ECONOMICS

STUDENT TEXTBOOK

GRADE 12

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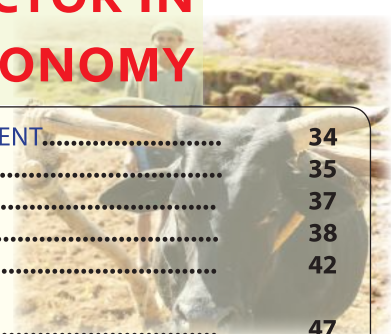

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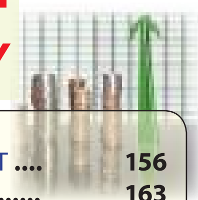

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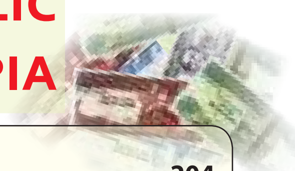

UNIT 7

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UNIT 1

MAIN SECTORS OF THE ETHIOPIAN ECONOMY

Unit Objectives

After completing this unit, you will be able to:

- realize the contributions of the main sectors to the Ethiopian economy;
- understand the structure and significance of various resource endowments; and
- evaluate the different economic systems implemented since the Imperial Regime.

Main Contents

INTRODUCTION

In your economics course of Grade 11, you studied the nature and scope of economics as a subject. You also studied the fundamental laws and principles of economics, and the main tools used in economic analysis. The basic purpose of studying all of them is to be able to understand how the various economic systems work or how a particular economy functions and solves its problems. Now, in Grade 12, you will focus on our national economy. So, this unit presents an overview of the main sectors, the resource base, and the national development objectives and strategies as they have evolved over the years.

1.1 AN OVERVIEW OF MAIN SECTORS OF ETHIOPIAN ECONOMY

At the end of this section, you will be able to:

- explain the characteristics of the Ethiopian economy.

Key Terms and Concepts

- Ancillary services
- Command economy
- Deregulation
- Diversification of agricultural products

Start-up Activity

How do you characterize the Economy of the:

a Imperial regime b Derg regime c Post 1991

Over about 100 years, the Ethiopian economy has experienced changes from market-oriented to centrally planned and back again to a market-oriented economy. Under the Monarchy (up to 1974), the economy was primarily agricultural. The economy was based on a feudal system under which land ownership was highly inequitable with major portions of farmland being in the hands of wealthy landlords of the very few industries, most were owned by foreigners.

During the Military Regime (1974 – 1991), the economy shifted to a command economy where socialist principles and ideologies ruled. Substantial land reforms were introduced in the agricultural, industrial and financial sectors. The government owned all the large-scale manufacturing industries, banks and insurance companies. In spite of all these measures, the regime failed to solve

Ethiopia's multifaceted problems. Finally, it ceased to rule in 1991 when the EPRDF marched into Addis Ababa on May 28th, 1991.

Since the assumption of power by EPRDF (1991), its government has followed a market-oriented economy. It has supported a process of economic reforms based on privatization of state enterprises, promotion of agricultural exports and deregulation (move towards free market) of the economy. This move has facilitated significant sectoral growth performances.

Table 1.1 **Sectoral Growth Performance**

Sectors \ Fiscal year	1974/75	1991/92	1997/98	2003/04	2005/06
Agriculture and allied activities	0.6	2.9	4.3	16.9	10.9
Industry	3.6	6.7	7.4	11.6	10.2
Distributive sectors	2.5	6.4	7.0	6.4	14.2
Other services	4.7	7.5	7.2	6.1	12.5
GDP	2.0	4.8	5.8	11.7	11.6
Per-capita GDP	1.4	1.9	2.9	8.7	8.6

Source: *Ministry of Finance and Economic Development, CSA (2005/06)*

1.1.1 The Agricultural Sector

For decades, agriculture has been the backbone of the Ethiopian economy. Hence its performance determines the economic well-being of the people. Also, many other economic activities, including transportation and manufacturing, rely heavily on the agricultural sector.

Main Features of the Agricultural Sector

Agriculture contributes about 45% of the overall GDP of the country; generates more than 80% of export earnings; employs about 85% of the population; and supplies about 70% of raw materials to the secondary activities (Central Statistics Office, 2006). The agricultural sector produces both crops and livestock. The crops produced include food crops, cash crops, fruits, and vegetables. It constitutes the greatest share of the country's GDP and export earnings when compared to the livestock production.

The main crops are:

- *Cereals (teff, barley, maize, wheat, sorghum and millet)*

- *Pulses (horse beans, vetch, lentils, etc)*
- *Oil seeds (viger seed, flax, rape seed, seasame, castor beans and soyabeans)*
- *Cash and industrial crops (coffee, oil seeds, pulses, cotton, sisal tobacco, etc.)*

Recent developments:

- *Crop production and productivity in both volume of production and yield per hectare have shown consistent increases for almost all categories of main crops during the last few years.*
- *Diversification of agricultural production.*
- *Establishment of an agricultural marketing system.*
- *Development of research and extension services.*
- *Improvement in the supply of agricultural inputs.*
- *Expansion of small-and medium-scale irrigation.*
- *Better management of natural resources.*

Major problems of the sector:

- *Frequent drought.*
- *Soil degradation largely caused by overgrazing and overpopulation.*
- *Land fragmentation.*
- *Prevalence of backward agricultural practices.*
- *Poor marketing facilities due to poor road networks, etc.*
- *Rapidly increasing prices of agricultural inputs like fertilizers etc.*

1.1.2 Industrial Sector

The Ethiopian industrial sector has been small compared to the agricultural and service sectors. This could be due to the short history of industrialization in the country. Its growth was modest, not exceeding 6.7 percent for the last four decades except during the years from 1997/98 to 2009/2010.

The industrial sector is dominated by three sub-sectors: manufacturing (38%), construction (25%), and electric and water supply (18%). The remaining sub-sectors, electricity, mining and quarrying, etc., constitute the remaining 19%.

Main Features of the Industrial Sector

- The sector contributes about 13% of GDP and 9.5% of employment.
- There are about 130 state-owned and 7,000 private manufacturing industries of all sizes, mainly engaged in the production of consumer goods. Main products of these manufacturing industries include:
  - *textiles, foodstuffs, tobacco, beverages, cement, leather and leather products, wood, metallic and non-metallic products, paper, plastic, tiles, clothing/apparel, canned and frozen meat, sugar and molasses, oil cakes and petroleum products.*
- The growth performance of the industrial sector saw an appreciable improvement in recent years, compared to the average growth rate of 6.7% over the 10 years 2001/02 - 2009/10.

Table 1.2 **Growth Performance in the Industrial Sub-sectors**

Sub-sector	Share in sector in percentage	Share in GDP in percentage 1999	Growth					
			1999/00	2001/02	2002/03	2003/04	2004/05	2005/06
Industry	100	13.1	6.7	9.2	6.5	11.6	9.4	10210.2
Mining and quarrying	3.5	0.5	5.1	4.0	4.1	2.0	4.1	7.2
Large and medium-scale manufacturing	25.5	3.3	6.3	8.4	1.4	7.7	11.6	13.7
Small-scale and handcrafts manufacturing	14.1	1.9	4.1	6.4	0.4	4.5	15.0	4.9
Electricity and water	16.9	2.2	4.0	6.8	4.8	5.6	7.9	8.8
Construction	39.9	5.2	4.6	12.1	13.6	19.5	7.5	10.5

Source: *Ministry of Finance and Economic Development, 2009*

Looking at the growth performance of each sub-sector, the construction sector registered the highest growth rate between 2002 - 2010. It averaged about 13% per year in 2006 - 2010, compared to only 4.6% between 1991/92 and 2005/06. Large-and medium-scale industries recorded the second highest growth rates.

Major problems in the sector:

- *Low industrial base*
- *Low productivity level*
- *Underutilization of capacity*
- *Shortages of foreign exchange, new investment, raw materials and spare parts*
- *Very low level of technology/high dependence on imported technology*
- *Low-level skills and management*

Recent developments:

- *Privatization of state enterprises*
- *Liberalization of investment regulations to attract foreign investment*
- *Tax incentives for potential investors*
- *Modernisation of the technological base through technology transfer agreements*
- *Establishment of industrial estates*
- *Implementation of training program for managers and technicians, both in the country and abroad*
- *Establishment of research and development (R & D) institutes*
- *Establishment of the National Network of Information System to ensure the flow of industrial information among different users*
- *Improvement of the National Standards Regulation System*
- *Development of infrastructure, including transportation and telecommunications.*

1.1.3 Service Sector

This sector is composed of various sub-sectors that range from wholesale and retail trade, to restaurants and to education and health service provision. More specifically, the service sector includes:

- *wholesale and retail trade,*
- *hotels and restaurants,*
- *transport and communication,*
- *banking and insurance,*
- *public administration and defence,*
- *education,*
- *health, domestic and other services.*

The Ethiopian service sector had the second highest share in GDP next to agriculture in the years preceding (2011); however, its contribution during the year 2008/09 was the highest.

Main Features of the Services Sector

- *The sector's share in GDP was 45.1% during 2008/09.*
- *A relatively small percentage of population (about 10%) has been engaged in the services sector.*

- *The large contribution of the sector to the GDP comes mostly from government employment.*
- *Significant achievements have been made in areas of health, trade, tourism, banking and insurance in the past few years.*
- *Growth Performance: The growth in the services sector has been significant following the reform carried out in the early 1990s. Consequently its growth rate and hence its share in GDP has progressively increased during the last two decades.*

Table 1.3 **Service Sector Growth Performance**

Sub-sectors	Share in GDP 1991/92	Growth Performance				
		1991/92	2002/03	2003/04	2004/05	2005/06
Services	36.7	7.5	8.3	6.3	12.8	13.4
Trade, Hotels and Restaurants	13.7	6.3	9.1	5.2	12.8	17.9
Transportation and Communication	5.0	7.2	11.1	9.5	19.2	5.7
Banking and Insurance	2.3	8.4	10.1	6.8	10.2	18.0
Public Administration and Defence	4.3	7.8	1.4	0.2	11.6	6.4
Education	2.4	6.7	10.7	11.6	12.6	8.6
Health	0.9	7.6	9.2	15.9	16.9	4.8
Other Services	2.1	4.2	5.5	4.4	7.4	8.8

Source: *MOFED, 2007*

From Table 1.3 we can see that higher growth trends are observed in the sub-sectors of Trade, Hotels and Restaurants, Transportation and Communication as well as in Banking and Insurance.

Activity 1.1

1 Prepare a report on major agricultural and allied activities carried out in your local area.

2 Identify the various manufacturing units operating in your local area/region and make a list of the products manufactured by them.

Content Check 1.1

1 Referring to Table 1.3, list the service sectors by rank, based on growth performance exhibited in the years between 2000/01 – 2004/05.

2 Which major economic activity has performed well since 1997/98?

3 Give a brief explanation of why the various economic sectors showed appreciable growth performance.

1.2 RESOURCE BASE OF ETHIOPIA

At the end of this section, you will be able to:

- identify and explain the resource base of the Ethiopian economy.

Key Terms and Concepts

- Decennial
- Working-age group
- Kyoto-protocol

Start-up Activity

Can you identify the potential resources that Ethiopia has to utilize the existing level of technology?

In terms of its natural resource base, Ethiopia is potentially a rich country, with fertile soil and good rainfall over large areas of the country. Farmers produce a variety of grains, including wheat, teff, sorghum, corn, and millet. Coffee, a cash crop, grows well on southern slopes. Herders raise cattle, sheep and goats in nearly all parts of the country. Additionally, Ethiopia possesses several valuable minerals including gold and platinum. Ethiopia is also one of the few African countries with the potential to produce hydroelectric and geothermal power. Furthermore, it has regions where dense forests exist, and its many lakes, rivers, reservoirs and their coastlines are fertile fishing grounds. Another notable point in the wider context of the resource base of Ethiopia is that over 50% of its population is in the working-age group of 15 – 64 years.

1.2.1 Population

Population is an important resource of a country since it determines the quantity and quality of available labour and entrepreneurship – the two important factors of production. As per the estimates of July 2009, the population of Ethiopia numbers 85.2 million. Since 1984, three approximately decennial Population Censuses (1984, 1994 and 2007) have been conducted by the Central Statistical Authority (CSA) which have given a more clear idea about Ethiopia's population and its structure.

The total number of persons enumerated in the third Population Census, aggregating the May and November data sets, was 73,918,505. Of these, 37,296,657 (50.5%) were males and 36,621,848 (49.5%) were females. The population of the country in the previous censuses of 1984 and 1994 were 39,868,572 and 53,477,265, respectively.

Table 1.4 **Percentage distribution of population by sex and census year**

Census Year	Sex	Population Size	
		Number	%
1984	Both Sexes Male Female	39,868,572 20,062,490 19,806,082	100.0 50.3 49.7
1994	Both Sexes Male Female	53,477,265 26,910,698 26,566,567	100.0 50.3 49.7
2007	Both Sexes Male Female	73,918,505 37,296,657 36,621,848	100.0 50.5 49.5

Source: *CSA, 2008.*

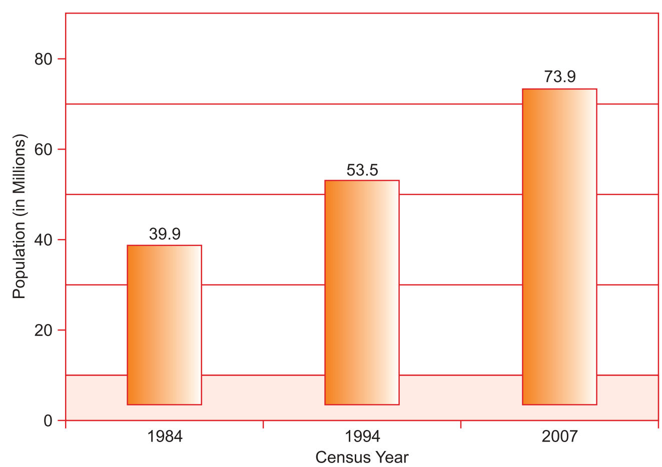


Figure 1.1

Counted population size of Ethiopia (in millions) 1984-2007

Each successive population census has demonstrated that national population size increased in steady increments of significant proportions. For instance, a comparison of the 2007 census results with those from 1994 shows that the population of the country had increased by more than 20 million over the 12 years. Similarly, in the previous decade (1984 to 1994), the population of the country increased by 13.6 million.

Population Growth

The 2007 population census results show that the population of Ethiopia grew at an average annual rate of 2.6 percent between 1997 and 2007 – a decrease of 0.2% from the annual growth rate during the previous period (1984 – 1994). The highest annual growth rate for the period 1994 – 2007 was observed for Gambella Region (4.1%), followed by Benishangul-Gumuz (3.0%), SNNP and Oromia (2.9%).

Population Composition by Sex (gender)

Sex composition is one of the basic characteristics of a population. Sex composition is very important for any analysis, as data on sex provides useful information about reproductive potential, human resources, level of school attendance by each sex, and so on.

As shown in Table 1.5, male population is slightly higher (50.5%) than female population (49.5%) at the national level. Sex composition of the population by region shows variation: in Afar, Somali and Gambella, the number of males exceeds that of females (no change from 1994 census results), while in Addis Ababa the number of females is considerably higher than the number of males.

Table 1.5 **Population Size of Regions by Sex (2007)**

Region	Sex					
	Both Sexes		Male		Female	
	Number	%	Number	%	Number	%
Country - Total	73,918,505	100.0	37,296,657	50.5	36,621,848	49.5
Tigray	4,314,456	100.0	2,124,853	49.2	2,289,603	44.3
Afar	1,411,092	100.0	786,338	55.7	624,754	44.3
Amhara	17,214,092	100.0	8,636,875	50.2	8,577,181	49.8
Oromiya	27,158,471	100.0	13,676,159	50.4	13,482,312	49.6
Somali	4,439,147	100.0	2,468,784	55.6	1,970,363	44.4
Benshangul-Gumuz	670,847	100.0	340,378	50.7	330,469	49.3
SNNP	15,042,531	100.0	7,482,051	49.7	7,560,480	50.3
Gambella	306,916	100.0	159,679	52.0	147,237	48.0
Harari	183,344	100.0	92,258	50.3	91.086	49.7
Addis Ababa	2,738,248	100.0	1,304,518	47.6	1,433,730	52.4
Dire Dawa	342,827	100.0	171,930	50.2	170,897	49.8
Special Enumeration	96,570	100.0	52,834	54.7	43,736	45.3

Source: *CSA, 2008*

Population Composition by Age

Age composition is the other basic demographic characteristic of population. Age data are useful for demographic analysis, for various types of socio-economic development planning, and for analysis of labour market and unemployment level of any country. The age-sex structure of the a population is usually depicted graphically by a population pyramid. It is determined by the effects of past fertility, mortality and migration.

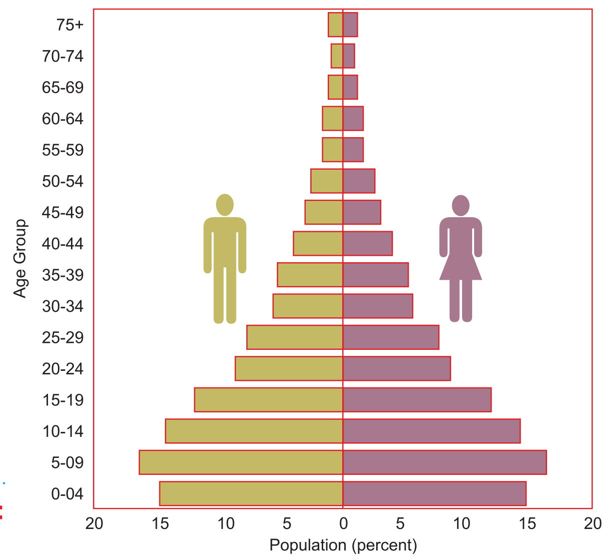


Figure 1.2

Population pyramid of Ethiopia: 2007 (Source: *CSA, 2008***)**

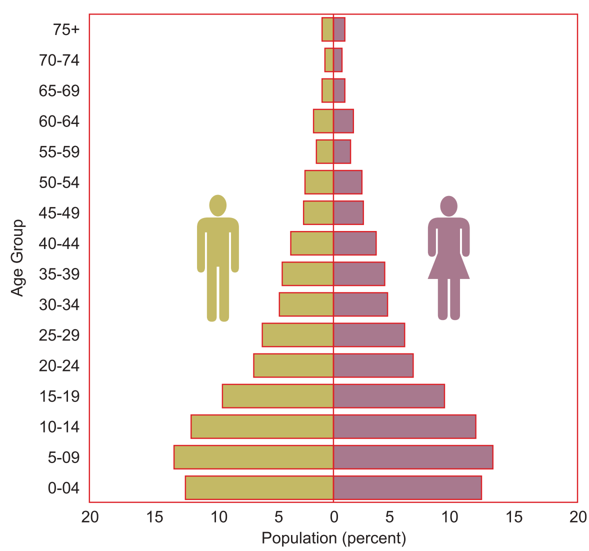


Figure 1.3

Population pyramid of Ethiopia: 1994 (Source: *CSA, 2008***)**

The broad base of the population pyramids depicted above shows that a significant proportion of the national population is below age 15, a pattern also observed in the 1994 census.

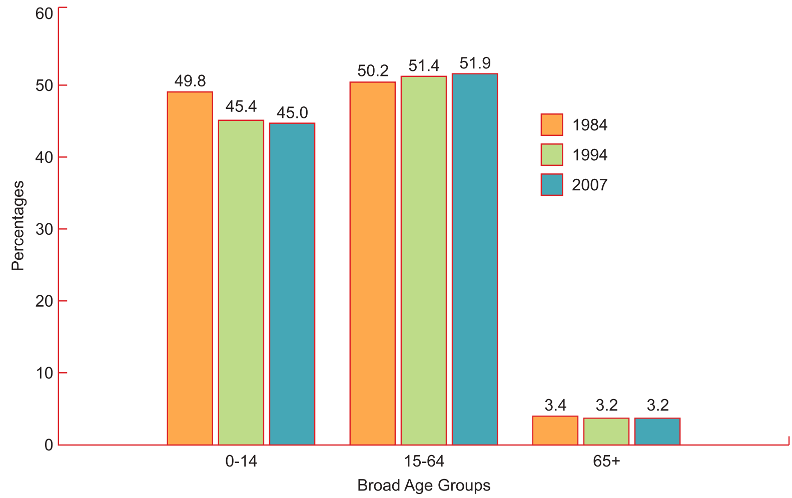


Figure 1.4 **Source:** *CSA 2008*

Percentage distribution of the population of Ethiopia by broad age groups: 1984, 1994 and 2007

The distribution of the national population by broad age groups depicted in the above figure shows that the proportion of young population under age 15 declined from 49.8 percent in 1984 to 45.0 percent in 2007. Conversely, the proportion of population in the working-age group (15-64) increased from 50.2 percent in 1984 to 51.9 percent in 2007. The proportion of population aged 65 years and over was 3.4 percent in 1984 and remained constant at 3.2 percent, according to both the 1994 and the 2007 census. In general, there was no significant change percentage-wise in the population of elderly persons between 1984, 1994, and 2007.

Population Composition by Sex on Urban /Rural Bases

Table 1.6 **Population Size by Sex on urban-rural bases (2007)**

Sex	Urban + Rural		Urban		Rural	
	No.	%	No.	%	No.	%
Both Sexes	73,918,505	100.00	11,956,170	100.00	61,962,335	100.00
Male	37,296,657	50.46	5,942,170	49.70	31,354,487	50.60
Female	36,621,848	49.54	6,014,000	50.30	30,607,848	49.40

Source: *CSA, 2008.*

Some Other Factors Affecting the Size and Growth of Population

Fertility, mortality, international migration, etc., are some of the important factors that affect the size and growth of the population of a country. Relevant figures are listed below to indicate the population growth, considering the 1984 and 1994 censuses.

Table 1.7 **Birth rate, death rate and life expectancy in Ethiopia**

Year	1984	1994	2009 Estimates
Crude Birth Rate (CBR)/1000	46.6	44.4	43.66
Infant Mortality Rate (IMR)/1000	110	116	80.8
Under 5 Mortality Rate (U5MR)/1000	166	171	112.0
Crude Death Rate (CDR)/1000	17.1	14.9	11.55
Total Fertility Rate (TFR)	7.5	6.7	6.12
Life Expectancy at Birth (LFaB)	52	50.7	55.41

Source: *CSA, 1984 and 1994 Population Surveys.*

When we observe the basic features of the population of Ethiopia – size, growth, composition, etc., the country has a relatively high growth rate, high infant mortality rate, low life expectancy and high dependency rate. In order to sustain the process of economic development, it has to restrain population growth. In this context, the government recently included a population component in its overall development program. Also, a national population policy has been formulated which aims at narrowing the gap between high population growth and low economic growth and at the reduction of maternal, infant and child morbidity and mortality rates.

Dependency ratio is the ratio or proportion of economically inactive age-group to the economically active age-group.

$$\text{Dependency ratio} = \frac{\begin{array}{c}\text{Economically inactive age group}\\ \text{(children + old aged)}\end{array}}{\text{Economically active age group (Adult)}} \times 100$$

$$\text{DR} = \frac{45\%+3.2\%}{51.9\%} \times 100$$

$$= \frac{48.2\%}{51.9\%} \times 100 = 93\%$$

The age dependency ratio of Ethiopia in 2007 is calculated to be 93%. This means that for every 100 persons in the working age group, there are about 93% dependants. In other words, every person in the working age group has nearly one dependent.

1.2.2 Land

For a country like Ethiopia, where agriculture is the backbone of the economy, land is a very important resource base. In the context of agriculture, *land* here refers not only to areal extent, but to its productivity of food crops and other crops. It is known that Ethiopia has a total area of 1,104,300 square kilometers of which 35 percent is considered suitable for agriculture. The availability of this much land for agricultural purposes is directly or indirectly the result of good soil and suitable climates for the performance of agriculture.

