced locally, goods imported, and services rendered locally³. A 5% sales tax is imposed on agricultural products, resources and other products such as pharmaceuticals, hides and skins, etc. that are detailed under 26 categories in the proclamation. The law imposes a 12% sales tax on both imported and domestically produced goods other than those mentioned above. A sales tax of 5% is also imposed on such services as contractors, telecommunications, garage, laundry, auditing, hair dressing and beauty saloon, etc. whose daily sales is between Birr 25 and 50, and 10% for those with daily sales more than Birr 50. The law also exempts some goods from sales tax particularly food, fertilizer, petroleum and petroleum products, works of art, collectors' pieces and antiques etc. In this proclamation an excise tax ranging from 10% to 200% (on pure alcohol) is introduced on a wide spectrum of goods grouped under 17 categories.⁴

Many amendments have also been made regarding foreign trade taxes. Of these, the most important is the proclamation to Cancel Taxes and Duties Levied on Export

³ One such a sales tax that generated a lot of controversy in the industry is the sales tax on interest income earned by banks. When this tax was levied on the service provider (banks) the latter transferred it to the service recipient so that the borrower now pays, in addition to the interest on the loan, a 5% additional payment on the interest he/she pays.

⁴ There is also a strong controversy on this tax. In addition to the high excise tax imposed on industries such as soft drinks, the recent addition on the plastics industry has generated very wide criticism in the business community.

Goods (38/1993) which canceled all taxes and duties levied on exports, except the one on coffee. This proclamation is expected to help towards the diversification of export and improve both the quality and quantity of exportable goods and make them competitive in the world market. Another proclamation (69/1993), further established export duty incentive scheme.

Furthermore, Council of Ministers Customs Tariff Regulation 122/1993 replaced the previous tariff schedule which contained 159 specific rates and 25 *ad valorem* rates, ranging from 0 to 230 per cent. The new regulation specified tariffs containing only three items and 10 *ad valorem* rates ranging between 0 and 80 per cent. Custom duties ranging from 5 to 15 per cent were also imposed by this same regulation on previously freely imported goods. This regulation was then amended by the Council of Ministers Customs Tariff Regulation 2/1996, which reduced the duty from its high rate of 80 per cent to 60 per cent. All these amendments are expected to liberalize the country's foreign trade sector by opening its market for imports and thus forcing domestic producers to be more efficient and competitive with international producers as suggested by the Structural Adjustment Program. Whether these measures will really lead to increasing the competitiveness of domestic industry or, as some local producers suggest, it will result in the closure of many manufacturing concerns leading to further de-industrialization, remains to be seen.

2.2. Recent Developments in Government Expenditure Policy

One way to minimize the government fiscal gap (i.e. reducing the gap between domestic revenue and expenditure) is expenditure reduction. This was the approach followed by the Ethiopian government since the Structural Adjustment Programme together with the effort to boost revenue. Resources have thus been shifted from defense to social sectors (like education and health) and economic infrastructure. More importantly, however, public expenditure review has been initiated and followed since 1993/94. The purpose being to systematically analyze public expenditures to improve their allocation and efficiency. Ministry of Finance (1997) aptly states that "... with the help of these periodic reviews, there is a great prospect to reduce unproductive spending, rationalize the budget and stimulate efficiency and growth". One new and crucial element of this rationalization process for Ethiopia is the process of fiscal decentralization that was introduced in 1992. The following section looks at this process in Ethiopia in greater detail.

2.3. Fiscal Decentralization

Decentralization is a widely debated subject in both the literature and among policy makers⁵ It could be performed through deconcentration, delegation, devolution or some combination of these⁶ Proponents of decentralization argue that local management of resources responds better to local preferences. Assignment of expenditures to the lowest level of government, they argue, is consistent with efficient performance since local administrations are accountable to local tax-payers, etc. In any case, fiscal decentralization addresses the fiscal relationships between central, state and local governments. It determines which taxes are to be collected by federal and local governments and the expenditures to be covered by the various levels of governments and so on.

With the introduction of Proclamation 33/1992, Ethiopia has started following a new course in its fiscal policy. The proclamation defined the sharing of revenue between the central government and the national/regional self-governments. It thus formed the basis for the fiscal decentralization process underway since the 1992/93 fiscal year. In Article 3 of Proclamation 33/1992, the objectives of revenue sharing are explained as:

- i. to enable the central government and national/regional governments efficiently carry out their respective duties and responsibilities;
- ii. to assist national/regional governments develop their regions on their own initiatives;
- iii. to narrow the existing gap in development and economic growth between regions; and
- iv. to encourage activities that have common interest to regions.

In essence Proclamation 33/1992 is effected to implement Proclamation 7/1992 that officially established national/regional self-governments. It was in Article 35 of Proclamation 7/1992 that the sources of income available for national/regional self-governments were identified as: first, revenue collected from taxes allocated to them; second, grants to be given by the central government; third, domestic borrowing; and fourth, other sources of income.

⁵ See Prud'homme (1995), McLure (1995), Sewell (1996).

⁶ Deconcentration is the distribution of administrative functions within a single administrative hierarchy. For instance the reporting by different regional bureaus to respective Federal line ministries. Devolution is the assignment of administration functions to autonomous or semi-autonomous administrative hierarchies. The national/regional self-governments of Ethiopia are good examples.

The sharing of revenue between the center and regions is indicated under Article 4 of Proclamation 33/1992 to be based on: i) ownership of source of revenue, ii) the national or regional character of the sources of revenue, iii) convenience of levying and collection of the tax or duty, iv) population, distribution of wealth, and standard of development of each region, and v) other factors that are necessary for an integrated and balanced economy. Accordingly, Article 5 divided the revenue sharing into three categories: center, region and joint. In the first category is revenue to be collected by the center such as

- duties, taxes and other charges levied on the importation and exportation of goods,
- Personal income tax collected from employees of the central government and international organizations,
- Profit tax, personal income tax and sales tax collected from enterprises owned by the central government,
- Taxes collected from national lotteries and other chance winning prizes,
- Taxes collected on income from air, train and marine transport activities,
- Taxes collected from rent of houses and properties owned by the central government,
- Charges and fees on licenses and services issued or rendered

In the second category is revenue to be collected by the regions including

- Personal income tax collected from employees of the regional governments,
- Rural land use fee,
- Agricultural income tax collected from farmers not incorporated in an organization,
- Profit and sales tax collected from individual traders,
- Taxes collected from rent of house and properties owned by the regional governments,
- Profit tax, personal income tax and sales tax collected from enterprises owned by the regional governments,
- Charges and fees on licenses and services issued or rendered by the regional governments

Finally, in the third category is a joint revenue for the center and regions, like

- Profit tax, personal income tax and sales tax collected from enterprises jointly owned by the center and regions,
- Profit tax, dividend tax and sales tax collected from organizations,
- Profit tax, royalty and rent of land collected from large-scale mining, and petroleum and gas operations, and
- Forest royalty.

The proclamation also indicated that the revenue sharing will be done based on the recommendation of the committee assigned by the Prime Minister and accountable to the Council of Ministers. Furthermore, Proclamation 33/1992 put in Article 7 that, national/regional governments will receive subsidies from the center. The practice in the provision of subsidies to regions is given in Box 1 below.

Box XIII.1

Distribution of Federal Grants/Subsidies among Regions

Since the 1993/94 fiscal year different formulas have been used to distribute the Federal Grant/Subsidy among regions. As discussed earlier, Proclamation 7/1992 put Federal grant as one source of budgetary revenue for regional governments. Consequently, Proclamation 33/1992 has set the legal framework for distributing the grant. It is stated that the distribution will be based on the recommendations of the committee assigned by the Prime Minister and accountable to the Council of Ministers.

The practice so far has been to use certain parameters in calculating the corresponding coefficients for respective regions. In the initial two fiscal years (1993/94 and 1994/95) five parameters were considered:

- Area,
- Population,
- Implementation capacity,
- Level of development,
- Revenue raising capacity

Different weights were assigned to each that add up to 100. To clarify some: a) implementation capacity refers both to financial and physical capacity; b) development level of regions was measured using the I-distance index. The I-distance index measures the level of development in the following way: first, it will form an imaginary region by considering either best or poor development indicators from all regions; second once the imaginary region is formulated, the I-distance index will then measure the distance of the actual regions from the imaginary one. This has been accomplished through a statistical package that uses partial correlation.

In later fiscal years (1995/96, 1997/98), however, the five parameters were reduced to three and the I-distance index was replaced with a simple linear weighted average. The three parameters are:

- Population (60%),
- Level of development (25%), and
- Revenue raising capacity (15%).

Now the level of development is calculated by averaging out the six indices, having different components. These indices are:

1. Health index
 - number of clinics
 - number of physicians
 - number of nurses
 - number of health assistants
 - number of hospital beds
 - infant mortality under five years
2. Education index
 - student to classroom ratio
 - teacher to student ratio
3. Electricity Index
 - Kwh/1000 population
4. Road Index
 - Road density/1000 of square km area
5. Water Index
 - Percentage of population with access to safe drinking water
6. Telephone Index
 - Telephone line/1000 population

One major shortcoming of this approach is that the difference in unit of measurement is not considered when calculating the weighted average of these indices.

3 THE STRUCTURE AND DEVELOPMENT OF REVENUES

The previous section has reviewed the major fiscal policy measures taken since 1991/92. Most of these measures are effected through amendments of existing tax proclamations (Proc. No. 30/1992, Proc. No. 107/1992, Proc. No. 30/1996, Proc. No. 68/1993) and introduction of new tax proclamations (Proc. No. 53/1993, Proc. No. 62/1993, Proc. No. 108/1994). The intention of all these series of measures is justified by the government on the grounds of broadening the tax base, ease of administration, and equity. The ultimate impact of these changes will, however, be on the size and structure of government revenue. Accordingly, this section will follow the changes observed in government revenue from policy changes and other factors. The analysis will focus on the sixteen years beginning 1982/83 to 1997/98 where the most recent complete data is available, to enable the reader to compare and contrast the revenue position of the two regimes.

3.1. Tax Revenue

Tax revenue constitutes the lion's share of government revenue. In the sixteen years period under consideration, taxes contributed, on average, about 69.4% of the total domestic revenue, of which 38.8% is direct tax and 29.6% and 31.0% are from indirect and foreign trade taxes, respectively. Expressed as a ratio of GNP, tax revenue is on average well above 12% of GNP at current market prices.

Tax revenue has shown substantial changes both in terms of size and structure during the sixteen years period. Tax revenue has jumped from 1.6 Billion Birr in 1982/83 to 5.3 Billion Birr in 1997/98. The largest amount of tax revenue collected during the previous regime was 2.37 billion collected in 1988/89. The recent increase in taxes is mainly from the introduction of new taxes such as revenues from urban land lease, mining income tax, rental income tax, and so on. Another factor that contributed to the rise in taxes is the increasing effort exerted in improving tax administration by the regional governments particularly since fiscal decentralization. The tax revenue collected from regions increased from 531 million in 1993/94 to 830 million by 1995/96 and 984 million in 1997/98, almost doubling in just four years. This is a clear indicator that regional governments have improved their tax collection capacity significantly. Equally importantly, the increase in overall economic activity, as indicated by a 5.4% average annual growth of real GDP during the five years of the new government, has broadened the tax base allowing an overall increase in tax revenue.

Table XIII.1
The Growth of Tax Revenue

Period	Average Annual Levels (Million Birr)	Tax Revenue/ GNP at Market Price	Tax Revenue/ Domestic Revenue	Average Annual Rate of Growth
1982/83 – 1990/91	1,981.8	13.9	70.0	3.4
1991/92 – 1997/98	3,732.8	10.9	68.6	16.3
1992/93 – 1997/98	4,354.9	12.7	80.0	19.0
1982/83 – 1995/96	2,747.9	12.6	69.4	9.1

Source: Calculated from Ministry of Finance, Annual Budgetary Revenue and Expenditure, various years.

Over the sixteen years period, tax revenue has registered an average annual growth of 9.1%. A dramatic increase is, however, noted since 1991/92. During the nine years period (1982/83–1990/91) tax revenue has shown an average annual growth of only 3.4% and, still worse, foreign trade tax has been declining on average by 0.3% annually. Conversely, the seven years period of the new regime (1991/92–1997/98) has witnessed an average tax revenue growth of 16.3% per annum. Even if we start from the high level of tax revenue achieved by the Derge regime in 1988/89, there is a 144% increase in tax revenue by 1997/98.

Table XIII.2
Tax Revenue Structure

Period	Direct Tax/ Total Tax	Indirect Tax/ Total Tax	Foreign Trade Tax/Total Tax
1982/83 – 1990/91	41.5	31.7	26.8
1991/92 – 1997/98	35.3	27.0	37.7
1992/93 – 1997/98	41.2	31.5	43.9
1982/83 – 1997/98	38.8	29.6	31.6

Source: Ministry of Finance.

Looking at the structure of tax revenue in the pre-reform period, direct tax was the major source followed by indirect and foreign trade taxes. This structure is altered in the post-reform period where foreign trade tax has become the major source of tax revenue followed by direct and indirect taxes (See Table XIII.2 above).

As can be seen from the above table, the foreign trade tax has significantly increased its share of the tax revenue mainly because of a significant increase in the actual value of taxes collected from foreign trade although the other items were also increasing. Foreign trade tax increased from 464 million in 1990/91 to over 2.2 billion by 1997/98. This was a more than five-fold increase compared with a 125% increase in direct taxes and a 55% increase in indirect taxes over the same period. The very high increase in foreign trade taxes is interesting as it was taking place while tax and duty rates on foreign trade were being reduced. While there was an increase in the volume of foreign trade during this period to account for some of this increase, a good part of the increase is a result of an increase in value owing to an increase in import prices in birr following the devaluation of the currency in 1992.⁷

3.2. Non-Tax and Capital Revenues

Non-tax and capital revenues which include all domestic revenues other than taxes (such as charges and fees, sales of goods and services, residual surplus and investment income, sales of movable property, and repayment of loans), constitute on average 30.5% of domestic revenue. Its actual value has increased from 616 million birr in 1990/91 to about 3 billion birr at the end of the reporting period. As a ratio of GNP, it has been 5.7% on average over the sixteen years period. Table XIII.3 below reveals that during the period under consideration non-tax revenue has risen on average at 18.3% per annum. Like the tax revenue the increment in non-tax revenue is quite significant in the post-reform period (about 36% per annum if we start in 1991 and 43.6% if we ignore the abnormal year of 1991) compared to the pre-reform period (which was only 4.6% per annum).

This increment is partly due to better financial performance of public enterprises and the resulting rise in residual surplus, capital charge, interest payments, and state dividends to the central treasury. Another important factor that contributes to the increase in non-tax revenue, although this is a one-time increase, is the large sum of proceeds obtained from privatizing public enterprises. Privatization accounted for 17.2% and 13.1% of the federal non-tax revenue in 1996/97 and 1997/98, respectively. While the proceeds from privatization increase revenue, the government will lose the annual revenue collected from these enterprises in the form

⁷ Other factors might have also contributed to this rapid rise in foreign trade tax. This includes the transfer of importing and exporting to the private sector which made the government more diligent in collecting taxes and a possible shift in imports from low-taxed capital goods to higher-taxed consumer goods. (See Befekadu, 1998).

of business profit, residual surplus, and capital charges. The net revenue implication of privatization, therefore, need to be assessed by considering these conflicting tendencies. What is clear, however, is that there will be a shift of revenue from the center to the regions since private unincorporated firms will be taxed by regional governments.

Table XIII.3
The Growth of Non-Tax and Capital Revenues

Period	Average Annual Levels (Million Birr)	Non-Tax Revenue/ GNP at Market Price	Non-Tax Revenue/ Domestic Revenue	Average Annual Rate of Growth
1982/83 – 1990/91	878.0	6.1	30.0	4.6
1991/92 – 1997/98	1,799.9	5.1	31.4	35.7
1992/93 – 1997/98	2,099.9	5.9	36.7	41.6
1982/83 – 1997/98	1,281.3	5.7	30.5	18.2

Source: Ministry of Finance.

3.3. External Grants

External Grants showed a remarkable growth of 34.2% per annum on average. It rose to a high amount of Birr 1.3 Billion in 1997/98 from its low level of Birr 299 million in 1982/83. As Table XIII.4 indicates this upsurge in external grants is recorded in the post reform period, where it grew by 52.5% per annum in local currency. This could be attributed to the massive support of the bilateral and multilateral donors and creditors in relation to the structural adjustment programme. Devaluation has exaggerated the value of the grants in birr as can be seen from Table XIII.4 below. The external grants constitute cash grant, technical assistance, and counterpart fund. Technical assistance accounts for a good proportion (60.6%) of the external grants on average over the reporting time although the proportion was declining especially after 1991 from a very high level of 88% in 1982/83 and around 77% in the last three years of the previous regime. The significant decline in the proportion of technical assistance in foreign grant starts with the introduction of counterpart fund beginning in 1993/94 which starts to account for an increasing proportion of the total grant. Counterpart fund, which was as high as 1.1 billion birr in 1993/94, is external grants extended in cash form and/or in-kind (fertilizer,

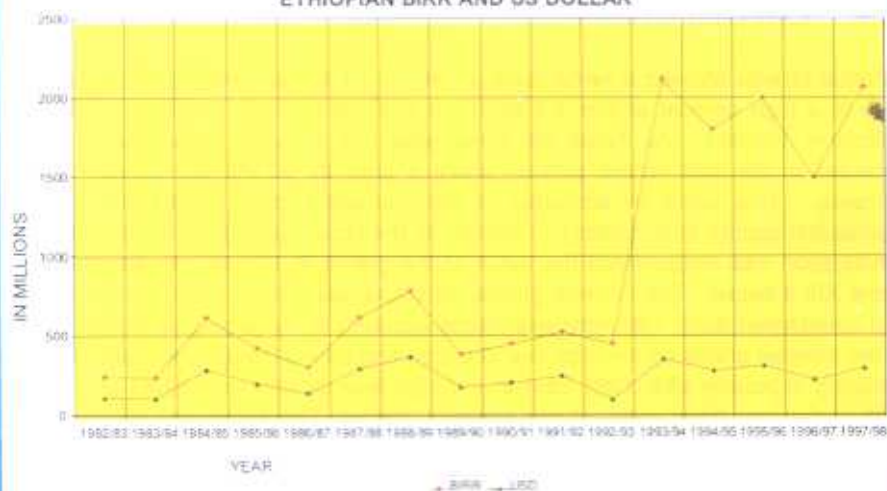
pharmaceuticals, construction materials, and so on). The cash grant is commonly used by government for foreign exchange auction and the Birr will then enter the central treasury. Likewise, the proceeds from sales of material grants in the domestic market, also enter the central treasury.

