UNIT 7

MACROECONOMIC REFORMS IN ETHIOPIA

Introduction to Ethiopia's Economic Reforms and Development Plans

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Historical Overview of Ethiopia's Economic Reforms

The Imperial Period (1950-1974)

During the imperial era, Emperor Haile Selassie I aimed to transition Ethiopia from a subsistence economy to an agro-industrial one. Several development plans were introduced:

1. **First Five-Year Plan (1957–1961):** Focused on infrastructure, skilled personnel, and agricultural development. Although it saw some progress, it failed to meet all targets, especially in agriculture and trade balance.
2. **Second Five-Year Plan (1962–1967):** Emphasized industrial development and commercial farming. It aimed to shift from a predominantly agricultural economy to an agro-industrial one.
3. **Third Five-Year Plan (1968–1973):** Focused on improving agriculture to address food shortages. It introduced the Integrated Rural Development project to enhance agricultural inputs and rural health services.

Despite these plans, Ethiopia faced challenges such as feudal land tenure systems, which contributed to widespread dissatisfaction and food shortages. These issues ultimately led to the overthrow of the monarchy in 1974.

The Socialist Period (1974-1991)

The Derg, a military junta, established a socialist state and implemented extensive nationalization and collectivization:

1. **Early Years (1974–1978):** Marked by economic dislocation due to nationalization and political instability. GDP growth was minimal.
2. **Recovery Period (1978–1980):** Economic improvement due to the Development through Cooperation Campaign ("Zemecha"). GDP growth

increased, and agricultural and manufacturing sectors saw some recovery.
3. **Crisis Years (1980–1985):** Economic downturn caused by drought, stagnation in manufacturing, and high defense spending.
4. **Later Years (1985–1990):** A ten-year plan aimed at agricultural development, export enhancement, and livestock quality improvement. Despite some success, the effects of droughts undermined overall progress.

The EPRDF Period (1991-Present)

The Ethiopian People's Revolutionary Democratic Front (EPRDF) introduced new economic strategies:

1. **Agricultural Development-Led Industrialization (ADLI):** Focused on boosting agricultural productivity to drive industrial development. Key strategies included expanding agricultural technologies, investing in infrastructure, and enhancing rural sectors.
2. **Sustainable Development and Poverty Reduction Programme (SDPRP):** Launched in 2002, this program emphasized agricultural development, food security, decentralization, and capacity building. Despite challenges like drought, Ethiopia saw notable growth in later years.
3. **Plan for Accelerated and Sustained Development to End Poverty (PASDEP):** Ran from 2005 to 2010, aiming for accelerated development, private-sector growth, and achievement of the Millennium Development Goals (MDGs).
4. **Growth and Transformation Plan I (GTP I) (2010/11-2014/15):** Focused on becoming a lower middle-income economy, improving agricultural practices, and promoting industrialization. It set ambitious growth targets and emphasized infrastructure and human development.
5. **Growth and Transformation Plan II (GTP II) (2015/16-2019/20):** Aimed to sustain growth and transform the economy. It focused on increasing productive capacity, enhancing competitiveness, and addressing infrastructure gaps.

National Development Objectives and Strategies

Monarchy Period (Imperial Regime)

- **Goals:** Infrastructure development, agricultural advancement, and reducing dependence on imports.

- **Strategies:** Implementing five-year plans with a focus on industrial and agricultural growth.

Socialist Period (Derg Regime)

- **Goals:** Restructuring the economy through nationalization and collectivization.
- **Strategies:** Centralized planning, control of agricultural prices, and large-scale collectivization.

EPRDF Period

- **Goals:** Agricultural-led development, poverty reduction, and economic transformation.
- **Strategies:** ADLI, SDPRP, PASDEP, and GTPs with a focus on agriculture, private-sector development, and infrastructure.

The Role of the Private Sector

The private sector plays a crucial role in Ethiopia's economic reform process, contributing to industrialization, agricultural productivity, and economic growth.

Understanding these historical and current reforms will provide a comprehensive view of Ethiopia's economic evolution and development strategies.

GTP I and II Performances and Major Challenges

Economic Growth and Performance:

- **Growth Achievement:** During the Growth and Transformation Plan (GTP) I and II periods (2009/10 - 2019/20), Ethiopia experienced notable economic growth. The gross domestic product (GDP) grew on average by 9.2% per year. The GDP increased from Birr 828 billion in 2009/10 to Birr 1.99 trillion in 2019/20, although the actual growth fell short of the 11% target by 1.8%.
- **Sectoral Contributions:**
  - **Agriculture:** Contributed 24% to GDP growth, with crops contributing 72.7%.
  - **Industry:** Contributed 37.9%, with construction and manufacturing making up 77.1% and 22.8% of this contribution, respectively.
  - **Services:** Contributed 40.8%, with wholesale and retail trade accounting for 37.8% of the service sector growth.

Investment and Consumption:

- **Nominal GDP Growth:** Increased from Birr 395.9 billion in 2009/10 to Birr 3.37 trillion in 2019/20.
- **Investment:** The share of gross domestic investment in GDP grew from 31.1% in 2009/10 to 38.4% in 2015/16 but declined to 30.8% in 2019/20 due to political instability and the COVID-19 pandemic.
- **Savings:** Gross domestic savings increased from 17.3% of GDP in 2009/10 to 20.9% in 2019/20. GDP per capita rose from USD 389 to USD 1,080 during the same period.
- **Consumption:** Total final consumption expenditure made up 79% of GDP, with private consumption being the largest component.