As far as the types of soil is concerned, most of the highlands have two main soil types that are generally believed to be suitable for agriculture. These soil types are:

- ***Red-to-reddish brown soils:*** *These soil types are well endowed with needed minerals for crops and they are found in areas of relatively good drainage. Further, these soil types are friable – easy for ploughing .*
- ***Brownish-to-grey and black soils with high clay content.*** *With proper drainage and conditioning, these soils have excellent agricultural potentials.*

Regarding the climatic aspect, the formation of different agro-ecological zones due to altitude has multiplied the resource potential of the land of Ethiopia. The presence of different agro-climate zones results in the growth of different crops that increases Ethiopia's exportable items for earning foreign currency.

1.2.3 Livestock

Ethiopia has the largest livestock population in Africa. The livestock sub-sector is estimated to account for 10% of the GDP and provides employment to over 30% of the agricultural labour force. The activity in the sector has grown since the government ended its monopoly on livestock trading in 1999, thereby encouraging local and foreign private investments in ranches, meat processing, and abattoirs. Livestock and livestock by products generate income in foreign currency in addition to serving local consumption. However, despite some improvement in recent years, especially in terms of an encouraging policy and strategy for the export of livestock and livestock products, the sector still remains under exploited.

Livestock Population

The official estimate by the CSA shows that there were about 43 million cattle in 2006/07. As 99.4 percent of the total cattle in the country are local breeds, the proportion of hybrid and exotic breeds is small. The predominant cattle breed found in Ethiopia is Zebu. The main cattle breeds identified and characterized so far include the Borena, Fogera, Horo, Sheko (Gimira), Abigar (Nuer), and the Afar. These main cattle breeds are indigenous to the respective regions of Ethiopia.

Ethiopia also has a large number of sheep and goats. There are 41 million head of cattle, 25 million sheep, 23 million goats, 41 million chickens, 5.7 million equines and 2.3 million camels distributed in all the administrative regions. With respect to the type of breed, almost all of the sheep and goats are indigenous. So far, some seven and about twelve breeds/populations of sheep and goats, respectively, have been identified in Ethiopia.

Data on poultry population indicate that the country has about 41 million poultry of different varieties. About 95 percent of the poultry are known to be indigenous, while the remaining are hybrid and exotic.

Livestock Products

- *It was estimated that 2.63 million liters of cow's milk and 114.18 liters of camel's milk were produced from rural sedentary and resettlement areas of the country in 2006/07.*
- *Annual egg production in 2006/07 was estimated to be 81.7 million.*
- *Estimates also show that 51 million kilograms of honey were produced in 2006/07 from 4.9 million beehives.*

Despite the huge livestock resource and the important role expected of livestock, the livestock sub-sector of the country is characterized by low productivity and production.

To conclude, we may say Ethiopia has a large number of livestock with considerable potential to contribute to the national economy if adequate attention is given to developing the subsector.

Livestock Development

The constraints that hindered livestock development can be broadly categorized as:

- ***Environmental*** – *the presence of diseases like, Tsetsefly, etc. that kill thousands of cattle every year.*

- ***Technical*** – *shortage of trained personnel to guide and use dairy farms as well as to fatten the cattle.*
- ***Infrastructural*** – *lack of water supply and road networks to transport the cattle to the required destinations in a timely way with less exhaustion of the livestock.*
- ***Institutional*** – *shortage of veterinary and other services for the rearing of better quality livestock.*

1.2.4 Fishery

Ethiopia's lakes, rivers, and reservoirs are fertile fishing grounds. The ten-year perspective plan in 1983/84 estimated that the country had the potential to produce more than 92,000 tons of fish. But actual production in 1983/84 was estimated at 600 to 1,200 tons. Furthermore, a study reported that only 15,389 tons were actually caught in 2001. The fishery sub-sector of the economy is estimated to contribute only about 1% of the gross domestic product.

In the post-1974 period, government encouraged the establishment of fishery associations and cooperatives along the Red Sea coast and in the Great Rift Valley lakes area. In 1978 the government established the Fish Production and Marketing Corporation (FPMC) to help improve the Ethiopian fish industry. Under the current government, with financial aid from the United Nations Development, the second Five-Year Agricultural Development Plan (2001-2005) also laid down a number of targets to improve the yield of Ethiopia's fisheries, but still a number of problems remain to be overcome. The absence of laws regarding commercial fishing until 2002/2003 led to localized overfishing. Some commercially important species are already suffering from over-exploitation.

1.2.5 Forestry

In the late nineteenth century, about 30% of Ethiopia was covered with forests. The clearing of land for agricultural use and the cutting of trees for fuel gradually changed the scene, and today forest areas have dwindled to about 3% of country's total land. An estimated 3.5 million hectares of natural forest presently remains in 58 areas designated as National Forest Priority Areas (NFPA). Of these, 13 are managed under integrated forest management systems, with about 80,000 hectares of industrial forest having being established for limited sustainable exploitation.

Economic Significance of Forestry

Lumber from the coniferous forests is important to the construction industry. The broad-leaved evergreen forests furnish timber that is used in construction and in the production of plywood. The woodlands are major sources of firewood and charcoal. Certain trees – *boswellia* and species of *commiphora* – are of special economic significance. Both grow in the arid lowlands and produce gums that are the bases for frankincense and myrrh. A species of acacia found in several parts of the country is a source of gum arabic used in the manufacturing of adhesives, pharmaceutical products, and confectionery. The eucalyptus, an exotic tree introduced in the late nineteenth century and grown mainly near urban areas, is a valuable source of telephone and telegraph poles, tool handles, furniture, and firewood. It is also a major source of the material from which fiber-board and particleboard are made.

Forest Conservation Efforts by the Government

Before 1974 about half of the forestland was privately owned or claimed to be owned, and roughly half was held by the government. There was little government control on forestry. The 1975 land reform nationalized forestland and sawmills, which existed mostly in the south. The government controlled harvesting of forestland. But this measure encouraged illegal logging and accelerated the destruction of Ethiopia's remaining forests.

To ensure that conservation activity conformed with government policy and directives on land use, reforestation programmes were organized through the Ministry of Agriculture and Rural Development or district offices that planned, coordinated, and monitored all work. Reforestation programs resulted in the planting of millions of seedlings in community forests throughout the country. A variety of non-government organizations, which had to organize their activities through local peasant associations, supplemented government efforts to rehabilitate the country's forests. Later on, the Ethiopian Forestry Action Plan (EFAP) was launched to improve woodland conservation, increase public participation in reforestation projects, and prevent further depletion of existing forest resources.

1.2.6 Energy

The Ethiopian energy sector can be classified into two sub-sectors:

i traditional and ii modern

The major traditional energy resources consist of fuel wood, crop residues, animal dung, and charcoal. These energy resources satisfy most of the energy needs of the country, and they are readily available and can be produced using traditional methods. However, except for the crop residues and animate energy, whose share is low, the main energy resources, i.e., wood and its by product, charcoal, are derived from forest resources which are continuously diminishing. As a result, the state of traditional fuel is on the road to destruction rather than development.

The main modern energy source upon which Ethiopia depends is hydroelectric power. According to the available data, the country has a natural potential to generate about 30,000 megawatts of hydroelectric power annually. However, what has been developed amounted to only 2000 megawatts, in 2011, which was about less than 10% of the total potential. Of the total electric-power generating capacity of 706 MW in 2004, 94% or 663 MW were from water, while the remaining 43 MW were largely from diesel and, to a limited extent, from geothermal resources. In addition to this, because Ethiopia is geographically situated in the tropics, it gets a lot of annual sunshine and longdays of sunlight, and thus is blessed with a great deal of solar energy. But unfortunately this energy resource has not yet been developed much.

Another potential of Ethiopian commercial energy resources are oil and bio-gas. As of 2011, all the oil that the country consumed was imported. The demand for it has also increased over time. The amount of oil products imported in 1992/93 was 555 thousand tons. This import had reached 1.1 million-tons by the year 2002.

Although petroleum explorations undertaken so far have not yet shown concrete results, it is believed that the country has other source of fossil fuel resources; Ethiopia has a proven deposit of about 100 billion cubic meters of natural gas and over 200 million tons of coal. Although efforts have been made over the past few years to develop these energy resources, and attempts are still underway, no concrete results have been achieved as yet.

1.2.7 Minerals

A wide variety of minerals including metals, non-metals (the most important currently being gold), as well as industrial and energy minerals, are extracted by various types of quarrying activities in the country. However, the exploitation and development of these minerals is at its infant stage. Mining contributes only about 1% to Ethiopia's GDP. Gold, marble, limestone and tantalum are the major minerals mined in Ethiopia. Meanwhile, additional explorations have confirmed the presence of deposits of platinum, tantalite, soda ash and phosphate rock. The capital intensity of the production process and technical problems have been the major constraints to the exploitation of the country's mineral resources.

Recent changes in the government's foreign investment policy and new tax-incentive plans are expected to give positive results in the development of the mining sector in Ethiopia.

Table 1.8 gives an idea about the production of two major minerals – gold and tantalum, over the period 1998 – 2007.

Table 1.8

Gold (kg)	Tantalum (ton)	Year
3,291	50	1998/99
3,206	66	1999/00
4,641	46	2000/01
4,916	136	2001/02
4,453	58	2002/03
3,458	71	2003/04
3,813	93	2004/05
3,456	109	2005/06
3,342	117	2006/07

Source: *CSA, 2008.*

1.2.8 Environment

Land degradation, which is accelerated by soil erosion and loss of soil fertility, deforestation and overgrazing, with their concomitant impacts on the loss of bio-diversity, and water resource degradation are challenging environmental problems of Ethiopia. Water pollution, especially in urban and suburban areas, has also become a growing environmental problem. In recent years, the government has taken several measures to curb the environmental problems of the country. Some of these are as follows:

The Environmental Policy of Ethiopia

The Environmental Policy of Ethiopia states: "The overall goal is to improve and enhance the health and quality of life of all Ethiopians and to promote sustainable social and economic development through the sound management and use of natural, human-made and cultural resources and the environment as a whole so as to meet the needs of the present generation without compromising the ability of future generations to meet their own needs."

Establishment of the Environmental Protection Authority (EPA)

The Environmental Protection Authority (EPA) is an autonomous government agency responsible for harmonizing environmental protection and economic activities so that both economic and environmental improvements become sustainable.

Establishment of the Regional Environmental Coordinating Committees

These regional committees oversee environmental protection in their respective regions and draft laws on overall environmental regulation, environmental impact assessment (EIA), and pollution control. Procedural and sectoral guidelines for EIA have also been developed.

Establishment of Regional Environmental Agencies

To oversee environmental affairs of their respective regions, Oromia, Amhara, and the Addis Ababa City Administration have established respective environmental agencies. Some of the regions have also issued environmental proclamations and formulated standards.

Establishment of Environmental Laboratories

The Environmental Protection Bureau of the Addis Ababa City Administration has established an environmental laboratory and research center.

In general, the government has marked certain priority areas of action in environment, which include:

- *Strengthening and expanding ongoing efforts to address the critical problem of land degradation and other allied problems of deforestation, overgrazing, soil erosion, etc.*
- *Strengthening regulatory and institutional capacity, and*
- *Strengthening measures taken for the preservation, development, management and sustainable use of biodiversity resources.*

However, it is necessary to point out here that since the nature of environmental issues and problems is multidimensional, a collective effort by the government, the private sector, non-governmental organizations (NGOs), and the local communities is the only approach which can produce environmental protection and conservation.

Note

Ethiopia has accepted the following international agreements on environment:

Biodiversity, Climate Change, Climate-Change-Kyoto Protocol, Desertification, Endangered Species, Hazardous Wastes, Ozone Layer Protection.

Activity 1.2

1 If possible, collect the available information about the population of your village/town/city. Compile the information systematically and make an analysis to find out the average annual growth rate and the population composition by sex.

2 Prepare a report on the natural resources of your local area/region.

3 What are the various environmental problems that your village/town/city is facing? Give your suggestions for solving these problems and for the protection of your local environment. Also indicate if these suggestions will be useful in solving the environmental problems of Ethiopia at the national level.

4 What policy measures are taken by your local authorities to protect the environment in your locality?

Content Check 1.2

1 Why does rapid population growth rate become a burden instead of being a resource?

2 What are the possible advantages to the Ethiopian economy of possessing diverse agro-climatic zones?

3 List down the factors that are responsible for the rapid growth of population in Ethiopia.

1.3 NATIONAL DEVELOPMENT OBJECTIVES AND STRATEGIES — A HISTORICAL REVIEW

At the end of this section, you will be able to:

- identify national development plan objectives and strategies; and
- analyse (compare and contrast) the national development plans of the Monarchy, Military and EPRDF Governments.

Key Terms and Concepts

- Agro-industrial
- Nationalization
- Poverty alleviation

Start-up Activity

1 When did Ethiopia begin to launch national development plan? Was it successful?

2 What were the battle – necks for its success?

Ethiopia is the oldest independent country in Africa and one of the oldest in the world.

The ancient Monarchy maintained its freedom from colonial rule with the exception of a short-lived Italian occupation from 1936 – 41. In 1974, a military junta, the 'Derg', deposed Emperor Haile Selassie I (who had ruled since 1930) and established a socialist state. Torn by bloody coups, uprisings, wide-scale drought, and massive emigration problems, the regime was finally toppled in 1991 by a coalition of rebel forces, the Ethiopian People's Revolutionary Democratic Front (EPRDF). A constitution was adopted in 1994, and Ethiopia's first multiparty election was held in 1995.

1.3.1 National Development Plan during the Monarchy

When their occupation of Ethiopia ended in 1941, the Italians left behind a country whose economic structure was much as it had been for centuries, although there had been some improvements in communications, particularly in the area of road building, and attempts had been made to establish a few small industries and to introduce commercial farming.

During the late 1940s and the 1950s, much of the economy remained unchanged. The government focused its development efforts on expansion of the bureaucratic structure and ancillary services. By the early 1950s, Emperor Haile Selassie I had renewed calls for a transition from a subsistence economy to an agro-industrial economy. A key element of the emperor's new economic policy was the adoption of centrally administered development plans. Between 1945 and 1957, several technical missionaries, including one each from the United States, the Food and Agriculture Organization of the United Nations (FAO), and Yugoslavia, prepared a series of development plans. However, these plans failed to achieve any meaningful results, largely because basic statistical data were scarce and the government's administrative and technical capabilities were minimal. In 1954/55 the government created the National Economic Council which helped to prepare Ethiopia's first and second five-year plans.

The First Five-Year Plan (1957 – 61)

Main Objectives

- *Development of a strong infrastructure, particularly in transportation, construction, and communications, to link isolated regions.*
- *Establishment of a cadre of skilled and semiskilled personnel to work in processing industries to help reduce Ethiopia's dependence on imports.*
- *Acceleration of agricultural development by promoting commercial agricultural ventures. During the plan period, the gross national product (GNP) increased at a 3.2 percent annual rate, as opposed to the projected figure of 3.7 percent, and growth in economic sectors such as agriculture, manufacturing, and mining failed to meet the national plan's targets. Exports increased at a 3.5 percent annual rate, whereas imports grew at a rate of 6.4 percent per annum, thus failing to correct the negative balance of trade that had existed since 1951.*

The Second Five-Year Plan (1962 – 67) and the Third Five-Year Plan (1968 – 73)

Main Objectives of the Plans

The second plan's objectives:

- *To change Ethiopia's predominantly agricultural economy to an agro-industrial one.*
- *Diversification of production, introduction of modern processing methods, and expansion of the economy's productive capacity to increase the country's growth rate.*

The third plan's objectives:

- *Raising manufacturing and agro-industrial performance.*
- *Expansion of educational opportunities.*
- *Improvement in peasant agriculture.*

The Second Five-Year Plan and the Third Five-Year Plan anticipated that the economy would grow at an annual rate of 4.3 percent and 6.0 percent, respectively.

But the Planning Commission never assessed the performance of these two plans, largely because of a shortage of qualified personnel.

However, according to data from the Central Statistical Authority, from 1960/61 to 1973/74 the economy achieved sustained economic growth. Between 1960 and 1970, for example, Ethiopia enjoyed an annual average growth rate of 4% in per-capita gross domestic product. The manufacturing sector's growth rate more than doubled (from 1.9 percent in 1960/61 to 4.4 % in 1973/74), and the growth rate for the wholesale, retail trade, transportation, and communication sectors increased from 9.3 percent to 15.6 percent. By the early 1970s, Ethiopia's economy not only had started to grow but also had begun to diversify into areas such as manufacturing and services. However, these changes failed to improve the lives of most Ethiopians.

This failure could be attributed to the feudal land tenure system that deprived millions of rural peasants from the right to appropriate land and other resources. This deprivation resulted in the decline of production and outbreaks of riots against the system.

1.3.2 National Development Plan under the Derg

The 1974 revolution by the Derg resulted in the establishment of a socialist state which aimed at the nationalization and restructuring of the Ethiopian economy. Economic planning and development in the post-revolution period had four distinct phases.

i **1974-78:** During this period there was little economic growth. Instead, the government's nationalization measures and the highly unstable political climate caused economic dislocation in sectors such as agriculture and manufacturing. Additionally, the military budget consumed a substantial portion of the nation's resources. As a result of these problems, gross domestic product increased at only an average annual rate of 0.4%.

ii **1978-80:** During this period, the economy began to recover as the government consolidated power and implemented institutional reforms. The government's new Development Through Cooperation Campaign (commonly referred to as *zemecha*) also contributed to the economy's improvement. Consequently, gross domestic product grew at an average annual rate of 5.7 percent. Benefiting from good weather, agricultural production increased at an average annual rate of 3.6 percent, and manufacturing increased at an average annual rate of 18.9 percent.

iii **1980-85:** Various annual development campaign programmes were implemented during this period, but still the economy experienced a setback – gross domestic product declined, manufacturing took a downturn, and agriculture reached a crisis stage. This happened because of four reasons:

- *widespread drought all over the country,*
- *manufacturing sector stagnated as agricultural inputs declined,*
- *lack of foreign exchange and declining investment, and*
- *high rise in defence expenditure.*

iv **1985-90:** The government prepared a ten-year perspective plan for the period 1984-94, which aimed at the development of agriculture, enhancement of exports, and improvement in the quality of livestock. To achieve this, strategies of *cooperativisation* and establishment of state farms, etc., were adopted. As a result, the agricultural decline was reversed and the manufacturing sector also grew. Gross domestic product increased at an average annual rate of 5 percent. However, the lingering effects of the 1984-85 drought undercut these achievements and contributed to the economy's overall stagnation during this period.

1.3.3 National Development Plan in EPRDF (1992 – 1996)

The EPRDF government initiated the Five-Year Development Program known as *Peace*, *Democracy* and *Development Program* which emphasized the interrelationships between peace, democracy and development. Major goals and objectives of the programme were as follows:

- *Poverty alleviation through rapid economic growth.*
- *Ensuring peace and security by strengthening a political system that promotes people's equality and fraternity guaranteeing administrative justice and peaceful coexistence with neighbouring countries.*
- *People's participation in the democratic governance of the country.*
- *Implementation of an efficient educational system and improvement in the quality of education.*
- *Development of a governance system that ensures social justice.*
- *Implementation of a prevention-oriented health care system based on cooperation and participation of the private sector.*

Some Recent Development Programs of EPRDF

Sustainable Development and Poverty Reduction Programme (SDPRP)

The program was launched in 2002 following wide-ranging public consultations in 2001 and covered a period of three years 2002/03 – 2004/05. It was built on the following goals and concepts:

- *Agricultural Development-Led Industrialization – ADLI*
- *Food security*
- *Decentralization and empowerment*
- *Capacity building in the public and private sector, and*
- *Reforms in both the justice system and the civil service.*

The first year of the programme was marked by a drought which led to an 11.6% fall in agricultural productivity, contributing to a 3.6% fall in gross domestic product. It was because of this that the average growth for the three-year period was 5.5%. However the country experienced 11.3% and 8.8% growth during the second and third years, respectively.

Plan for Accelerated and Sustained Development to End Poverty (PASDEP)

The programme covered a period of five years — 2005/06 – 2009/10. It was built on the directions pursued under SDPRP and aimed at private-sector development and at the scaling up of resources to achieve the MDGs (Millennium Development Goals).

Overall Objectives of PASDEP

The main objective of PASDEP was to lay out the directions for accelerated, sustained, and people-oriented development and to pave the groundwork for the attainment of the MDGs by 2015.

The purpose of achieving this PASDEP objective was to contribute to the attainment of Ethiopia's vision of becoming a middle-income country.

The country's vision, specifically for the economic sector, set the following goals:

- *To build an economy which has a modern and productive agricultural sector with enhanced technology and an industrial sector that plays a leading role in the economy;*

- *To sustain economic development and secure social justice; and*
- *To increase per-capita income of citizens so that it reaches at the level of those in middle-income countries in the coming 20 years.*

The term of the programme was completed in June 2010, and its performance has yet to be evaluated. However, the general observations were that it achieved good results in the road construction and energy sectors, although the performance of the agriculture and export sectors was less than expected. Note that the five-year period of PASDEP was affected by multiple problems, including less donor support than expected, poor rainfall, and the global financial crisis of 2008-09.

Growth Targets for PASDEP

- *Annual average real GDP growth rate of 7% per annum during the PASDEP period 2005/06 to 2009/10;*
- *Annual average agricultural value added growth of 6.2% per annum;*
- *Annual average industrial value added growth rate of 11.5% per annum;*
- *Annual average services sector value added growth rate of 7.1% per annum.*

National Development Policy Framework of Ethiopia

- Fight and eradicate poverty through achieving broad-based and pro-poor growth;
- Medium-term plans/programs such as the previous Sustainable Development and Poverty Reduction Programme (SDPRP) and the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) were primary vehicles for overall socio-economic transformation and for achieving the Millennium Development Goals (MDGs);
- The SDPRP, which spanned the three-year period (2002/03-2004/05) and was launched in 2002 following wide-ranging public consultations in 2001, was built on agriculture, rural development and food security (Agriculture Development Led Industrialization-ADLI), decentralization and empowerment, capacity building in the public and private sector, and reforms in both the justice system and the civil service;
- The Plan for Accelerated and Sustained Development to end Poverty (PASDEP) was a five-year (2005/06-2009/10) strategic framework to build on the directions pursued under the SDPRP. The PASDEP deepened the fundamentals of the SDPRP, private sector development, and the scaling up of resources to achieve the MDGs.

Source: *Ministry of Finance and Economic Development.*

Note

The next five-year plan, the Growth and Transformation Program (GTP) replaced the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) and was effective as of fiscal year 2010-11. According to the Ministry of Finance and Economic Development, this plan emphasizes roads, telecommunication, energy and water sectors.

Activity 1.3

You have studied the national development plans of the country and also the goals and objectives of these plans and the strategies adopted to achieve the objectives. Suppose you were given the responsibility to formulate a national development plan for Ethiopia, what would be the objectives of your plan? Indicate the approaches and strategies you would implement to obtain those objectives.

Content Check 1.3

1. What is the overall objective of setting national development plans in Ethiopia?
2. What were the targets achieved by the Ethiopian government in its first Five-year plan (1957 – 61)?
3. Present your opinions as to why the GDP increased at an average annual growth rate of less than 1%.
4. Identify the challenges faced by EPRDF's development plan adopted for 2002/03 – 2004/05.

UNIT REVIEW

UNIT SUMMARY

- The Ethiopian economy is predominantly agrarian with over 85% of its population living in rural areas and engaged in agricultural and allied activities.
- Agriculture contributes over 40% to the GDP of the country and generates over 80% of total export earnings.
- The agricultural sector suffers from problems such as periodic drought, soil degradation, high population density, and lack of agricultural technology.
- The main crops grown are: teff, barley, maize, wheat, horse beans, sesame, soyabeans, coffee, tobacco and sugarcane.
- The industrial sector of Ethiopian economy is smaller than the agriculture and service sectors.
- The industrial sector contributes about 13% to the GDP and 9.5% to employment.
- The main manufactured products are: textiles, foodstuffs, beverages, cement, leather products, paper, tiles, clothing, sugar, and oil cakes.
- The industrial sector suffers from problems such as low level of technology, resource underutilisation, low productivity, low levels of skills and management, and shortages of raw materials and spare parts.
- As of 2011, the service sector of the Ethiopian economy had contributed its the highest share to the GDP during the years 2008 and 2009. Earlier its share was second highest.
- A relatively small percentage of population (about 10%) is engaged in the service sector.
- The most important segment of the services sector is government employment.
- As per the estimates of July 2009, the population of Ethiopia numbers 85.2 million.
- The number of males in the population is approximately equal to the number of females.
- The annual average population growth rate was 2.6% between 1994 and 2007.
- A significant proportion of the national population is below 15 years of age.
- Total land area of Ethiopia is 1,104,300 sq. km.
- Soil erosion has been one of the country's major problems over the centuries.
- Ethiopia has the largest livestock population in Africa.
- The livestock subsector is estimated to account for 10% of the GDP.