Table XIII.4
The Growth of External Grants

Period	Average Annual Levels (Million Birr)	External Grants/ GNP at Market Price	External Grants/ Domestic Revenue	Average Annual Rate of Growth
1982/83 – 1990/91	467.7	3.2	16.2	19.8
1991/92 – 1997/98	1,392.1	4.2	26.6	45.0
1992/93 – 1997/98	1,642.1	4.9	31.0	52.5
1982/83 – 1997/98	872.1	3.7	20.7	30.8

Source: Ministry of finance

Fig. XIII.1: TRENDS IN EXTERNAL GRANTS (1982/83-1997/98) IN ETHIOPIAN BIRR AND US DOLLAR



4. THE STRUCTURE AND DEVELOPMENT OF EXPENDITURES

Government expenditures are composed of recurrent and capital expenditures by the Federal Government and Regional Governments. The former basically contains outlays to run the state organs and is of recurrent in nature. The later, however, is outlays for the acquisition of fixed assets and could be referred to as government development expenditure.

These expenditures are financed from revenues mobilized through fiscal measures as discussed in the preceding section. Managing these resources carefully and putting them to an optimum use at a minimum cost is a necessary condition to achieve economic efficiency and to increase the welfare of society. Therefore, as stated in Ministry of Finance (1997), government expenditure policy must take into account both the cost effectiveness of each public programme and the most desirable mix of public sector output, in terms of the overall social return on the investment, in order to ensure that maximum benefit is derived from public capital expenditure with high levels of productivity. This section thus looks into the developments in government expenditures both in terms of size and structure during the fourteen years period.

Table XIII.5
Composition of Government Expenditures

Period	Total Expenditure/ GNP at Market Price	Recurrent/ Total Expenditure	Capital/ Total Expenditure	Average Annual Rate of Growth
1982/83 – 1990/91	31.3	69.5	30.5	3.7
1991/92 – 1997/98	24.0	64.7	35.3	13.7
1992/93 – 1997/98	24.5	62.5	37.5	18.2
1982/83 – 1997/98	28.1	67.4	32.6	8.1

Source: Ministry of Finance

Government expenditure in Ethiopia, on average, accounted for about 28.1% of GNP in the reporting period. This ratio was 31.3% in the pre-reform period and dropped to an average of 24.5% after the reform. When compared to the ratio of domestic revenue to GNP of 18.3% in 1982/83–199/98, the expenditure to GNP ratio is remarkably high indicating that the government is spending money it does not have. However, in the reference period expenditure has been growing at an average rate of

8.1%, while domestic revenue has been increasing by 10.6% gradually narrowing the gap between revenue and expenditure.

4.1. Recurrent Expenditure

Recurrent expenditure has substantially increased during the total reporting period rising from its low level of Birr 2.6 Billion in 1982/83 to a high of Birr 7.1 Billion in 1997/98. It has grown by an annual average rate of 7.4% in the sixteen-year period. As can be seen from Table XIII.7 below, again the growth rate during the Derge period was substantially lower than the post-Derge period. Recurrent expenditure was growing only by 4.9% per annum in the former period while it grew by 10.7% per annum in the post-reform period in general and 14.3% beginning 1992/93. One possible explanation could be the federal administration structure followed by the government. The federal structure requires government institutions to be duplicated at the regional level (various bureaus) at the zone levels (various departments) and at the *woreda* levels. The effect of this duplication of government institutions is the requirement for both manpower and material resources. (for example, the number of civil servants have increased from 261,000 in 1990/91 to as high as 308,950 in 1996/97.) The cost of these resources are covered by the recurrent expenditure. This, therefore, is one plausible reason why recurrent expenditure increased during this period while defense expenditure is substantially trimmed. Defense accounted for 18% of total recurrent expenditure down from a whopping 40.6% before the reform. In effect, the resource saved from defense spending is partly financing the regionalization process. Another possible explanation for the increase in recurrent expenditure is the increase in the country's debt payment which more than doubled to 18.7% of recurrent expenditure in the post-reform period.⁸ A third explanation is the increase in expenditure related to the expansion of the extension program in agriculture, which constitute the major development strategy of the government.

The increase in recurrent expenditure owing to decentralization has to be evaluated, *inter alia*, in relation to the expected increase in the efficiency of resource allocation that is usually presented by proponents of decentralization. If the duplication of government institutions in the regions simply result in the expansion of an already inefficient bureaucracy into a bureaucratic nightmare, the economy will suffer both from misallocation of scarce resources in the form of a sub-optimal expenditure and a worsened state of service provision by the government. Although it is very difficult to adequately judge its effect at this point in time, it is an important area to closely

⁸The increase in debt servicing is partly due to the devaluation of the birr.

watch in the future to ensure that plan and reality match in the area of fiscal decentralization at least in the realm of efficiency in resource allocation.

Table XIII.6
The Growth of Recurrent Expenditure

Period	Average Annual Level (Millions Birr)	Recurrent/ GNP at Market Price	Average Annual Rate of Growth
1982/83 - 1990/91	3,130.9	21.7	4.9
1991/92 - 1997/98	5,107.2	15.4	10.7
1992/93 - 1997/98	5,407.5	15.3	14.3
1982/83 - 1997/98	3995.5	18.9	7.4

Source: Ministry of Finance.

Recurrent expenditure is structured into four major categories. These are, general public services, containing recurrent spending for such government organs as council of ministers, justice, defense, etc., economic services which include recurrent spending for such ministries as agriculture, industry, transport and communication, and so on, social services such as spending by the ministry of health, ministry of education, etc., and various services containing pension payments, debt service, subsidies, and so on. Regarding the changes in the structure of recurrent expenditure several developments have taken place.

Table XIII.7
Structure of Recurrent Expenditure

Period	Share to Total Recurrent Expenditure				Average Annual Growth Rate			
	General Service	Econ. Service	Social Service	Various Service	General Service	Econ. Service	Social Service	Various Service
1982/83 - 1990/91	51.2	5.5	18.3	25.0	5.1	4.4	5.3	9.0
1991/92 - 1997/98	33.9	9.7	25.0	31.4	10.7	18.2	15.3	11.8
1992/93 - 1997/98	33.9	10.1	25.5	30.5	14.3	18.9	15.0	6.1
1982/83 - 1997/98	43.6	7.4	21.2	27.8	7.4	10.4	9.5	10.2

Source: Ministry of Finance, Annual Budgetary Revenue and Expenditure, various issues.

As can be seen from Table XIII.7 above, a good proportion of the recurrent expenditure is allotted to general services. The value of general services was about birr 1.3 billion in 1982/83 out of which defense took over one billion. This value grew to a peak of about 2.3 billion in 1989/90 of which defense took close to 1.9 billion. Expenditure on defense started to decrease substantially for the following four years reaching a low of 663 million birr in 1993/94. This was close to one third of the value of the peak period of the Derge.⁹ This reduction in defense expenditure, unfortunately, is short-lived. Expenditure on defense started to pick up after 1993/94 rising to an all-time high level of about 2.1 billion budgeted for 1997/98 even before the conflict with Eritrea began. It does not require much imagination to see where this is going during and after the conflict.

General service expenditure took on average 51.2% of the total recurrent expenditure in the pre-reform period and an average of 33.9% in the post reform period. A point worth emphasizing is that the bulk of the General Services expenditure is defense spending accounting for 78.3% and 53% in the pre- and post-reform periods, respectively although the ratio increased to over 65% in 1997/98. Clearly, this high spending for general services, more specifically for defense, has been at the cost of the economic and social sectors.

However, it seems that there is a change in the structure of recurrent expenditure. A shift from general to economic and social services is observed in the post reform period. This is indicated by an average annual growth of expenditures on education and health by 15.0% and 18.5% in the post reform period respectively, while economic services grew by 18.9%. Compared to the respective average annual growth of only 5.9%, and 5.1% for education and health and 4.4% for economic services in the pre-reform period the growth in the post-reform period is indeed substantial.

9. This decrease is even more remarkable if one takes into account devaluation. Defense expenditure during the peak period of the Derge at the then exchange rate was over \$904 million US dollar. The expenditure on defense at the peak of the post reform period in 1995/96 was 797.6 million birr which translates roughly to \$133 million dollars (with a 6:1 dollar birr exchange) which makes only about 15% of the defense expenditure of the Derge period.

Fig. XIII.2: STRUCTURE OF RECURRENT EXPENDITURE (1982/83-2000/01)

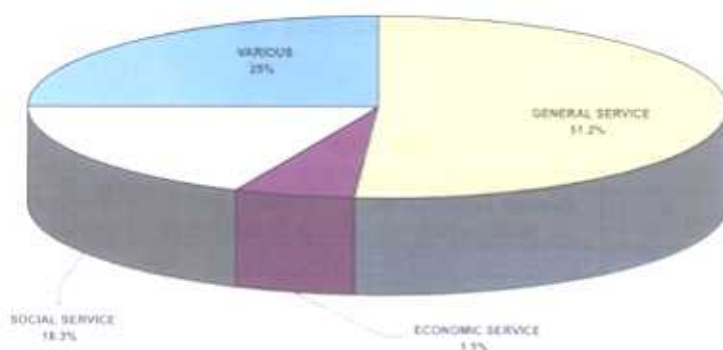
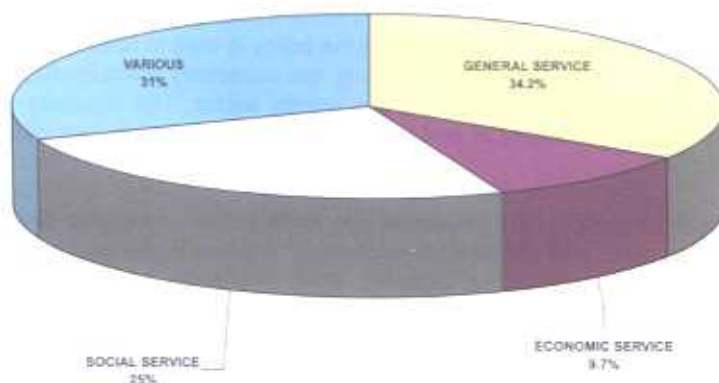


Fig. XIII.1: STRUCTURE OF RECURRENT EXPENDITURE (1991/92-1997/98)



4.2. Capital Expenditure

Capital expenditure as stated earlier is outlay for the acquisition of fixed assets. Like recurrent expenditure, capital expenditure has also increased in magnitude and a number of changes have occurred in its structure over the fourteen years period under consideration.

Table XIII.8
The Growth of Capital Expenditure

Period	Average Annual Level (Millions Birr)	Capital/ GNP at Market Price	Average Annual Rate of Growth
1982/83 – 1990/91	1,363.7	9.6	1.9
1991/92 – 1997/98	2,959.3	8.5	23.8
1992/93 – 1997/98	3,293.9	9.2	31.4
1982/83 – 1997/98	2,061.8	9.1	11.5

Source: Ministry of Finance.

In terms of magnitude capital expenditure has tripled from its 1982/83 level of Birr 1.2 Billion to Birr 4.2 Billion in 1997/98. The substantial change, however, is observed since 1991/92 where it was growing at an annual average rate of 23.8% and even more significantly at 31.4% if we exclude 1991/92. This resulted from government's increased intervention in such sectors as roads, education, health, and water supply. Government spending increased in these areas since these areas are at present less attractive to private investors while it decreased its involvement in the directly productive sectors. The essence of the policy is thus to raise the provision of social services to the public while supplying the necessary infrastructure to make investment in the country attractive to the private sector. The structure of capital expenditure has thus changed in favor of roads, education, health and water supply sectors.

Broadly, capital expenditure is structured into three groups: economic development, social development, and general development. Economic development includes production activities (agriculture, industry, etc.), economic infrastructure facilities (mining, energy, road etc.), commerce, communication, and so on. Social development includes education, health, urban development, welfare and so on. General development includes services like cartography, statistics, public and administrative buildings, and so on. The shares of these groups to total capital expenditure have changed significantly in the sixteen years period.

Table XIII.9
The Capital Budget Structure

Period	Share to Total Capital Expenditure			Average Annual Growth Rate		
	Economic Dev't	Social Dev't	General Dev't	Economic Dev't	Social Dev't	General Dev't
1982/83 - 1990/91	90.0	7.6	2.4	2.0	4.2	16.2
1991/92 - 1997/98	75.9	19.2	4.9	17.6	57.6	64.1
1992/93 - 1997/98	73.9	20.7	5.4	24.3	68.8	77.7
1982/83 - 1997/98	83.8	12.7	3.5	8.8	27.6	37.1

Source: Ministry of Finance.

In the Derge period, the share of economic development was 90%. While social development accounted for only 7.6% of total capital expenditure. This is mainly because of the involvement of government in directly productive activities such as state farms and manufacturing public enterprises. Government thus spent a large sum annually in establishing these public enterprises and expanding their capacity. In the periods since 1991/92, the share of social development has shown an upward trend, increasing to 19.2% of total capital expenditure from a mere 7.6% in the previous period. This is essentially a result of the emphasis given to the health and education sectors in the new policy regime.

While capital expenditure is generally considered positive as it has the potential to increase the country's productive capacity, there is concern that its expansion, especially in sectors that can be adequately taken by the private sector, could only come by crowding out the private sector.³ The crowding-out argument in the Ethiopian case, however, operates at different levels. For instance, during the Derge period, private investors were crowded out by design (through capital limits, credit rationing, licensing and permit procedures, etc.) as the whole policy was geared towards discouraging meaningful participation by the private sector in the economy. In essence, there was a direct and deliberate crowding-out measure by government capital expenditure.

³ Higher government expenditure raises the level of gross national income which, in turn, increases the demand for money and thus increases the rate of interest and therefore, a decrease in the level of private investment.

Fig. XIII.4: STRUCTURE OF CAPITAL EXPENDITURE

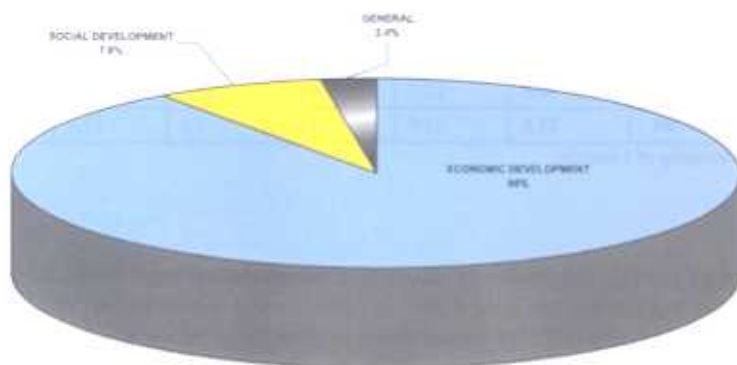
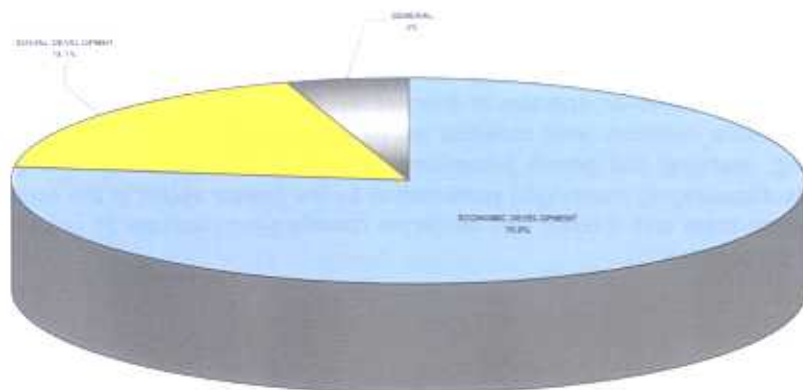


Fig. XIII.5: STRUCTURE OF CAPITAL EXPENDITURE (1991/92-1997/98)



After the introduction of the new economic policy in 1991, deliberate attempt to discourage the private sector was officially stopped and a more private sector friendly stance was officially taken by the government. At the same time, as discussed above, government expenditure has increased significantly. There is no evidence, however, that this increased government expenditure has crowded out private investment as all data indicate that most financial institutions such as commercial banks (including the private ones) are over liquid. (see Box XIII.2 for more). Monetary surveys show that the private sector is the main borrower now. For instance, in December 1997 and December 1998, domestic credit claims on government was 47% while that of the private sector was 53%.

5. FISCAL DEFICIT AND ITS FINANCING

Fiscal deficit (the excess of expenditure over domestic revenue) and its financing have always been the core of public finance. Some blamed fiscal deficit for the economic ills of developing countries.¹⁰ Accordingly, the debt crisis facing developing countries, high inflation, poor investment performance and low level of economic growth in general in the 1980s are, at least partially, presumed to be caused by uncontrolled government expenditure without a parallel increase in revenue. But is fiscal deficit necessarily bad and does that necessarily lead to economic malaise?

Clearly government expenditure, if used prudently and in projects with high overall return, could contribute quite positively to the overall economic performance of a country. What matters most in relation to deficit is the efficiency of the expenditure and the source of financing the deficit. If the deficit is economically worth-incurring in the sense that there is a high social and economic return from the expenditure and is not excessive, in the sense that the deficit is sustainable, then there should no *a priori* reason for it to cause economic problems. Before making any judgement about the effect of fiscal deficits, therefore, one needs to look at the specific circumstance of the case under consideration. In this spirit, the following section looks into the magnitude of the fiscal deficit in Ethiopia, the mechanisms used in

¹⁰ Easterly and Schmidt-Hebbel (1993), World Bank (1988)

financing the deficit, and its possible implications on the performance of the economy.

5.1. Trends in Fiscal Deficit in Ethiopia

The overall fiscal balance in Ethiopia has moved from a surplus in the early 1950s to a balanced budget up to the mid 60s and a rather small deficit in the 1965-74 period owing to the fiscal conservatism of the state during the imperial period. Fiscal deficits started to grow rather rapidly following the 1974 revolution. The ever-increasing trend of fiscal deficit in the post-revolution period was partly due to the relatively higher growth of expenditure than revenue caused by unplanned expenditure by government and the increasing spending on defense.

In the sixteen years period under consideration, the fiscal deficit has continued to climb until 1990/91, and gradually started to decline. In the post 1991/92 period domestic revenue has fully covered the recurrent expenditure and in more recent years partly financed the capital expenditure. Table XIII.10 reveals the developments in this regard.