Challenges:

1. **Quality of Growth:** Despite high growth rates, there were issues with job creation, equitable distribution of benefits, and structural transformation.
2. **External Debt and Trade Imbalance:** Ethiopia faced external debt distress and a widening trade deficit due to weak export performance and reliance on imports.
3. **Investment and Savings Imbalance:** Domestic savings were insufficient to meet investment demands, despite various measures to boost savings.
4. **Inflation:** High inflation rates persisted, impacting the cost of living and economic stability.
5. **Unemployment:** Urban unemployment rates increased, with youth unemployment being particularly high.
6. **Structural Weaknesses:** Slow structural transformation, weak sectoral linkages, and limited capacity in resource mobilization and financial accessibility were major issues.
7. **Social Services:** Despite infrastructure expansion, there were gaps in the quality and accessibility of social services and basic infrastructure.

National Development Plan (2021-2030):

- **Vision:** To make Ethiopia an "African Beacon of Prosperity" by focusing on improving income levels, basic services, quality of life, and social dignity.
- **Objectives:**
    1. Build a prosperous country with a market-based economy and active private sector.
    2. Maintain macroeconomic stability and create decent jobs.
    3. Promote structural transformation and productivity.
    4. Ensure quality and accessible social services.
    5. Strengthen governance and civil service.
    6. Build inclusive institutions and regional peace.

Strategic Pillars:

1. Quality economic growth and shared prosperity.
2. Economic productivity and competitiveness.
3. Technological advancement and digital economy.
4. Sustainable financing.
5. Private sector-led growth.
6. Green economy.
7. Institutional transformation.
8. Gender and social inclusion.
9. Access to justice and efficient civil services.
10. Regional peace and economic integration.

Home-Grown Economic Reforms:

- **Focus:** To sustain growth, stabilize the macroeconomic environment, reduce debt vulnerabilities, and create sustainable jobs.
- **Components:**
    1. **Macroeconomic Reforms:** Enhance overall economic stability.
    2. **Sectoral Reforms:** Improve productivity and competitiveness.
    3. **Structural Reforms:** Transition from public to private sector-led growth and reduce reliance on heavy debt and public spending.

Macroeconomic Reforms and Fiscal Decentralization

Macroeconomic Reforms

Objective: The primary goal of macroeconomic reforms is to stabilize the economy and eliminate imbalances. Key focus areas include:

1. **Sustainable Economic Growth:**
    - **Efforts:** Implementing reforms across various sectors to boost economic growth that had slowed in recent years.
    - **Approach:** Involves multiple actors, including the private sector and development partners, with a focus on learning from past experiences to design inclusive development plans.
2. **Fiscal Policy Reform:**
    - **Tax Collection:** Modernizing tax collection mechanisms and increasing public awareness about tax responsibilities.
    - **Public Expenditure:** Improving management of public spending and debt.
    - **Tax Administration:** Making tax processes fair, transparent, and accountable.

    - **Justice Sector Reforms:** Addressing informal sectors and contraband to protect domestic income and businesses.
3. **Budget and Auditing:**
    - **Budget Administration:** Ensuring allocated budgets are used efficiently for intended purposes through rigorous auditing and monitoring.
    - **Project Evaluation:** Emphasizing thorough appraisal and feasibility studies for development projects.
4. **Financial Sector Reform:**
    - **Objective:** Achieve financial stability, inclusion, and competitiveness.
    - **Measures:** Promoting market-based interest rates, expanding capital markets, and strengthening the National Bank of Ethiopia's regulatory capacity.
5. **Foreign Currency and Export:**
    - **Policies:** Expanding foreign currency inflow through improved export performance and diversification.
    - **Remittances:** Encouraging diaspora remittances through formal banking systems.
    - **Foreign Direct Investment:** Attracting quality investment for technological transfer and job creation.
6. **External Public Debt:**
    - **Strategy:** Minimize commercial loans, seek concessional loans, and reschedule existing debt.

Sectoral Reforms:

- **Agriculture:** Enhancing productivity through irrigation, improved input supply, and research-based food security.
- **Mining:** Reforming policies to attract investors and support infrastructure development.
- **Tourism:** Expanding infrastructure and improving sectoral participation to harness tourism potential.

Structural Reforms:

- **Government Role:** Balancing government intervention with private sector participation.
- **Transport and Logistics:** Improving efficiency and reducing costs in trade.
- **Import Substitution:** Reducing reliance on imports through domestic production.
- **Investment Landscape:** Optimizing industrial parks and business environments to boost investment and job creation.
- **Privatization:** Accelerating the privatization of state-owned enterprises.

- **Global Partnerships:** Strengthening international trade and investment partnerships.

Fiscal Decentralization

Definition: Fiscal decentralization involves transferring taxing and spending powers from central authorities to regional or local governments. It aims to balance local needs with central oversight.

Objectives:

- **Fiscal Equalization:** Ensuring local governments can provide similar services and reduce regional disparities.
- **Support for Regional Development:** Allocating funds for capital projects that align with national development goals.

Advantages:

- **Local Responsiveness:** Tailoring public services to local preferences.
- **Intergovernmental Competition:** Encouraging efficiency through competition among local governments.
- **Innovation:** Allowing local experimentation with policies and services.

Disadvantages:

- **Externalities:** Local decisions may impact other regions, creating inefficiencies.
- **Loss of Scale Economies:** Small local governments may face higher costs for public services.
- **Inefficient Tax Systems:** Local tax policies may be less effective at the national level.
- **Ineffectiveness in Redistribution:** Local policies may attract poor residents and repel wealthy taxpayers.

Summary:

- Ethiopia's development plans have evolved from centralized state-led initiatives to more inclusive, market-oriented reforms.
- Recent reforms focus on sustaining growth, improving fiscal management, and enhancing sectoral and structural efficiencies.
- Fiscal decentralization aims to balance local needs with central oversight, offering both benefits and challenges.