- The country has about 43 million cattle, 25.5 million sheep, 23.4 million goats, and 2.3 million camels.
- The fishery sector is estimated to contribute only about 1% to the GDP.
- An estimated 3.5 million hectares of natural forests presently remain in Ethiopia.
- The country derives about 90% of its electricity needs from hydropower.
- Traditional energy resources include fuelwood, crop residues, animal dung, and charcoal.
- The minerals mainly mined in Ethiopia are: gold, marble, limestone and tantalum.
- The mining sector contributes about 1% to Ethiopia's GDP.
- Land degradation, deforestation, overgrazing, and water-resource degradation are challenging environmental problems of Ethiopia.
- Under the Monarchy, three Five-Year National Development Plans were implemented: 1957-61, 1962-67, and 1968-73.
- The National Development Plans formulated under the Derg aimed at the establishment of a socialist state through nationalisation of private enterprises and through restructuring the economy.
- The EPRDF government initiated the Five-Year Development Programme known as Peace, Democracy and Development Programme.
- Among the recent development programmes of EPRDF are:
  - Sustainable Development and Poverty Reduction Programme (SDPRP), 2002/03-2004/05.
  - Plan for Accelerated and Sustained Development to End Poverty (PASDEP), 2005/06-2009/10.
  - Growth and Transformation Plan, 2010/11 – 2014/15

REVIEW EXERCISE FOR UNIT 1

I ***Write 'True' or 'False' each of the following.***

1 Agriculture generates over 80% of Ethiopia's export earnings.

2 Coffee is a major cash crop of Ethiopia.

3 Ethiopia has the smallest livestock population in Africa.

4 The contribution of the industrial sector to the GDP of Ethiopia is greater than that of the agricultural sector.

5 Ethiopia has a very high industrial base.

6 Ethiopia has a relatively high population growth rate.

7 Soil erosion has been one of Ethiopia's major environmental problems.

8 Ethiopia is a party to Climate Change-Kyoto Protocol.

9 Droughts are not common in Ethiopia.

10 SDPRP was initiated during the Derg regime.

II *Choose the best answer from the given alternatives.*

11 The contribution of the agricultural sector to Ethiopia's GDP is more than:

A 40% B 50% C 60% D 70%

12 The contribution of the industrial sector to Ethiopia's GDP is:

A less than 10% C more than 10%

B equal to 10% D none of these

13 Which of the following is not a major manufactured product of Ethiopia?

A textiles C leather products

B motor cars D sugar

14 The current estimate of Ethiopia's population is:

A over 80 million C over 120 million

B over 100 million D none of these

15 The Military government ruled the country:

A during 1940s C after 1991

B between 1957 and 1962 D between 1974-1991

III *Write the full form of the following.*

16 GDP 20 CBR 24 SDPRP

17 ADLI 21 TFR 25 PASDEP

18 EPRDF 22 IMR

19 CSA 23 MDGs

IV *Answer the following briefly.*

26 Describe how the Ethiopian economy has changed over the years, from the time of the Monarchy to the present time.

27 Describe the main features and problems of Ethiopia’s agricultural sector.

28 Point out the major changes and developments in the industrial sector of the Ethiopian economy, since 1991.

29 Of what sub-sectors is the service sector of the Ethiopian economy composed? Also describe the main features of the sector.

30 Discuss in detail the structure and composition of the population of Ethiopia.

31 What are the major issues and problems related to land and environment in Ethiopia?

32 Describe minerals function as an important but less exploited resource of the Ethiopian economy.

33 Discuss the status of fishery and forestry in the Ethiopian economy.

34 “Ethiopia has a huge livestock resource with considerable potential to contribute to the national economy.” Justify the statement.

35 Discuss the development of the energy sector in the Ethiopian economy.

36 Outline the major steps undertaken by the government in recent years to curb the environmental problems of Ethiopia.

37 List the objectives and strategies of the Five-Year National Development Plans during the Monarchy (1960-1973).

38 Summarize the economic planning and development that existed during the Derg (1974-1991).

39 Discuss the goals and objectives of the Peace, Democracy and Development Programme of the EPRDF government.

40 Describe the main features of the National Development Policy Framework of Ethiopia.

UNIT 2

THE AGRICULTURAL SECTOR IN ETHIOPIAN ECONOMY

Unit Objectives

After completing this unit, you will be able to:

- appreciate the role of the agricultural sector in the Ethiopian economy;
- understand the different policies and strategies applied by the Imperial, Derg, and recent governments;
- analyze the performance of and the possible remedies for the Ethiopian agricultural sector.

Main Contents

INTRODUCTION

As records reveal, the agricultural sector in Ethiopia is the mainstay of the country's economy. It is also the most volatile sector, as exhibited in the unevenness of its growth patterns, which is the effect of its heavy dependence on rainfall and the seasonal shocks that are frequently observed in Ethiopia. However, it contributes the largest share to the GDP, export trade earnings, and employment. It also provides raw materials for the various industries in the country to a great extent. With this scenario, the various strategies so far adopted to develop it need rethinking. This serious work of rethinking the development priorities should be made considering the various regional as well as local objective conditions.

2.1 AGRICULTURAL VERSUS INDUSTRIAL DEVELOPMENT

At the end of this section, you will be able to:

- assess the debate on agriculture versus industry.

Start-up Activity

1 Do you have any ideas related to the various agricultural development approaches or strategies adopted by the preceding regimes of Ethiopia?

2 Did they change the LIFESTYLES of the poor peasants or of the landlords?

Different views or paradigms have been adapted for the development of a country. The role of agriculture in economic development has been considered as largely passive and supportive or secondary. In the Western economies, the industrial sector was given priority, based on the assumption that it has the largest potential to adopt technology and to create forward and backward linkages with the other sectors.

However, the desirability of placing such heavy priority on industrial growth is questionable for most developing countries like Ethiopia. Since the 1970s, development economists have come to realize that the agricultural sector needs to be viewed as a leading and dynamic sector. They further state that, without the development of the agricultural sector, the growth of the industrial sector will become weak. Hence, the agricultural sector has to be the leading sector, and this is the approach of the current Ethiopian strategy of development, ADLI.

Activity 2.1

Your teacher will arrange the class into two groups so that you can debate the issue of agricultural versus industrial development.

2.2 UNI-MODAL AGRICULTURAL STRATEGY

At the end of this section, you will be able to:

- define the uni-modal agricultural strategy;
- explain the characteristics of the strategies and
- identify the advantages and limitations of the uni-modal approaches.

Key Terms and Concepts

- Uni-modal strategy
- Paradigms
- Transformation

Start-up Activity

Did the poor benefit from the development plans practiced?

Uni-modal and bi-modal strategies are two types of agriculture-development pathways or options that can be used to transform the agricultural sector, which is the core section of the country's economy.

2.2.1 What is the Uni-modal Strategy?

It is a pathway based on the proposal that the achievement of transformation in the agricultural sector is possible through intensification of small-scale peasant farms. It is based on the concept of a specific peasant economy in which small producers who are not separated from their means of production retain a degree of control over land and family labour in spite of international secular differentiations (example: Japan, Thailand and China).

2.2.2 Characteristics of the Uni-modal Strategy

- *The central element of this approach is the development and diffusion of highly divisible innovations that promote output expansion within the existing agrarian structure (small-size holdings)*
- *It is a pro-poor growth strategy.*
- *It believes in enhancing small-landholders' access to modern inputs such as improved seeds, fertilizers, and providing them to farmers on revolving-credit bases.*
- *It focuses on the production of food crops with a view to ensuring food security.*

2.2.3 Advantages

- *It protects the existence of a differentiated peasant group/class.*
- *It protects the peasants from eviction.*
- *It creates a huge potential for the government to gain political support.*
- *It reduces poverty in the rural economy.*
- *It provides individual peasants with access to modern technologies.*
- *It reduces outgoing migration from rural areas.*

2.2.4 Limitations

- *It focuses only on food crops rather on other marketable or high-value products for the market.*
- *Does not improve the shortage of knowledge regarding market information and weather conditions.*
- *Does not improve the shortage of infrastructures that is due to the smallholders' settlement patterns (fragmentation)*
- *The small-size holdings cannot employ large-scale agricultural inputs.*
- *Continuous price rises of the agricultural inputs, like urea, dap, etc. are not controlled.*

2.3 BI-MODAL AGRICULTURAL STRATEGY

At the end of this section, you will be able to:

- define bimodal agricultural strategy;
- explain the characteristics of the strategy; and
- identify the advantages and limitations of the bi-modal strategy.

Key Terms and Concepts

- Pathway
- Divisible innovations
- Dualistic/economic dualism

2.3.1 What is the Bi-Modal Agricultural Strategy?

It is an agricultural development pathway that advocates the practices both of the intensification of small peasant farms and of commercialisation. It is based on a dualistic structure of farm units (as in the case of Mexico and Columbia) which proposes that commercialisation and commoditization inevitably generate differentiation in agrarian societies, whereby rural producers are set apart into agricultural capitalists and landless agricultural employees.

2.3.2 Characteristics of the Bi-modal Approach

- *It is a dualistic agricultural development approach that supports a strong principal commercial sector.*
- *An obvious implication of this pathway is that entrepreneurial individuals should be allowed to accumulate land.*
- *It supports the differentiation of individuals who invest more in farming and those who develop business.*

2.3.3 Advantages

- *It supports individual rights to acquire land*
- *It invites more capital and technology investment for agriculture*

- *It promotes large-scale diversification*
- *It allows the transfer of technology*

2.3.4 Limitations

- *It creates differentiation in the rural society*
- *Lack of off-farm job opportunities*
- *Promotes the eviction of small peasants/poor people*
- *It deprives the majority of the rural population of land.*

Activity 2.2

Your teacher will invite an extension package worker or another nearby agricultural service expert. From his/her presentation and available literature, discuss the two approaches. Which approach is most advisable in the Ethiopian context? Debate this issue.

2.4 ROLES OF THE AGRICULTURAL SECTOR

At the end of this section, you will be able to:

- identify the contribution of the agricultural sector to the rest of the economy;
- examine the forward and backward linkages of the agricultural sector;
- analyze how surplus is transferred from the agricultural sector; and
- assess the role of the agricultural sector in Gross Domestic Product and in the creation of employment.

Key Terms and Concepts

- Backward linkage
- Forward linkage
- Compulsory delivery

Observe your locality carefully. In which economic activity/sector is the majority of the people engaged? What percentage of the student population belongs to peasant families?

It is apparent that agriculture is the backbone of the Ethiopian economy, as you can see from the important roles it plays, as discussed in the following sections.

2.4.1 Source of Food and Raw Materials

One of the main roles of agriculture in the Ethiopian economy is being the source of food and raw materials. For example, agriculture supplies the country with food grains, dairy and meat products. A productive agricultural sector provides relatively abundant food and raw materials to the population.

Backward linkages: an efficient/productive agricultural sector supplies food and raw material to the industrial sector and its labour force. In turn, it has to be supplied with modern inputs and technologies to cope with responding to the growing demand of the non-farming and farming population. Without such support, the agriculture sector appears weak and non-supportive. It may even risk its own population facing food insecurity.

Furthermore, productivity in the agricultural sector improves the level of income received by rural people. Increased income of rural people is believed to generate increased demand for manufactured goods from the industrial sector.

Forward linkages: productivity in the agricultural sector can promote the following forward linkages. First, it reduces the cost of living in the industry-based/urban areas which, in turn, reduces the pressure on wages and makes industrial profit higher. Second, increasing the provision of raw materials reduces the cost of raw materials and makes industrial profits higher. These two factors can contribute significantly to increasing industrial savings and investment that leads to the promotion of the sector.

Activity 2.3

1 Refer to the 'Agrarian Reform in Ethiopia' by Desalegn Rhamento and two other materials related to the status of Ethiopian agriculture, and then give reasons why the agricultural sector has not been active enough to promote the country's development. For this task, your teacher will help the class to form two or three groups in the classroom. One of the groups will collect the source information, and the other group will produce the reasons or facts.

2 How many of you (in the class):

a fully depend on the income generated from agriculture?

b experience and understand positive changes in your families' income from year to year?

2.4.2 Source of Capital

Although the agricultural sector provides meagre surpluses of savings and taxes to support investment, the transference of surplus from the agricultural sector to other sectors is made through the following three modalities:

- *tax;*
- *defining the terms of trade to protect domestic agriculture by imposing price controls on agricultural products, and*
- *compulsory delivery of agriculture commodities at very fixed prices.*

The question is how much surplus should be transferred. In this regard, two opposing views can be discussed. One is that agriculture does not require large amounts of capital for its expansion. The other view is that the investment requirements for agricultural transformation are so large that there may be a need for a net flow of capital from non-agriculture to agriculture.

The Derge regime removed a great deal of surplus from the agricultural sector to supply both the urban consumers and its huge army with cheap foodstuffs. However, this surplus was used ineffectively. This indicates that the potential of the agricultural sector to produce surplus that could be transferable to the other sectors could be high.

2.4.3 Contribution to Gross Domestic Product

Over the last four decades, the share of agriculture and allied sectors (fisheries and forestry) to the national GDP has been declining. The percentage share declined from 76 percent in the early 1960s to 45 percent in 2003/04. Consequently, it has been the major source of fluctuations in the Ethiopian economy.

Table 2.1 **The Performance of the Agricultural sector and its contribution to GDP**

Years	Share of agriculture and allied sectors to the GDP in percentage
1960/61	76
1970/71	68
1980/81	52
1999/00	43.6
2000/01	45. 1
2001/02	43.2
2002/03	39.4
2003/04	45.1

Source: *Computed based on data obtained from NBE 2001/02.*

Note:

From Table 2.1, we see a decrease in the performance of the agricultural sector and of its contribution to the country's GDP. This could be attributed mainly due to

- the frequently appearing drought
- the agricultural percentage share has been taken by the service sector
- the increasing prices of agricultural inputs

In general, available data reveal that Ethiopian agriculture generates only a meagre amount of surplus and contributes much less than expected.

2.4.4 Contribution to Employment

More than 80% of the Ethiopian population earn their livelihood from agriculture (crop cultivation and livestock rearing activities). High population growth and low urbanization have been an increasing major challenge to this sector that it could not absorb the growing surplus labour force. Neglect or less attention to urbanization and non-farm sector development has put the farm sector under a growing pressure. Nevertheless, it supports a large percentage of the labour force.

In the face of the increasing scarcity of other resources, particularly agricultural land, measures should be taken to improve labour productivity in the agriculture sector.

Activity 2.4

Your teacher will ask a certain number of students to voluntarily come to the front of the class and draw a flow chart that shows the various roles played by the agricultural sector.

The remaining students should ask questions. The teacher shall help the students who produce the explanation. Finally, a consensus has to be reached regarding the existing status of agriculture in providing the expected contribution.

2.5 STRUCTURE OF THE AGRICULTURAL SECTOR

At the end of this section, you will be able to:

- examine the structure of the agricultural sector of Ethiopia, and
- identify and explain the major agricultural production systems.

Key Terms and Concepts

- Household size
- Smallholder
- Price incentive

Start-up Activity

How many types of farming system are dominant in Ethiopia? How do you characterize them?

The agricultural sector of Ethiopia is composed of the *crop-production, livestock, forestry,* and *fishery sub-sectors. About 65% of the sector's GDP comes from crop-production, while animal husbandry contributes 25%*. The remaining 10% is generated from the allied sectors, forestry, fishing and others.

The national *2001/2002* Sample Agricultural Figures provides some data on the major *agricultural production system*. The report has identified three categories of farms

2.5.1 Farming Systems in Ethiopia

Currently, the following farming systems are widely practiced in Ethiopia.

- The smallholder farming system,
- The pastoral/nomadic system, and
- The modern commercial farming system.

i *The Smallholder Farming System*

It is the most important or dominant system. It accounts for more than 90 percent of the agricultural production and for about 95 percent of the total area under crop production. It is characterized by mixed farming.

The total number of households in this category were estimated to be about 10.58 million heads. The average household size stood at around 5 members per household.

Over 86 percent of this community cultivates farmlands with areas less than 2 hectare each.

Figure 2.1: **Ensete Farm (a smallholder farm in the Guraghe zone, SNNPR).**

Table 2.2 **The distribution of landholding size of smallholder households**

Landholding size	% of agricultural house-holds	Cumulative % of agricultural households
< 0.10 Ha	7.2	7.2
0.10 – 0.5 Ha	28.6	35.8
0.51 – 1.00 Ha	25.8	61.6
1.01 – 2.00 Ha	24.8	86.4
2.01 – 5.00 Ha	12.5	98.9
– 10.00 Ha	1	99.9
> 10.00 Ha	0.1	100

Source: *Girma, 2006.*

Based on Table 2.2

- *86.4 percent of agricultural households own land with areas of two hectares or less.*
- *only 12 percent of agricultural house-holds own farmland with areas of 2.01 and above hectares.*
- *1 percent or fewer house holds own farm land with areas greater than 10 hectares.*

ii *Pastoral Farming System*

About 40% of Ethiopia's land area is in the arid and semi-arid zones and is located in the lowlands, below 1,500 m. There rainfed crop production is not possible because of low-level erratic rainfall, and people rely more on livestock for subsistence. The lowlands are home to about 20% of Ethiopia's cattle, 25% of the sheep, and 73% of the goats, plus about one million camel. These animals support some 5.5 million people.

In addition to feeding this population, the livestock in the range lands account for a major portion of the country's exports of live animals, in particular of cattle. Surplus sheep and goats sourced from the rangelands represent about 19% of the domestic supply.

Ethiopia's range lands are also important for wildlife. The main areas of wildlife concentration are in the southwestern part of the country, particularly in the Omo River basin and the Gambella region. In these areas, which have a high rainfall and fertile soils, tsetse infestation has greatly suppressed agricultural and pastoral activities. Although less abundant, wildlife also exists in the eastern part of the country, particularly in the Awash Valley and in the southern rangelands. The conservation and development of these resources are carried out through the development of national parks, wildlife sanctuaries, and reserves. In addition, 14 controlled areas have been established, of which the largest is the Borena controlled hunting area.

There is not much documented information about this system of farming. Most of the people are nomadic, moving seasonally, together with their livestock, from one place to another in search of pasture and water. Some studies have been undertaken about the pastoralists roaming in the Awash Valley, in connection the with development of medium-to large-scale irrigation schemes there.

Livestock production is much greater than crop production in the pastoral nomadic system. General and empirical observations suggest that this system is characterized by chronic food shortages. Thus, agricultural products and productivity are extremely low. With the possible exception of livestock vaccination, there is virtually nothing that the government (or any other, non-governmental organization) has provided for long in terms of assistance or support to the pastoral-nomadic system. However, these days, the sub-sector has been the focus of serious concern through the expansion of extension service.

iii *Commercial Farming System*

Commercial farming system was officially introduced during the third five-year plan (1968 – 73) of the Imperial Government of Ethiopia. Among the strategies envisaged to modernize agriculture and increase marketable surplus, the plan stated that available government land would be utilised for the establishment of large commercial farms. As a result, many entrepreneurs rented and developed commercial farms in the Awash Valley, the Rift Valley and other areas. After the 1974 revolution, all these farms were confiscated by the government. Additional government lands in many parts of the country were also developed into large-scale state farms. These were organized into enterprises which in turn were grouped under corporations, according to their locations and output specialization. A separate ministry, the Ministry of State Farms Development was set up to manage and expand state farms. Also another separate ministry, the Ministry of Coffee and Tea Development, was established.

The state farm enterprise introduced intensive farming and extensive mechanised agriculture. The former was based on irrigation, while the latter was marked by rainfed agriculture, with or without the use of fertilizers and other chemicals. It is based on bringing unused land, into cultivation a predominant feature of modern agriculture in Ethiopia prior to 1974.

Figure 2.2: **Commercial Farming**

State farms have been the most pampered of all production systems in Ethiopia. There had been no limit for these farms in terms of receiving land, agricultural inputs, credits, price incentives and marketing facilities. Despite all these advantages, they were unproductive and inefficient. The major characteristics of many of them were mismanagement, abuse of assets, corruption, etc. It must be noted that some of these farms were developed without adequate studies, resulting in huge financial losses. In fact, most of the state farms were run on government financial resources.

This system, comprising about 5% of the total cropland area, together with co-operatives, accounted for less than 10% of total agricultural production.

The efficiency of state farms is extremely low, relative to the high expenditure made in establishing and operating them. The major crops grown in these farms include cotton, coffee, tea, sugarcane, fruits and vegetables.

The size and role of state farms declined after 1992 when the new government granted some of the state farms to nearby farmers and investors. At present, there are only 13 state farms. They produce mainly wheat, maize, cotton, coffee, and tea on 156,040 hectares of land.

Under the current economic policy attempted have been made establish commercial farms. Out of the total investment permits issued between 1992/93 and 1997/98, 1148 or 26.8% of them were in agriculture. However, only 508 projects became operational.

With the advent of market economy, the Federal Government has recognized the decisive role that private capital can play in the expansion and development of large-scale modern farming in order to enhance the supply of food and raw materials and to create employment opportunities. As a result, the role of state farms is expected to fall significantly. The state may operate those state farms that are strategic to the economy, jointly with domestic or foreign private capital. In order to encourage domestic and foreign private capital, without any capital limitation, the government is committed to creating an enabling environment.

Activity 2.5

Identify the dominant farming system in your area. Are there commercial farms? If yes, please write down their basic characteristics. If not, give your opinion.

2.6 SPECIFIC POLICIES AND STRATEGIES OF THE AGRICULTURAL SECTOR SINCE 1960S

At the end of this section, you will be able to:

- examine the specific policies and strategies of the agricultural sector that existed during the different regimes.

Key Terms and Concepts

- Package projects
- Fiscal
- Green-revolution
- Market forces

Start-up Activity

1. Does Ethiopia have a long history in practicing specific policies and strategies in the agricultural sector?
2. Have the polices and strategies adopted hit their targets?

Although Ethiopia does not have a long history of adopting economic policies, attempts begun in the 1960s in the form of five-year development plans. Starting from then, both sectoral as well as national development plans have been launched with varying priorities and institutional frameworks.

2.6.1 PRE–1974 AGRICULTURAL POLICIES AND STRATEGIES

There were two policy paths for the development of the agricultural sector in the late 1960s. They were large-scale mechanized commercial farms and the establishment of package projects to assist the sector in diffusing agricultural innovations.

A *Large-Scale Mechanized Commercial Farm*

The main objective of this path was to facilitate agricultural exports and to create new employment opportunities.

As the name implies, LSMCF (Large Scale Mechanised Commercial Farm) requires bringing extensive areas of land under cultivation with the use of modern agricultural inputs such as modern technology, machinery, equipment (tractors and combiners), chemical fertilizers and hired labour, in contrast to the family labour used in the small-holder farming system.

The government took some fiscal measures to encourage the expansion of these farms in the country. Among the resulting policy measures were credit arrangements, tax holidays for the first five years for investments in excess of 200,000 Birr, low land use fees, tax-free import of heavy machinery, and possibilities of remitting profits to investor countries of origin. As a result, some foreign-owned profitable plantations developed. They mostly produced food and fiber. However, these results were too small to achieve the given incentives. They accounted for almost 5% of the total agricultural output and 3% of the total area cultivated. The 1974 popular uprising led to the nationalization of these farms and their conversion into state farms in 1975.

B *Establishment and Development of Package Projects*

The package approach was successful in improving the productivity of farmers in Mexico, India, Bangladesh, Israel, etc.

The basic objective of donors and the government in initiating the package project in Ethiopia was to repeat the success of the Green Revolution of India in Ethiopia. The Green Revolution was a type of agrarian revolution characterized by the large-scale use of improved and high yield variety (HYV) seeds and other inputs.

There were two types of package projects: *comprehensive package projects* and *minimum package projects*.