Table XIII.10
Domestic Revenue Expenditure Ratios

Period	Domestic Revenue/ Recurrent Expenditure	Domestic Revenue/ Total expenditure
1989/90	80.0	58.5
1990/91	73.2	55.1
Av. 1982/83 - 1990/91	92.3	63.9
1994/95	103.5	66.7
1995/96	118.2	73.7
1997/98	118.6	74.1
Av. 1991/92 - 1997/98	104.2	66.3
Av. 1992/93 - 1997/98	110.4	68.7
Av. 1982/83 - 1997/98	97.5	64.9

Source: Ministry of Finance.

Domestic revenue has covered only 73.2% of recurrent expenditure in 1990/91, while there was a surplus of domestic revenue over recurrent expenditure beginning in 1994/95. There is also significant difference in the average domestic revenue to

recurrent expenditure ratios between the two regimes. Looking at the domestic revenue to total expenditure ratios there is improvement in the post 1991/92 period. This increasing ratio further confirms the narrowing gap between domestic revenue and expenditure. The absolute magnitudes of the fiscal deficit and its growth rates are provided in Table XIII.11 below.

The level of fiscal deficit before grant has increased in the post-reform period compared to the pre-reform period. In 1990/91, when the war had essentially paralyzed the economy, the level of the deficit was limited to Birr 2.2 Billion. In the relatively normal year of 1994/95, however, the fiscal deficit before grant has grown to Birr 3.4 Billion. When considering the deficit after grant, the situation is different. The level of deficit has shown a declining trend in the post-reform period up to 1996/97 and started to increase in 1997/98 mainly owing to the significant increase in defense that fiscal year.

Table XIII.11
Level of Fiscal Deficit

Periods	Level of Deficit (Million Birr)		Deficit With Grant	
	W/O Grant	With Grant	As a Ratio of GNP	Rate of Growth
1989/90	2,226.7	1,825.3	13.3	50.3
1990/91	2,206.6	1,743.3	11.6	4.5
Av. 1982/83 - 1990/91	1,834.8	1,167.1	8.0	7.6
1994/95	3,425.0	1,608.5	4.8	1.8
1995/96	2,952.6	941.0	2.5	41.6
1997/98	3,047.1	1,773.8	3.9	179.1
Av. 1991/92 - 1997/98	2,745.4	1,353.3	4.5	20.2
Av. 1992/93 - 1997/98	2,861.5	1,327.9	4.0	18.7
Av. 1982/83 - 1997/98	2,120.7	1,248.6	6.5	13.1

Source: Ministry of Finance.

The remarkable deviation in the level of fiscal deficit before grant and after grant clearly indicates the massive inflow of external assistance in local currency in the post-reform period.¹¹ For instance, the level of deficit declined to Birr 0.9 Billion after grant in 1995/96, from a high level of Birr 3.0 Billion without grant. The upsurge in capital expenditure is thus financed through grants since recurrent expenditure is

¹¹ We said in local currency advisedly. If we look at the inflow of grants in the two periods adjusting for birr devaluation, the inflow in the post reform period is much less than what the birr figures show.

fully covered by domestic revenue. A point worth-raising here is whether this financing of capital investment from grant is sustainable. As is well known, the flow of external grant is highly dependant on the rather precarious and shifting political interest of donors rather than a more enduring economic commitment.¹²

5.2. Sources of Deficit Financing

The fiscal gap between revenue and expenditure is commonly financed from external and internal sources. The former consists of external assistance and loan, while the later includes borrowing from domestic banks and non-bank sources. Table XIII.12 portrays the nature of deficit financing in Ethiopia over the past fourteen years.

Table XIII.12
Level and Growth of Deficit Financing

	Average in			
	1982/83- 1990/91	1992/93 - 1997/98	1991/92- 1997/98	1982/83- 1997/98
<i>Average Annual Levels (Million Birr) of</i>				
External Borrowing	489.4	709.5	658.3	563.3
Domestic Borrowing	677.7	618.6	695.2	685.4
<i>Average Annual Growth Rate of</i>				
External Borrowing	6.0	16.2	9.9	7.7
Domestic Borrowing	17.0	-239.4	-195.1	-17.8

Source: Ministry of Finance.

The magnitude of deficit financing from external borrowing has shown a fluctuating trend between 1982/83–1997/98. In general terms, it has increased in the post-reform period growing at an annual average rate of 16.2% than the pre-reform period when it grew only by 6.0% annually.

In contrast, domestic borrowing has followed an increasing trend up until 1990/91, and sharply declined since then. It was increasing at an average rate of 17% per annum in 1982/83–1990/91, and declining at an average of 239.4% per annum in 1991/92–1997/98. This declining trend of domestic borrowing and increasing trend

¹² The issue of the accumulating debt burden and its effect on the overall economy is discussed in detail in another chapter of this report.

of external borrowing since 1991/92, together with the massive inflow of external grant, reveal the shift of financing our deficit from domestic to external sources.

In the pre-reform period, domestic borrowing was bank borrowing in its different forms (i.e. direct advance from the National Bank, selling treasury bills and bonds to the commercial banks, and so on). In the post-reform period, however, the domestic borrowing figure is not disaggregated into its components. As a result, it is not possible to look into the developments in bank and non-bank borrowing in recent years. What we know in this regard is the repeated statements in different government policy papers that, "government will not borrow from domestic banks to finance the fiscal deficit". The major rationale is that bank borrowing is more inflationary (see Box XIII.2 below).

Box XIII.2

Is deficit financing from domestic bank borrowing inflationary?

It is strongly argued in the literature that fiscal deficit financing from domestic bank borrowing results in inflation and the crowding-out of private investment. Government intentions in post-reform Ethiopia seem to be informed by these arguments. The various policy framework papers have clearly stated that the government will not finance its deficit through domestic bank borrowing.

Is bank borrowing really inflationary? Will bank borrowing really crowd-out private investment in the Ethiopian context? Given the liquidity ratio of our banks and the degree of monetization of our economy, bank borrowing might not result in inflation and crowding-out.

As we all know, the Ethiopian economy is basically agrarian, where 85% of the population reside in rural areas, and agriculture is the major contributor to GDP and export earnings. In rural areas, money transactions are less frequent and farmers have no access to formal financial institutions. The implication is that the money in the hands of farmers/rural residents is nearly out of circulation. Under such conditions, bank borrowing for that matter direct advance from the National Bank might not significantly raise the money supply and invoke inflation.

Second, according to the National Bank, banks will be considered over liquid when the liquidity ratio (deposit/liquid assets $\times$ 100) is greater than 35%. But as can be inferred from the annual audit reports of the commercial banks (including private banks) the liquidity ratio is mostly greater than 35% and in some cases significantly higher. Under normal circumstances, banks should not be so liquid. Rather, they should lend out the money to credit-worthy borrowers and earn interest. The essence here is thus, there is money for private investors in the banks.

Therefore, bank borrowing by government will not necessarily crowd out private investment. What crowds out private investment most is the extremely stringent lending policies of banks.

6. CONCLUSIONS

In the sixteen years period (1982/83–1997/98) both government revenue and expenditure has shown an upward trend with some changes in its structure. In the post-reform period, government has rationalized its expenditure through various measures including:

- Increasing expenditure in the social sector and infrastructure.
- A short-lived reduction in defense expenditure
- A shift in emphasis from recurrent to capital expenditure

On the revenue side, a number of tax/tariff reforms have been introduced in order to increase revenue mobilization. Highlights of these reforms include:

- Several tax/tariff rates have been lowered
- New taxes were introduced
- Inland Revenue Authority and Customs Authority have been reorganized

Given these changes in fiscal policy, the following observations can be made by way of identifying future policy challenges.

First, in response to the policy measures introduced since 1991/92, government revenue has increased significantly. However, some of the measures need to be further reconsidered. For instance, the newly introduced capital gains and rental income taxes seemed to be high for the business community with potential negative effect on business transactions in the sectors affected most and eventually to the overall economy.

Second, generally fiscal deficit has followed an increasing trend in the pre 1990/91 period, and gradually declined in the post 1991/92 period. However, fiscal deficit without grant has continued to increase significantly in the post-reform period. In essence, there is inflow of huge external resources (both grant and credit). The sustainability of this external inflow and its implication on the public debt of the country need closer consideration. To reduce this dependence on foreign sources, more effort is needed to increase the current surplus (revenue minus expenditure) and to further develop the non-bank financing of fiscal deficit.

Third, the proceeds from privatization of public enterprises are a once-for-all income for the federal government. Once the sell is completed, there will be a substantial decrease in revenue. Hence, the government should increase its effort to compensate this loss using some kind of revenue enhancing mechanism.

Finally, the period of low defense budget seems to be over with a short honeymoon. While the increase in defense budget might have been imposed by external circumstances, the implication for government fiscal policy is serious. We need to find mechanisms to increase revenue if we are to continue spending on the social programs that have legitimately attracted government attention since the reforms, while at the same time building our defense capability.

XIV

LOOKING FOREWORD: FORECASTING AND POLICY CHALLENGES

1. INTRODUCTION

At the beginning of this report, we performed a simple calculation to show the relative position of Ethiopia with respect to other low and middle income countries. According to that calculation, if Ethiopia's per capita income is to double from the current \$100 to \$200, it will take about 18 years if real GDP grow by an annual rate of 7%. It will take 40 years to reach the current level of the average Sub-Saharan country and 87 years to reach the level currently achieved by middle income countries. As dismal as this scenario looks, it is by no means obvious that Ethiopia could even achieve this level of growth and thus achieve the standard of living of say the average Sub-Saharan African country in four decades. It is therefore natural to ask if this 7% growth rate is achievable if current conditions continue. In this final section of the report, we look at two pertinent issues about the future of the Ethiopian economy.

The first issue concerns where we are heading in terms of major macroeconomic variables if current conditions continue. In this regard, we performed a little forecasting exercise for the next five years assuming the current policy regime and other conditions of the economy continue as they have since the post reform period. The first section of this chapter briefly reports the findings of this exercise. The second section deals with the various policy challenges facing the country if sustainable development and structural transformation is to be achieved in Ethiopia.

2. FORECASTING THE ETHIOPIAN ECONOMY IN THE SHORT RUN

An attempt to project the major macroeconomic aggregates in Ethiopia is frustrating not only because of lack of appropriate macro model for Ethiopia but also due to the erratic nature of the growth pattern of major macro aggregates, in particular the (agricultural) GDP growth. This is the direct result of the extreme dependence of the Ethiopian economy on rain-fed agriculture. The recent (since 1992) macro trend, as can be read from this report, shows that the GDP registers the highest figure when

there is good rain and the lowest (sometimes negative) when otherwise. Notwithstanding such erratic macro trend, one needs to look ahead, however. Looking ahead entails formulating policies and examining their future impact.

There is an acute shortage of macro models that can be used for projection purposes. The existing models are not only very rudimentary but also are designed to address specific issues. We hope that the EEA will develop a macro model that can be used for its future reports. It is in the context of such dearth of models that a preliminary projection is made in this section. For this exercise three approaches are employed. First, we have employed a simple Harrod-Domar model and arrived at the GDP growth projection. In the second stage we have developed a simple 'two gap model for Ethiopia'. In this 'two-gap' model all the parameters required are derived and estimated using Ethiopian data. Finally, we have provided another set of projection based on a simple Keynesian model that we have employed for Ethiopia. In the latter case the parameters of the model are taken from previous studies. Almost all models are based on data from the post reform period particularly the past seven years and gave fundamentally similar results. The details of the models are outlined in the Technical Appendix and the background papers. Here we have reported only the results.

The projection result shows that, assuming an inflation rate of 6.2% per annum, which was registered in 1998, the real GDP is projected to grow by an average figure of about 5.7% per annum for the coming five years. This is of course without taking in to account the possible detrimental effect of the war and the vagaries of nature. During the projection period investment as the share of GDP will be around 21% while saving, as the share of GDP will be around 8%. This will create a resource gap of 13% of GDP per annum. In terms of the external sector imports as the share of GDP will be around 47% while export will range from 20% at the end of 1999/2000 to 37% by the end of the projection period, year 2005. However, as we noted earlier, this result should be taken cautiously not only due to the rudimentary nature of the models used but also the erratic nature of agricultural and the external sector performance. Readers interested in more details can refer to the background paper and the technical appendix in this report.

Clearly, the 5.7% average growth rate we forecasted given the existing policy regime and that the conditions that obtained in the last seven years hold, is far from the 7% growth rate that we needed to achieve in forty years the dismal levels of standard of living that the average SSA country has currently achieved. This is not a bright future in deed. What is very important to note here is that this forecast is achieved in a rather optimistic scenario. It assumes that there will be no natural disasters (such as draught), no war or no adverse international trade condition such as significant fall in

commodity prices over the forecasting period. To achieve this growth rate, investment is forecasted to rise to 21% of GDP from the current average 15.2%, savings is expected to increase from the current 6.5% to 8%, the resource gap will widen from 8.7% of GDP to 13% requiring a more than 50% increase in foreign aid and investment flow from its current high (but clearly decreasing) level and imports doubling from the current level while exports more than double the current levels over the forecast period. In other words, the likely hood of achieving this very modest 5.7% growth rate (given the dire need for a much higher growth rate to reduce poverty and achieve structural transformation) during the forecast period is extremely slim.

What this suggests is clear. If Ethiopia is to achieve a more robust economic performance and have any hope of maintaining the current distance with other developing countries let alone catch up; if the country has any hope of reducing the current level of absolute poverty not by half but by even a quarter by the year 2015 as the UN hoped, the country needs, in addition to a mountain of good luck, a sound economic policy than what it is currently following. It also needs a more open and inclusive policy formulation and implementation process. The policy challenges facing the country and suggested alternative policy options are discussed next.

3. POLICY CHALLENGES

In order to identify the major challenges facing policy makers to achieve sustainable development for the country, it is useful to first summarize the key economic and social problems confronting the country that are discussed in detail in this Report.

The most critical challenge facing the Ethiopian policy makers today and in the years ahead is the urgent task of reducing and eventually eliminating absolute poverty in the country. The basic objective of economic management and indeed the fundamental goal of government every where and at all times is to see to it that the standard of living of their people improves over time. Past governments have miserably failed in this regard and it is the lot of this and future governments to pick up the pieces and declare war on this greatest of the enemies of the country and the people. Rather than focusing on the financial balance sheet, as some donors would want the government to do, the Ethiopian governments should focus on the well-being of its people as their prime and enduring goal.

To this end the government would need to elaborate a strategy and develop a policy regime that is consistent with the objective of rolling back the wide expanse of the

poverty frontier. One cannot over exaggerate the urgency of this task. Neither should one underrate the difficulty of this challenge. But it is a task that could be accomplished if only the government would rise to the occasion by developing appropriate policies, creating a conducive environment, providing the leadership through an active involvement and mobilization of the population to this end.

By any standard, by any economic criteria, using any measurement of social well-being, there is no escaping the fact that ours is a miserably poor country in absolute and comparative terms. It is a country where a great majority of its citizens eke out a miserable existence in a subsistence economy with out much improvement in their daily lives or much hope in their future. It is a land suffocated by poverty and debilitated by hopelessness.

The country's socio-economic problems are indeed alarming. Addressing these problems successfully requires wisdom, foresight, a coherent and multi-faceted strategy and the ability to effectively implement this strategy on the part of our political leaders. An important element, one without which success will remain elusive is a political commitment at the highest level for an equitable and dynamic poverty reducing growth.

This would require strategic thinking and planning on how best to use the nation's scarce resources, and an understanding of the international economic environment on the part of the business community. It requires a seriousness of purpose, attention to detail and quality from educators and intellectuals in producing the human resources that the country needs if it is to appropriately define its priorities, make an optimal use of its limited resources, and take advantage of the opportunities the external environment creates while avoiding the dangers it poses.

Above all, it requires lots of hard work and dedication from all of its able bodied and working citizens and the political leadership. It also would help to get a genuine support from the international community; one that is centered on the needs and priorities of the country rather than geared towards implementing an *apriori* established ideological agenda.

In other words, the task requires a multi-dimensional approach and need an effective utilization of all the resources, particularly the human resources, available to the country. In what follows we will go through a summary of the major problems confronting the country as discussed in the body of the *Report* and present a summary of the key policy challenges.

The report starts the analysis of the Ethiopian economy by looking at the overall macro economic condition. Albeit modest, probably the single most important achievement of the Ethiopian economy in the past seven years has been in the area of macro economic stabilization and performance. The various policy measures taken since the transition to undo the misguided and suffocating policies of the previous regime have, at least partially, succeeded in lifting the constraints imposed by the socialist policies and generate a modicum of growth averaging a decent 4.4% annually. This compares rather favorably with what has happened during the Derge period.

The key factors contributing to this healthy macro economy performance include, as suggested earlier, the elimination of some of the bottlenecks imposed by the policies of the previous regime, the energy that these reforms unleashed from the productive sectors of the society particularly from the private sector at least initially, the strong support from donors owing to the reforms and some cooperation from nature by way of good rains. All these are transitional factors and potentially reversible as we have seen with the rains and donor attitudes. The negative growth rate of GDP (-0.8%) achieved in the most recent reporting periods (1997-98) and the corresponding -3.2% growth in per capita GDP during the same period clearly attests to the fact that we are very far from achieving sustainable growth.¹

Determinants of sustainable macroeconomic performance such as investment and domestic savings are still at very low levels to guarantee long term sustainable development forcing the country to depend heavily on unreliable foreign savings with sometimes unacceptable and detrimental conditionalities.

The government has pinned its growth strategy on foreign direct investment. As discussed in the text, numerous measures were taken by the government to make the "investment environment" conducive to foreign investors including revising the country's investment code at least three times over the past seven years. However, if the past seven years are any thing to go by, not much is coming by way of foreign investment to make us rely on it as the engine of our future growth. Looking at the past trend and the experience of other countries, it is safe to say that foreign investors are mostly attracted to invest in a stable and growing economy. They are rarely seen investing in countries to generate the initial growth impulse. So the need to generate the initial growth from domestic sources.

¹ This is the most recent data obtained from the World Bank "World Development Report, 1999/2000." Government data (MEDaC) provides a slightly improved figure of -0.5%.

To this end the government needs to encourage and assist the private sector and it should also actively participate in the economy where the private sector is unwilling or is incapable of investing. This is an absolutely essential precondition to kick-start growth that foreign investors would find attractive.

Another potential source of investment are Ethiopians in Diaspora. We might be better served in our quest to increase foreign investment if we concentrate our energies in attracting Ethiopians living abroad to come and invest in their country. This is one area that the government is not focusing on. The recent gesture to provide special status in the investment code to Ethiopians who have accepted foreign nationality is a good start. But more needs to be done. Reforming the land lease policy is necessary to encourage investors, both foreign but most importantly domestic investors. ***The current policy has proven to be one of the most important bottlenecks to both domestic and foreign investment in this country.*** The country should also be at peace with itself to make it attractive for them to contemplate repatriation. In other words, it is not just the economic environment that need to be attractive but also the political atmosphere must be stable and conducive for investment.

As all data on investment in Ethiopia in the past eight years clearly show, the great majority of the investment activity that fueled economic growth has been undertaken by the domestic private sector. This is happening inspite of all the constraints. The domestic private sector is stifled by a suffocating regulatory environment and an obstinate bureaucracy that seems to privilege foreigners over domestic investors. A capital poor domestic private sector is required to compete with foreigners and pay very high rates to acquire land for investment that consumes a big portion of its capital. Even then it takes months if not years to secure the land that one has paid for without any consideration for the time value of money on the part of the irrational and hopelessly incompetent municipality governments. Exorbitant rent increases by the Addis Ababa city government has pushed many a domestic business out of business. The "open competition" to acquire government owned enterprises have prevented the meaningful participation of the domestic private sector in modern manufacturing by putting it in competition with well endowed multi nationals who are slowly driving the domestic capitalist out of this dynamic sector. Still, against all odds, the domestic private sector, with all its weaknesses perseveres. It is still the largest investor and the main engine of economic growth. It is the sector that needs a lot of help from the government and not getting it.

It is high time that policy makers pay attention to the needs of the domestic private sector and take positive measures to support

and encourage the sector by any means available and include the sector in policy dialogue and formulation.

At the end of the day, economic performance is about people's lives. Accordingly the report proceeded to look at the human condition in the country beginning with the demographic situation. There, we found that there is a very serious and unsustainable demographic pressure that is put to bear on the economic resources of the country. Population has been increasing dramatically, doubling every 23 years, while per capita land holding declined to less than a tenth of a hectare. Food output in 1990 was 6 per cent lower than its 1960 level while population increased by 132 percent.

The factors behind the inordinate growth in population are the high fertility rate accompanied by a decrease in mortality rate, the latter owing to the availability of better health care services.

High rates of population growth require a commensurate economic growth to sustain the same standard of living. A three-percent real GDP growth, for example, accompanied by the same percentage growth in population would leave the average person at the same income level. With out an increase in income, savings will remain at a low level leading to a low level of investment and hence a low level of economic growth and development. That is why the development imperative for countries such as Ethiopia needs to incorporate an aggressive but realistic population policy.

It is to the credit of the current government that it formulated National Population and Women Policies to address this concern. The National Population Policy of Ethiopia (NPPE) hopes to harmonize population growth with the available natural resources of the country by attacking the problem through a reduction in the fertility rate and reducing mortality through the promotion of maternal and child health programs. Specifically, it hopes to reduce the total fertility rate from the current 7 to 4 by the year 2015 and increase the contraception prevalence rate from the current 4 to 44 during the same period. These objectives are to be achieved through Information, Education and Communication strategies (IEC) and Community Based Distribution (CBD) methods of distributing contraceptives. Reduction of infant and child mortality is to be achieved through a wide spread of maternal and child health programs. An important component of the government's population policy is the Ethiopian National Policy on Women which, although does not address the issue of fertility directly, is hoped to contribute towards that objective by empowering women and giving them more human and property rights. An important item that is conspicuously absent in the policy, and that is directly relevant to population control, is women's reproductive right.

Overall, the government's population policy is quite ambitious. Its intention is to be applauded. However, ambition is not matched by the ability to implement the program. Most of the funding for the implementation of the program is expected to come from donors whose reliability and sustainability is at best questionable as we are witnessing these days. More importantly, such policies to be effective need as broad a public support as possible. Such broad support can be achieved if the public gets a sense of ownership of the policy, which, in turn, needs wide public participation in the policy formulation process. The success of the population policy, for example, very much depends on the degree to which the community is convinced of the value of such a policy. Recent rumors about the opposition of powerful religious institutions to the use of contraception is a clear indication of the weakness in the policy making process in general and the absence of consultation with key stakeholders in policy formulation in particular.

The challenge to effectively implement this policy requires:

- a) expansion of health services at the grass roots level,
- b) steady and uninterrupted supply of contraceptives
- c) reduce health risks that require large number of children by families as an insurance
- d) education of girls
- e) increasing income.

In addition to reducing population growth, these measures would assist in the controlling the spread of HIV/AIDS, which has become a most serious threat to the survival of the nation.

Low level of average income is one macro indicator of the level of poverty in a country although by itself this does not always show the whole picture. In this *Report*, we looked carefully at the status of human development particularly the poverty situation. Despite recent gains, Ethiopia continues to face a frustrating situation in its efforts to achieve sustainable human development. The country is beset with poverty; shortage of skilled human resources; underdeveloped socio-economic infrastructure; low level and slow development of technologies and growing unemployment and underemployment. These problems have been aggravated by more than two decades of civil war and recurrent drought. The structural adjustment programs that the country pursued did not help the situation either as it puts little commitment to the alleviation of poverty nor address the needs and priorities of the country. Added to all this are major external shocks such as deteriorating terms of trade and the increasing burden of the external debt and debt servicing obligations which all combined to make poverty a permanent feature in the life of over half of the country's population.

The Report has discussed in detail the current state of poverty and its trends. The level and depth of poverty in this country is very alarming to say the least. What we wish to flag here is what is not reflected in the statistics and what we think is happening at the level of social psychology. *It is our considered opinion that our society is getting used to poverty as a normal form of its existence.* People are used to living in poverty for so long that they seem to have settled to a stoic acceptance of their fate as a product of some predestined allotment by a supernatural power that mere mortals could do very little about. The human instinct to continually struggle against material deprivation and hope for improved material existence seem to have been replaced with hopelessness and settling for mere survival. And this is a result of powerlessness. A feeling that the individual can do very little to change his/her circumstances. We believe this is a very debilitating state of mind that needs to be mitigated through a concerted effort of all responsible government and non-governmental bodies.

The key policy challenge here is to create a national consensus against poverty. All sectors of society, all government and civil society institutions must be able to speak in one voice against poverty and be committed to its alleviation. In addition to implementing all the macroeconomic and sectoral policy reforms necessary for rapid economic growth (a crucial factor in poverty alleviation) we need to take direct and positive measures to address the problem of absolute poverty. *We need to be committed, as a society, to take care of our poor particularly those that are unfortunate enough to be able to earn a decent living because of one physical impairment or another.* We have to have a national commitment to address the issue of food insecurity in rural areas in the short run and fundamentally changing the life of the peasantry in the medium run. We also have to give a lot of attention to the creation of employment, lack of which is the main cause of poverty in the cities.

As discussed in detail in the text, the government is taking some positive measures in addressing the problem. In fact some success was registered in reducing poverty up to 1994, although recent data suggest that the gains have been wiped out in subsequent years. But whatever achievement was registered, it is not enough and what we are suggesting here goes much beyond that. *We are raising the key issue of genuine popular empowerment and mobilization. There is an urgent need to forge an alliance of all the sectors of the population as a matter of national emergency.* We need to have business people thinking about creating employment and poverty alleviation as part of their business decisions. We need to have labor unions to think beyond the interest of their employed members and worry about their unemployed compatriots. Business and labor have to forge an alliance in raising the productivity of their endeavors, as it is crucial to the increase in income. We need

educators to constantly revisit their curriculum to impart employable skills to their students. Religious and other civic institutions have to play an important role in mobilizing the public for collective action. We need the general population to feel and hope that through hard work their life could be improved and that of the life of their children would be much better than theirs. Above all we need a political commitment that goes beyond rhetoric and the mere calculus of staying in power. Our leaders should know that the best and only insurance they have is the degree to which they have succeeded to minimize national problems and improving the life of the people.

In other words, we have to attack poverty from every angle: economic, political, social and cultural milieus. All this requires building trust between the government and civil society and the former's genuine acceptance of the latter and its institutions as an important and indispensable partner in the fight against poverty.

The government must assume active and dynamic leadership and engineer economic resurgence. In a country where the private sector is weak and entrepreneurial culture is foreign, it is the responsibility of the government to create and nurture this indispensable agent of growth and development through, among others, teaching by doing. One cannot imagine national development in Ethiopia without the active participation of the government.

An important component of human development that we dealt with in the report is the status of education and health in the country. Here again, the picture is not rosy. It is safe to conclude from the available, albeit sketchy, data that some inroads have been made in the area of increasing the reach of educational opportunities to a larger section of the society. In this regard, the government's expenditure on education in general and the investment on the physical infrastructure of education in particular has increased dramatically although this was not matched directly by a commensurate increase in the enrollment ratio. Despite this improvement, however, the country's capacity to develop the skilled manpower necessary for sustainable development is very inadequate. Not only is the existing labor force mainly unskilled and of very low productivity, the majority of children do not go to school to acquire skills, further increasing the future size of the unskilled labor force. To make matters worse, those children able to go to school and fortunate enough to complete a certain level of education are not trained in skills commensurate to the needs of the nation. In effect the educational institutions are producing functionally illiterate graduates.

This phenomenon has rendered the country's educational institutions nothing less than manufacturers of unemployed and unemployable cadre of students. As the recent statistics on the country's unemployment clearly attests, the fastest increase in

the rate of unemployment is in the category of students that have completed high schools.²

This is the clearest indication of the need for a thorough reevaluation of the education curricula. The education to be provided at all levels must be focused on and anchored in the needs and the problems of the society as well as prioritized to meet the visions that the political leaders have for the country.

A related and relevant issue in the educational system is that of quality. It is a well-accepted fact that the quality of education in the country has deteriorated significantly in the past thirty years and this decline has yet to be abetted. Not only is this reflected in the standard measures of quality educators use such as teacher to pupil ratio, class size, quality and training of the teaching staff, availability of instructional material and the like, but evidence abound about the low quality of graduates from our educational institutions including higher education institutions. The business community often complains about the low quality of workers recruited from our university. Even government institutions are openly complaining about the low quality of the crop they are getting from higher education institutions.³ This is an issue that the government has not even begun to address. The exclusive concentration of the government's education policy in increasing the overall enrollment ratio particularly those at the elementary and secondary level has allowed the continuation of the deterioration in the quality of higher education to an alarming level. Given the fact that these graduates are the ones that are recruited to teach the lower levels, the level of mediocrity observed in our educational system is bound to continue for a long time to come with dire consequences to the economy and society.

We therefore would like to highlight the importance of addressing the issue of quality of education as one of the most important policy challenges facing the country in the immediate future. In particular, we wish to emphasize the need to reverse the decline in the quality of our higher education institutions.

Increasing the productivity of labor is one of the most serious challenges facing the productive sector of our economy. This presumes a highly skilled and a well-nourished and healthy work force. The issue of skill is related to education and on the job training which, as suggested earlier, are lacking both in quantity and in quality.

² See Abebe Haile, "The Nature and Extent of Unemployment in Ethiopia." In Berhanu and Alemayehu, Proceedings of the 8th Annual Conference on the Ethiopian Economy", 1999.

³ So much was admitted by Ato Mekonnen Manyazewal, Vice minister of MEDaC, in his opening address to the Seventh General Assembly of the Ethiopian Economic Association which discussed the issue of education.

The health sector of the country is no better if not worse than the education sector. The country's morbidity and mortality profile clearly show that the population is still suffering from easily preventable and communicable diseases that it has been suffering from decades ago. Lack of access to clean water, unavailability of proper sanitation facilities to the majority of the population, low income which, among other things, reduces nutritional intake, poor environmental conditions and poor coverage of health and other social services have contributed to the high morbidity and mortality profile. The low health status of the people is reflected in high infant mortality rate, which is estimated at 111 per 1000 live births and a declining life expectancy of the population which was estimated at 42 years for males and 44 years for females in 1997 down from 48 and 51 years in 1996.⁴ To make a bad situation worse, epidemics such as tuberculosis, malaria and HIV-AIDS have seriously diminished the capacity of our health care institutions.

The problem of the health situation is made even more complicated by the rapid and frightful deterioration of our health care institutions as a result of total neglect and the sheer volume of patients. In the primate city of Addis Ababa, for example, not a single hospital has been built over the past 25 years while the population has more than doubled during the same time. The infrastructure and the service provision of these hospitals have deteriorated so bad that only the desperate are served by them. Most of the elite of this society prefer to go abroad to get health care service at a very high cost and using scarce foreign currency resource of the country rather than be serviced by these institutions.

The saving grace in all this in recent years is the increasing privatization of health care provision in the major cities which, although still in its infancy, has helped ease the pressure on public health institutions. However, the government's recent policy of prohibiting healthcare professionals working in the public institutions from providing services in private clinics in their spare time has further affected the quality of health care services provided by public institutions. The relatively high pay in private clinics for part time work used to supplement income of doctors and other professionals that work for public institutions. This supplemental income was denied to the high caliber professionals by this ill-informed policy, forcing them to abandon low paying public institutions in favor of the more lucrative private practices. The net result of this policy was the further deterioration in the quality of the service provided to the poor as they are the ones that are mostly served by these public hospitals.

⁴ Table 2, Selected World Development Indicators, World Bank, World Development Report, 1999/2000 and 1998/99

As in the case of education the government, since the transition, has acknowledged the severity of the problem and allocated significant resources to the sector and has developed a health sector strategy with laudable intentions. The cornerstone of the strategy is built around principles of decentralization, prevention and development of an equitable and acceptable standard of health. However, there is need for its effective implementation. This requires proper prioritization by giving emphasis to communicable diseases and epidemics, diseases related to and derived from malnutrition and poor living conditions; rehabilitation of the health structure, maintaining of environmental health, and the development of appropriate health service management systems. Support should also be provided to the curative and rehabilitative components of health services. Provision of essential medicines, medical supplies and equipment need to be strengthened. The observed dilapidation of hospitals needs to be reversed and the technical skills of health professionals upgraded. Applied health research addressing the major health problems needs to be emphasized. We also need to devise an appropriate mechanism to finance health services through public, private and intersectional sources among which raising taxes and revenues, formal contributions or insurance by public employees and the private sector, individual or group insurance, and voluntary contributions will be the major components.

Finally, given the importance of human development that was discussed in detail in the text, we also wish to emphasize the need for meritorious appointment of officials dealing with these sectors. We have to move away from taking loyalty and ethnic representation as the central criterion for appointing high level officials irrespective of their capacity to handle their jobs.

If the Ethiopian economy is to prosper and the human condition is to improve, fundamental change has to occur in the agricultural sector. This is simply because of the sheer size of the sector both in relation to overall output and even more importantly, in the size of the population that it supports. Ethiopian agriculture, as discussed in detail in the report, is characterized by stagnant output, very low labor productivity, extremely backward technology and deteriorating soil fertility. No discernible positive change has occurred in Ethiopian agriculture both in the method of production and in the social and economic life of the population since recorded history. If there was any change, it was a change for the worse as the land's ability to support the increasing population is threatened by environmental neglect and the resultant recurrent draught.

The sector's poor performance in the past three decades is a clear indicator of its negative contribution to economic growth and development of the country. Instead of

being the basis for the country's future development through the production of food for the urban economy and for export, supplying savings for investment, generating a sizable effective demand and supplying raw materials for industry, the sector has become an impediment to the overall growth of the country. The causes for this inferior performance are many and we have discussed most of them in the text. But the single most important factor has been the blind extraction of resources from the sector. This was a clear policy of killing the goose that was laying the golden egg.

Government policy was also not supportive of agricultural development. Among the major factors behind the poor performance of Ethiopian agriculture that relate to government policy and the institutional structure that prevail in the country side, are diminishing farm size and subsistence farming, soil degradation, tenure insecurity, weak agricultural research base and extension system, lack of financial services, imperfect agricultural markets and poor infrastructure. The first three reasons are directly or indirectly related to the current institutional arrangement in agriculture particularly the land tenure system of the country while the four latter issues are related to the overall backwardness and poverty of the country.

Probably the most important policy issue facing Ethiopian agriculture today is the issue of the current land holding arrangement. Of course, the land tenure system that prevail in the country today, save for minor improvements regarding short term leasing by peasants, is the one inherited from the previous regime. The current government has made its views on the matter clear by accepting the inherited tenure arrangement. What is new with the new government's policy is that land policy is enshrined in the constitution and thus has effectively eliminated the possibility of flexible application. Even worse, it has eliminated all meaningful debates about efficient utilization of land. Accordingly, land is no more treated as another factor of production (such as labor, capital or technology). Instead, it is treated as a normative and ideological factor that cannot be evaluated by ordinary measures of efficiency in resource allocation.

The Ethiopian economy in general and the Ethiopian peasants in particular have lived through the terrible consequences of such a rigid and ideologically driven policy. The central issue of land policy as it relates to the development of agriculture is the issue of tenure security which has important implications for agricultural productivity via the incentive to invest in agriculture by peasants in general and investment in soil preservation and environmental protection in particular. A host of evidence is presented in the *Report* to show that this issue is indeed a major cause of the problem.

of Ethiopian agriculture and, given the rapid increase in population, it is bound to lead to a Malthusian disaster in not too distant a future.⁵

It is therefore, one of the most important policy recommendations of this report for the government to revisit the land issue much more soberly by genuinely involving the key stake holders in the policy formulation process.

There is a wide literature on land tenure and the debate about what kind of land tenure is more appropriate for Ethiopia is far from settled. What we can say, as part of our policy recommendation is that the tenure structure that we need to have, whatever form it takes (private ownership, associated ownership, a mixed state-private ownership...etc.), must be able to provide at least the following key elements:

- Firm security of tenure
- The possibility of consolidation
- Facility for migration without loss of holding or adequate compensation
- The possibility of transfer for as long a period as possible including complete transfer

We feel that a tenure arrangement that allows for these elements is important to institute if Ethiopian agriculture is to have any bright future. We also feel that a land tenure system that incorporates these elements shall do the trick no matter what the nomenclature. The starting point for such a revision of land tenure system, as we said above, is to reopen the debate on the issue for public deliberation by stake holders that includes a genuine participation by peasants themselves.

If the performance of the agricultural sector is crucial for our economic and social well being in the short-run and the medium term, our long-term future most heavily depends on the industrial sector and industrialization in general. Unfortunately for the country, this is not a sector that is doing well by any measure. As intimated in the report, the sector is small in its contribution to GDP, is not showing significant growth, and exhibits very low productivity to be able to compete in the cut throat competition of global capitalism. The report looked in detail at the various constraints to the development of industry by categorizing them into seven groups. These are technology-related problems, market, finance, policy issues, inputs supply, human

⁵ In this regard it is instructive to look at a recent Ph.D. dissertation by Tekie Alemu, which provided a strong empirical evidence connecting crop production, investment in soil conservation and tenure security. The paper also showed farmers willingness to pay for an alternative institutional arrangement that provides them with tenure security. See Tekie Alemu "Land Tenure and Soil Conservation: Evidence from Ethiopia," Unpublished Ph.D. dissertation, Goteborg University, 1999.

resource constraints and the overall political environment. For the purpose of this section of the report, we will concentrate on the policy environment and policy related problems.