Comprehensive Package Projects

These are package projects include integrated rural development. They were designed to supply important inputs such as chemicals, fertilizers, improved seeds, improved farm tools, credits, pesticides, and know-how. These inputs were for the purposes of:

- *raising the living standard of the poor peasants by raising per-capita income;*
- *creating employment opportunities by encouraging labour-intensive technology;*
- *encouraging peasant participation in the development process to solve problems;*
- *expanding experimental stations for propagating new ideas in agricultural technology and providing improved farm tools.*

The criteria for selecting areas for such a package were the availability of adequate rainfall, good weather conditions, fertility of soil, the possibility that the areas are conductive for further expansion, etc. Accordingly, the Chilalo Agricultural Development Unit (CADU), the Welayita Agricultural Development Unit (WADU), and the Adaa District Development Package Project (ADDP) were established. These projects were sponsored by the Swedish International Development Agency (SIDA) and the United States Agency for International Development (USAID).

Some achievements were observed in the project areas. For example, income of participating farmers increased by Birr 340 per year, productivity in crops and livestock increased significantly, and the adoption of modern inputs expanded in the project areas. But there were also some adverse effects, such as an increase in the eviction of tenants. For example, in 1969 and 1970, over 500 tenant farmers were evicted from CADU. This means that the number of landless people increased. The other problem associated with these projects was their huge cost. At the start of the project, the cost per beneficiary farmer was Birr 15,000. Because of these problems, the comprehensive package project was too difficult to be duplicated in other areas of the country. Therefore, a relatively less costly package programme, known as the minimum package programme, was launched, substituting for the comprehensive package projects which covered larger areas.

Minimum Package Projects (MPP)

These projects were designed in order to raise production and income of smallholders quickly over a wide area with a minimum reliance on scarce resources. These projects involved the diffusion of a few proven imports of agriculture such as chemical fertilizer, improved seeds, and farm implements.

The first minimum package project was established in 1971. It was hoped that these would be duplicated at a rate of 10 projects every year to cover all rural areas. But, as with the comprehensive package projects, the benefits were poorly distributed in favour of landowners and large cultivators, and the eviction of tenants was still a problem in some areas.

The second phase, MPP II, launched in the first half of the 1980s, continued well through the Military Regime. However, the over ambitious objectives attached to the projects and the relatively small amount of resources allocated made the projects unsuccessful. The projects largely concentrated on the coopertivization process.

2.6.2 Agricultural Policies and Strategies During the Derg

The uprising in 1974 led to the overthrow of the Imperial regime and to changing the official national ideology to socialist principles. This was followed by overall shifts in the economic policies of the country. State control of the economy was overextended. There were no circumstances in which private-sector participation in economic activity was encouraged. The new policy paradigm was manifested in the different sectors of the economy.

The comprehensive and the minimum package projects launched during the Imperial regime continued in the Derg period. CADU was transformed into Arssi Rural Development Unit (ARDU) and then to Bale-Arssi Rural Development Unit (BARDU), which resulted in the thinning of resources over wide areas. Finally, all these projects were transformed into Peasant Agricultural Development Extension Projects (PADEP) which were organized along pluralist principles. Some of the objectives of PADEP included decentralization of the activities of the Ministry of Agriculture.

These objectives resulted in the formulation of eight PADEP zones, each with its own plan, budget, administration, and research activities, but by 1988, PADEP came to an end due to shortage of funds and changes in administrative structure. The financing of PADEP was expected from international development agencies like the World Bank, SIDA and International Fund for Agriculture, upon conditions which would be fulfilled by the government of Ethiopia, such as the adoption of liberalization programmes. Research and feasibility studies were conducted by foreign experts especially by the World Bank.

The government also organized the small holders along socialist lines for the purpose of the collective production and marketing of agricultural output and distribution of inputs. There were three types of associations, namely peasant associations, service cooperatives, and producers’ cooperatives. By 1989 most peasant households were organized into 17,000 peasant associations, 3,700 service cooperatives, and 3,300 producers’ cooperatives. But these associations could not help the farmers due to various problems, such as their inability to make decisions in their own affairs and the emphasis given to politics at the expense of everything else. These facts led to poor leadership and the embezzlement of funds.

In general, the agricultural sector policies of the military government were characterized by the following:

- *Nationalization of all private and commercial farms*
- *Prohibition of private investment in the agricultural sector*
- *Involuntary collectivisation of peasants into peasant associations, and into producers' and service cooperatives*
- *Forced villagization and settlements*
- *Government control of virtually all agricultural input and output markets*
- *Forced food-grain quota deliveries at predetermined low prices*
- *Restriction of the movement of agricultural outputs from one part of the country to another.*

These ill-conceived government interventions were the primary reasons for the lack of success in the development of the agricultural sector, in particular, and the national economy, in general.

2.6.3 Post-1991 Agricultural Policies and Strategies

The Transitional Government of Ethiopia adopted a new economic policy in 1991, with a general objective of replacing the command economy with an economic system driven by market forces. Some of the changes observed in the agricultural sector include:

- *dissolution of producers' and service cooperatives;*
- *encouragement of smallholders and private commercial farms;*
- *termination of public investment in state farms; and*
- *abolition of compulsory food-grain quotas and restoration of freedom of market.*

The government also adopted Agricultural Development-Led Industrialization (ADLI) in 1993, which revolved around enhancing the productivity of smallholder agriculture and industrialization based on the utilization of domestic raw materials via adopting labour-intensive technology.

The essence of this strategy rests on the belief that the agricultural sector can serve as the driving force for the rest of the economy. This means that the strategy aims at better use of the massive agricultural labour force in rural areas. It has internal forward and backward linkages with the industrial sector. This strategy has been adopted by the government to fit in the Ethiopian context.

These linkages can be explained as follows:

- *Agriculture will provide the domestic food requirement, supply industrial inputs, and provide commodities for export.*
- *Development of agriculture expands the market for domestically produced goods as a result of increased farmer incomes.*

The development of the agricultural sector is said to be achieved through the improvement in the productivity of smallholdings and the expansion of large-scale private commercial farms. The smallholder farmers are the major source of stable food production for the national food supply. Food security could be achieved through promoting smallholder development in a sustainable manner. In order to do this, special emphasis is given to raising production and the productivity of farmers. In this regard, policies focused on designing incentive packages, such as access to fertile land, provision of inputs, credit and tax incentives; improving budgetary allocations; developing human resources; and improving the infrastructure and logistical support.

Agricultural extension services are the basis for raising the productivity of the smallholder farmers, who are the participants at the grass-roots level. Thus, a new system of agricultural extension activities, named “Participatory, Demonstration and Training Extension System” (PADETES), was formulated. The system is based on demonstrating to and training farmers in proven technologies in line with the philosophy of bottom-up development approaches. This strategy gives special emphasis to human resource development along with efforts to transfer appropriate technologies that are suitable to conditions in rural areas. Human resource development in this context implies improving the status of agricultural labour by upgrading skills by way of investments in health, education and appropriate training.

The implementation of this strategy involves a package approach geared towards different agro-ecological zones: areas with reliable moisture and nomadic pastorals. According to some appraisals, the stratagy is effective: in the reliable moisture areas, the results achieved in 1994 and 1995 included high output and yield such appraisals help to justify the possibility of overcoming chronic food shortages in a relatively short time if the strategy is implemented on a wider scope.

At the program level, ADLI consists of the following:

i One of the basic goals of the program is ensuring **accelerated economic growth** through a rural-centred development program strategy which mainly focuses on the development of the agricultural sector's output using "a package programme" through:

- *the distribution of improved seeds, fertilizer, and pesticides to farmers;*
- *the provision of credit and improved extension services;*
- *the construction of small-scale irrigation schemes;*
- *the development of livestock resources through an improved feed base, improved veterinary services, better use of improved breeding, and improved livestock products;*
- *conservation and rehabilitation of natural resources;*
- *implementing a favourable land-use policy;*
- *establishing agricultural marketing services;*
- *encouraging private sector development;*
- *expanding the economic and social infrastructure; and*
- *establishing peasant associations and service cooperatives.*

ii Ensuring accelerated economic growth to improve the living standards of urban dwellers through:

- *rapid changes in urban dwellers' living condition;*
- *supporting indigenous investors; and*
- *the development of urban infrastructure.*

iii The programme also targets adopting an effective education strategy which:

- *spells out the efficiencies of the existing educational curricula;*
- *suggests measures to increase the quality of the existing educational curricula;*
- *ensures the fairness of the curricula;*
- *takes appropriate measures necessary for the expansion of vocational education;*
- *encourages the participation of the community, NGOs, and private investors to improve the standard of education; and*
- *improves educational administration.*

iv The preventive and primary health care strategy of the programme is aimed at:

- *the identification of health service problems in Ethiopia;*
- *the expansion of preventive and primary health care services;*
- *improving the supply of basic medicine; and*
- *encouraging private entrepreneurs to participate in rendering health services.*

In general, ADLI aims at improving the productivity and production of smallholders by improving both allocative and technical efficiency.

At local levels, efficiency will be improved by using existing resources of land, labour, and capital in a better way through improved agronomic practices. But the technical efficiency of smallholding farmers will be improved by increasing their resources, essentially capital, to introduce improved technology, be it biological, chemical, or mechanical.

Activity 2.6

Compare and contrast the agricultural polices and strategies adopted by Derg and EPRDF.

2.7 THE PERFORMANCE OF THE AGRICULTURAL SECTOR

At the end of this section, you will be able to:

- examine the performance of the agricultural sector in terms of crop production and livestock production.

It is apparent that agriculture is the mainstay of the Ethiopian economy. But its performance is not strong. Can you guess why this is the case?

In earlier discussions, we said that agriculture is the dominant sector in the Ethiopian economy, accounting for about 45% of the GDP and employing close to 85% of the labour force. It is also the major source of foreign currency for the country. However, the performance of the sector has been unsatisfactory relative to the rapidly growing population. During the period of the Derg, especially from the years 1980/81 to 1990/91, the growth rate of the value added in agriculture and allied activities averaged a mere 1% per annum. Crop production and livestock rearing, forestry, and fishing exhibited annual average growth rates of 0.8, 2.6 and 4.6 percent, respectively, for the period. Besides population growth was about 2.9% per annum over the same period per capita agricultural value added increased at only a little less than 2% per annum. The sector did not register any significant improvements after the reform period. Between 1993/94 and 1999/2000, the average annual growth rate of value added in agriculture was only 1.8% while that of population growth was 2.9%. This value indicates the level to which the productivity of the agriculture sector is incompatible with population growth.

The economic policy and strategy reforms of the 1990s positively influenced the performance of Ethiopian agriculture. Total production of food crops increased. However, the drought of 2002/03 weakened the capacity to produce food. In some parts of the country where agriculture has performed relatively better, drought has forced people to depend on food aid.

2.7.1 Crop Production Sub-sector

This sub-sector involves the production of food crops and cash crops. About 97 percent of the food crops is produced by smallholders.

A *Food crops*

The food crops include grains, root and tuber crops, pulses and oil seeds. They are almost rain fed. Among the food crops, cereals are the most dominant in terms of areal coverage and total output.

Table 2.3 **Area coverage, total production and yield per hectare for five major food crops for the period 1980/81 – 1999/2000**

Teff	Barley	Wheat	Maize	Sorghum											
Year	Yield (Q_t/Ha)	Quintal ('000)	Area ('000Ha)	Yield (Q_t/Ha)	Quintal ('000)	Area ('000Ha)	Yield (Q_t/Ha)	Quintal ('000)	Area ('000Ha)	Yield (Q_t/Ha)	Quintal ('000)	Area ('000Ha)	Yield (Q_t/Ha)	Quintal ('000)	Area ('000Ha)
1980/81	14.5	11,337.0	1,385.0	9.6	9810.5	743.2	13.2	5105.5	462.2	11.0	8304.7	671.1	12.3	14,194.1	973.3
1984/85	8.7	9,057.1	13,334.8	6.7	7721.9	741.4	10.4	5850.4	592.1	9.8	9598.8	847.7	11.3	5058.1	754.4
1988/89	13.8	1,287.4	1,367.6	8.8	7415.3	648.8	11.4	6884.1	561.3	12.2	1455.07	7888.8	18.4	8423.5	607.5
1992/93	14.8	14,007.1	1395.7	10.0	8090.5	612.9	13.1	8860.3	55.2	15.9	14,374.7	775.8	18.5	6456.8	435.1
1996/97	14.3	20,018.9	2167.7	9.2	7423.8	697.6	10.6	10,015.4	772.2	12.9	25,320.0	1316.8	19.2	20,073.4	1399.9
1997/98	11.0	13,287.8	1807.1	7.4	9827.2	897.2	11.0	11,472	831.8	15.9	23,443	1448.9	16.2	10,832.7	981.8
1998/99	12.4	16,422.9	2091.3	7.9	7685.9	830.2	9.3	1113	987.1	12.9	24,166	1303.1	18.6	13,208.4	1042.4
1999/00	11.9	17,175.6	2123.5	8.1	7419.3	794.1	9.3	12,126	1025	13.7	25,254	1407.3	17.9	11,811	995.4
Average 74/75-90/91	11.9	11,694.7	1382.4	8.4	9343.2	832.9	11.3	6540.9	595.1	11.5	13,437.1	888.9	15.0	9608.5	791.9
Average 91/92-99/00	11.2	15,764.7	1825.6	8.7	8826.2	850.5	10.4	9697.1	798.7	12.5	21,025.9	13.54	15.6	11,128.3	924.7
Average 80/81-96/97	13.2	12,925.5	1467.4	8.9	8407.2	717.5	11.8	7504.8	615.2	12.2	14,754.9	878.2	16.6	10,488.0	793.2

Source: *EEA (Ethiopian Economic Association) 1999 and 2002*

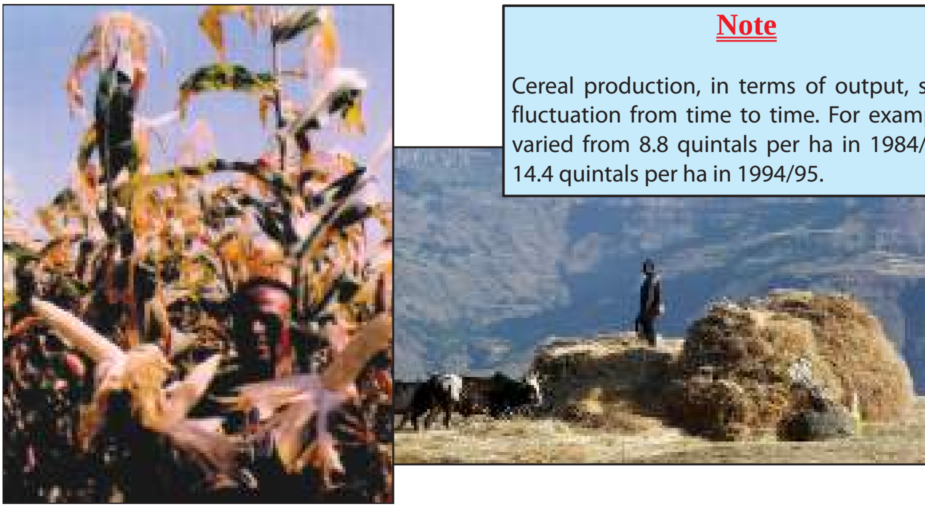


Figure 2.3: **Benefits of extension service**

> **Note**
>
> Cereal production, in terms of output, shows fluctuation from time to time. For example, it varied from 8.8 quintals per ha in 1984/85 to 14.4 quintals per ha in 1994/95.

Activity 2.7

Make a field trip around your area and by consulting the extension worker identify the major food crops cultivated in terms of:

a Total output b Coverage c Output per hectare

B *Cash crops*

Cash crops are produced for the market in order to generate income. Ethiopian cash crops include coffee, chat, cotton, tea, cut flowers, etc. The three most important cash crops are coffee, chat and sugarcane. These days, the production of cut flowers is gaining importance.

Coffee, chat and sugarcane were cultivated by about 1.5 million, 0.5 million, and 2.1 million farmers, respectively, in 2001/02. The average holding size was 0.062 ha per holder for chat, 0.021 ha per holder for sugarcane and 0.12 ha for coffee.

Table 2.4 **Land allocation and management practices of the three major cash crops in the peasant sector**

Cash crops	Number of holders	Total area (ha)	Per holder (Ha)	% of land under improved crop management			
				Improved seeds	Irrigation	Fertilizer	Pesticide
Chat	1,545,861	96,066	0.062	NA	11.27	42.25	4.34
Sugarcane	556,310	11,775	0.021	0.25	27.10	28.75	0.63
Coffee	21,209.24	246,033	0.12	4.4	2.17	16.46	0.72

Source: *CSA (2003 NA: Not Available.*

The data shows that

- *Chat producers apply more fertilizers and 11 percent of land is irrigated*
- *29 percent of land under sugarcane cultivation is fertilized, while 27 percent of the land is irrigated*
- *Only 4.4% of the land under coffee cultivation is planted with improved varieties, while 2.2 percent is irrigated.*

C *Fruits, vegetables and flowers*

Ethiopia's agro-climatic conditions make it suitable for the production of a broad range of fruits and vegetables. Cut flower and vegetable production have been fast-growing export businesses in recent times.

Table 2.5 **Landholding and crop management in vegetable and fruit production (the peasant sector)**

		Area	Percent of land under improved crop management practices				
Crops	Number of holders	Total (Ha)	Per holder (Ha)	Improved seeds	Irrigition	Fertilizers	Pesticides
Lettuce	9,656	231	0.022	9.36	68.08	69.95	13.15
Head cabbage	38,755	965	0.025	6.42	54.51	59.07	12.44
Ethiopian cabbage (Kale)	1,439,965	24,398	0.017	0.23	1.87	56.70	1.48
Tomatoes	45,647	3,035	0.067	6.99	65.57	61.58	27.55
Green peppers	407,900	4,633	0.011	0.86	21.86	51.54	2.27
Swiss chard	21,260	158	0.007	12.66	28.48	46.84	
Others	558,106	9,662	0.017	0.12	0.91	44.86	0.38
All vegetables	3,046,339	98,262	0.032	0.54	6.51	51.05	2.91
Avocados	324,489	2,414	0.007	2.82	3.31	26.01	0.04
Bananas	1,327,486	21,268	0.016	0.45	17.34	25.38	0.09
Guavas	140,261	1,224	0.008	7.68	24.35	33.99	0.41
Lemons	111,884	749	0.007	0.80	26.30	25.63	0.27
Mangos	298,303	3,642	0.012	1.57	8.15	30.48	-
Oranges	309,219	2,402	0.008	1.17	18.11	34.47	1.00
Papayas	404,188	2,713	0.007	2.80	17.25	29.19	-
Pineapples	10,974	171	0.016	-	-	4.68	-
Others	255,007	5,494	0.022	0.51	7.35	22.59	-
All fruits	2,110,342	40,076	0.019	1.13	14.63	26.49	0.41

Source: *CSA (2003). Ethiopian agricultural Sample Enumeration, 2001/02. Addis Ababa. All data are for the peasant sector. NA = not available.*

Table 2.5 shows that 3.1 million farmers cultivated different kinds of vegetables on about 98.2 thousand hectares of land. Out of this, 0.5, 6.5, 51.1, and 2.9 percent were planted with improved varieties, irrigated treated with organic and inorganic fertilizers, and treated with pesticides, respectively. The average landholding size was about 0.03 ha. Red peppers and Ethiopian cabbage occupy about 56.2 and 24.8 percent of the total area under vegetable crops, respectively.

Similarly, 2.1 million farmers cultivated different kinds of fruits on about 40 thousand hectares of land. Out of this, 1.13, 14.63, 26.5, and 0.41 percent were planted improved varieties, irrigated treated with organic and inorganic fertilizers, and treated with pesticides, respectively. The average landholding size was about 0.019 ha.

Vegetables and fruits are not only important for domestic consumption, they also generate some foreign earnings. The major trade partner for Ethiopia's fruits and vegetables is Djibouti.

D *Floriculture*

In recent years, both local and foreign investors are showing a growing interest in the production of cut flowers due to the high demands for fresh cut flowers in European markets, especially in the Netherlands. In 2001/02, 10 tons of flowers were exported. Following government support, in terms of providing suitable land, finance and other incentives, this sub-sector is growing rapidly.

Activity 2.8

1. Visit the periodic markets or the open markets functioning in your area. Before the visit, make a check-list and use it to:
   a. Identify the types of cash crops, fruits and vegetables frequently available.
   b. Identify whether most of the sellers are the direct producers or traders.
2. List the crops by rank, based on:
   a. Their significance in generating income to the sellers.
   b. Their availability — that is, are they available all year round or not?

2.7.2 Livestock Production

It is often reported that Ethiopia possesses the largest livestock population in Africa. Ethiopia maintains a mix of livestock species, depending on the products and services needed from the livestock.

Figure 2.4: **Livestock**

Performance of the Sub-sector

Livestock resources in Ethiopia means many things. It is a source of food, draft power, fuel, cash reserves, and pride. The output of this sub-sector can be divided into food, and non-food items. The food items comprise meat and meat products, milk and milk products, eggs, honey, etc. The non-food items include draft power, hides and skins, bees-wax, manure, transport facilities, etc.

The livestock sub-sector contributed 23.4%, to agricultural exports and 10% to total exports, respectively, in 1987/88. However, the trend in the following years was a decline. The reason for the decline was the rise of cash crop exports. Almost 96% of the livestock exports was accounted for by hides and skins in the same year.

Apart from hides and skins, meat production occupies a significant position. It consists of beef, mutton, chicken, goat, and camel meat. From 1980/81 - 1996/97, it increased by 0.9%. Beef, mutton and goat meat accounted for 61.3%, 20.5% and 17.4%, respectively, of the over all meat production in 1980/81. The per capita meat production was 7.5 kg per head per annum in 1996/97, which was insignificant compared to world standards.

Similarly the standard of milk production per head per annum was very low in the same year, accounting for 22 litres per head per annum. The largest share of milk production came from cows, followed by milk obtained from goats.

Activity 2.9

Ethiopia possesses the largest portion of Africa's livestock population. But the country's annual output in terms of livestock products is very low, relative to world standards. Give your opinion the reason for this paradox.

2.7.3 Fisheries

Ethiopia has large potential fishery resources in the country's bodies of water: lakes, reservoirs, rivers, and others. The lakes and rivers support a wide variety of aquatic life, including more than 100 fish species, of which 40 are endemic to Ethiopia.

Table 2.7 **Ethiopia's bodies of water and their fisheries**

Bodies of water	Area (km^2)	Potential (ton/year)	Actual catch (ton) in 2001	Off take (in %)
Major lakes	6477	23342	10598	45
Major reservoirs and dams	857	4399	1366	31
Smaller bodies of water	275	1952	303	16
Rivers	7185	21788	3121	14
Total	14794	51481	15389	30

Source: *FAO, 2003.*

According to Table 2.7, the major lakes account for 45%, while small rivers account for the least (14%) of the fish production in Ethiopia. Although hundreds of local fish species have been identified in Ethiopian bodies of water, the bulk of production is of tilapia, lates, Nile perch, etc. It is estimated that this sub-sector provides a means of livelihood for more than 20,000 people.

Activity 2.10

Write a brief report on why Ethiopian fisheries are not strong when compared to their estimated potential. Then discuss the reports produced.

2.8 PROBLEMS OF AND POSSIBLE REMEDIES FOR THE AGRICULTURAL SECTOR

At the end of this section, you will be able to:

- assess the problems of the agricultural sector; and
- identify possible remedies.

Think of the various agricultural polices and strategies adopted, such as package programs and extension services. To what extent did they transform the agricultural sector? Has the country achieved self-sufficiency in food production?

It has become an every-day saying that agriculture has been the mainstay of the Ethiopian economy for decades. However, its performance in achieving food security and generating capital for the other sectors is poor. This situation has attracted the concern of policy makers, experts, and international organizations, who hope to change the situation. *Why is this so? What are the problems? What are some possible remedies?*

2.8.1 Problems

According to the studies made so far, the sector's problems identified fall into two major categories:

i **Natural problems – Unpredictable Weather Conditions** - These problems relate to recurrent drought and its negative effects. Almost all the farming and livestock practices in the highlands of Ethiopia depend on rainfall. The variability of rainfall in time and amount affects the country's crop production and live-stock rearing; millions of cattle have died of the hazard. For instance, the drought that occurred in 1972/73 victimized 100,000 people and their cattle. This disaster has continued up to now with more than thirty-and forty-fold victims. If the situation is not checked, the number of victims will increase in unimaginable ways.

ii **Human-Made Problems** - These are negative effects that result from the social and economic practices.