Unlike in agriculture, where there is a clear strategy, there is no clear and transparent industrialization strategy for the country. Industrialization in the government's five-year development strategy is taken to follow automatically with the development of the agricultural sector. No matter what the validity of the strategy towards the agricultural sector, it certainly is not sufficient to promote aggressive industrialization that the country desperately needs. Therefore, the first thing that we need to be absolutely clear about is that industrialization is not an option for development but a necessity.

Our economic survival requires that we industrialize. To do that we need to have an industrial policy. That is, we need to have a clear strategy for industrialization. Industrialization is not an activity to be left to the vagaries of the market. It is and should be the result of a conscious and vigorous drive.

When we talk about industrial policy or strategy, we are not talking about getting detailed plans for resource allocation as was common in the failed "socialist experiment". We are talking about having a general guideline about where we are going in the medium term. Every firm in a capitalist country needs to have a short-term plan as well as long term strategy to survive in a competitive market. Countries also need to have a strategy to survive in a competitive world. The relevant issue is what kind of industrialization and to identify the elements that go into a successful industrial policy.

We believe that one of the most important elements for a successful industrial policy is to identify the country's static and dynamic comparative advantage. In other words we need to first identify those sectors where the country has a relative cost advantage now or those sectors that the country could have a cost advantage if the appropriate conditions are met. This might be effectively done in rich countries with large corporations with huge R&D budgets. Not in countries such as Ethiopia nor has it been done in the rich countries at the early stages of their industrialization. The state, with all its resources has to do this in cooperation with the private sector. Once such sectors are identified, the state must be committed to develop industries in these sectors either by giving a package of incentives to the private sector (which could include subsidies, credit priorities and interest rate support, supplying free land, assist in the acquisition of foreign exchange, ...etc.); by jointly investing with the private sector or, in the absence of a private sector willing and able to take the challenge, the state has to make the investment itself. An important element of such a package of incentives, whether done by the private sector (foreign or domestic) or by the state is

some degree of protection from more experienced foreign competitors. Such support has to be selective and limited over a span of time.

Equally important for the success of such a strategy is the transparency in the formulation and implementation of such a strategy. In formulating such a strategy, the public must be well informed through public discussions and stakeholders must participate in the design of such a strategy. Even more important, there must be transparency in implementing such a strategy to avoid for the policy to be hijacked by special interest groups that would use it for rent seeking purposes. This means clearly identifying the projects that benefit from the package of incentives and officially announcing the kinds of incentives offered.

This issue of industrial policy directly takes us to the country's foreign trade position and policy. As was clearly stated in the Report, the structure of Ethiopia's foreign trade has remained what it was some five decades ago. The country is still dependent on primary commodities for exports with coffee taking the lion's share. Like all primary commodity exporters, Ethiopia's foreign exchange earnings suffers from instabilities in the export market ranging from declining demand and the secular decline in international prices and the secular increase in manufactured goods prices or what is commonly referred to in the literature as adverse terms of trade.

The key to reversing this trend is diversification of exports or moving more towards high value added export products. This, of course, implies export of industrially manufactured products or at least moving towards export of industrially processed agricultural products. Which brings us back to the issue of industrial policy.

The government recently established an export promotion agency, which was mandated to find ways to increase the country's exports. From early indications, the agency seems to be intending to fulfill its mission by looking for more markets for the traditional exports of the country. If this is the long-term strategy, we are afraid that it won't take us too far in resolving our balance of payment problems. Instead, what we need to do, we believe, is to use trade policy as an instrument of an overall industrialization strategy. As was suggested earlier and clearly indicated in the box on European trade policy in relation to agro-industrial products, we know no country that has implemented a fully liberal trade policy and we are not about to be the first one to show the world that you can indeed industrialize via a completely open and free trade policy. So, the urgent need to design and pursue a trade policy that supports the nation's overall industrialization effort. What this means is that we need to protect and support industries that are deemed to have a dynamic comparative advantage and we need to develop an industrial policy to identify industries that can be internationally

competitive in the future in order to diversify our exports. That is the only guarantee for a long-term healthy balance of payment position and national development.

The recommendation with respect to trade policy is to structure it in such a way that it is consistent with development strategy. Scarce foreign exchange should be used for national development. The government needs to use trade policy to influence domestic consumption behavior by limiting access to or making it expensive to engage in conspicuous (exorbitantly luxury) consumption that compete for our limited foreign exchange.

Furthermore, the national development policy should encourage competition among domestic producers in the domestic market, while at the same time encouraging them to export. Such a policy regime would have the additional advantage of attracting foreign investment much more than an open trade policy.

This brings us finally to the policy challenges facing our country in relation to the financial sector. The policy issue concerning the financial sector is related to the degree of liberalization the sector needs in order to play the key role of financial intermediation effectively. This is an issue that has gotten more attention since the Asian crisis of 1997. The liberalizers (as always led by the IMF) argue that an unrestricted competitive financial sector with full participation by foreign financial firms is the only guarantee for an efficient sector that could help the overall development effort. Their opponents suggest that fully liberalized finance not only eliminates the government's ability to use financial policy for targeted development, as was effectively used by the Asian Tigers in their miraculous achievements, but even worse, it could expose developing countries to financial crisis when implemented without a strong regulatory framework and an internationally competitive domestic financial sector. The Ethiopian government has followed a policy of gradual liberalization since 1992 and we believe it has gone as far as it should go and no further.

We generally agree with the position of the government regarding the sector and hope that the government will not be pushed to drastic liberalization by the international financial institutions (IFIs).

The government should use financial instruments (for example through use of differential interest rates for priority projects) and the exchange rate as part of its overall development policy. We particularly emphasize the need for developing and strengthening the domestic financial sector and shielding them from an unequal competition by powerful multi-national financial corporations.

In the interest of insuring an orderly distribution of financial institutions in all parts of the country, we insist that the National Bank of Ethiopia (NBE) revive the requirement that any bank that seeks to open a branch in one of its preferred locations should match this by establishing a branch in one of the small towns and cities in the country. Otherwise all the banks and particularly the private financial institutions would concentrate in the profitable urban centers, leaving out the vast population without the service of a bank.

4. CONCLUSION

The Political Economy of Development

Theories of economic development since its beginning in the 1950s have tried to determine the key factors necessary for economic development. Beginning from the famous Harrod-Domar model, economists have emphasized the need for high levels of savings and investment for rapid economic growth. While the importance of savings and investment is still acknowledged, it was clear that these are not sufficient conditions for achieving rapid growth and structural transformation. Second generation researchers introduced additional factors such as education as explanatory variables and broadened the concept of development to incorporate alleviation of poverty. Again, without denying the importance of these additional elements, the ability to explain the development process with these variables was not satisfactory. Beginning with the Berg report of 1981, the emphasis shifted to the need for "good policy" as the key to development. In particular, it was presumed that lack of market friendly policies were the key villains to the slow growth in developing countries and a quick and universally applicable package of pro market policies (structural adjustment) were recommended as a panacea to the development problems of poor countries. Here again, this policy package could not produce the desired result for many developing countries. In some cases it even made the problem worse.

The most recent thinking about development is now bringing a more "political economy" approach in the sense that it is acknowledging that the problems of economic development require more than just manipulating narrowly defined economic variables. It is now a widely accepted view across the ideological spectrum that economic development is a broad phenomena that incorporate structural transformation of societies. *To effectively address it necessitates a well thought out economic policy that takes into account structural factors within each*

country, a clean and efficient bureaucracy, an accountable governance structure, stable polity and above all developing a broad coalition for development in each society. Such a broad coalition, on the other hand, requires an open and inclusive government that works closely with stakeholders in policy discussion, formulation and implementation.

We believe this is as applicable for Ethiopia as it is for many African countries. We have repeatedly mentioned in the *Report* the need for consultation in the policy making process. The development challenge we are facing as a country is far too heavy and complicated to be shouldered by any group or even to be understood by any one intellectual discipline let alone by a small group of "wise men" who think alike. The policy making process should allow the participation of differing social groups, competing theoretical perspectives and opposing political or ideological positions. We hope, those competing for political leadership in Ethiopia realize this and heed to our call for an inclusive policy making process.

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TECHNICAL APPENDIX*

1. Theoretical Outline of Models used for Projection

1.1. The Two Gap Model

To project GDP, major macro variables as well as internal and external gaps, a simple growth model specified along the Harrod-Domar line is estimated using the Ethiopian data. The Harrod-Domar equation is given by

$$g = \left(\frac{1}{k}\right) \frac{I}{Y} = \frac{\Delta Y}{Y} = \left(\frac{1}{k}\right) \frac{\Delta K}{Y} \quad [1]$$

Where: g is the growth rate, k the incremental capital-output ratio (ICOR) and I/Y the investment (I) GDP (Y) ratio. Based on the projection of I/Y it is straightforward to project GDP. This is reported in Annex B of Tables 1 - 4

According to the 'two gap' model, capital is the key constraint to growth. In the context of such discussion equation [1] may be written into

$$Y_{t+1} - Y_t = \frac{1}{k} I_t \quad [2]$$

Since,

$$Y_{t+1} = (1+g)Y_t \quad [3]$$

then,

$$Y_{t+1} - Y_t = gY_t \quad [4]$$

If the target rate of growth is specified as ' g ', then it will be straightforward to estimate the desired level of investment (I^*) required. This is given by:

$$I_t^* = gkY_t \quad [5]$$

* The editors are grateful to Dr. Alemayehu Geda who authored the background paper for this section and the data in Annex C.

Desired level of saving (S^*) and imports (M^*) are given by the following equations,

$$S_t^* = \alpha_0 + \alpha_1 Y_t \quad [6]$$

$$M_t^* = \beta_0 + \beta_1 Y_t \quad [7]$$

The level of exports are also given by,

$$X_t = (1 + \varepsilon) X_{t-1} \quad [8]$$

Where: ε is an exogenously given value of export growth rate.

Based on equations [5] to [8] it is possible to compute the *ex ante* saving ($I^* - S^*$) and trade ($M^* - X$) gaps.

In this version of the 'two gap' model the desired level of investment (and hence the target growth) is always met. This requires, however, that external finance (aid, A) need to bridge the larger of the two gaps.

$$A = \max \{ I^* - S^*, M^* - X^* \} \quad [9]$$

It is also easy to compute the *ex post* level of the two gaps by computing saving and imports as,

$$S_t = I_t - A_t \quad [10]$$

$$M_t = X_t + A \quad [11]$$

1.2. The Simple Keynesian Model Based Projection

The model specified in this section is a very simple one. The prime objective is to contrast the projection obtained in the context of the Harrod-Dommar model with a somewhat complete framework. The model closure is the national income identity given as equation 1 below.

$$Y = C + I + G + X - M \quad [1]$$

Where: Y is GDP, C = consumption, I = gross capital formation, G = government expenditure, X and M = export and import of goods and non-factor services, respectively.

$$C = \alpha_0 + \alpha_1 Y_d \quad [2]$$

Where: Y_d is disposable income taken as GDP less aggregate taxes.

The consumption equation is derived from the saving equation estimated in the context of the 'two gap model' constructed for this exercise.

The gross fixed capital formation is taken as the sum of private (I_p) and public (I_g) investment. The public investment is taken as a policy variable that can be manipulated by the government. Thus, it is exogenous to this model. The private investment function used is basically an accelerator type (Chenery 1952) but modified to accommodate the externally constrained nature of investment in developing countries (See FitzGerald *et al* 1992; Alemayehu 1999b). This function is given as,

Private (p) investment (I) is defined to reflect adjustment of capital stock (K) to its desired level (K^*)

$$I_p = \lambda (K_p^* - K_{pt-1}) \quad [1]$$

Where: λ is an adjustment coefficient.

The desired capital stock is further defined as,

$$K_p^* = b_1 Y_t + b_2 K_{pt-1} + b_3 M_A + b_4 J_A + b_5 DG \quad [2]$$

Where: M is level of import; J_A an indicator of capital flight and DG the level of public debt.

Substituting [2] into [1] and taking the first difference of the result, to circumvent the capital stock data problem, gives equation 3 which is estimated for East and Southern African countries in the form of equation [4].

$$I_p = \beta_1 \Delta Y_t + \beta_2 I_{pt-1} + \beta_3 \Delta M_A + \beta_4 \Delta J_A + \beta_5 Z_A + I_{pt-1} \quad [3]$$

Where $\beta_1 = \Sigma b_i$ and Z_A public borrowing

Owing to lack of disaggregated and long series Ethiopian data, we have used parameters estimated for countries in East and Southern Africa (where Ethiopian data is included) (See Alemayehu 1999b). This dynamic equation is given as;

$$\Delta \ln \left(\frac{I_p}{Y} \right) = 0.04 \Delta \ln \left(\frac{Y_t}{Y_{t-1}} \right) + 0.56 \Delta \ln \left(\frac{I_e}{Y} \right)_{t-1} + 0.68 \Delta \ln \left(\frac{\Delta M}{Y} \right)_{t-1} \quad (0.32) \quad (4.3)^* \quad (4.3)^*$$

$$-0.25 \ln \left[\left(\frac{I_p}{Y} \right)_{t-1} + 0.47 \ln \left(\frac{Y_t}{Y_{t-1}} \right) - 0.83 \ln \left(\frac{I_e}{Y} \right)_{t-2} - 2.0 \ln \left(\frac{\Delta M}{Y} \right)_{t-1} \right] \quad (-3.8)^* \quad (-0.80) \quad (10.2)^* \quad (2.2)^*$$

[4]

R^2 -adj = 0.35 R^2 -level = 0.44 Reset = 1.7 Jarque-Bera = 3.27* Chow = 1.5* BG=3.8(0.03) LM=2.2 (0.15) n=76; Values in bracket are t-values * significant at 1% ** at 5% and ^ at 10%

Similarly an export-supply function estimated for East and Southern African countries (including Ethiopia) is used for the purpose of this model. The general theoretical model is given below (See Alemayehu 1999b how this is reconciled with data problem).

$$X_{it}^{ex} = a_0 + a_1 \left(\frac{ep_s}{p_d} \right) + a_2 \left(\frac{ep_s}{p_d} \right)_{t-1} + a_3 \left[\left(\frac{ep_s}{p_d} \right)_{t-1} - k^{-1} \sum_{i=1}^k \left(\frac{ep_s}{p_d} \right)_{t-i} \right] + a_4 (\Delta K)_{t-1} + a_5 FF_{t-1}$$

Capacity utilization Expected profit Capital formation

Where:

X - Export supply; e - nominal exchange rate, Ps - Export price of South; Pd - domestic price; FF - Foreign Inflow; ΔK - Capital formation indicator; the term in bracket, [...], is the expected profit indicator - the deviation of current price from k years moving average.

In the projection model, we have used the parameters estimated for East and Southern Africa (in particular for exports of beverage). The latter is a realistic assumption owing to more than 60% share of coffee in Ethiopia's export.

Finally, the import function, estimated in the context of the 'two gap model for Ethiopia' in the previous section, is used. Government expenditure and the level of tax are assumed to be exogenous. In the projection model long-run elasticities are used. This is assumed to tally with the medium-term nature of the projection.

We must admit from the outset that this is a very simple model and can have many weaknesses. It should be evaluated, however, in the context of the absence of macro models, the limited time as well as the more complementary role of this model to the two models above.

The model is solved and projections are made using the Guass-Sedel algorithm (using Eviews software version 2.0). The beauty of Guass-Sedel lies in its ability to render solution (especially to large-scale models) without the difficult process of derivatives, matrix inversion and similar procedures required in numerical solution.

TECHNICAL APPENDIX

Notes About the Data Sets

The data used in this study are independently compiled by the authors of each of the background papers. However, the macro data is compiled in an integrated framework. The database is an extremely rich covering almost all macro variable and the method of arriving at them. It is a time series data that stretches as back as 1973 E.C (1980/81). The electronic version of this data can be obtained from EEA secretariat. In this section we will not be going into the details of the data and methodology. We will rather present a simple definition of the terms used in the report in section A, and describe briefly the essence of the integrated framework in section B.

A. Definitions:

GDP: In estimating GDP by kind of activity, the production approach is employed in commodity producing sectors and income approach for many of the service sectors. The whole economy is divided into seventeen (17) sectors for estimation purposes.

Agriculture GDP

Crop: This sub-sector covers the production of temporary and permanent crops such as cereals, *enset*, oilseeds, pulses, industrial and plantation crop like tea, coffee, sugar cane, cotton and tobacco; fruits and vegetables and other crops like spices, sisal and chat. The production of by-products such as hay and straw are also included.

Livestock: This sub-sector covers rearing of livestock, production of livestock products such as meat, milk and milk products like butter and cheese, raw hides and skins, wool, eggs, honey, bees wax and animal dung for fuel.

Forestry: The sector covers production and gathering of firewood, production of logs and timber, production and gathering of forest products such as gum, resin, incense as well as planting of trees.

Fishing: The activity covers fishing for sale and own subsistence consumption.

Industry GDP

Mining and Quarrying: The sector covers the production of gold, platinum, tantalum, soda ash, gemstones, rock salt, marble and quarrying.

Large and Medium Scale Manufacturing: The sector covers all establishments (both public and private) employing ten or more workers and using some power driven machinery.

Small Scale Manufacturing and Handicrafts: This sector specifically refers to activities such as handloom production, tailoring of clothes, leather products, oil pressing, pottery, carpentry shops, bakery and similar activities.

Electricity Supply: The electricity sub-sector includes the electric power generation and distribution activities of Ethiopian Electric and Power Corporation (formerly EELPA). Electric power generated for own consumption and distribution is excluded from the sub-sector.

Water Supply: The water supply sub-sector covers the services of the Addis Ababa Water Supply and Sewerage Authority and the water supply services in other urban areas. It also includes the drawing and carrying of water by rural households.

Construction: The sector covers the construction and maintenance of: (1) residential buildings and non-residential buildings; (2) Other construction works, e.g. roads, railroads, streets, sewers, bridges, viaducts, subways and tunnels, parking facilities, airports, harbor, piers, canals, water wells, etc; and (3) Construction work connected with land reclamation and improvement including afforestation and soil conservation as well as permanent crops development and extension.

Services GDP

Trade, Hotels and Restaurants: The sector covers wholesales and retail trade, services rendered by hotels, other lodging places, restaurants, cafes and other eating and drinking places.

Transport and Communication: The sector includes (1) Road transport, (2) Railway transport, (3) Water transport, (4) Air transport and (5) Communications (Telecommunication and Postal Services). The value added of each sub-sector is derived simply from their income and expenditure accounts using either the production or income approach.