- *Land fragmentation: In a country like Ethiopia, where the majority of the people's livelihood is attached to land, entitlement to land possession, land size, and land utilization are core. In rural Ethiopia, where the average landholding size is shrinking over time, land fragmentation and over-cultivation are inevitable. This decreases the productivity of the farm plots, in turn effecting food insecurity at a national level and causing the migration of rural people into urban environments.*
- *Lack of infrastructure: poor infrastructure facilities is a the major problem in the agricultural sector. Transportation and communication facilities are poorly developed in rural Ethiopia. About 75% of rural household farms are located far away from transportation and communication*

lines, and this that prevents farmers from accessing proper markets and information about prices for their products.

- *Lack of credit facilities: A serious problem that the Ethiopian small-landholders face is the absence of microfinance institutions to provide the farmers with credit facilities to overcome shortages of money for buying improved seeds, fertilizers and storage facilities. For decades, lack of this facility subjected the farms to the mercy of man-made and natural problems. This prevented farmers from using even the meagre resources available at hand. Now, however, reforms have created accesses to micro-finance loans, opening the gate to increasing small holder productively.*
- *Lack of effective land-ownership entitlement: Effective land-ownership entitlement is important for long-term, sustainable agricultural development. Without it we have poor work attitudes, the improper use of common resources, and poor output.*
- *Erosion and land degradation: Although Ethiopia's rugged highlands naturally produce erosion and degradation, the magnitude of the process is accelerated by human activities. When the population of the country increased rapidly after the 1950s and 1960s, the need for more farmland greatly increased. These practices have exacerbated the rate of erosion and degradation which in turn, contribute to the recurrence of drought. Without preventative measures; this situation will accelerate in the near future, putting millions of hectares out of use.*
- *Traditional practices: These are rural practices that result in misusing work time, unproductive consumption and retaining resources especially livestock resources unscientifically, resulting in very low output per ox, sheep, goat, etc.*
- *The use of backward technology.*
- *Inadequate rural markets.*

2.8.2 Remedies

Possible Remedies: to reduce or mitigate the problems affecting the agricultural sector of Ethiopia, the following possible remedies are proposed.

i Reduce the prevailing heavy dependence on rain-fed agricultural practices by:

- *promoting the use of local streams and lakes for irrigation purposes of various scales.*
- *promoting and expanding the storage of rain water in shade to reduce the rate of evaporation and to enable people to store water for longer periods of time.*

- *expanding the number of afforestation and reforestation schemes through a structured and financed agency or office.*

ii Production of drought-resistant crops in drought-prone areas so that the recurrence of acute shortages of food will be minimized.

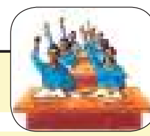
iii Pursue an effective land-ownership right so that the farmers will develop long-term developmental commitments.

iv Promotion of extension services supported with consistent capacity-building tasks.

v Promote committed literacy campaigns to help farmers understand price and farm-technique information.

vi Promote infrastructure facilities as per their availability.

vii Inclusion of the issue in school curricula.



Activity 2.11

1 Your teacher will organize a field visit to nearby farming areas perhaps having different groups of students visit farmers in different areas.

a Check whether the farmers practice crop agriculture only or mixed agriculture (crop-production and livestock keeping).

b Then prepare a checklist containing the items listed below and interview three or four farmers and record their responses.

Content Check 2.1

1 What are the contributions of live stock production to the country's economy?

2 What are the major human - made problems that affected the development of agriculture in Ethiopia?

3 Suggest four possible remedies for the problems.

4 State the major frequently occurring nature - made problems that affected the development of agriculture in Ethiopia.

UNIT REVIEW

UNIT SUMMARY

- The agricultural sector is the mainstay of the Ethiopian population, in which more than 85 percent of the people work. It also plays an important role in the development of the national economy, for example in:
    - *supplying food for both the rural and urban population.*
    - *providing raw materials for domestic manufacturing.*
    - *supplying foreign earnings.*
    - *suppling employment opportunities.*
    - *contributing about 45 percent to the country's GDP.*
- Various strategies and policies have been adopted since the 1960s to transform the sector. These strategies, have used the uni-modal or bi-modal approaches, or both at the same time. However, food security at the national level has not been satisfactorily maintained.
- The existing government adopted a strategy of Agricultural Development-Led Industrialization (ADLI) to transform the agricultural sector and promote economic development. To effect this, different incentives are being offered to both domestic and foreign investors.
- Crop production is the first major sub-sector. It is largely engaged in the production of cereals, pulses, Oil seeds, and cash crops.
- Among the food crops, cereal production has the largest share in total output and areal coverage. Coffee exceeds all other cash crops in terms of value of export. However, these days chat is gaining strength, due to its relatively higher prices.
- The livestock production is also a significant source of. It produces 15.20%, of the country's foreign earnings. This sub-sector is victimized by the frequent droughts as much as crop production.
- The agricultural sector, though dominant, is facing problems that have deterred it from meeting national requirements. The problems are both social and natural. The social (human-made) problems are related to allocation of resources and decision-making, while the natural ones relate to recurring and unexpected weather conditions.
- Possible remedies have been suggested and implemented to overcome the problems.

REVIEW EXERCISE FOR UNIT 2

I ***Tell whether each statement is True or False.***

1 Agricultural development is more important than industrial development.

2 The current developmental strategy adopted in Ethiopia is the Industrial Development-Led Agriculture Strategy (IDLA).

3 The uni-modal approach gives priority to the intensification of agricultural practices for smallholders.

4 The curren approach to improving the agricultural sector is the bi-modal approach.

5 Cereal production ranks second, next to oil seed production, in terms of volume of output.

6 The European demand for the cut flowers of Ethiopia has little effect on the promotion of floriculture in Ethiopia.

II *Match the items in column A with those in column B.*

	A		B
7	Comprehensive Package Program	A	Cadu, Ardu, etc
8	Djibouti	B	Ethiopia's cut flowers trade partner
9	The Netherlands	C	Relatively drought resistant crop
10	Inset	D	Chat, coffee, and sugarcane
11	Cash-crop	E	Cereals and pulses
12	Land fragmentation	F	The diminishing size of per-capita landholding
		G	Agricultural development approach
		H	Ethiopia's vegetable trade partner

III *Choose the best answer from the given alternatives.*

13 Which of the following is not one of agricultur's roles in the Ethiopian economy?

A Source of raw materials for non-agro-based industries
B Source of food supply
C Source of foreign currency earnings
D All of the above

14 One of the following is the dominant farming structural type in Ethiopia.

A The large-scale animal husbandry sub-sector
B State farms
C The smallholder farm system
D The collective farm system

15 All are natural problems that hinder agricultural development in Ethiopia except

A rugged topography
B unpredictable weather changes
C rapid rate of deforestation
D A and B

16 The Agricultural Development Approach adopted by the Imperial Regime was

A Un-imodal B Bi-modal

17 The bi-modal approach pursues

A the intensification of the smallholder farm system
B the promotion of large-scale farming
C the promotion of exportable agricultural products
D All of the above

18 Which one of the following practices does not discourage the transformation of the rural economy?

A Inappropriate or incorrect pricing policy towards agricultural land property
B Inappropriate or incorrect entitlement of land property
C Increasing prices of agricultural inputs
D Credit offerings at lower interest rates

19 Ethiopia's largest share of export earnings is obtained from

A Chat C Live animals
B Coffee D Cut flowers

20 The livestock sub-sector contributes to the country's GDP

A 15 – 20 percent C 5 – 10 percent
B 25 – 30 percent D 50 – 60 percent

IV *Answer the following questions briefly.*

21 What is meant by "agriculture versus industrial development"?
22 What is meant by ADLI?
23 What is meant by the transformation of the agricultural sector?
24 What are the major problems responsible for the fluctuating performance of both crop production and livestock rearing?
25 Why did the pre-1974 bi-modal approach in the development of Ethiopian agriculture fail?
26 Which cash crop is gaining significance these days? Why?

UNIT 3

THE INDUSTRIAL SECTOR IN ETHIOPIA

Unit Objectives

After completing this unit, you will be able to:

- appreciate the role of the industrial sector for the Ethiopian economy;
- understand the different policies and strategies applied by the Imperial, Derg, and current governments; and
- analyze the performance of, identify problems of and understand the possible remedies for the Ethiopian industrial sector.

Main Contents

INTRODUCTION

The national income account of Ethiopia classifies the industrial sector into these sub sectors:

- *manufacturing,*
- *mining, quarrying,*
- *construction,*
- *water and energy supply.*

Economic development cannot be achieved without the development of this sector. A developed industry is likely to boost the entire economy by making it nationally integrated, flexible, and capable of self-generated and self-sustained growth. That is why the ultimate objective of the developing nations, including Ethiopia, is industrial development.

3.1 INTRODUCTION

At the end of this section, you will be able to:

- define industrialization
- identify the main features that are the important characteristics of industrialization
- describe the historical development of the industrial sector in Ethiopia

Key Terms and Concepts

- Linkage
- Strategies
- Gross value output
- Value added
- Industrialization
- Manufacturing sector

Do you know the definition of industrialization?
Are you familiar with the important features or characteristics of industrialization?

Historical Development of the Industrial Sector in Ethiopia

Ethiopia has a long tradition in the development of handcrafts and cottage manufacturing activities such as weaving, blacksmithing, pottery, and woodwork.

But the introduction of modern industries began at the end of the 19th century. Particularly, the following two major early 20th century events contributed to the introduction of modern manufacturing industries in Ethiopia:

- *The emergence of a strong central government, which resulted in political stability and*
- *The construction of the Ethio-Djibouti railway.*

These events gave way to the establishment and expansion of cities and the settlement of foreigners, mainly from Armenia, Greece, Italy, and India, which in turn increased the demand for imported commodities and hence created the basis for industrial development. The domestic production of manufactured goods was also necessitated by the increasing problems of transporting bulky imported commodities such as wood, clay, printing products, etc.

By 1925 there were 25 factories in the major urban centers of Addis Ababa, Dire Dawa, Asmara, and Massawa. Of these factories, private entrepreneurs established 22 factories. About 10 additional manufacturing industries were built from 1928 to 1941, of which two (the Artistic Printing Press and Ambo Mineral Water) were established before the Italian occupation. The Italians established the Dire Dawa cement and textile factories. The rest were set up by Armenian and Greek settlers. A number of manufacturing industries also came into existence between 1941 and 1955, mainly due to strong relations between Ethiopia and the governments of the United States of America and of the United Kingdom. However, it was after the 1950's that industrial development gained strong momentum due to the conscious effort exerted by the Ethiopian government. For instance, the government adopted measures like generous tax incentives and high levels of tariff protection, easy access to domestic credit on favorable terms, and it allowed foreigners to take profits out of the country, thereby helping to attract the inflow of foreign capital to the manufacturing sector.

The earliest types of industrial activities were largely confined to small-scale establishments producing wood and furniture, leather, edible oil, soap, flour, etc. But after the Second World War, the improved relationships with the governments of the USA and UK and the import-substitution industrial development strategy adopted by the government resulted in the emergence of large-scale industries in the country. These mainly foreign-owned industries started to produce different light consumer goods such as fiber products, ceramics, bottles and glasses.

The change of state to the Military government in 1974 significantly altered the ownership and management of the industrial sector. The Military government declared socialism as its principle and nationalized almost all medium- and large-scale enterprises. About 87 foreign-owned private enterprises were put under the government. The private sector was deliberately discouraged and discriminated against, which brought the dominance of the private sector in Ethiopian industry to an end.

The Military government followed the preceding regime's import-substitution industrial development strategy, but did not change the composition of output in the manufacturing sector. It was still dominated by the production of light consumer goods which heavily depended on technology, raw materials, and spare parts.

Definition of Industrialization

The United Nations Industrial Development Organization (UNIDO) defined industrialization as follows:

> *Industrialization is a process of economic development in which a growing part of the national resources are mobilized to develop a technically up-to-date, and diversified domestic economic structure characterized by a dynamic manufacturing sector having and producing means of production and consumer goods and capable of assuring a high rate of growth for the economy as a whole and of achieving economic and social progress.*

Activity 3.1

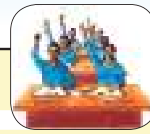
What important characteristics do you observe in the defintion of industrialization?

From the definition given above, some features can be identified as important characteristics of industrialization:

- *Industrialization is not a one-time or sudden occurrence but rather a sustained process. This means it is a continuous process taking place over a long period of time.*
- *Industrialization requires the application of modern science and technology to the production process.*

- *The manufacturing sector plays the most important and dynamic role in the industrialization process;*
- *Industrialization brings about a structural transformation of the national economy, especially in the composition of output and the pattern of employment.*

Activity 3.2



1 Discuss the significance of industrialization to the Ethiopian economy.
2 Discuss the level of industrialization in Ethiopia in relation to the characteristics of the industrialization process.

According to Sutcliff, industrialization is a process by which a non-industrialized country becomes an industrial one. Sutcliff identified three criteria for a country to be considered to be an industrialized one.

- *25% of the GDP should come from the industrial sector.*
- *At least 60% of the industrial output should originate from the manufacturing sector.*
- *At least 10% of the population should be engaged or employed in the industrial sector.*

From the above criteria, Ethiopia is one of the least industrialized nations in the world.

Content Check 3.1

1 "Emergence of major towns is one of the factors that contribute to the introduction of modern manufacturing in Ethiopia". Indicate whether this statement is True/False and explain your answer.

2 Which of the following were not settlers in Ethiopia at the time when modern industries were introduced in Ethiopia?

A British
B Armenians
C Italians
D Indians
E none

3 Factors contributing to an increase in local demand for industrial goods in Ethiopia in the early 20th century include:

A Shortage of supply

B An increase in income of the population

C Problems of transporting imported goods

D All are possible answers

4 The dominance of the private sector came to an end during

A The Imperial period

B The Derg period

C The current government

D None

3.2 ARGUMENTS OF INDUSTRIAL SECTOR VS THE REST OF THE ECONOMIC SECTOR

At the end of this section, you will be able to:

- explain the arguments about the industrial sector versus the rest of the economic sectors.
- examine the arguments about the industrial sector versus the rest of the economic sectors.

Key Terms and Concepts

- Balance of payments
- Forward linkage
- Backward linkage

What are the arguments in favour of the industrial sector?

There are five basic arguments, development that maintain the idea that the industrial sector's development should be given priority over that of the other sectors. These arguments are:

A *The Development Argument*

One can generally observe that economic development industry goes with: the more developed nations are better industrialized, and the less developed nations are less industrialized.

B The Employment Argument

The industrial sector has more potential to create job opportunities for the rapidly growing urban populations of developing countries than any other sector.

C The Balance of Payment Argument

A developed industrial sector, in general, generates more foreign currency, compared to an agricultural sector. That is, industrialization helps developing nations to alleviate their balance-of-payments problems.

D The Linkage Argument

If industrial development is directed to use local raw materials, it can create strong linkages among the different sectors of the domestic economy. This is due to the dynamic nature of the industrial sector which includes positive externalities in consuming agricultural raw materials to produce consumer and producer goods for the entire economy. For instance, the industrial sector can create backward linkages with the agricultural sector for its raw materials instead of depending on imported raw materials. This gives the sector assured sources of supplies. Similarly, the sector can also create linkages with the market in order to assure market for its products. This is what is called forward linkage. In this regard, the development of modern telecommunication services is expected to be of paramount importance.

E The Saving/Surplus Argument

Profit margins in the industrial sector are higher than those in agriculture, and this may lead to higher levels of saving.

Activity 3.3

Do you agree with the statement that industry always goes with economic development? Justify your answer by providing practical examples.

Content Check 3.2

1 Identify the argument that refers to a capacity of a developed industrial sector to generate more foreign currency:

A Linkage argument

B Balance of payments argument

C Employment argument

D All of the above

2 The ____________ argument states that profit margins in the industrialized sector are higher than those in agriculture.

3 The contribution of manufacturing value added to GDP is high in one of the following African countries:

A Kenya

B Ethiopia

C Egypt

D None

4 "Industry goes with development." Decide whether this is True/False and explain why.

5 Of all the sectors in the developing countries, one of the following has more potential to create job opportunities for the urban population:

A The industrial sector

B The agricultural sector

C The service sector

D All are possible answers.

3.3 THE ROLE OF THE INDUSTRIAL SECTOR IN THE ETHIOPIAN ECONOMY

At the end of this section, you will be able to:

- identify the role and size of the industrial sector.

Key Terms and Concepts

- Employment
- Labour force
- Foreign exchange
- Gross value of production

Is it true to say that the role being played by the industrial sector is greater than that of agriculture?

3.3 THE ROLE OF THE INDUSTRIAL SECTOR IN THE ETHIOPIAN ECONOMY

According to the International Standards for Industrial Classification (ISIC), the Ethiopian industrial sector is composed of mining and quarrying, manufacturing, electricity, water supply, and construction. During the years 1991/92 - 1997/98, large- and medium-scale manufacturing contributed 38.4% of the gross value of industrial production, while small-scale manufacturing and handcrafts contributed around 18.7%. The contributions of mining, quarrying, and electricity-supply activities were 3.9%, 15.8%, and 23.2%, respectively. From this we can conclude that the manufacturing sub-sector dominated the Ethiopian industrial sector, providing more than 57% of the sectoral output.

Since the manufacturing sub-sector is the most dominant and dynamic component of the industrial sector, and also due to availability of time series data, we will concentrate on this sub-sector as we analyze the contribution of the industrial sector to the national economy.

3.3.1 Output Contribution

According to ISIC, the manufacturing sector is characterized by the physical or chemical transformation of materials or components into new products, whether the work is performed by power-driven machines or by hand, and whether it is done in a factory or in the worker's home.

The following table shows the contribution of the different industrial groups to the manufacturing sector for the year 2007/08.

Table 3.1 **Gross Value of Output of Manufacturing Sector (in thousand Birr), 2007/08**

Industrial group	Gross value of output	% of total
Food and beverage	8,751,377	47.9
Textiles	693,552	3.7
Leather and footwear	1,447,236	7.9
Wood and furniture	118,684	0.6
Paper and printing	1,236,481	6.7
Chemicals	1,733,378	9.4
Non-metal	3,068,948	16.8
Metals	1,203,517	6.5
Total	18,253,173	100.0

Source: *Computed from CSA survey, 2007/08.*

As indicated in Table 3.1, food and beverages accounted for about 48% of the gross value of output of manufacturing establishments in 2007/08, followed by non-metal and chemicals. These three industrial activities accounted for more than 74% of the entire gross value of products in large- and medium-scale manufacturing organizations during the same period.

In terms of the value added by the large- and medium-scale industry sub-sector, the food and beverage industrial group is the leading one. For example in 2007/08, the contribution of the food and beverage industrial group was 50.7%.

Looking at the data on revenue obtained from sales, the food and beverage industrial group generated around 8.3 billion Birr, which is close to 48.5% of the total revenue obtained from large and medium scale manufacturing in 2007/08.

Activity 3.4

1 Mention at least one manufacturing enterprise that you know in each industrial group.

2 List at least three important industrial groups that contributed significantly to the total gross value of output in the manufacturing sub-sector in 2007/08.

3.3.2 Employment Contribution

The industrial sector, in general, and the manufacturing sub-sector, in particular, serves as important sources of employment, especially for the rapidly growing urban population in Ethiopia. In 2007/08, there were 1,677,906 persons engaged, out of which 678,911 were employees in the industrial sector. The number of persons engaged and employees during this period showed an increase of 6.4 and 5.8 percent, compared to that of 2006/07, respectively. These increases in the number of persons engaged and employees could be attributed to the increase in the number of establishments created in 2007/08 (CSA, 2009).

When we examine the employment capacity of each industrial group in the manufacturing sector, as of 2007/08:

- *The food and beverage group employed 50%,*
- *The non-metal, and paper and printing industrial groups contributed 14% and 10.9% of the sector's employment, respectively.*

These three industrial groups, together, employed close to 75% of the total workforce in the manufacturing sub-sector for the year 2007/08.

- *The relative importance of the rest of the industrial groups, in terms of employment, varies between 2.1% in wood and furniture manufacturers to 8.8% in textile-product manufacturers. The decline in the share of employment of these sectors is mainly due to increased employment opportunities in other industrial groups such as in non-metal, paper and printing.*

Activity 3.5

What measures should be taken in order to create more jobs in the industrial sector?

3.3.3 Foreign Exchange Contribution

From the previous chapter you remember that more than 90% of the nation's foreign currency earnings come from the agricultural sector. The poorly developed industrial sector of Ethiopia contributes very little to the foreign currency earnings of the nation.

Table 3.2 shows the contributions of the different industrial groups to the total foreign exchange earnings in the manufacturing sector.

Table 3.2 **The Foreign Exchange Contribution of the Industrial Sector (in thousand Birr)**

Industrial group	Value of export	% of total
Food and beverage	232,481.60	32.9
Textiles	293,365.00	41.5
Leather and footwear	76,764.00	10.8
Wood and furniture	43,269.70	6.1
Paper and printing	334.40	0.04
Chemical	30,198.9	4.27
Non-metal	6,375	0.9
Metals	23,173.80	3.2
Total	705,962.4	100.0

Source: *Computed from CSA Survey, 2009*

Activity 3.6

What can you infer from the information given in Table 3.2?

As we can see from Table 3.2, textiles generate 41.5% of the sector's foreign exchange, which is the largest contribution. Food and beverages, leather and footwear follow as the second and third with 32.9% and 10.8%, respectively. This pattern has remained almost the same in recent years. The only noticeable change is in the wood and furniture and chemical groups. The total value of wood and furniture and chemical exports in 2007/08 was Birr 43,269.7 and 30,198.9, respectively. This can be taken as an indicator of the potential the nation has in bringing in foreign currency from non-traditional commodities.

The benefits for the Ethiopian manufacturing sub-sector from preferential treatment which the developed world offers are great. In this regard, The Africa Growth and Opportunity Act (AGOA), which allows some developing countries, including Ethiopia, to have access to the US textile market without tariffs and quotas, is the most notable opportunity. European countries are also opening their markets to African manufactured products. For instance, Ethiopia can now sell its sugar products in European markets. Therefore, the nation should try its best to benefit from these and other preferential treatments which the developed world is offering to the poorest nations of Africa.

Activity 3.7

Discuss how the Ethiopian government can increase its foreign currency earnings from the manufacturing sector.

Content Check 3.3

1 In terms of value added to the large- and medium-scale sub-sector, which one of the following is dominant?

A Textile
C Food and beverage
B Wood and furniture
D Chemicals

2 Revenue obtained from sales is relatively high in which of these?

A Food and beverages
B Non-metal
C Metals
D Leather and furniture

3 Identify the industrial groups that contributed more than 75% of the sector's total employment

A Food and beverages, textiles and metal
B Food and beverages, textiles, leather and shoes
C Food and beverages, leather and shoes, and wood
D Food and beverages, chemicals, and textiles

3.4 INDUSTRIAL DEVELOPMENT STRATEGIES DURING THE IMPERIAL PERIOD

At the end of this section, you will be able to:

- examine the development strategies during the Imperial period ,based on strategy, size, ownership, and regional distribution of the manufacturing sector and discuss the state of industrialization.

Key Terms and Concepts

- Commercial farms
- Import-substituion

What is the import-substitution industrial development strategy?

A *Development Strategies*

The policies of regimes are one of the major factors influencing the development of the industrial sector of a nation. In Ethiopia, various industrial development strategies have been employed in order to develop and direct this sector since the 1950s.

Industrialization in Ethiopia was at an incipient stage during the Imperial period. A conscious effort towards developing a modern industrial sector did not start till the1950s. It was only in the 1950s, when development plans (the three five-year plans) were formulated, that the development of the industrial sector began to be shaped by policies and strategies pertinent to the manufacturing sub-sector. 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. Hence, development programs and government policies were formulated to pursue this objective. A number of proclamations were declared to encourage foreign investment, and the investment proclamation was revised in 1964.

A number of incentives such as tax holidays, easy financing loans, exemptions from duty payments, and effective tariff protection from foreign competition were given. However, these incentives were based on some conditions. For example, a tax holiday was for those who had an initial investment of, made more than Birr 200,000 and duty exemption was for heavy machinery.

During the later years of the Imperial era, the main strategy for industrial development was import-substituion, a process assisted by a system of import duties intended to encourage the domestic production of goods and to discourage imported goods. The government placed much faith on private foreign investment and it went to a considerable length to attract it. As a result of the existing polices and the enabling investment environment, a number of manufacturing establishments were created. There was, however, an obvious neglect of small-scale industries during that period as the investment incentives benefited only the medium- and large-scale manufacturing establishments.

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 very low compared with the case in other developing countries. Although several reasons can be given to explain the poor performance of the industrial sector, poor infrastructure facilities and the level of articulated government economic policy towards the development of the sector were the main constraints. In fact, as we will discuss later on, these problems have also been inherent in other regimes.

Activity 3.8

What measures were taken by the government to attract foreign investment to Ethiopia during the Imperial period?

B Size, Ownership and Regional Distribution of the Manufacturing Sector

Manufacturing can be classified into different categories by using different criteria. The criteria vary from country to country. For instance, in Japan enterprises that have less than 10 million yen and that employ fewer than 300 employees are considered as small-scale industries. But for Egypt, small-scale industries are those having a fixed capital of at least USD 23,000 and employing not more than 50 employees. Ethiopia also has its own criteria.

According to the Central Statistical Authority (CSA), the Ethiopian manufacturing sector is classified into three, namely large- and medium-scale, small-scale and cottage/handcraft manufacturing. This categorization is mainly based on the number of people employed and use or non-use of power-driven machinery: Large- and medium-scale manufacturing establishments use power-driven machinery and employ 10 persons and above. Small-scale industries are those establishments that employ less than 10 persons and use power-driven machinery. Cottage/handcrafts units are those establishments that produce goods and services primarily for sale but do not use power-driven machinery in performing their main activities, regardless of the number of persons employed.

According to the Ethiopian Economic Association (EEA) report, during the Imperial period, industrialization, with an inward looking orientation based on import substituion, 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, only 26 of the total number of manufacturing enterprises were either fully or partially owned by the government, and in seven of them the government's stake was less than 50%.The great majority of the manufacturing firms in Ethiopia before the 1974 revolution, especially the medium- and large-scale ones, were owned by foreigners. Out of 273 establishments, 178 or 65% were set up with the assistance of foreigners, and 101 or 40% were totally owned by foreign nationals. In short, by 1974 the industrial sector of Ethiopia was small and characterized by production for the domestic market, mainly to substitute for imports, and its enterprises were largely private and foreign owned. The role of the government in the evolution of the Ethiopian manufacturing industries prior to 1974, at least as direct producers, was very limited.

Content Check 3.4

1 Conscious efforts to promote industrial development started during

A 1950's B 1970's C 1980's D 1990's

2 Main agents for the expansion of the industrial sector during the Imperial era were

A Ethiopians
B Foreign nationals, particularly Russians
C Foreign nationals residing in Ethiopia
D All are possible answers

3 Which of these factors that gave impetus to the industrial expansion?

A Settlement of foreigners
B Expansion of commercial farms
C Tax holiday
D All

4 "During the Imperial era the main strategy for industrial development was export promotion." Decide whether the statement is True/False (Give reasons).

3.5 INDUSTRIAL DEVELOPMENT STRATEGIES DURING THE DERG REGIME

At the end this section, you will be able to:

- examine the development strategies used during the Derg, based on strategy, size, ownership and regional distribution of the sectors.

Key Terms and Concepts

- Capital ceiling
- Handcrafts and small-scale Industrial Development Agency (HASIDA)

What was the objective of the ten-year perspective plan that was adopted during the Derg regime?

Development Strategies

The industrial sector underwent a radical change in the structure of ownership and management during this period. As a first step in this process, the government nationalized almost all the medium- and large-scale enterprises which were formerly owned by the private sector on December, 20, 1975. It also imposed a capital ceiling on private sector investment, limited to Birr 500,000, and investors were not allowed to have licenses for more than one line of business. This discouraged any possible revival of the private sector in medium-, large-scale and handcraft activities. The tax structure was also very harsh, with the maximum rate on personal income going as high as 89%. The interest rate was also higher for private borrowers, relative to that for public enterprises and cooperatives. These polices severely hampered the expansion of the manufacturing sector during the Military government by paralyzing the private sector.

Later on, the Ten-Year Perspective Plan (1984/85 – 1993/94) sought to promote the production of intermediate and capital goods and the expansion of small-scale industries. The state took responsibility for developing and managing the medium- and large-scale industries with wide linkages to capital-good producing industries that could be used to develop other manufacturing industries. The prevailing economic management policy created different hierarchies in the industrial sector. Putting the Ministry of Industry at the top, corporations were established to supervise the management of the grouped enterprises. The general managers had the responsibility of supervising the day-to-day operations of the industrial enterprises in accordance with the guidelines prepared by the Ministry.

The plan, however, failed to attain its goals for various reasons, and significant improvements were not witnessed in the structure and the level of development of the sub-sector. For example, government corporations decided whether these enterprises were efficient. Accordingly, producing enterprises had weak links with market forces, which did not permit them to have the necessary feedback so as to become more competitive in the market. In short, the industrial policy of the Derg stifled the speedy development of the sector by creating too much government intervention and by limiting the participation of the private sector.

To support small-scale industrial enterprises, the government established the 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 might have been due to the lack of institutional and other supportive measures that should have been taken to boost the capacity and the efficiency of the small-scale and handicrafts enterprises.

After the collapse of socialism in Eastern Europe and, later, in the former Soviet Union, the regime tried to introduce some economic liberalization by way of introducing a mixed economic policy. A number of constraints that stood in the way of private-sector development were lifted. For instance, the capital-ceiling restriction was relaxed. However, several of these encouraging measures did not attain their goals because as the civil war reached its climax and diverted government resources towards resolving security problems.

Activity 3.9

1. Describe the industrial development strategies during the Derg period.
2. Explain briefly how the Derg restricted the participation of private investors in the industrial sector.
3. Discuss the drawbacks of the development strategies of the Military government.

Size, Ownership, and Regional Distribution of the Manufacturing Sector

No adequate database was available to use to analyze the growth in the number of manufacturing establishments until the CSA conducted surveys of manufacturing industries in 1995/96 for each of the industrial groupings. It is only for the 10+ group (manufacturing establishments with 10 or more employees) that time series data was available. According to this survey, the number of manufacturing establishments with 10 or more employees in 1975/76 was 430. This number declined to 402 in 1985/86, a decline of 0.82% 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 the number of employees, owing to low capacity utilization which in turn was caused by the unfavorable government policies towards private activities to obtain foreign exchange (for raw materials, spare parts and replacements), credit and licences. Therefore, some of the establishments fell below the "10 and above" employee category. The way the number of establishments fluctuated year after year seems to prove this.*
- *The possibility was high for establishments to cease operation for the obvious reasons of the period, such as war, burdensome regulations, and lack of foreign exchange. Indeed, the economic policy of the time did not encourage the establishment of firms.*
- *The third reason the independence of Eritrea, achieved by 1991/92, which reduced the number of industries by the number of those that existed in Eritrea.*

A few surveys have been conducted on handicrafts and small-scale industries. 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 3.3 **Trend of Manufacturing Establishments (10+ group)**

Year	Number	Average annual change in Employment
1975/76	430	-
1985/86	405	-0.82
1992/93	273	-4.62
1995/96	642	34.71
1975/76 – 1995/96		9.76

Source: *CSO/CSA: Results of Surveys of Manufacturing industries (1975/76 – 1995/96).*

Definition:

According to HASIDA , private small-scale manufacturing establishments are those:

- *which use manually operated machines or motor-driven machinery;*
- *which employ at least one person (other than the owner and the owner's families); and*
- *those with fixed assets not exceeding a million birr, excluding land and buildings.*

Given this definition, the number of private small-scale manufacturing establishments were 7,706 in 1985/86 and 7,600 in 1986/87. These numbers appeared to dramatically change as reflected in the results of the 1997 CSA survey, which registered 892,719 cottage/handicrafts and 2,731 small-scale industries. Clearly the main cause this apparent change was the change in definitions, in that the later survey included cottage and handcrafts industries which were not included in the former survey. Furthermore, a significant increase in these establishments owing to the more liberal economic policies of the new government probably contributed real changes, since these are the first categories to quickly respond to changes in policy regimes.

The contribution of 10+ manufacturing firms accounted for only 9.15% of the value added of the manufacturing sector in 1975/76, and the value has declined since then, 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.

The ownership of large- and medium-scale manufacturing enterprises has shown changes in the past few decades. During the Imperial period, this sub-sector was dominated by the public sector due to various measures taken by the government. Public or government ownership of establishments showed continuous increase during the period of the Derg, reaching a maximum of around 120% in 1991/92, with 152 out of 279 enterprises owned by the government. However, this trend has been reversed due to the economic policies adopted by the EPRDF government.

When we look at the regional distribution of manufacturing establishments, we see unbalanced distribution, with most of them concentrated in major metropolitan areas, primarily in Addis Ababa. In general, it is better to have evenly distributed manufacturing establishments, but distribution depends on several factors, including infrastructural developments, including those in roads, electricity, communication, water, proximity to input and output markets, and social services.

Activity 3.10

1. Why do more manufacturing enterprises exist in Addis Ababa than elsewhere in Ethiopia?
2. What measures should be taken to increase the number of establishments in relatively less developed regions?
3. Compare the participation of the private sector in the industrial development of Ethiopia during the Imperial and Derg eras.

Content Check 3.5

1. Which of the following is not true regarding the Derg period?
   - A Some medium and large scale enterprises were nationalized.
   - B A capital ceiling of 1,000,000 birr was imposed on public investment.
   - C Investors weren't allowed to have licences for more than one line of business.
   - D None of the above.
2. "Government corporations decided the efficiency of industrial enterprises during the Derg regime." True/False (Give reasons).
3. HASIDA was established to support:
   - A large-scale industrial development
   - B small-scale industrial development
   - C medium-scale industrial development
   - D All of the above
4. The concentration of manufacturing activities in food and beverages, textiles, and non-metallic mineral deposits during the Derg regime was due to
   - A Heavy dependence on local inputs
   - B Availability of domestic markets for their products
   - C Both are possible answers
   - D None of the above

3.6 INDUSTRIAL DEVELOPMENT STRATEGIES DURING THE POST-DERG PERIOD

At the end of this section, you will be able to:

- examine the development strategies used during the post-Derg era, based on strategy, size, ownership, and regional distribution of the manufacturing sector.

Key terms and Concepts

- Gross value product
- Value added at factor cost
- Structural adjustment programme
- Agricultural Development-led Industrialization

What were the major industrial development strategies during the post Derg period?

Development Strategies

After the over-throw of the socialist government and its replacement by the Ethiopian Peoples Revolutionary Democratic Front (EPRDF) in 1991, the government sought to rationalize its role in the economy while enhancing the active participation of the private sector.

Accordingly, the transitional government of Ethiopia announced an economic policy which could be described as "cautious captialism''. Believed to be conducive for investment, the government accepted the Structural Adjustment Programs (SAPs), though with some reservations.

With respect to the industrial sector, the Transitional Government of Ethiopia (TGE) indicated that the role of the state would be limited to areas of large-scale engineering, metallurgical plants, communications, power, and pharmaceutical industries from which the private sector was bared. The government, undertook a Public-Enterprises Reform Program in August 1992, which aimed at enhancing efficiency, productivity, and competitiveness in public enterprises (most of which were manufacturing) through the granting of managerial autonomy and responsibility. This was done by dismantling the sub-sectoral corporations under the Ministry of Industry. The overall management of each manufacturing enterprise was thus put under its own board of directors and a general manager responsible for output, price, and investment decisions as well as appropriate market channels.

In general, these measures 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 of enhancing the development of strategic industries which were expected to have multiplier effects through contributing to 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 particularly taken to encourage private sector participation in the economy. These include:

- *the lifting of the restrictions on private-sector investment capital and the number of business ventures;*
- *the easing of licensing requirements and regulations;*
- *the enactment of an investment code which, upon successive revisions, opened up a wider range of economic activities for both domestic and foreign investors. In addition to the investment code, investment incentives were offered in the form of tax holidays, duty-free importation of investment goods and the like designed to favour investment in selected sectors and regions; and*
- *the downward revision of taxes and tariffs from the extremely high levels that existed before the reform period. The marginal tax rate on personal income was also slashed from 89% to 40%. Business profit tax was reduced from 59% to 35%, while the maximum tariff on imports was reduced to 50% down from 240%.*

In addition to the above measures, the government introduced an overall development strategy, the Agricultural Development-Led Industrialization (ADLI) strategy. As stated in Chapter two, agriculture is the primary focus of development in the short and medium terms, and its production will be expanded through increased availability of modern inputs such as fertilizers, improved seeds, and pesticides and through improved extension services and other socio-economic infrastructures. This, of course, is expected to increase the income of rural people, which will, in turn, raise the purchasing power of the largest proportion of the population, consequently augmenting the demand for industrial goods. Agriculture would become a source of domestic market demand and a reliable raw material base. This strategy is also expected to strengthen the inter-sectoral linkage between agriculture and industry.

To sum up, several interventions have been made to enhance the development of this sector. Key among these measures is the establishment and strengthening of institutions necessary to promote industrialization. A policy goal is to create a conducive environment for industrial development by developing infrastructure and the nation's technological capability. Other goals are to promote inter- and intra-sectoral linkages, create an appropriate financial environment, encourage balanced regional industrial development and strengthen the linkage between industry and other sectors. Also, in addition to expanding the domestic market for industrial products by increasing the income of the rural population as a result of the ADLI strategy, the government policy is also designed to promote industrial exports.

Activity 3.11

1 Describe the different reform measures undertaken for the industrial sector during the EPDRF.

2 How does the ADLI strategy bring industrial development in Ethiopia?

Size, Ownership, and Regional Distribution of the Manufacturing Sector

According to the Central Statistical Authority there were 1,930 large- and medium-scale, 43,338 small-scale, and 974,676 cottage/handicraft establishments during 2007/08 (CSA, 2003). The majority of the establishments do not use power-driven machinery, irrespective of the number of persons employed.

The sectoral structure of the manufacturing sub-sector, 2007/08 based on numbers of establishments, reveals that food and beverage establishments accounted for 52% of the total manufacturing enterprises, while textiles accounted for 22%, as indicated in Table 3.4.

Table 3.4 **Sectoral Structure of the Manufacturing Sub-Sector by Number of Establishments, 2007/08**

Industrial Group	Large- and Medium-scale Manufacturing	Small-scale	Cottage/ Handcrafts	Total	Percent %
Food and beverage	485	1541	524,172	526,198	(52.1%)
Textiles	25	1366	221,848	223,239	(22.1%)
Leather and footwear	83	46	12,025	12,154	(1.2%)
Wood	70	90	60,462	60,622	(6.0%)
Paper and printing	143	3	197	343	(0.03%)
Chemical	80	6	1117	1203	(0.1%)
Non-metallic minerals	488	457	92,403	93,348	(9.2%)
Metals	101	4355	20,788	25,244	(2.5%)
Others	455	35,474	31,664	67,593	(6.6%)
Total	1930	43,338	964,676	1,009,944	(100%)

Source: *CSA, 2003,2010.*

As shown in Table 3.4, food and beverage, textile and non-metallic minerals dominate the Ethiopian manufacturing sub-sector. These groups accounted for 83% of the total number of establishments during 2007/08. The concentration of Ethiopian manufacturing activities in these establishments might be due to the fact that they depend heavily on local inputs and due to the availability of domestic markets for their products.

The number of large- and medium-scale establishments reached 779 in 1998/99 from its level of 642 in 1995/96, with an annual average growth rate of 6.8%. This growth rate is not satisfactory, given the low level of manufacturing activities in the nation.

When we come to the ownership structure, small-scale and cottage/handcrafts enterprises are totally owned and managed by the private sector. The ownership of large- and medium-scale manufacturing enterprises has shown changes in the past few decades. During the Imperial period, this sub-sector was dominated by the public sector, due to various measures taken by the governments. The proportion of public-to-private establishments showed continuous increase during the period of the Derg, reaching a maximum of around 120% in 1991/92, with 152 out of 279 enterprises owned by the government. However, this trend has been reversed due to the economic policies adopted by the EPRDF government.

As you can see from Table 3.5, the share of the private sector increased from 46.3% in 1995/96 to 91.5% in 2007/08. This is due to the active involvement of the private sector, the privatization program, and the withdrawal of the government from new investments in the area of large- and medium-scale manufacturing.

Table 3.5 **Ownership Structure (share in %)**

Indicators	1995/96		1998/99		2007/08	
	Private	Public	Private	Public	Private	Public
Number of establishments	46.3	53.7	73.7	26.3	91.5	8.4
Gross value of product (GVP)	13.6	86.4	35.8	64.2	59.5	40.4
Value added at factor cost (VAFC)	12.1	87.9	21.4	78.6	54.3	45.6
Number of persons engaged	13.7	86.2	31.4	68.6	66.3	33.6

Source: *EEA, 2002; CSA, 2007/08.*

However this does not mean that the private sector has the largest share in terms of output. Even though the value of output of the private sector, using both

Gross Value of Product (GVP) and Value Added at Factor Cost (VAFC), showed increments from 1995/96 to 2007/08, it is very recently that the public sector dominance in large- and medium-scale manufacturing in terms of output has been overtaken by the private sector. This is one underlying reason that the private sector employed 66.3% of the total labour force engaged in this sub-sector.

When we look at the regional distribution of the manufacturing establishments, we see unbalanced distribution. In general, it is better to have evenly distributed manufacturing establishments, but distribution depends on several factors including infrastructural developments, including those in roads, electricity, communication, water, proximity to input and output markets and social services.

Table 3.6 **Distribution of Large- and Medium-Scale Manufacturing in Ethiopia in 2007/08**

Region	Establishments (% of Total)	VAFC (% of Total)	Employment (% of Total)
Addis Ababa	46.4%	48.3%	48.4%
Oromia	16.7%	26.6%	24.0%
SNNPS	0.1%	2.0%	6.7%
Amhara	8.7%	5.3%	7.0%
Dire Dawa	2.0%	1.9%	3.1%
Harari	1.9%	1.4%	1.4%
Tigray	12.5%	13.5%	8.3%
Others	1.5%	0.6%	0.7%
Total	100%	100%	100%

Source: *Computed from CSA Bulletin (2009)*

From Table 3.6, we can see that Addis Ababa has the largest number of establishments land provides the most employment in the sector: 46.4%, and 48.4%, respectively. Oromia follows Addis Ababa with 16.7% of the establishments and 24.0% of total employment in the sector. Tigray and Amhara take the 3rd and 4th place in regional distribution of the establishments. The 3rd place in value added and employment shares are taken by Tigray. In Table 3.6, the category "Others" includes the four relatively less developed regions, namely

Somali, Afar, Benishangul-Gumz and Gambella, which, together, have only 1.5% of the establishments. These values indicate the unbalanced manufacturing establishment distribution. In an attempt to narrow this gap, the existing investment code of the country promises special incentives for investors who want to work in those backward regions.

Activity 3.12

1. What factors are responsible for the higher number of manufacturing enterprises existing in Addis Ababa and Oromia administrative region in comparison with other regions?
2. What measures should be taken to increase the number of establishments in the relatively less developed regions?
3. Discuss what the ownership structure of the manufacturing sector has looked like during the post-Derg period and mention the reasons for this structure.

Content Check 3.6

1. The objective of undertaking a public-enterprise reform program when the new government assumed power was to
   - A enhance efficiency
   - B increase productivity and competitiveness in private enterprises
   - C increase productivity and competitiveness in public enterprises
   - D All except C
2. ADLI envisaged
   - A an increase in agricultural production
   - B an increase in the demand for industrial goods
   - C making agriculture a source of domestic demand
   - D strengthening intersector linkage between agriculture and industry
   - E All of the above
3. "Expanding the domestic market for industrial products is the result of ADLI strategy." *True/False (Give reasons).*

4 Currently, the public sector still dominates in the _____.

A large- and medium-scale manufacturing, in terms of output

B small- and medium-scale manufacturing, in terms of output

C large-scale manufacturing, in terms of output

D None of the above

3.7 THE PERFORMANCE OF THE INDUSTRIAL SECTOR

At the end of this section, you will be able to:

- examine the performance of the industrial sector in terms of gross value of the manufacturing sector;
- examine the performance of the industrial sector in terms of gross value of output of the large- and medium-scale manufacturing sector; and
- examine the performance of the industrial sector in terms of the value added by the large- and medium-scale manufacturing enterprise sub sector.

Key Terms and Concepts

- Gross value of output
- Value added at factor cost
- Value added at current market price
- Gross domestic product

What different values can we use to measure the performance of the industrial sector?

The performance of the industrial sector can be measured, among other things, by:

- *Gross value of output (GVO), which refers to the total output produced during a given period of time;*
- *Value added at factor cost (VAFC), which is the difference between the gross value of output and the value of intermediate inputs, such as the cost of raw materials;*

VAFC = Gross value of output – Value of intermediate inputs

- *Value added at current market price (VACMP), which is the sum of value added at factor cost and indirect taxes, regardless of any subsidies:* $VACMP = VAFC + IBT - S$ *and value added per person employed* in other words, *the ratio of value added generated in a given period to the number of people employed during the same period:*

$$VAPPE = \frac{Value\ Added\ generated\ in\ a\ given\ period}{Number\ of\ people\ employed\ during\ the\ same\ period}$$

Given these definitions, we can briefly look at the contributions of the Ethiopian industrial sector to the national economy.

The available evidence indicates that the industrial sector accounted for 13.6 % of the national GDP during the period 1961-1974. This share declined to 12.2% and 10.9% in the periods spanning from 1980 - 1990 and 1991 - 1999, respectively. This implies that even if the broader definition of industry is taken (including mining and quarrying, manufacturing, electricity and water, and construction), the contribution of this sector to the national economy is not only marginal but declined over time. According to the information obtained from the national Bank of Ethiopia (NBE, 2008/09) the industry share of GDP for 1999/00 – 2008/09 was 13.1%. If we look at the GDP role of each component of the industrial sector in the national economy, we find that large- and medium-scale manufacturing accounted for 4.3%, small-scale 2.01 percent, and handcrafts 2.58 percent of the national output in the period spanning 1991-1999. The major contribution came from the large- and medium-scale manufacturing sector, as indicated in Table 3.7.

Example 1: Let the gross value of output of the small - scale industry during the year 2003 be 913, 921, 346. If the value of intermediate input or cost of raw material used to produce the above state output is 3 million, what will be the value added at factor cost?

$$VAFC = 913{,}921{,}346 - 3{,}000{,}000 = 910{,}921{,}346$$

Example 2: The total industrial employment during the year 2007/08 (CSA) is 1,677,906. If the value added of the manufacturing subsector during the same period is 922,013,083, what will be the value added per person employed?

$$VAPPE = \frac{922{,}013{,}083}{1{,}677{,}906} = 549.5$$

Table 3.7 **Major Components of the Industrial Sector (as % of total industrial GDP)**

Type	1980 - 1990	1991 - 1999	2000-2008
Large- and medium-scale manufacturing	39.1	38.1	25.4
Small-scale and handicrafts	17.7	18.0	12.8
Construction	29.6	23.6	37.1
Other industrial subsectors	13.6	20.3	58.6

Source: *Calculated from CSA Data, 1999, 2009*

As indicated in Table 3.7, the GDP contribution of large- and medium-scale manufacturing industries declined for the three decades of 1980 - 2008. The share of small-scale and handcrafts showed marginal increments during the last two decades of that period and then declined there after. 'Other' sub-sectors which, together, contributed about 20.3% and 58.6% to the total industrial GDP during the periods of 1991-1999 and 2000 -2008, respectively, include mining and quarrying, water, and electricity.

The size of 1995/96 manufacturing output shown in Table 3.8 indicates that a significant proportion of the gross value of output came from a small number of large- and medium-scale manufacturing activities, followed by cottage and handcrafts.