Banking and Insurance: The sector is limited to the activities of the National Bank of Ethiopia, the Commercial Bank of Ethiopia, the Housing and Savings Bank (now the Construction and Business Bank), Development Bank, Ethiopian Insurance Corporation and recently private owned commercial banks and insurance companies. Excluded from the sector are savings and credit associations of employee, informal credit and insurance institutions such as *equb* and *edir* for which no reliable data are available. Income and expenditure statement of institutions and organizations operating in the sector are used for estimation.

Real Estate and Ownership of Dwellings: what is included in the sector is the ownership of dwellings. This is because between 1975 and 1991 commercial operation of residential and non-residential buildings were prohibited by law.

Public Administration and Defense: The activity covers the services provided by all central government ministries (excluding education and health which are treated separately), commissions, agencies, authorities and institutes and the activities of chartered and non-chartered municipalities. Regional and sub-regional administrations are also included.

Education Services: This sector covers all activities of all government, private, mission and community education institutions of all types.

Health Services: The sector includes hospitals, sanatoria, health centers, clinics and similar institutions. Military and police hospitals are excluded, as they are included in the sub-sector 'public administration and defense'.

Domestic Services: The sector covers the services provided by house hold employees such as maids, cooks, laundresses, baby sitters, watchmen and other housekeeping service workers.

Other Services: The 'Other Services' sector includes all services not covered under the previously treated economic activities.

GDP by Expenditure Approach

Government Consumption Expenditure (GCE): Government Consumption Expenditure (GCE) includes the consumption expenditure of all central, provincial or regional and local government organs. The consumption expenditures of the administrative services of *kebeles* are included to the extent their employees are paid by the municipalities.

Private Final Consumption Expenditure (PFCE): Covers the final consumption expenditure in the domestic market of households and nonprofit making bodies serving households on current goods and services less net sale of similar goods, mainly second hand goods. It also includes consumption of own-account production valued at producer prices and imputed gross rent of owner occupied dwellings.

Gross Domestic Capital Formation (GDCF): Is made up of two major components: increased in stocks and gross fixed capital formation (GFCF).

Export and Imports of Goods and Non-Factor Services: This section covers all transactions of Ethiopian residents with the rest of the world in merchandise and transportation, communication and insurance services irrespective of whether the goods and services are acquired or disposed off through purchase, sale or donation.

Data on Public Finance: The type of data used is time series that covers from 1974 E.C – 1988 E.C. The Ministry of Finance prepares the data on public finance. The data reported in

this study is compiled from the 'Annual Budgetary Revenue and Expenditure' document. We have double-checked some of the aggregations¹ made by the Ministry and reported the corrected one.

B. Method of the Integrated Framework

There is analytical inconsistency among the data reported by different institutions in Ethiopia. In this section we will describe the methodology employed in this study to generate analytically consistent macro data series.

The first problem relates to the inconsistency across different source (i.e. macro variables obtained from different institutions vary). First, by resorting to original suppliers of data for different categories, we have attempted to circumvent problems that may arise when data change hands. The second major problem relates to analytical inconsistency in an identified source. Consistency between *National Account* and *Balance of Payments* data requires the net factor payment and current transfer (NFPCT) computed from the National Account should be equal to the same item computed from the Balance of Payment.

In this report we have not attempted to investigate the problem at the level of the source of data. The focus rather was on the discrepancy and inconsistency of the existing data reported by different institutions. The existing Ethiopian data does not obey to this accounting rule.

The major adjustment lies in dealing with the discrepancy. Depending on the assumption about the accuracy of national account data vis-a-vis the balance of payment, there are two options in dealing with this discrepancy.

If one assumes that the NFPCT computed from national account is correct, this value could be imposed on the balance of payment statistics. The discrepancy on the balance of payment will be accounted for in the variable *other net factor payments and current transfers of the private sector* (for any other reasonable choice).

The second alternative is to assume that the NFPCT computed from balance of payment is correct. This figure should be imposed upon the domestic saving to give the national saving. Assuming further that saving in the public sector is relatively accurately recorded, the private sector saving could be chosen to account for the discrepancy. The choice between the two alternatives should depend on the nature of the analysis to be made and the relative faith one puts on the two sources. For instance if the analysis is largely based on the external sector it is reasonable to assume net factor payment and current transfer as computed from balance of payment to be correct (assuming equal faith in both sources). It is this latter assumption that is chosen in this study. The major rationale being the BOB is relatively accurately recorded. This adjustment has resulted in a consistent database that can be obtained from EEA.

¹ We have found some mistakes when the totals are generated in the Ministry's documents.

SELECTED MACROECONOMIC INDICATORS

ANNEX A

Table 1: 'Schedule A' in Proclamation 30/1992

Taxable Monthly Income (in Birr)	Rates of Tax (%) on Every Additional Income
Up to 105	Free
106 - 400 on the next 295	10
401 - 700 * * * 300	15
701 - 1000 * * * 300	20
1001 - 1300 * * * 300	25
1301 - 1600 * * * 300	30
1601 - 1900 * * * 300	35
1901 - 2200 * * * 300	40
2201 - 2500 * * * 300	45
2501 or More	50

Source: Proclamation 30/1992.

Table 2: 'Schedule A' in Proclamation 107/1994

Taxable Monthly Income (in Birr)	Rates of Tax (%) on Every Additional Income
Up to 120	Free
121 - 600 on the next 480	10
601 - 1200 * * * 600	15
1201 - 2000 * * * 800	20
2001 - 3000 * * * 1000	30
3001 or More	40

Source: Proclamation 107/1994.

ANNEX B

Table 1

Calendar		Y	I*
Ethiopian	Gregorian		
1990	1997/98	45204.18	9467.56
1991	1998/99	50583.48	10594.20
1992	1999/2000	56602.91	11854.91
1993	2001/2002	63338.66	13265.65
1994	2002/2003	70875.96	14844.26
1995	2003/2004	79310.20	16610.73
1996	2004/2005	88748.11	18587.40
1997	2005/2006	99309.14	20799.31

Table 2

Projection of Major Macro Aggregates [in Millions of Birr (nominal)]

Calendar		Y	I*	S*	M*	X
Ethiopian	Gregorian					
1990	1997/98	45204.18	9467.56	3607.53	20992.46	7283.00
1991	1998/99	50583.48	10594.20	4037.88	23520.73	9176.58
1992	1999/2000	56602.91	11854.91	4519.43	26349.87	11562.49
1993	2001/2002	63338.66	13265.65	5058.29	29515.67	14568.74
1994	2002/2003	70875.96	14844.26	5651.28	33058.20	18356.61
1995	2003/2004	79310.20	16610.73	6336.02	37022.29	23129.33
1996	2004/2005	88748.11	18587.40	7091.05	41458.11	29142.95
1997	2005/2006	99309.14	20799.31	7935.93	46421.79	36720.12

Note: Y = GDP; I = Investment; S = Saving; M = Import of goods and non-factor service; X = Export of goods and non-factor service; I* and S* desired level of S and I.

Table 3
Projection of Gaps and External Assistance [in Millions of Birr (nominal)]

Calendar		Ex ante		Binding Gap	Aid Required	Ex Post	
Ethiopian	Gregorian	I*-S*	M*-X			I-S	M-X
1990	1997/98	5860.03	13709.46	Trade	13709.46	13709.46	13709.46
1991	1998/99	6556.33	14344.15	Trade	14344.15	14344.15	14344.15
1992	1999/2000	7335.48	14787.38	Trade	14787.38	14787.38	14787.38
1993	2001/2002	8207.36	14946.93	Trade	14946.93	14946.93	14946.93
1994	2002/2003	9182.98	14701.59	Trade	14701.59	14701.59	14701.59
1995	2003/2004	10274.71	13892.96	Trade	13892.96	13892.96	13892.96
1996	2004/2005	11496.36	12315.16	Trade	12315.16	12315.16	12315.16
1997	2005/2006	12863.37	9701.67	Saving	12863.37	12863.37	12863.37

Note: I= Investment; S= Saving; M= Import of goods and non-factor service; X= Export of goods and non-factor service; I* and S* desired level of S and I

Table 4
Keynesian Model Based Projection

Calendar		Y (GDP)	CONS	I	IG	IP	M	X
Ethiopian	Gregorian							
1990	1997/98	42114.93	38748.54	10256.05	4018.96	6237.09	19544.02	7525.88
1991	1998/99	47915.19	44084.77	11357.61	4621.80	6735.81	22270.14	9204.28
1992	1999/2000	55391.96	50963.40	12629.17	5315.08	7314.10	25784.22	11601.83
1993	2001/2002	64965.70	59771.25	14100.05	6112.34	7987.71	30283.88	14917.95
1994	2002/2003	77207.29	71033.51	15798.35	7029.19	8769.16	36037.43	19435.89
1995	2003/2004	92886.52	85458.40	17757.38	8083.56	9673.81	43406.67	25542.04
1996	2004/2005	113029.90	103990.30	20016.00	9296.10	10719.90	52874.06	33759.68
1997	2005/2006	139002.00	127884.60	22619.23	10690.51	11928.72	65080.92	44790.01

CONS = Consumption, IG and IP = public and private consumption, respectively.

ANNEX C

Table 1.: ETHIOPIA: Components of GDP (Millions of Birr) (Current Prices), Ethiopian Year

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
GDP (periods)	0.00	0.00	10020.86	10935.76	12770.42	10887.62	13208.55	13875.15	14831.52	16875.32	18742.14	19453.71	19195.34	20793.20	20617.40	20228.90	37037.40	41445.10	42118.00
GDP	0.00	0.00	5240.18	5635.84	6571.34	5265.63	6947.62	8116.31	7264.74	7192.36	7241.12	6192.34	1200.86	12721.15	15019.40	14159.02	0.00	0.00	0.00
Agriculture	0.00	0.00	1172.86	1780.27	4489.22	1521.14	4531.44	4808.74	4178.36	2682.52	2164.76	2071.18	1832.49	3508.45	2271.86	2668.19	0.00	0.00	0.00
Industry	0.00	0.00	3.00	1469.68	5666.44	1916.22	1911.16	2177.24	2443.52	2622.86	2587.34	2772.12	2281.17	2281.88	3055.54	3951.53	0.00	0.00	0.00
Distributors Services	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other Services	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Services	0.00	0.00	3228.08	3275.83	3950.28	4117.00	4238.53	4873.37	5204.68	5629.86	6258.87	6386.85	5987.85	6707.86	6000.70	8728.28	8.00	0.00	8.00
X	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
F	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Sol	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Govt	151.52	205.55	189.44	347.74	606.43	970.27	1462.76	1953.03	2673.26	3577.23	2852.48	1942.87	1488.87	1478.72	2647.64	3734.20	5882.23	8027.11	8779.90
Non-Govt	1179.80	1521.10	1741.20	1947.50	2130.20	2436.53	2464.20	2601.15	2822.88	2937.02	3750.00	4173.88	3495.04	3713.54	3063.44	3660.56	5231.58	6141.95	6743.21
Govt	229.80	315.60	380.30	469.60	565.10	647.20	638.20	581.50	641.50	742.00	796.00	805.20	846.00	831.50	771.50	687.00	970.00	1010.00	1010.00
Non-Govt	181.10	271.60	377.50	398.00	448.40	495.50	527.10	528.80	548.80	642.00	642.00	642.00	642.00	642.00	642.00	642.00	642.00	642.00	642.00
Foreign Trade	326.20	562.60	544.40	495.00	475.10	573.80	572.10	537.60	490.20	362.80	368.00	402.20	403.80	397.00	442.80	427.50	1264.00	1662.00	1904.00
Others including	29.81	31.02	34.30	52.50	14.20	61.90	111.86	111.86	111.86	111.86	111.86	111.86	111.86	111.86	111.86	111.86	111.86	111.86	111.86
Govt	130.30	147.30	164.60	170.40	184.70	248.80	224.64	2418.26	2418.26	2418.26	2418.26	2418.26	2418.26	2418.26	2418.26	2418.26	2418.26	2418.26	2418.26
Non-Govt	200.40	425.40	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10	419.10
CPI	1420.00	1530.21	1972.69	1604.00	1807.02	2143.11	2161.87	2706.98	3091.31	3232.31	3405.78	2927.40	2818.80	3155.20	3075.30	4190.30	4000.30	5129.60	5129.60
Expenditure (GDP)	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07	2.07
govt	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Sources: Table 5 and MEDAC for National Accounts; CSA for CPI.

Table 2: Gross Domestic Product by Industrial Sector at Current Factor Cost

Activity/Year	EFY G.Y.	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
		1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94
A. AGRICULTURE & ALLIED ACTIVITIES															
agriculture		5304.92	5451.82	6318.4	5046.38	5632.28	5690.51	5853.67	6957.68	7338.73	7972.05	15903.97	12701.15	15010.43	14159.02
Forestry		4783.44	4691.41	5426.17	4161.88	5605.60	5597.62	5632.61	5815.81	6207.08	6133.77	9605.98	11301.52	13377.72	12485.83
Fishing		508.46	707.21	848.64	880.38	1018.83	1090.65	1215.30	1134.84	1124.71	1231.61	1280.38	1389.85	1621.81	1681.31
		3.02	3.18657	3.59	4.02	4.19	5.30	5.76	6.33	6.96	7.67	8.01	9.78	10.91	12.10
B. INDUSTRY															
Mining & Quarrying		1011.84	1104.22	1205.19	1265.47	1369.87	1517.34	1768.78	1751.51	1763.02	1735.71	1831.03	1508.45	2274.55	2859.19
Large & Medium Scale Manufacturing		12.4	15.3	18.8	16.30	20.10	22.79	17.60	18.81	22.70	24.00	86.20	45.49	132.80	85.30
Small Scale Industry & Handicrafts		400.421	410.055	436.832	437.04	422.68	472.64	548.69	555.55	553.73	582.05	443.07	330.48	699.20	1150.39
Electricity & Water Construction		190.428	222.634	238.062	275.44	273.72	325.37	381.13	394.73	389.91	434.41	402.53	517.77	658.74	698.95
		115.094	117.6	121.812	125.08	135.96	174.07	228.80	230.00	239.60	215.29	244.80	236.48	245.80	253.72
		280.898	339.732	372.685	412.60	516.91	522.47	594.23	551.42	557.07	510.96	453.43	378.24	538.01	672.83
C. DISTRIBUTIVE SERVICES															
Trade Hotels & Restaurants		1202.94	1482.35	1613.75	1648.95	1836.18	1985.00	2114.96	2100.81	2226.69	2431.46	2106.87	2301.66	3505.54	3981.53
Transport & Communications		916.536	1040.3	1106.07	1102.78	1246.60	1294.22	1436.80	1491.35	1466.56	1659.90	1380.03	1455.81	2103.69	2360.85
		376.402	436.00	507.672	546.18	589.59	690.78	678.16	699.46	760.13	771.56	726.84	895.85	1341.85	1540.68
D. OTHER SERVICES															
Banking & Insurance		1635.26	1773.75	1980.87	2047.37	2265.95	2369.62	2575.71	2887.81	3222.40	3559.04	3337.43	3396.33	4500.16	5027.76
Real Estate & Ownership		254.862	251.541	269.13	328.04	388.76	378.62	331.22	405.11	385.62	383.12	373.57	427.89	601.87	1222.00
Dwellings		238.78	250.08	261.28	274.12	280.07	303.52	318.18	333.30	352.64	373.18	383.12	412.39	433.89	457.08
Public Administration & Defence		616.4	602.6	769.7	797.70	874.60	924.80	976.70	1125.50	1379.30	1609.80	1231.60	959.00	1490.87	1792.70
Education		194.3	225.5	256.3	284.80	309.80	335.00	371.10	394.30	418.70	447.30	425.40	505.10	617.60	752.50
Health		65.6	69.9	75.2	79.60	86.00	81.50	101.40	103.20	110.70	115.70	108.60	128.90	168.80	265.70
Domestic & Other Services		265.32	284.128	330.267	383.11	411.72	435.18	477.11	526.40	575.45	659.93	805.14	923.06	1137.53	1347.78
Total		9324.95	9812.14	11118.2	10098.17	12102.38	12565.52	13313.11	13787.82	14500.85	15699.26	17979.30	19917.59	25290.68	28747.50

Source: Ministry of Economic Development and Cooperation.