Table 3.8 **Gross Value of Output of Manufacturing Subsector of 1995/96 (in thousand Birr)**

Industry Group	Gross value of out put	% share
Large- and medium-scale	5,799,104	72.2
Small-scale	187,882	2.3
Cottage/ Handicrafts	2,042,931	25.5

Source: *CSA Survey, 1997*.

The bulk of output, which is about 72.2%, is created by large- and medium-scale manufacturing, and the contribution of small-scale industry is insignificant. In terms of value added at factor cost, large- and medium-scale manufacturing establishments contributed a significant proportion of the total value added, followed by cottage/handicrafts. This suggests that we should have a closer look at the performance of large- and medium-scale manufacturing establishments. The following analysis will be limited to large- and medum-scale manufacturing establishments because of the availability of adequate information on these establishments and because of their greater contribution to the national economy.

The Ethiopian large and medium-scale manufacturing sub-sector is characterized by the dominance of four-consumer good producing industrial groups, namely the food and beverages, textiles, and leather and shoes groups. These groups of industries account for the bulk of the gross value of output and for the value added of the sub-sector. For instance, the four groups of industries (but substituting chemical for leather and shoes) accounted for 78% of the gross value of output during the 1980s. However, the gross value of the output of the large- and medium-scale manufacturing sub-sector declined by about 1.6 percent during the1980s due to a sharp decline in the production of the chemical and textile groups.

The decline or stagnation in the gross value of output of the large- and medium-scale manufacturing sub-sector reversed after the launching of the economic reform program. The available official documents indicate that almost all large- and medium-scale manufacturing industrial groups showed significant improvement after the reform program was implemented. The gross value of output of the large- and medium-scale manufacturing sector registered an average annual growth rate of 20.2 % during the period covering 1991/92 - 1998/99 as shown in Table 3.9.

Table 3.9 **Gross Value of Output of the Large- and Medium-Scale Manufacturing Sub-Sector (in thousand Birr).**

Industrial Group	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Food	414,939	521,597	717,920	948,127	1.316,745	1,351,224	1,610,079	2,068,703
Beverages	357,125	474,929	601,473	792,465	863,945	630,408	922,627	922,878
Textile	268,068	454,098	722,131	651,181	770,968	685,517	646,987	689,799
Tobacco	146,335	188,537	191,227	199,936	244,180	240,371	243,776	252,929
Leather and shoes	181,594	288,032	376,970	601,359	634,500	452,133	652,486	565,695
Wood and furniture	38,643	53,001	104,689	120,028	132,621	58,863	158,291	254,524
Paper and printing	90,733	141,835	208,497	200,807	291,564	205,184	291,224	288,047
Chemical	111,798	248,555	422,878	443,633	503,785	465,784	786,595	737,211
Non-metal	68,344	127,838	223,418	336,653	419,673	444,066	550,963	567,797
Metal	84,758	175,769	441,501	636,301	621,113	484,899	530,178	1,024,735
Total	1,762,337	2,674,168	4,010,704	4,930,490	5,799,104	5,996,199	6,393,205	7,272,317
Average Growth Rate 1991/92 - 1998/99 = 20.4								

Source: *Compiled from CSA Survey, 1997 and 2000*.

In absolute terms production increased from Birr 1.8 billion in 1991/1992 to Birr 7.3 billion in 1998/99. That is, production quadrupled, representing an annual average growth rate of 20.5%. The major share of the increment in the value of production was contributed by food, chemical, non-metal and metal, which achieved average annual growth rates of 22.9%, 26.9%, 30.2%, and 35%, respectively, during the period of 1991/92 - 1998/99. The smallest annual average growth during the reform period in gross value of output was observed in the tobacco industrial group. It registered an annual average growth rate of 7.8% during the period under consideration.

Note that a mere increase in the gross value of the output of manufacturing industries might not have meaningful economic importance unless it is supported by a commensurate growth in the value added. Evidence indicates that the value added in the large- and medium-scale manufacturing declined annually at an average rate of 2.4% during the 1980s. However, this trend has been reversed since the introduction of the economic reform program. The value added at factor cost of large- and medium-scale manufacturing increased from Birr 336.8 million in 1991/92 to Birr 1,982.9 million in 1998/99, representing an annual average growth rate of 25.3% during the period covering 1991/92 - 1998/99.

Table 3.10 **Value Added of the Large- and Medium-scale Manufacturing Sub-sector (in thousand Birr).**

Industrial Group	1991/92	1996/97	1997/98	1998/99
Food	70,083	482,606	352,024	759,179
Beverages	43,981	180,123	173,832	166,162
Textile	57,378	155,252	130,850	131,838
Tobacco	39,426	64,950	99,384	135,141
Leather and shoes	20,486	177,804	108,448	141,443
Wood and furniture	13,809	59,561	60,869	52,234
Paper and printing	35,698	94,105	108,829	107,676
Chemical	29,665	157,840	231,826	170,660
Non-metal	16,883	186,948	187,148	172,957
Metal	9,406	122,680	81,821	145,634
Total	336,815	1,681,871	1,535,031	1,982,924

Source: *Compiled from CSA Survey*.

Food, non-metal, leather and shoes, and chemicals registered high annual growth rate of 34%, 33.2%, 27.6% and 25%, respectively, in value added in the period spanning 1991/92 - 1998/99. The lowest annual growth in value added during that period was recorded in the wood and furniture group Also, the beverage and textile groups increased by 1.9% to 11.9% annually during the same period, respectively.

Another indicator of the performance of the manufacturing sector is the value added per person, defined as the ratio of value added created to the number of persons employed. Value added per person is also known as *labor productivity*. Value added per person declined at an annual average rate of 3.4% during the 1980s. This might have been be due to, among other things, redundancy of labor in the sector together with obsolete and outdated technology causing the marginal product of labour to decline over time. After the reform, however, value added per person increased. Labor productivity was highest in metal, followed by those of food and leather and shoes. Labor productivity registered an annual average growth rate of 33.9%, 30.1%, and 25.6% in the metal, food, and leather and shoe industrial groups, respectively, during the 1991/92 - 1998/99 period.

The manufacturing sector has shown improvements in terms of gross value of output, value added, and value added per person during the post-reform period. This might be attributed to the incentive for profit and the creation of a relatively conducive environment induced by the granting of managerial autonomy to public enterprises; the active involvement of a number of private manufacturing establishments; the improved availability of inputs and spare parts; and the recovery of the agricultural sector, which enhanced the supply of raw materials to the manufacturing sector. These factors are expected to continue to contribute to the improvements in the performance of the manufacturing sector.

Activity 3.13

1. What indicators would you use to assess the performance of the industrial sector?
2. Explain the reasons for the poor performance of the industrial sector during the Derg.
3. Discuss the factors that contributed to the relatively improved performance of the industrial sector during the post-reform period.

Content Check 3.7

1 One of the following can be used to measure the performance of the industrial sector except

A Gross value of output

B Value added at factor cost

C Value added at current market prices

D Employment

E None of the above

2 All of the following contributes to declining value added per person except

A redundancy of labor

B obsolete and outdated technology

C shortage of raw materials

D None of the above

3 As a percentage of total industrial GDP, one of the following has the highest growth

A small-scale manufacturing

B large- and medium-scale manufacturing

C construction

D other industrial subsectors

4 "Mere increase in the gross value of output of manufacturing industries definitely has meaningful economic importance". *True/False (Give reasons).*

3.8 PROBLEMS OF AND POSSIBLE REMEDIES FOR OF THE INDUSTRIAL SECTOR

At the end of this section, you will be able to:

- assess the problems of and identify possible remedies for the industrial sector.

Key Terms and Concepts

- Market-related
- Input-related
- Technology related

What specific problems does the manufacturing sector within your locality encounter?

The manufacturing sector of Ethiopia is in its infant stage due to many interrelated problems. These problems are generally related to finance, technology, market, policy, input supply and other socio-economic factors. Let us examine some of these problems.

A *Lack of Finance*

The shortage of financial resources has been one for the major bottlenecks for industrial development in Ethiopia. The possible sources of this finance have been agricultural- and non-agricultural-commodity producing sectors in the economy. The agricultural sector, which is the mainstay of the Ethiopian population, has not been capable of generating the required surplus for the industrial sector, given its subsistence nature and backwardness. The other commodity-producing sectors, especially the manufacturing industry, is underdeveloped and most public enterprises are heavy users of foreign exchange. That is, they are highly import-dependent. This means that they have not been net savers and hence have no surplus. Given such a low saving rate, it is difficult to undertake industrial investment.

High collateral requirements by the formal lending institutions have aggravated the problem of financial shortage.

B *Market-Related Problems (Marketing Problems)*

The availability of markets is obviously one of the determinants of the development of the manufacturing sector. According to CSA survey (2000), market-related problems accounted for 39.5% of the underutilization of the capacity observed in the large- and medium-scale manufacturing establishments.

Market-related problems arise due to the following factors:

- *Weak domestic demand for manufacturing output — this is due to the subsistence nature of agriculture on which the vast majority of the people rely for food, etc. As a result, the purchasing power of the people is very low.*
- *Lack of marketing information about both local and export markets.*
- *Strong competition from cheap imports.*
- *A consumer bias against local products.*

C Technology-Related Problems (Technological Problems)

It is argued that it is impossible to think of industrial development without the application of modern science and technology. Technology-related problems have contributed to the poor level of industrialization in Ethiopia.

Technological problems may reveal themselves in one of the following ways:

- *Lack of sufficient information on appropriate technology. This is a serious obstacle to both existing firms and to those investors wishing to invest in the sector. This is related to the shortage of local institutions involved in technological support services.*
- *The technology we have today is not developed based on available local raw materials. This limits the linkage that is expected in the domestic economy of the manufacturing sector. It rather makes the sector triangulating the shortage of foreign currency of the country. The ratio of imported raw material to total raw material is too high for Ethiopian local manufacturing to flourish. For instance, in 2002/03, the import intensity was 22.0% and 29.0% for food and beverage, and textile groups, respectively. The situation is worse in basic iron and steel, and motor vehicles, trailers, and semi-trailers, with 99.2% and 93.4%, respectively. On average, for the indicated year, the import intensity for all medium- and large-scale manufacturing was 43.5%.*
- *The technology we use is also capital intensive. This approach is basically not recommended for economies like Ethiopia where unemployment is rising.*

D Input-Related Problems

Input-related problems also hamper the development of industry in Ethiopia. This is mainly due to the high cost and shortage of foreign exchange for imported inputs and to the unreliability of domestic sources of inputs and their poor quality. The survey conducted by CSA in 2000 ranked the shortage of raw materials as the second most serious problem that contributes to the underutilization observed in large- and medium-scale enterprises, accounting for 25.9% of the total underutilization.

There are also other problems like policy problems and human-resource-related problems in relation to lack of skilled manpower and absence of industrial discipline and work ethics. These and other problems do not only limit new investments, but also reduce the productive capacity of the already existing enterprises. For instance, according to CSA (2000), the large- and medium-scale manufacturing establishments used only 49.2% of their capacity due to various problems, the most serious of which were market-related problems and the shortage of raw materials. Therefore, in order to create accelerated industrialization in Ethiopia, it is imperative to identify and tackle the problems that are hampering the development of this sector.

Activity 3.14

What are the major constraints limiting industrial development in Ethiopia and what measures do you recommended to tackle these problems?

Content Check 3.8

1. "Shortage of financial resources has been one of the major bottlenecks of industrial development in Ethiopia". True/False (Give reasons).
2. "The manufacturing industry is highly export-dependent". True/False (Give reasons).
3. "The reliance on capital-intensive technology is one of the technology-related problems in Ethiopia". True/False (Give reasons).

Unit Review

UNIT SUMMARY

- The industrial sector of Ethiopia has undergone significant evolution. The main factor for such developments include, the establishment of strong central government together with the construction of the Ethio-Djibouti Railway, increased settlement of foreign citizens from Armenia, Greece, Italy and India, which brought the necessary entrepreneurial skills for manufacturing establishments, and the increased demand for imported goods among the urban population. The industrial structure so evolved was characterized by substantial foreign ownership and has been dependent on imported technology.
- However, this trend was completely reversed during the Derg period in terms of ownership and control of industries. Almost all large- and medium-scale establishments were in the government's hands, and the participation of the private sector was curtailed. That is, no room was available for private sector involvement, especially in large- and medium-scale establishments. As a result, the proportion of public-owed large- and medium-scale manufacturing establishments was higher than that of private establishments during the 1980s because of the nationalization programme.
- This trend reversed again during the 1990s, and both public and private sectors have participated in large- and medium-scale manufacturing. The ownership structure also changed, that is, there have been privately-owned large- and medium-scale establishments. And the size of large- and medium-scale manufacturing has increased recently because of the active participation of the private sector.
- Coming to the role of the industrial sector in the national economy, the sector contributes output, employment, and foreign exchange to the Ethiopian economy. Of all the industrial groups, large- and medium-scale manufacturing contributes the most significant proportion of value added, employment, and foreign exchange earnings to the national economy.
- With regard to industrial development strategies, we have reviewed the Imperial, the Derg and the Post-Derg periods. Prior to 1974, the declared state policy was to promote a pro-capitalism economic

system, based on public and private initiative. In this regard, the state's role included the actual undertaking of industrial investment, promotion of industrial enterprises through its financial institutions, and the promotion and execution of policies intended to attract industrial investment. These polices included encouraging the processing of local raw materials, promoting import-substituion, and giving special emphasis to industries that have strong linkage effects with the rest of the economy.

- The performance of the industrial sector can be measured by using the sector's gross value added at factor cost, value added at current market price, and value added per person employed. By any of these indicators, the sector's performance has been less impressive during the last two decades or so.
- There are a number of problems that have constrained the growth of the sector. These problems include weaknesses in technology, markets, finance, policies, skilled manpower, and the like. Broadly, these problems can be classified as technological, structural, and policy problems. On the technology front, lack of information on suitable technologies and lack of support for technology are the main problems for the sector. We use the term structural to refer to bottlenecks inherent in the overall economy, such as the small size of the domestic market. Finally, policy-related problems include tariff rates, land policies, unfair and arbitrary tax imposition, and the like, which have hampered the development of the sector.

REVIEW EXERCISE FOR UNIT 3

I ***Choose the best answer from the given alternatives.***

1 The Ethiopian manufacturing sector suffers from all of the following except _______.

A lack of infrastructure
B absence of adequate institutional support
C strong competition with imported goods
D usage of labor intensive technology
E None of the above

2 Due to post-Derg reforms, the manufacturing sector showed some improvements after the Derg period. This was due to all of the following except _______.

A active involvement of the private sector.
B higher level of protection given to domestic producers.
C improved availability of foreign exchange for importing necessary inputs.
D A and B
E None of the above

3 Which of the following is not true about the manufacturing sector of Ethiopia?

A It is highly import intensive.
B It is dominated by the production of non-consumer items.
C Weak domestic demand.
D All of the above
E None of the above

4 The production structure of Ethiopian manufacturing is dominated by _______.

A textile, metallurgical, and food.
B textile, food, and chemicals
C food, beverages and wood products
D food, beverages, and textile
E none of the above

5 According to the system of National Accounts of Ethiopia, which one is different from the rest?

A Water supply
B Press
C Mining
D Construction
E Manufacturing

6 Compared to the agricultural sectors a well-developed industry is expected to _______.

A employ more people

B serve as a reliable source of foreign currency

C create strong linkages among various sectors

D all of the above

E none of the above

7 Import intensity refers to:

A the excess of imports over exports in a nation

B debt burden

C the ratio of value of imported raw materials to the total value of raw materials used

D the total value of imported machinery, equipment, spare parts, raw materials, etc. in a year

E none of the above

8 The dominance of the private sector came to an end during

A the Imperial era

B the Derg era

C the current government

D None of the above

9 In terms of value added to the large- and medium-scale sub-sectors, one of the following is dominant

A textile

B wood and furniture

C food and beverage

D chemicals

10 _______ has the largest number of establishments and share of employment

A Oromia

B Addis Ababa

C Tigray

D SNNPs

E none of the above

II Say True or False and give your reasons.

11 The control of power by the Military regime changed both the ownership and management of the industrial sector significantly.

12 According to the definition of industrialization, the small-scale manufacturing industries play the most important role in the industrialization process.

13 In terms of the revenue obtained from sales, the food and beverage industrial group has been the highest contributor in recent times.

14 The share of employment in the non-metal, paper and printing industrial groups has been declining recently.

15 Sugar is one of the Ethiopian products which is given preferential treatment by European countries.

16 ADLI was instituted to strengthen the inter-sectoral linkages between agriculture and industry.

17 During the Imperial period, the large- and medium-scale manufacturing enterprises were dominated by the public sector.

18 The manufacturing sector contribution to the overall economy is still at its lowest level.

19 One of the factors expected to contribute to the improved performance of the manufacturing sector is the recovery of the agricultural sector.

20 The shortage of foreign exchange for imported inputs and the poor quality of domestic sources of inputs are some of the problems hampering the development of industry in Ethiopia.

III Answer the following briefly.

21 What criteria are used to categorize nations as industrialized? Also discuss the situation of Ethiopia's industry in relation to these criteria.

22 Explain factors that have contributed to the development of the industrial sector in Ethiopia.

23 Discuss the linkages between agriculture and industry.

24 Discuss the shortcomings of the industrial development strategies of the Imperial era.

UNIT 4

THE SERVICE SECTOR IN ETHIOPIA

Unit Objectives

At the end of this unit, you will be able to:

- distinguish the roles of the different service sectors in the Ethiopian economy;
- examine the policies and strategies of the Imperial, the Derg and the current government regarding the education, health, and communication sectors; and
- realize the effects of tourism on the Ethiopian economy.

Main Contents

INTRODUCTION

This unit deals with the role of the different service sectors such as education, health, transport, communication, and tourism in Ethiopia. We will also examine the policies and strategies of the Imperial, Derg and EPRDF governments regarding the education, health, and communication sectors. Finally, we will study the performance, the major problems of, and possible remedies for the sectors.

4.1 INTRODUCTION

At the end of this section, you will be able to:

- define the service sector; and
- identify the sub-sectors of the service sector

Key Terms and Concepts

- Service sector
- GDP

During 2003/04 - 2007/08, the Ethiopian economy witnessed broad-based and sustainable growth, owing to large-scale efforts undertaken by the government in the areas of infrastructure, agriculture, rural development and poverty alleviation programs and investments, and also owing to favorable weather conditions that characterized those years. In line with this, an average real GDP growth rate of 11.9 percent was registered during the 2003/04-2007/08 period. For 2003/07, the real GDPs for the agriculture, service, and industrial sectors were 7.5%, 16.0%, and 10.1%, respectively.

Table 4.1: **Growth Rate of GDP by major industrial classification at constant basic prices (%) 2002/03 - 2007/08**

Sector	Percentage change (%)					
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Agriculture	-10.5	16.9	13.5	10.9	9.4	7.5
Industry	6.5	11.6	9.4	10.2	9.5	10.1
Service	6.0	6.3	12.8	13.3	15.3	16.0
GDP	**2.0**	**11.8**	**12.7**	**11.8**	**11.8**	**11.4**

Source: *Calculated from IMF Country Report No. 08/260, July 2008.*

The service sector or the service industry is one of the three main economic sectors. The basic characteristic of this sector is the production of services (also known as '*intangible goods*'), and does not include the goods-producing sector.

This sector is composed of various sub-sectors. More specifically, the service sector includes: trade, hotels and restaurants, transport and communication, education, banking and insurance, public administration and defense, health, and other services.

According to the Ethiopian National Income Account classification, the first five sub-sectors are referred to as distributive services while the remaining are in the 'Other' service sector.

According to the 2009/10, MOFED Report the GDP share of the service sector increased from 41.1% in 2002/03 to 46% in 2009/10. This is mainly the result of the fast growth in the areas of real estate, hotel and restaurant, education, and health. In contrast, the share of agriculture fell from its level of 56.7% in 1995/06 to 42% in 2009/10.

Table 4.2 **Percentage Distribution of GDP by Major sectoral Classification at a Constant Basic Prices (%).**

Share as % of GDP	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Agriculture	44.9	47.0	47.0	47.0	46.0	44.6	43	42
Industry	14.0	14.0	13.0	13.0	13.0	13.0	13	13
Services	41.1	39.0	40.0	40.0	41.0	42.4	44	45
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: *MOFED Annual Report 2009/10.*

There are a number of ways to consider the service sector such as:

- *Its divisions,*
- *Its components, and*
- *The types of activities within the components.*

The service division includes a wide variety of industries, but they can be categorized into primarily consumer-oriented (providing a service directly to a consumer), primarily business-oriented (providing a service directly to another business) or mixed (providing services to both businesses and individual consumers).

Alternately, the activities of the services division can be described in reference to their economic activities as:

- *physical,*
- *intellectual,*
- *aesthetic*

i **Physical activities:** involve working with objects; examples include repairing cars, hairdressing, and cooking.

ii **Intellectual activities:** involve providing education or training at such levels as university and vocational school.

iii **The aesthetic activities:** entail providing consumers with artistic experiences such as offered by museums, theater performances, art shows, and musical performances.

Activity 4.1

Mention some of the service-giving subsectors functioning in your locality.

Content Check 4.1

1 Distinguish the service sector from other sectors.

2 What is the difference between the physical and intellectual service divisions?

4.2 THE ROLE OF THE SERVICE SECTOR IN THE ETHIOPIAN ECONOMY

At the end of this section, you will be able to:

- identify the roles of the service sector and explain their contributions to the economy.

Key Terms and Concepts

- Foreign exchange earning
- Output
- Employment

What do you think about the role of the service sector?
Discuss the significance of the service sector to the Ethiopia economy.

The service sector plays an important role in the country's economy. Its contribution can be seen from three angles, namely: output, employment, and foreign exchange contributions.

A Output contribution

The service sector has played a dominant role, next to the agriculture sector, in the Ethiopian economy. But in 2008/09 and 2009/10, the output contribution of the service sector in Ethiopia dominated the agriculture sector, contributing about 45% and 46% respectively.

This mainly the result of the fast growth of education, health, socio services, tourism, transport service, construction and related engineering services, wholesaler and retail trade, hotel and restaurant sub sectors. Moreover, relatively large investment expended on the sector.

Activity 4.2

Explain the output contribution of the service sector.

B Employment contribution

In Ethiopia, the service sector is the second largest sector, next to agriculture, in terms of absorbing a significant part of the labor force. About 1.4% of the total labor force is employed in the health and education sectors, while about 0.5% is employed in the communication and transport sectors.

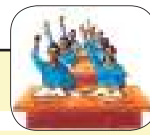
In Ethiopia, a significant number of mostly permanent employment opportunities are being created because of the rapidly growing economy. In particular, employment opportunities are being created by:

- *Sustained government efforts to enhance private sector investments;*
- *The big push in infrastructure development;*
- *The expanding services industry; and*
- *The rapid growing horticulture sector*

C Foreign exchange contribution

The value of exports of services increased from $261 million in 1980 to $348 million in 1998, representing an average growth rate of 33%.

In 2008/09, foreign exchange income earned from service providers such as Ethiopian Airlines and Ethiopian Shipping Lines, as well as from various service sub-sectors such as tourism, communication, insurance and financial services, collectively reached nearly 2 billion dollars, when compared to just 1.5 billion dollars for the export of goods.



Activity 4.3

Your teacher will help the class form groups so that you can discuss the following.

1 Mention some of service giving organization.
2 Identify the service sector activities in your locality and explain their contribution in terms of output, employment, and foreign exchange earning ______.

4.3 THE EDUCATION SECTOR IN ETHIOPIA

At the end of this section, you will be able to:

- review the historical background of education in Ethiopia;
- examine the educational sector polices and strategies of the Monarchy, the Derg regime and the EPRDF;
- evaluate the performance of the education subsectors, comparing primary, secondary, and higher education; and
- assess the problems of and identify possible remedies for the education sector.

Key Terms and Concepts

- Primary education
- Secondary education
- Higher education

In your opinion, what is the importance of education in a country?