Table 3: Gross Domestic Product by Industrial Sector at Constant Factor Cost

Activity 1 Year	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
A. AGRICULTURE & ALLIED ACTIVITIES																	
Agriculture	4783.44	4565.99	5248.36	4483.80	3441.42	4022.67	4804.38	4724.62	4765.63	5043.22	5330.71	5147.39	5488.27	5271.85	5450.03	6519.76	6879.29
Forestry	598.46	620.69	643.69	666.68	634.09	706.31	722.23	736.41	751.40	766.74	779.48	795.20	814.77	800.57	826.60	856.80	867.60
Fishing	3.02	3.13	3.25	3.37	3.51	3.66	3.82	3.99	4.23	4.44	4.70	5.01	5.28	5.58	5.90	6.10	6.40
B. INDUSTRY																	
Mining & Quarrying	1011.84	1097.56	1182.26	1231.77	1284.78	1369.17	1478.61	1422.50	1327.82	1265.28	1024.14	951.41	1222.33	1307.21	1413.65	1632.58	1660.73
Large & Medium Scale Manufacturing	12.40	14.80	15.10	16.80	24.50	24.19	21.33	16.77	20.30	19.20	32.10	38.98	57.10	45.00	49.01	55.37	62.67
Small Scale Industry & Handicrafts	406.42	431.96	443.10	480.94	458.16	528.02	565.66	584.75	575.40	566.65	336.40	306.09	456.39	514.15	562.63	615.92	670.51
Electronics & Water Construction	196.43	208.80	231.89	218.51	202.11	233.50	253.32	234.39	210.99	232.99	200.78	201.33	234.25	237.48	256.63	278.37	300.07
Electricity & Water	115.69	123.20	128.96	129.03	136.30	146.26	154.20	163.80	170.50	174.60	179.90	186.66	197.80	207.90	219.33	233.30	248.46
Construction	280.90	318.61	343.13	303.68	463.72	457.20	484.10	422.79	350.62	281.85	254.97	218.15	276.78	302.67	325.98	349.63	379.11
C. DISTRIBUTIVE SERVICES																	
Trade, Hotels & Restaurants	1202.94	1349.51	1387.05	1391.63	1404.56	1453.03	1671.66	1727.98	1633.42	1705.83	1304.92	1272.14	1555.13	1650.98	1757.39	1930.79	2084.15
Transport & Communications	916.37	958.82	968.02	957.81	933.27	922.79	1135.19	1156.81	1036.90	1117.72	760.78	648.44	887.09	945.16	1027.70	1115.60	1206.90
Other Services	376.39	390.51	418.71	433.60	471.21	530.10	536.24	570.94	596.26	587.93	544.09	623.62	667.09	705.75	729.60	799.20	884.80
D. OTHER SERVICES																	
Banking & Insurance & Real Estate	1635.17	1737.48	1882.33	1856.80	1966.51	2042.87	2178.54	2332.96	2504.06	2647.63	2494.33	2363.72	2713.74	2693.29	3190.50	3377.30	3611.00
Public Administration & Defence	463.55	516.18	581.39	559.69	549.56	570.19	642.57	684.20	688.95	699.06	654.42	621.14	677.91	747.91	810.30	879.70	964.50
Education	616.40	671.80	724.60	743.10	791.70	822.00	852.20	932.90	1053.40	1147.50	985.70	842.00	1096.10	1213.70	1327.60	1391.60	1483.40
Health	194.30	200.10	206.90	203.80	210.10	212.50	220.20	228.40	243.00	248.90	271.30	278.50	271.10	278.20	287.00	296.00	318.30
Domestic & Other Services	65.60	68.60	72.00	74.80	78.70	81.60	87.10	85.10	91.80	94.10	90.80	100.00	114.70	136.80	146.50	154.00	160.10
Total	265.32	280.80	297.44	315.50	336.45	356.38	376.48	399.36	426.93	458.07	492.11	522.09	553.93	586.68	619.00	654.10	694.70
Total	9268.25	9315.47	10253.40	9608.20	8676.90	9536.02	10874.75	10684.87	10906.07	11548.56	10664.16	10471.36	11724.42	11910.33	12532.23	14120.13	15053.14

Source: Ministry of Economic Development and Cooperation

Table 4: Gross Domestic Product by Industrial Sector at Constant Factor Cost Growth Rate (%)

Activity \ Year	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
E.F.Y.	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97
G.Y.																
A. AGRICULTURE & ALLIED ACTIVITIES	-3.6	13.6	12.5	20.9	16.0	18.8	-2.8	1.0	5.3	5.2	-2.7	6.1	-3.7	3.4	17.5	5.3
Agriculture	4.5	14.8	14.6	23.2	16.9	21.7	-3.5	0.9	5.8	5.7	-3.4	6.6	-3.9	3.4	19.8	5.5
Forestry	3.7	3.7	3.9	15.2	11.4	2.3	2.0	2.0	2.0	1.7	2.0	2.5	-1.7	3.5	3.4	3.0
Fishing	3.8	3.9	3.6	4.2	4.3	4.4	4.5	6.0	5.0	5.9	6.6	5.5	5.6	5.7	3.4	4.9
B. INDUSTRY	8.5	5.9	6.0	4.3	6.6	8.0	-3.8	-6.7	-4.7	-19.1	-7.1	28.5	6.9	8.1	8.4	8.4
Mining & Quarrying	19.4	2.0	24.0	30.3	-1.3	-11.8	-21.4	21.1	-5.4	171.4	-25.2	46.5	-21.2	8.9	13.0	13.0
Large & Medium Scale Manufacturing	6.3	2.6	8.5	-4.7	10.9	11.3	3.4	-1.6	-3.3	-39.6	-9.0	49.1	12.7	9.4	9.5	8.9
Small Scale Industry & Handicrafts	6.3	11.1	-5.8	-7.5	15.5	8.5	-7.5	10.0	10.4	13.8	0.3	16.4	1.4	8.1	8.5	7.8
Electricity & Water Construction	6.5	4.7	0.5	5.1	7.3	5.4	6.2	4.1	2.4	3.0	3.9	5.9	5.1	5.5	6.4	6.5
	13.5	7.6	15.8	20.8	-1.4	5.8	-12.7	-17.1	-18.6	-9.5	-14.4	26.9	9.4	7.7	7.3	8.4
C. DISTRIBUTIVE SERVICES	4.4	2.8	0.3	0.9	3.5	15.0	3.4	-5.5	4.4	-23.5	-2.5	22.2	6.2	6.4	9.9	7.9
Trade Hotels & Restaurants	4.6	1.0	-1.1	-2.6	-1.1	23.0	1.9	10.4	7.8	-31.9	-14.8	36.8	6.5	8.7	8.5	8.4
Transport & Communications	3.7	7.2	3.6	8.7	12.5	1.2	6.5	4.4	-1.4	-7.5	14.6	7.1	5.7	3.4	9.5	10.7
D. OTHER SERVICES	6.3	8.3	0.8	3.7	3.9	6.6	7.1	7.3	5.7	-5.8	-5.2	14.8	9.2	7.7	5.9	6.9
Banking & Insurance	4.5	12.6	3.7	-1.8	3.6	12.7	6.5	0.7	1.5	-8.4	5.1	9.1	10.3	6.3	8.0	8.5
Public Administration & Defence	9.0	7.9	2.6	6.5	3.6	3.7	9.5	12.9	8.9	-14.1	-14.6	30.2	10.7	9.4	4.8	8.6
Education	3.0	3.4	-1.5	3.1	1.1	3.6	3.7	5.4	2.4	9.0	-2.7	2.7	2.8	3.5	3.5	6.6
Health	4.6	5.0	3.9	5.2	3.9	6.5	1.1	4.2	2.5	-3.5	10.1	14.7	19.3	7.1	5.1	4.0
Domestic & Other Services	5.8	5.9	6.1	5.6	5.9	5.6	6.1	6.9	7.3	7.4	6.1	6.1	5.9	5.3	5.8	6.2
Total	0.5	10.1	6.3	19.7	9.9	14.0	-4.8	0.3	4.1	-4.2	-3.6	12.0	1.6	5.2	12.7	6.3

Source: Ministry of Economic Development and Cooperation

Table 5: ETHIOPIA : Public Finance, Current Prices (Millions of Birr), Ethiopian Year

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Government Total Revenue	1179.8	1331.1	1541.7	2130.2	2701.62	3401.46	3744.71	4447.42	5565.37	6551.1	7755.32	7261.43	8252.18	6661.23	7620.73	5474.8	5633.0	5474.8	5633.0
Current Revenue (incl. Grants)	1179.8	1331.1	1541.7	2130.2	2701.62	3401.46	3744.71	4447.42	5565.37	6551.1	7755.32	7261.43	8252.18	6661.23	7620.73	5474.8	5633.0	5474.8	5633.0
Tax Revenue	945.1	1150	1302.2	1902.9	2439.3	3003.4	3251.9	3952.71	4962.71	5944.3	7241.1	6742.1	7771.5	6171.5	7771.5	5921.7	6171.5	5921.7	6171.5
Direct Taxes	225.0	315.0	300.3	409.6	565.1	647.2	638.2	597.5	647.0	796.0	825.2	796.0	825.2	796.0	825.2	796.0	825.2	796.0	825.2
Indirect Taxes	103.1	271.6	377.5	385	396.1	448.4	495.5	527.1	529.0	598.3	778.9	847.1	777.7	643.7	664.5	692.7	699.8	692.7	699.8
Foreign Trade Taxes	620.2	902.8	644.4	485	475.1	573.8	572.1	531.8	450.2	552.1	508.0	452.2	440.8	477.5	1264.0	1602.3	1904.0	1602.3	1904.0
Non Tax Revenue	162.3	106.6	204.9	304.5	440.1	520.1	539.0	316.8	314.8	348.6	342.2	794.8	807.2	529.5	660.6	417.2	1936.9	470.8	1936.9
Grants	71.8	194.5	174.1	180.4	281.6	243.0	219.4	308.0	287.5	251.9	823.8	896.8	519.6	815.5	834.5	2710.1	1793.7	1348.4	1793.7
Capital Revenue	540.152	529.676	610.51	1591.28	384.567	1102.66	1387.32	1057.40	1372.81	898.051	5249	3030.55	2919.29	2206.57	2206.57	2206.57	2206.57	2206.57	2206.57
Capital Expenditure	3066.2	1040.1	1732.8	2706.5	2642.2	3732.76	3157.86	3030.25	3938.86	4714.81	4558.38	3508.92	3525.71	4360.83	4440.01	7618	7605.87	8432.49	7605.87
Current Expenditure	1307.3	1477.3	1694.0	1701.4	1034.7	2406.88	2224.84	2419.25	2766.88	2731.27	3099.74	3369.27	3679.39	3543.81	3409.05	3695.11	4008.23	3447.67	3095.31
General Admin. Services	1580.5	1205.33	1259.02	1254.92	1648.05	1428.31	1865.78	2132.16	2655.81	1338.11	1545.47	1344.87	1478.09	983.310	983.310	983.310	983.310	983.310	983.310
Economic Services	1509.93	161.774	167.446	169.161	178.057	204.209	274.758	277.894	243.186	285.551	394.236	402.79	473.54	440.431	440.431	440.431	440.431	440.431	440.431
Social Services	651.701	455.320	526.040	570.829	602.388	615.12	263.788	344.271	242.582	244.558	318.222	1220.95	1205.81	1236.10	1236.10	1236.10	1236.10	1236.10	1236.10
Others	2450.88	252.372	551.475	524.37	756.148	895.648	1048.66	1048.66	175.55	1297.54	161.361	329.426	248.54	417.683	1950.44	2045.25	2045.25	2045.25	2045.25
Capital Expenditure	320.4	1247.3	1604.0	1701.4	1313.8	2450.88	252.372	551.475	524.37	756.148	895.648	1048.66	1048.66	175.55	1297.54	161.361	329.426	248.54	417.683
Economic Development	320.4	368.8	442.2	505.1	716	1243.14	1331.05	1186.38	1417.77	1383.07	1453.24	1935.69	1440.12	1218.06	361.79	1784.0	1611.76	1784.0	1611.76
Social Development	82.208	85.8277	79.307	101.991	108.972	120.832	120.832	120.832	120.832	120.832	120.832	120.832	120.832	120.832	120.832	120.832	120.832	120.832	120.832
General Development	23.096	35.0021	14.4324	38.8381	47.195	31.4977	50.2927	28.3045	23.1652	19.55	26.1054	202.514	202.514	202.514	202.514	202.514	202.514	202.514	202.514

Source: Ministry of Finance

Shaded figures are obtained from other Ministry of Finance sources (not collected in the context of E.E.A.)

Table 6: ETHIOPIA: Net Factor Payments and Current Transfers (Millions of \$)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
NET FACP AND CT	75.7	90.3	52.0	58.0	81.0	157.3	275.6	379.1	775.7	2223.9	4566.2	423.1	2793.5	400.7	411.8	932.2	461.5	682.8	609.2	446.4	577.6
Public Sector	10	0	54	49	10	100	101	108	427	97	254	187	143	192	192	354	271	372	346	188	287
Private Sector	16	10	39	40	47	12	110	111	299	127	228	232	231	245	222	245	245	311	313	258	317
NET FACTOR PAYMENTS	11.1	0	7	8	7	1	11	17	50	27	95	30	28	54	62	96	70	56	46	38	0
Public Sector	7	4	7	8	7	1	1	10	30	21	25	11	12	11	12	16	70	54	46	38	0
Investment Income	10	5	16	7	7	2	4	0	3	4	41	47	78	14	0	0	0	0	0	0	0
Other	12	10	17	12	10	1	11	17	19	14	23	4	10	17	12	16	10	56	46	38	0
Private Sector	14	13	16	10	12	1	1	11	19	14	72	41	29	11	0	2	0	0	0	0	0
Investment Income	1	0	16	6	6	0	0	0	4	0	2	2	1	0	0	0	0	0	0	0	0
Other Income	0	0	0	0	0	0	0	0	0	0	1	1	1	0	0	2	0	0	0	0	0
Other	23	13	16	10	12	1	1	11	19	14	72	41	29	11	0	2	0	0	0	0	0
QUANTITATIVE TRANSFERS	38.5	80.9	60.1	34.5	75.8	1162.8	201.1	342.1	624.8	196.5	433.2	453.7	341.3	454.8	564.4	948.3	512.0	718.7	705.1	404.2	577.6
Public Sector	11	34	0	14	41	102	128	184	258	174	278	262	197	120	182	400	285	428	392	226	261
Private Sector	11	44	61	54	45	100	104	160	366	114	278	262	191	120	182	400	285	428	392	226	261
Grants	9	0	16	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Transfers	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Private Sector	11	37	29	30	34	48	103	156	227	92	138	132	111	124	222	248	247	311	313	258	317
Investment Income	18	37	29	34	48	103	156	227	92	93	138	132	111	124	222	248	247	311	313	258	317
Foreign Off Sector	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Table 7: ETHIOPIA: STRUCTURE OF EXTERNAL DEBT (in million \$) European Year

European Calendar	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Year Cycles	42.0	43.2	44.4	45.6	46.8	48.0	49.2	50.4	51.6	52.8	54.0	55.2	56.4	57.6	58.8	60.0	61.2	62.4	63.6	64.8	66.0	67.2	68.4
Subtotal	75.00	85.50	96.00	106.50	117.00	127.50	138.00	148.50	159.00	169.50	180.00	190.50	201.00	211.50	222.00	232.50	243.00	253.50	264.00	274.50	285.00	295.50	306.00
Amenities	44.00	51.00	58.00	65.00	72.00	79.00	86.00	93.00	100.00	107.00	114.00	121.00	128.00	135.00	142.00	149.00	156.00	163.00	170.00	177.00	184.00	191.00	198.00
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00	43.00	45.00	47.00	49.00	51.00	53.00	55.00	57.00	59.00	
C&F	17.00	19.00	21.00	23.00	25.00	27.00	29.00	31.00	33.00	35.00	37.00	39.00	41.00										

Source: World Data Table Database, 1992-1994. The 1992 data is used for disaggregation while others are used as adjusting factor.

Table 8. ETHIOPIA: Structure of Exports and Imports (In millions of Birr)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Exports of G.O.P. & note	1077.4	1007.2	1094.8	1164.5	1057.1	1233.7	1385.8	1258.4	1422.8	1285.0	1262.2	937.5	2222.5	3273.0	4957.7	6441.3	8790.0				
Coffee	434.2	457.7	520.2	600.2	455.1	715.1	471.5	135.2	541.8	392.8	243.2	198.6	582.9	862.3	1920.4	1834.8	2719.2				
Waxes and gums	92.0	82.6	77.6	62.6	97.4	110.8	110.4	110.4	110.4	110.4	110.4	110.4	110.4	110.4	110.4	110.4	110.4				
Oil seeds	20.7	22.1	14.5	30.5	12.8	7.6	11.2	50.8	12.5	6.7	3.8	2.1	1.2	48.4	58.2	33.995	104.4				
Char	10.2	26.5	35.1	31.8	11.1	8.5	40.7	27.1	26.5	20.8	9.2	5.9	34.1	11.3	17.2	170.528	240.5				
Oil Cakes	8.8	6.5	6.7	16.6	8.6	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9				
Others	157.3	205.1	181.7	166.6	143.2	111.2	119.7	119.7	119.7	119.7	119.7	119.7	119.7	119.7	119.7	119.7	119.7				
Non-factor goods and Services (net)	293.0	169.3	268.3	220.3	325.6	313.0	481.7	338.0	578.3	399.7	598.1	629.7	1771.56	1747.21	2028.43	2373.71	2547.77				
Imports of G.O.P. & note	1621.5	1833.2	1855.8	2125.0	2067.8	2255.3	2335.6	2768.4	2768.4	2768.4	2768.4	2768.4	2768.4	2768.4	2768.4	2768.4	2768.4				
Food & Live Animals	101.2	130.3	205.5	324.2	421.9	550.2	531.1	272.4	31.8	272.4	31.8	272.4	31.8	272.4	31.8	272.4	31.8				
Plant products	310.0	327.3	336.2	329.4	360.1	324.4	331.8	43.2	178.7	178.7	178.7	178.7	178.7	178.7	178.7	178.7	178.7				
Mineral & Metal Exports	100.5	95.6	116.1	104.7	145.2	170.1	75.1	43.0	124.4	124.4	124.4	124.4	124.4	124.4	124.4	124.4	124.4				
Machine & Transport	226.0	230.8	276.0	531.1	301.8	273.9	145.4	137.6	285.9	305.7	321.8	321.8	321.8	321.8	321.8	321.8	321.8				
Basic Metal articles	140.7	210.7	181.0	210.2	201.3	221.0	173.2	144.6	144.6	144.6	144.6	144.6	144.6	144.6	144.6	144.6	144.6				
Chemicals	97.6	105.6	149.9	106.6	135.9	195.5	213.1	52.6	120.4	120.4	120.4	120.4	120.4	120.4	120.4	120.4	120.4				
Other imports	442.1	429.0	533.0	429.6	566.5	661.0	137.2	141.0	145.5	145.5	145.5	145.5	145.5	145.5	145.5	145.5	145.5				
Non factor goods and Services (net)	205.3	260.2	105.1	111.7	204.1	-27.0	137.2	1342.9	287.1	223.4	486.6	346.7	627.7	310.1	2918.0	10900.7	12632.4				

Source: Customs Authority

Note: Import for 1988-90 and imports for 1990 not taken directly from National Accounts of MEDC due to lack of data (Note the formula)

For lack of disaggregated data on export and import of non factor goods and services, these values are derived from MEDC data

Table 9 : ETHIOPIA : Changes in the External Asset and Liability Positions of the Public and Private Sectors (Millions of Birr), Ethiopian Year

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
PRIVATE SECTOR																					
Fg	310.8	420.6	304.1	04.4	659.0	170.3	190.9	40.2	226.3	606.4	173.1	624.9	677.4	1277.6	1208.2	583.5	1874.8	3365.2	890.5	2509.9	1593.5
FgCA	14.9	21.3	60.1	74.3	41.0	50.3	562.9	239.3	250.9	417.3	378.4	364.5	199.3	30.0	414.2	88.8	87.3	112.8	44.8	325.6	1297.8
FgR	8.1	39.1	102.0	147.6	57.3	33.9	56.8	72.0	98.5	8.0	8.5	0.0	117.8	328.7	93.4	565.5	185.0	314.4	1624.4	1069.1	325.1
CAgR	13.7	37.5	79.7	109.1	43.7	36.4	49.5	50.1	25.5	0.0	6.0	0.0	96.3	273.2	63.5	555.5	143.5	572.3	87.4	220.9	0.0
CLgR	21.7	1.7	21.3	34.4	13.7	7.5	1.4	21.9	13.1	0.0	0.0	0.0	274.0	53.5	156.3	410.0	41.5	257.9	537.1	808.2	335.3
FgURCA	6.6	60.4	40.4	60.1	15.5	22.4	112.0	311.7	369.4	437.3	378.4	164.6	81.5	288.7	127.8	654.4	118.0	207.8	460.4	743.5	962.7
FgURNA	333.7	447.0	343.4	10.1	577.2	80.0	353.8	279.9	24.5	278.1	226.3	430.3	328.1	1341.8	774.0	1042.3	1547.5	3677.8	540.5	2611.3	2641.3
PUBLIC SECTOR																					
Fg	186.3	221.1	113.6	334.7	29.2	329.1	207.0	200.8	221.3	27.9	400.1	618.5	685.0	1519.2	1839.8	1702.9	2374.0	3181.9	1720.8	4879.2	3605.0
FgCA	30.8	38.1	73.9	124.0	253.4	173.1	97.5	89.5	114.5	207.8	178.6	372.4	781.1	1474.2	902.5	1978.6	3209.5	2869.3	3243.9	2902.4	2713.4
CAg	41.6	16.2	31.1	21.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	39.2	58.2	0.0	0.0	0.0	0.0	0.0	0.0
CLg	70.6	72.3	42.6	100.8	263.4	173.1	97.5	85.5	114.5	207.8	178.6	372.4	771.4	1476.7	902.9	1978.6	3209.5	2869.3	3243.9	2902.4	2713.4
CNR	130.4	183.0	39.1	210.7	224.2	156.1	109.5	115.3	335.8	235.6	227.5	44.2	78.2	44.5	136.7	274.7	1115.5	653.1	1523.3	2014.8	922.9
$E = Fg + FgR$	151.5	205.6	130.4	410.1	640.2	465.4	367.0	241.0	447.6	667.4	228.0	6.4	157.5	907.8	431.4	750.5	559.5	417.7	1224.0	1640.3	4132.0
$FCA = FgCA + FgR$	162.2	242.4	53.0	409.0	71.0	385.4	44.1	38.9	472.2	385.4	21.7	421.9	448.6	1542.2	1354.4	1762.8	2307.0	1364.5	1764.5	4351.0	4361.4
$CAB = FCA + FgURCA$	175.3	162.0	12.6	470.2	86.5	363.1	156.1	272.8	122.8	27.9	400.1	818.5	567.2	1547.9	1233.0	1138.4	2181.0	1468.4	1926.1	3910.1	4020.7
$CLCAB = CLg + CLgURCA$	161.5	205.6	160.4	419.1	645.2	465.4	367.0	241.0	447.6	667.4	228.0	6.4	157.5	907.8	431.4	750.5	559.5	417.7	1224.0	1640.3	4132.0

Table 10: Value of Imports, by Major Commodity Groups (In Thousands of Birr)

Period E. C.	Food & Live Animals	Beverage in	Tobacco	Petrol Crude	Prod. Prod.	Chem- icals	Fertiliz- ers	Medicinal Prod.	Soap & Polish	Paper Rubber Prod.	Paper Mamf.	Textiles	Glass & Choking	Metals (Glass ware)	Mach. & Metals Mamf.	Road & Aircraft	Tras. Vehicles	Electric Material	Comm. Appara	Grain	Others	Grand Total
1971	107,280	16,358	0	336,078	41,131	97,638	0	46,443	19,916	21,256	33,136	41,289	5,879	0	190,549	228,540	1,01,751	98,491	0	0	141,284	1,470,161
1972	139,366	22,979	0	377,298	32,199	105,837	0	41,884	22,876	31,292	16,287	45,123	11,818	0	165,460	338,256	218,711	49,761	0	0	131,297	1,614,211
1973	108,521	19,879	0	336,205	29,121	84,940	0	41,711	26,452	31,498	18,935	39,734	12,015	0	134,119	275,534	183,239	178,213	0	0	181,278	1,790,836
1974	139,366	18,422	0	329,435	56,331	109,609	0	51,966	8,853	88,152	24,534	56,135	6,278	0	164,655	331,266	210,167	98,763	0	0	175,801	2,011,312
1975	421,971	13,234	73	368,081	73,699	73,699	14,094	42,064	4,874	61,834	33,821	56,816	8,216	414	147,477	207,838	201,155	47,802	21,783	240,023	199,335	1,878,726
1976	510,232	7,751	5,334	124,499	166,448	195,457	88,930	181,039	194,257	113,971	998,234	45,662	3,553	3,638	176,121	271,895	217,818	86,439	64,082	415,540	197,303	2,354,174
1978	210,144	16,217	5,919	177,061	199,706	265,695	51,558	207,281	42,910	131,383	984,491	42,234	2,267	3,444	112,569	277,687	256,474	61,095	61,538	336,534	1,046,035	1,501,999
1980	53,125	12,842	0	45,235	9,403	51,271	3,155	13,678	7,526	32,642	5,321	12,173	397	80	43,844	331,636	94,894	19,884	1,119	18,522	40,876	555,547
1981	272,197	8,913	374	178,660	34,230	120,413	92,808	63,093	30,832	41,245	28,441	45,772	8,434	2,525	174,572	285,877	249,814	89,829	92,366	211,871	212,164	2,025,198
1982	91,695	24,082	8,122	197,963	39,159	118,403	76,038	63,816	16,210	42,792	41,402	45,123	2,515	6,336	144,634	365,642	197,822	108,305	51,278	181,661	180,160	1,836,374
1983	258,204	12,900	1,858	184,177	48,979	62,158	56,822	33,600	27,843	33,114	12,336	45,122	37,496	3,815	138,229	521,827	231,595	61,668	38,336	199,366	180,199	1,911,280
1984	33,466	6,664	1,485	193,491	159,364	175,364	189	49,572	17,613	31,156	12,564	51,773	17,187	6,264	56,437	182,568	181,347	61,237	16,330	2,338	132,644	1,204,169
1985	498,045	19,617	4,817	439,139	368,753	144,851	13,062	132,376	22,531	79,886	28,768	101,668	11,445	8,547	182,686	776,569	394,591	103,643	46,812	67,882	368,116	1,976,682
1986	649,046	9,867	23,081	392,174	173,201	192,680	65,956	182,897	65,213	105,457	56,862	179,245	15,991	15,167	491,789	391,932	94,291	100,665	17,079	559,018	448,379	1,551,123
1987	928,569	11,140	11,567	445,982	445,976	181,602	187,112	176,335	24,243	206,235	65,106	237,679	48,278	22,256	521,837	675,983	943,081	173,471	19,788	341,099	673,722	6,006,606

Source: Customs Authority

Table 11: Value of Exports, by Major Commodity Groups (In Thousands of Birr)

Period E.C.	Coffee	Oil seeds	Hides & Skins	Pulses	Meat & Meal Prods.	Fruits & Vegt.	Sugar	Oil Cakes	Live Animals	Chat	Petrol Prods.	Bees Wax	Others	Re- expor. t.	Grand Total
1973	474,117	266,652	939,770	205,741	5,350	47,092	10,557	86,265	9,633	12,444	0	31,295	103,396	179	779,313
1974	487,930	271,103	920,335	453,255	57,691	71,719	6,997	53,328	10,539	25,478	0	16,801	127,706	215	937,799
1975	501,147	140,431	770,118	1,960,010	10,781	43,555	10,285	67,722	15,490	35,566	0	22,244	58,685	216	796,541
1976	600,241	305,302	926,695	17,967	5,551	67,158	9,540	166,663	18,110	31,803	0	51,900	103,599	11,465	938,514
1977	466,146	128,222	974,195	130,119	2,312	5,440	8,244	671	19,595	11,137	92,510	24,701	62,006	14	731,469
1978	718,121	74,400	1,108,660	91,455	4,206	78,716	12,778	1,999	13,895	85,466	402,338	14,275	21,587	485	968,062
1979	421,461	10,004	1,104,337	37,011	6,264	146,341	8,160	1,725	22,768	407,201	287,831	676	34,834	4	705,004
1980	536,746	20,002	1,026,431	10,321	4,898	255,220	10,149	11,971	29,952	210,521	330,041	21,995	41,883	0	967,374
1981	542,041	124,456	1,394,771	107,111	2,073	85,719	13,151	541	38,009	200,761	16,543	297	53,507	18	944,275
1982	362,773	69,019	1,295,501	35,065	5,990	77,933	41,746	474	87,158	207,164	306,628	1,601	61,553	31	695,285
1983	243,239	36,323	789,223	1,507,121	7,071	184,571	5,244	24	3,060	92,461	206,121	618	75,204	2385	464,039
1984	159,086	56	503,695	386	10	6,007	17,519	5	298	58,711	27,959	607	15,003	0	307,782
1985	562,034	11,095	1,451,104	40,550	430	23,671	5,090	14	13,114	641,115	260,339	24,861	16,299	0	851,448
1986	662,347	463,561	2,320,445	30,957	11,401	159,440	25,743	5	11,521	131,289	860,281	6,081	267,451	291	1,475,795
1987	1,894,383	5,660,005	3,831,561	1,029,711	6,725	86,225	2,209	0	7,150	172,151	96,338	70,118	118,055	0	284,367.2
1988	1,808,772	3,32,566	3,054,693	835,661	15,530	22,444	0	0	510	17,0626	52,375	8,605	84,703	0	2,895,990
1989	22,13,196	104,422	3,806,719	941,197	23,848	49,636	47,351	0	1,2661	240,456	93,154	92,041	261,606	0	3,493,533

Source: Customs Authority

Table 12: Ethiopia - Monetary Survey (MS), June 1975 - June 1998.

	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86
	June	June	June	June	June	June	June	June	June	June	June	June
Foreign Assets (Net)	678.7	758.8	807.9	547.4	452.6	371.7	249.5	222.8	221.9	130.1	232.7	574.6
National Bank	0.0	0.0	646.1	432.0	270.4	212.2	114.7	263.6	182.8	19.4	153.7	439.1
Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	443.0	227.8	315.0	624.7
Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	289.2	208.4	161.3	185.6
Commercial Banks	0.0	0.0	161.8	115.4	182.2	153.5	134.8	106.2	39.0	110.7	77.0	135.5
Assets									176.7	211.9	176.2	219.1
Liabilities									137.7	107.2	97.2	93.0
Average	56.4											
Domestic Credit	741.4	983.1	1,085.5	1,078.3	2,082.0	2,613.3	2,822.7	3,123.1	3,721.1	4,138.0	4,523.5	4,877.0
Govt	18.2	29.7	30.1	45.3	46.4	45.9	53.1	51.1	66.1	68.0	68.2	92.4
Claims on Government	209.6	407.4	443.2	790.3	962.3	968.1	1,107.9	1,192.9	1,979.4	2,283.4	2,620.7	2,760.6
National Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1,174.3	1,489.5	1,353.4	1,427.9
Commercial Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	805.1	803.9	1,270.3	1,343.9
Claims on other sectors	531.8	575.7	645.3	932.0	1,222.7	1,644.2	1,721.8	1,944.2	1,741.7	1,644.6	1,996.8	2,110.2
National Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	816.5	970.1	1,090.5	1,312.0
Commercial Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	925.2	674.5	906.3	798.2
Broad money	40.2	40.5	43.7	53.9	60.0	76.0	82.5	84.2	57.3	54.7	49.0	47.0
	1,150.9	1,421.7	1,470.4	1,690.8	1,859.3	2,108.7	2,087.8	2,306.7	3,040.6	3,374.6	3,940.1	4,436.0
Money	832.7	1,092.7	998.8	1,185.8	1,325.6	1,488.6	1,425.5	1,557.2	2,100.4	2,374.2	2,687.1	3,172.6
Currents outside banks	661.4	610.2	686.6	857.2	952.1	1,065.9	1,021.1	1,120.1	1,258.2	1,282.9	1,358.5	1,591.9
Demand deposits	171.3	282.5	382.2	330.6	400.6	435.7	398.4	427.4	492.2	1,091.3	1,328.6	1,590.7
Quasi-money	318.2	329.0	471.6	495.0	500.7	610.1	662.3	751.5	860.2	1,000.4	1,153.0	1,264.0
Savings deposits	104.1	214.5	333.4	333.4	371.0	427.9	472.4	529.1	529.1	711.1	812.8	939.2
Time deposits	214.1	114.5	154.2	161.6	135.7	182.2	189.9	223.4	251.1	283.3	340.2	324.8
Other items (net)	40.1	294.3	423.0	534.9	676.3	875.2	991.4	1,186.2	902.3	893.5	916.1	1,015.0
National Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1,040.7	915.4	1,106.1	1,147.1	1,582.1
Commercial Banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	145.5	131.1	392.6	225.0	567.1
GDP	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7	16,825.7
Boards Money/GDP	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3
Memorandum items												

Table 12 (continued)

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Foreign Assets (Net)	June	June	June	June	June	June	June	June	June	June	June	June	June
	533.4	140.7	117.7	133.5	270.0	407.9	865.9	3,767.4	5,709.4	6,235.9	5,635.5	5,630.9	5,635.5
National Bank													
Assets	405.7	51.0	(26.0)	112.2	140.4	308.5	150.4	2,143.1	3,055.0	4,901.4	2,870.4	2,155.5	2,870.4
Liabilities	359.5	241.2	169.0	45.3	163.2	346.7	1,347.6	3,193.4	3,850.7	5,718.2	3,958.6	3,155.9	3,958.6
Commercial Banks	152.8	190.3	195.8	157.5	42.6	238.2	1,183.2	1,050.3	890.7	815.8	1,068.2	940.1	1,068.2
Assets	120.7	99.8	144.5	176.0	130.2	299.2	706.4	1,044.3	2,104.4	1,334.4	2,755.1	3,695.4	2,755.1
Liabilities	195.5	195.0	247.4	150.3	209.2	387.1	973.4	1,524.5	3,504.0	3,389.4	4,269.2	5,737.9	4,269.2
Other	69.6	107.1	102.9	71.5	139.1	86.6	356.9	469.2	799.0	1,555.0	1,514.1	2,072.5	1,514.1
Autocash													
Domestic Credit	1,509.3	5,270.2	6,965.2	8,041.5	5,909.4	10,167.7	11,633.6	12,789.0	14,352.0	15,410.5	16,446.1	18,523.3	16,446.1
SSA	46.9	97.1	98.6	79.2	76.9	76.2	90.0	82.9	63.9	50.4	48.0	47.7	48.0
Claims on Government	3,200.6	3,502.3	3,890.9	5,027.4	6,021.0	7,033.6	8,128.0	8,615.8	9,251.6	7,880.0	7,942.2	8,957.8	7,942.2
National Bank	1,092.3	2,129.0	2,195.5	4,647.2	3,556.5	4,647.2	6,035.5	7,453.1	7,034.1	5,900.7	6,036.3	7,581.0	6,036.3
Commercial Banks	1,304.3	1,373.3	1,724.1	2,071.9	2,465.1	2,386.4	2,092.5	2,152.8	2,023.5	1,987.3	1,315.9	1,176.0	1,315.9
Claims on other sectors	2,392.7	2,707.9	2,978.3	3,014.1	2,465.4	2,386.4	2,092.5	3,173.1	5,294.4	7,522.5	8,503.9	9,055.7	8,503.9
National Bank	1,473.2	1,095.1	1,859.5	2,008.8	2,072.8	2,091.7	449.6	462.8	463.1	465.1	465.1	465.1	465.1
Commercial Banks	919.5	1,077.8	1,118.0	1,005.3	1,392.6	1,294.7	2,646.0	2,710.3	4,631.3	7,057.4	8,038.8	9,200.6	8,038.8
Broad money	4,791.9	5,223.0	5,697.8	6,987.9	7,934.8	8,992.1	10,156.7	11,598.7	14,406.3	15,654.9	16,548.8	18,354.8	16,548.8
M1	3,556.3	3,903.2	4,145.5	4,992.0	5,123.3	6,040.1	7,260.7	8,373.2	9,922.4	9,917.4	10,024.0	11,005.9	10,024.0
Current outside banks	1,743.5	1,906.3	2,103.0	2,736.3	3,017.4	4,315.6	4,853.2	5,158.9	5,833.8	5,956.9	5,176.3	4,716.0	5,176.3
Deposits	1,012.8	1,044.0	1,063.7	2,346.3	2,355.9	2,504.3	2,697.5	3,214.3	4,288.6	4,200.5	4,847.7	6,268.8	4,847.7
Quasi-money	1,235.6	1,319.8	1,524.4	1,705.2	1,911.5	2,152.0	2,566.0	3,225.5	4,468.1	5,737.5	6,524.8	7,549.2	6,524.8
Savings deposits	1,053.3	1,208.0	1,367.1	1,574.5	1,676.7	1,922.3	2,346.8	2,844.3	3,869.0	4,584.0	5,085.2	6,481.2	5,085.2
Time deposits	1,023.3	1,111.6	1,155.3	1,301.6	1,341.6	1,521.9	2,019.2	2,811.2	3,911.1	4,533.9	5,039.6	6,007.5	5,039.6
Other assets (Net)	1,240.6	1,187.9	1,315.0	1,320.0	1,355.2	1,582.6	2,363.8	4,957.7	5,652.9	5,991.4	5,522.8	5,799.4	5,522.8
National Bank	2,018.7	1,962.8	1,813.7	2,113.8	1,942.3	2,531.4	2,562.3	4,910.2	4,703.3	5,610.4	4,795.9	203.9	4,795.9
Commercial Banks	677.9	672.0	(53.8)	(795.9)	(617.1)	(948.6)	(198.6)	47.6	982.6	391.2	737.3	5,595.5	737.3
GDP	16,625.7	16,625.7	16,625.7	19,155.3	20,792.0	26,671.1	28,338.9	33,885.0	37,931.6				
Broad Money/GDP	0.3	0.3	0.3	0.3	0.4	0.3	0.4	0.3	0.4				
Monetary aggregates													

Memorandum item: Continued from Table 12. Net domestic assets

Source: National Bank of Ethiopia

- CBB and AIB are included beginning from March, 1995. Dashen Bank (DB) beginning January 1996
 Bank of Abyssinia beginning Nov. 1996 & Wegagen Bank beginning Dec. 1997
- 2/ Excludes the accounts of the Djibouti branch of the Commercial Bank of Ethiopia
 Transactions of the branches in Entrea are included only through April (for the National Bank) and May (for the Commercial Bank). 1991. Thereafter, their balances are held constant in the monetary survey of Ethiopia
 - 3/ Changes for April 1998 are computed against money stock at the end of January and February 1997, respectively
 - 4/ The AIDB debt transfer operations (March 1994) are not reflected in the figures for June 1994, in order to maintain comparable data series

Sources: National Bank of Ethiopia;

- 1/ CBB and AIB are included beginning from March, 1995. Dashen Bank (DB) beginning January 1996
 Bank of Abyssinia beginning Nov. 1996 & Wegagen Bank beginning Dec. 1997
- 2/ Includes provision for doubtful debts, excludes the account of the Djibouti branch of CBE
- 3/ Excludes Loans and advances by DBE