4.3.1 Historical Background

Education is the basic component of human resource development, which is a means of:

- *raising political and social consciousness;*
- *increasing the number of skilled workers;*
- *raising the level of trained manpower, thereby facilitating creativity and innovation;*
- *increasing opportunities to individuals for better lives.*

The economic and social development of any country depends on the scope and level of the peoples education. Education in Ethiopia dates back to the 4^{th} Century. For about 1,500 years, the church controlled most of the traditional educational institutions. However, education in Ethiopia has undergone tremendous changes since the 19^{th} century as a result of government policies that have attempted to improve basic education.

Formal education began in 1908. However, the education system in Ethiopia suffered from shortcomings in quality, coverage, efficiency, and relevance, due to the following four key problems.

First, the education and training policies that were in place for many decades focused only on solving immediate problems, rather than tackling major long-term challenges at the national level.

Second, children – especially girls – were not encouraged to attend school.

Third, since there were no specific learning profiles set for students at different levels, neither the student nor the teacher had a clear vision of what and why they were learning or teaching.

Fourth, too many subjects were taught, both at primary and secondary levels (up to 15 in some cases), which resulted in lessons being too fragmented to develop necessary skills, attitudes, and behaviors.

Because of these and other constraints, the educational system was unable to contribute to solving the development problems of the country.

The same hypothesis holds true for institutions of higher education. Higher education started 50 years ago and was entrusted with the task of producing capable, problem-solving, responsible citizens. Nevertheless, the reality prevailing in higher institutions was far from encouraging. This was especially true during the Imperial Regime.

Due to the inappropriate education policy of the Military Regime, the coverage of education was, relatively, very narrow. And a number of schools were demolished by the war in different parts of the country. One of the characteristics of the Derg was its spending on defence rather than expanding the sector. Between 1987 and 1991, only 8.94% of the annual budget was allocated for education.

But the allocation for education between 2003/04 and 2007/08 was 22.6% (*according to Education Statistics Annual Abstract, 2007-2008 pp-15*). According to Education Statistics Annual Abstract 2007/08, school construction at different levels in different regions of a country increased rapidly post-1990.

The population of school-age, both male and female, increased from 69,126,001 to 73,819,951 between 2003/04 and 2007/08 (*Education Statistics Annual Abstract, 2007-2008 pp-10*).

Activity 4.4

Compare the evolution of the education sector during the Derg and post-Derg periods.

4.3.2 Education Sector Policies and Strategies

i **Pre-1974:** Generally speaking in this era the government didn't adopt strategies for the education sector. But in 1925, the government issued a plan to expand secular education. Ten years later there were only 8,000 students enrolled in 20 public schools. A few students also studied abroad on government scholarships. Schools closed during the Italian occupation of January 1936 - 1941. After the restoration of Ethiopian independence, schools reopened, but the system had shortages of teachers, textbooks and facilities. The government recruited foreign teachers for primary and secondary schools to off-set the teacher shortage.

The Imperial government initiated a comprehensive study of the education system. The education sector review (ESR) recommended attaining universal primary education, ruralizing the curricula through the inclusion of informal training, equalizing educational opportunities, and relating the entire system to the national development process. However, the ESR was not published until February 1974.

By contrast, the Derg invested relatively highly in education, in particular through the expansion of schools in rural areas and by launching an adult education program called the Literacy Campaign. These efforts had reduced the illiteracy rate to 38% by 1990. Although the drive for expanding primary education continued in the post-Derg period, the Literacy Campaign was stopped, and this explains the recent rise in the level of illiteracy.

Given these trends, it is not surprising to see that the positive contribution of education per worker in the period 1989-90 produced, relatively speaking, the period in which the literacy rate was highest.

ii ***Post-1974:*** the Military Government dismantled the feudal socioeconomic structure through a series of reforms that also affected the educational sector. By the early 1975, the government closed Haile Selassie I University and all senior secondary schools and had deployed some 60,000 students and teachers to rural areas to participate in the government's Development through Cooperation Campaign (commonly referred to as zemecha). In 1975, the Derg Regime nationalized all private schools.

Education for socialist consciousness, education for production and education for science and research' became the objectives and directives set during the Military Government. The Military Government also worked towards a more even distribution of schools by concentrating its efforts on small towns and rural areas that had been neglected during the Imperial Regime.

Primary education enrollment increased over the years 1968 to 2003:

Enrolement	Year	
	1968 – 1973	1974 – 1990
	496,334 to 835,045	961,580 to 3,080,710

iii **Post-1991:** The gross enrollment ratios for primary and secondary education have since showed an upward trend: 68.4% in 2003/04 for primary education and 22.1% for secondary education. The government of Ethiopia is now working towards achieving universal primary education by the year 2015 (MEDaC, 1999, MoE, 2005).

The Ethiopian government in 1993/94 introduced a National Education and Training Policy strategy to gradually overcome the aforementioned problems of quality, quantity, and efficiency. An education system is said to be efficient if maximum output is obtained from a given input, or if a given output is obtained with minimum possible input. In a more complete definition of output, the educational attainment of the pupils, the dropout rate, and the level of educational achievement of the graduates should be taken into account. Educational inputs comprise the buildings, teachers, books, teaching materials, etc., which may be aggregated financially in terms of expenditures per pupil-year.

In order to improve the critical situation of the education sector, the government launched the Education Sector Development Program (ESDP) in 1997.

The ESDP outlines long-term goals for the sector and the means to attain them by way of a series of phased, medium-term plans. The program has the following six components:

- ***Primary Education:*** *Activities under this component include: construction, expansion, and rehabilitation of primary schools; curriculum revision and development; upgrading of teachers' skills; and increasing the supply of textbooks.*
- ***Secondary Education:*** *Activities under this component include: expansion of school services; curriculum revision and development; and increases in the supply of educational equipment and material.*
- ***Technical-Vocational Training:*** *Under this component, there are plans to expand programs that train students in technical and vocational fields.*
- ***Teacher Training:*** *This component includes: the upgrading and expansion of training institutions; in-service (on-the-job) training of primary school teachers; curriculum revision and development; introduction of distance learning and alternative education methods; and the training of school directors or coordinators in school management.*

- ***Tertiary Education:*** *Under this component, the goal is to meet growing demand for teachers, engineers, health specialists, public administrators, and others.*
- ***Institutional Capacity Building:*** *Activities under this component include upgrading the Ministry's and Regional Education Bureaus' skills in planning, financial management, implementation, monitoring and evaluation of policies and strategies.*

4.3.3 Performance of the Education Sector

Primary Education (Grade 1 - 8)

As shown in Table 4.3, Table 4.4, and Table 4.5, primary education enrollment increased, over the years 1968-2003.

Table 4.3: **Trends in Primary School Enrollment in Ethiopia pre-1974**

Year	Primary (1-8)	Year	Primary (1-8)
1968	496,334	1972	796,064
1969	570,899	1973	853,045
1970	653,660	1974	961,580
1971	728,548		

Source: *MOE, Annual Education Statistics, year.*

Table 4.4: **Trends in Primary School Enrollment in Ethiopia, Post-1974**

Year	Primary (1-8)	Year	Primary (1-8)
1975	1,084,406	1983	2,789,107
1976	1,226,124	1984	2,800,695
1977	1,326,765	1985	2,728,253
1978	1,287,087	1986	2,811,910
1979	1,538,579	1987	3,160,563
1980	1,997,040	1988	3,345,049
1981	2,341,437	1989	3,302,593
1982	2,623,116	1990	3,080,710

Source: *MOE, Annual Education Statistics, year.*

Table 4.5: **Trends in Primary School Enrollment in Ethiopia, Post-1991**

Year	Primary(1-8)	Year	Primary(1-8)
1991	2,871,325	1998	5,090,670
1992	2,422,746	1999	5,702,233
1993	2,204,697	2000	6,462,503
1994	2,641,067	2001	7,401,473
1995	3,098,422	2002	8,144,337
1996	3,787,919	2003	8,743,265
1997	4,468,294		

Source: *MOE, Annual Education Statistics, year.*

Major Objectives of Primary Education

The major objectives of primary education are achiving functional literacy (1 – 4) and preparing students for further education (5 – 8).

Primary education is absolutely critical to a nation's development, providing on average, the highest public return on investment in education, and it is the critical under-pinning for later education and economic growth. In Ethiopia, primary education is defined as education in grades 1-8, in two cycles: first cycle (grade 1 – 4), and second cycle (grade 5 – 8).

Gross Enrollment Rate (GER) at Primary Level (1-8)

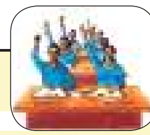
Gross Enrollment Rate (GER): is the percentage of total enrollment in primary schools, irrespective of age, out of the corresponding primary school age population, (7 – 14 years).

Table 4.6: **GER at the primary level, 2003 - 2008**

Year	Primary 1st cycle (1-4) %			Primary 2nd cycle (5-8) %		
	Boys	Girls	Total	Boys	Girls	Total
2003/04	95.2	78.3	86.5	57.0	36.9	47.1
2004/05	109.8	95.5	102.7	62.0	42.6	52.5
2005/06	123.9	111.2	117.6	67.4	49.8	58.8
2006/07	122.9	111.2	117.1	68.3	53.7	61.1
2007/08	133.0	122.5	127.8	64.8	55.5	60.2

Source: *Ministry of Education, Education Statistics Annual Report, 2007/08.*

There has been increased access to primary education in absolute numbers at all levels. The most significant progress is the Gross Enrolement Rate (GER) in primary schools. As a result of the expansion of schools in rural areas, and of improvements in awareness of the need for the education of girls at the community level, primary education, particularly the first cycle (1-4), enrollment has increased significantly. GER (1-8) was 22 percent for boys and 16 percent for girls in 1991, and was it is 98 percent for males and 85.1 percent for females in 2006/2007. However, there are wide regional variations in female enrollement rates. Some of the lowest rates for girls are in emerging regions and pastoralist areas. The national gender gap at the primary level was 20.2 percent in 1999/2000 and 12.9 percent in 2006/07. Despite such improvements, this gap is still a cause for concern.



Activity 4.5

Based on the above Table 4.6, compare the Gross Enrollment Rate (GER) at primary Level (1-8) in each year.

Secondary Education (Grade 9 – 12)

Objectives of Secondary Education

The major objectives of secondary education are enabling students to identify area of interest for further education and vocational training (9 – 10) and preparing them for higher education (11 – 12)

- *To provide basic education and integrated knowledge at various levels of vocational training.*
- *To satisfy the country's need for skilled manpower by providing training in various skills and at different levels.*

Secondary school in Ethiopia provides post-primary education in two cycles. The first is Grades 9-10 and the second is Grades 11 – 12. Secondary education expansion and construction has focus predominantly on the first cycle.

Secondary Gross Enrollment Rate (GER)

Secondary-school GERs compare those students, regardless of age, with the population of the appropriate age range. For Ethiopia, the ages for the first cycle (general secondary) is 15 – 16, and that for the second cycle is 17 – 18 years of age.

Table 4.7 shows the secondary school-age enrollment composition, by cycle, gender and Gross Enrolement Rate for each year of 2003/04-2007/08.

Table 4.7 **Secondary Enrollment by Cycle and Gender-Gap**

Year	Secondary 1st cycle						Secondary 2nd cycle					
	Enrollment			GER%			Enrollment			GER%		
	Boys	Girls	Total	Boys	Girls	Total	Boys	Girls	Total	Boys	Girls	Total
2003/04	443,779	242,197	685,976	28.2	15.9	22.1	69,189	25,471	94,660	4.5	1.7	3.2
2004/05	553,914	306,820	860,734	34.6	19.8	27.3	67,413	25,070	92,483	4.3	1.7	3.0
2005/06	678,716	387,707	1,066,423	41.6	24.5	33.2	91,889	31,794	123,683	5.7	2.0	3.9
2006/07	760,674	462,988	1,223,662	45.7	28.6	37.3	117,000	58,219	175,219	7.3	3.7	5.5
2007/08	793,228	514,691	1,307,919	44.4	29.6	37.1	130,533	62,911	193,444	7.8	3.8	5.8
Average annual growth rate	15.6%	20.7%	17.5%				17.2%	25.4%				

Source: *Ministry of Education, Education Statistics Annual Report, 2007/08.*

As can be seen from Table 4.7, enrolement grew, but in the first cycle, the rates for boys and girls diverged, with boys predominating.

Challenges related to girls' education becomes greater as one moves up to secondary level and above. The gap increased from 6.7 percent in 2001/2002 to 14.8 percent during 2007/08 for the secondary school first cycle. This change is mainly attributable to the high dropout rates of girls from Grade eight on. Several factors explain this situation. A few of them are:

- *Girls reach the age of puberty between the ages of 14-16 and in most rural areas get married through family arrangement or by abduction;*
- *High schools might not be available close to a girl's neighborhood. Therefore, girls may need to walk far, to reach them but their families might fear for their safety, including dangers of rape;*
- *Furthermore, in cases where girls would need to reside in a different town in order to receive such education, their families might not be able to pay for housing, food, and related expenses.*

Higher Education

Higher education in Ethiopia includes institutions with three, four, and six-year undergraduate programs, as well as two-year master programs and three-year Ph.D. programs.

Table 4.8 shows that total enrollment in the higher education institutions in 2007-08, for 61 reporting government and non-government institutions, was 270,356 in all programs, including:

- *Regular*
- *Evening*
- *Kiremt and distance.*

As noted in Table 4.8, out of this, non-government institutions enroll approximately 48,802 students, which accounts for 18.1% of the total. Data for non-government institutions captures only those institutions that are accredited by the Ministry of Education (MoE). Additionally, over 97.2% of all enrollments are at the undergraduate-degree level.

Table 4.8 **Enrollment in higher education institutions (2007-08)**

Program	Enrollment									GER		
	Government			Non-Government			Government and non-government					
	Male	Female	Total	Male	Female	Total	Male	Female	Total	Male	Female	Total
Undergraduate Degree	164,868	49,331	214,199	34,816	13,986	48,802	199,684	63,317	263,001	7.0%	2.2%	9.2%
Postgraduate second degree	6,401	696	7,097	-	-	-	6,401	696	7,097			
Postgraduate PhD	251	7	258	-	-	-	251	7	258			
Total	171,520	50,034	221,554	34,816	13,986	48,802	206,336	64,020	270,356			

Source: *Ministry of Education, education statistics annual report, 2007/08.*

Pupil-Teacher Ratio (PTR)

Pupil-teacher ratio is one of the common indicators for efficiency and quality in education. However, there are two conflicting views about PTR:

- *The lower the PTR is, the better the opportunity for contact between the teacher and pupils and for the teacher to provide support to students individually, thereby improving the quality of education;*
- *On the other hand, a very low PTR may indicate inefficient use or underutilization of teachers, resulting in low efficiency.*

In Ethiopia, the standard set for the pupil-teacher ratio is 50 pupils per teacher for the primary level (1-8) and is 40 pupils per teacher for the secondary level.

4.3.4 Problems of and Possible Remedies for the Education Sector

Problems

According to MEDaC (1999), the education sector in Ethiopia is beset by a number of problems, such as

- *Great disparity between the relatively developed and undeveloped regions and between rural and urban areas;*
- *Enrollement of girls at every level of education is lower than that of boys;*
- *Inadequate facilities, insufficient training of teachers, overcrowded classes, and shortage of books and other teaching materials all indicate the low quality of the education provided;*
- *A high illiteracy rate is an overall problem of the society. Opportunities for high school education and technical and vocational training are limited to big towns. Higher education institutions are found only in cities. In addition, they are over-crowded and their research capacities are very low;*
- *It is known that our country's education has complex problems of relevance, quality, accessibility, and equity;*
- *Financial and resource constraints;*
- *Lack of alternatives in resource mobilization in addition to the public budget;*
- *Poor quality and commitment of the leadership of the sector at all levels.*
- *High drop-out and repetition rate*
- *Limited access to tertiary education level. Although the priority focus in the country is on expanding basic education, the capacity of tertiary level also requires improvement.*

Possible remedies. The available documents indicate that the budget allocated to the education sector has increased during the post-reform period. However, further increases in resources for the sector are required to:

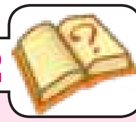
- *Expand the participation of parents, teachers and communities in policy formulation.*
- *Provide adequate student textbooks, teaching materials and various school facilities.*
- *Narrow the gap or disparity among regions.*

- *Inspect the private education sector to ensure the minimum necessary quality, standard of certification, service fees, etc.*
- *Improve the quality of teachers, in terms of training and motivation.*

Activity 4.6

1 Discuss in gorup the performance of the education sector during the Derg and post-Derg periods and presetn the result to your class ______.
2 How do you measure the performance of the education sector?
3 Outline the major problems in the education sector in Ethiopia.

Content Check 4.2



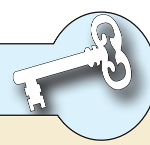
1 How do you relate education to economic development?
2 Discuss the possible remedies for the education sector.
3 Identify the problems of your school and suggest some remedies _____.

4.4 THE HEALTH SECTOR IN ETHIOPIA

At the end of this section, you will be able to:

- review the historical background of the health sector;
- examine the health sector policies and strategies of the Monarchy, Derg, and EPRDF governments;
- evaluate the performance of the health sector;
- assess the problems of the health sector;
- identify possible remedies for the health sector; and
- analyze the impact of HIV/AIDS.

Key Terms and Concepts



- HIV/AIDS
- Mortality
- Fertility
- Morbidity

What do you know about the eight Millennium Development Goals (MDGs) set for attainment by 2015?

4.4.1 Historical Background of the Health Sector

The health status of many Ethiopians remains very poor, and the system is not yet large enough to meet demand. The major limitations of progress in the sector are:

- *High population growth;*
- *Low educational and income levels, especially among women;*
- *Lack of access to clean water and sanitation facilities;*
- *Nutritional disorders and insufficient access to health services.*

4.4.2 The Health Sector Policies and Strategies

Ethiopian National Health Policy

The Ethiopian health care delivery system has historically been unable to respond quantitatively and qualitatively to the health needs of the people.

Definite policies and strategies for the development of health service were not formulated until 1963. However, efforts were made to include the health sector into the development plans. After the 1974 revolution, Ethiopia embarked upon different approaches towards solving health-sector problems, through the declaration of primary health care in a ten-year development plan in 1978. In these approaches, priority was given to creative types of strategies. It was highly centralized and there was little collaboration between public and private providers.

The Ethiopian Transitional and Federal Government formulated the 1993 Health Policy and Strategy. Goals of the Federal Government and the regional administrations included reorganizing health services to make them more cost-effective and efficient so, that they can contribute more to the overall socio-economic development effort of the country.

Following the change of government in 1991, a number of political and socio-economic reform measures were put in place. Two of these were the development and introduction of a new National Health Policy in 1993 and the formulation of a comprehensive rolling 20-year Health Sector Development Plan (HSDP) in 1997. Both are the results of the critical assessment and analysis of the nature and causes of the country's health problems. The HSDP is now in its third phase (HSDP III). The major goals of the health policy are decentralization of the health care system, development of preventive, facilitative, and curative components of health care, assurance of accessibility of health care for all segments of the population, and the promotion of private-sector and NGO participation in the health sector.

The national health policy focuses on a comprehensive health service delivery system to address:

- *Communicable diseases*
- *Malnutrition*
- *Improving maternal and child health.*

The health service delivery system is decentralized with the responsibility for implementation being largely devolved to the districts, which operate on the basis of block funding for the sector.

The policy emphasizes inter-sectoral collaboration, particularly in ensuring family planning for efficient family health and population planning, in formulating and implementing an appropriate food and nutritional policy, and in accelerating the provision of safe and adequate water for the urban and rural populations.

General Policy goals

The main policy goals of (the Health Sector Strategic Plan, HSDP-III, 2005/06-2009/10) are:

1. Democratization and decentralization of the health service system.
2. Development of the preventive and facilitative components of health care.
3. Development of an equitable and acceptable standard for the health service system that will enable it to reach all segments of the population within the limits of resources.
4. Promoting and strengthening inter-sectoral activities.
5. Promotion of attitudes and practices conducive to the strengthening of national self-reliance in health development by mobilizing and maximally utilizing internal and external resources.
6. Assurance of accessibility of health care for all segments of the population.
7. Working closely with neighboring countries and with regional and international organizations to share information and strengthen collaboration in all activities the contribute to health development, including the control of factors detrimental to health.
8. Development of appropriate capacity building, based on assessed needs.
9. Provision of health care for the population on a scheme of payment according to ability, with special assistance mechanisms for those who cannot afford to pay.

10 Promotion of the participation of the private sector and nongovernmental organizations in health care.

The health policy has also identified the priority intervention areas and strategies to be employed to achieve the health policy objectives.

Major components of the health care strategies are:

- *Preventive and curative health service*
- *Curative and rehabilitative care*
- *Drugs and medical supplies*
- *Health information, documentation, and processing*
- *Organization and management of the health delivery system*
- *Human-resource development and management*
- *Research and development*
- *Financing the health care delivery system.*

4.4.3 Performance of the Health Sector

Achievement of the Millennium Development Goals (MDGs) is one of the top priorities of global policies influencing the national development policies and strategies.

The eight Millennium Development Goals (MDGs) set to be reached by 2015 are relevant and directly linked to the health sector and are described below:

1. Eradicating extreme poverty and hunger
   - *Target – reducing extreme poverty and hunger by half (50%) of the level in 2000 G.C.*
2. Achieving universal primary education: target – 100% primary education.
3. Promoting gender equality and empowering women.
4. Reducing child mortality: target – reduce infant and under-five mortality rates by two thirds, between 1990 and 2015.
5. Improving maternal health: target – reduce maternal mortality ratios by three-quarters between 1990 and 2015.
6. Combating HIV/AIDS, malaria and other diseases.
   - *Target – halt by 2015 and begin to reverse the spread of HIV/AIDS.*

- *Halt by 2015 and begin to reverse the incidence of malaria and other major diseases.*

7 Ensuring environmental sustainability.

8 Developing a global partnership for development.

4.4.4 Problems of and Possible Remedies for the Health Sector

Indicators

A combination of rapid population growth, poor economic performance and low educational levels have constrained Ethiopia's socio-economic development and impacted health status in particular.

According to MOH, infectious and communicable diseases are the major causes of health problems in Ethiopia. Most of these diseases are caused by:

- *over-crowded housing conditions;*
- *contaminated water supplies;*
- *substandard waste management systems;*
- *nutritional deficiency.*

Ethiopia's burden of disease is dominated by malaria, diarrhea, and AIDS. Although largely preventable, the most significant childhood and maternal illnesses and communicable diseases are:

- *HIV/AIDS*
- *Malaria*
- *Tuberculosis (TB)*

The major indicators of health status prevailing in Ethiopia are presented below:

1 ***Infant mortality rate (IMR):*** it indicates the number of deaths of babies under one year of age per 1,000 live births. The rate in a given region, therefore, is the total number of newborns dying under one year of age divided by the total number of live births during the year, with the result multiplied by 1,000. The infant mortality rate is also called the infant deathrate (per 1,000 live births).

2 ***Maternal Mortality Ratio (MMR):*** is the ratio of the number of maternal deaths per 100,000 live births. The MMR is used as a measure of the quality of a health care system.

3 ***Life Expectancy at Birth (LEB):*** is the probable number of years a person will live after a given age, as determined by mortality in a specific geographic area.

4 ***Child mortality rate (CMR):*** is the number of children dying between the first and the fifth birthday per 1000 live births.

5 ***Access to safe water:*** is measured by the number of people who have a reasonable means of getting an adequate amount of water that is safe for drinking, washing, and essential household activities. It reflects the health of a country's people and the country's capacity to collect, clean, and distribute water to consumers.

Performance

- *According to the Ministry of Health, the maternal mortality rate in Ethiopia was reduced to 673/100,000 in 2005/06 from 871/100,000 in 2001/02.*
- *The infant mortality rate was reduced to 77/1000 live births in 2004/05 from 97/1000 in 2001/02 and to 123 /1000 in 1992/93.*
- *The child Mortality Rate per 1000 was reduced to 123/1000 in 2004/05 from 167/1000 in 2001/02 and to 180/1000 in 1992/93.*
- *Life expectancy at birth (measured in years) for each year of the 2005 – 2010 was, according to a UNICEF report, was 48.83, 49.03, 49.23, 54.99, 55.41, and 55.8 in that order.*

The provision of safe and adequate water supplies for the population has far -reaching effects on:

- *Health;*
- *Productivity;*
- *Quality of life, in particular for reducing poverty; and*
- *Sustainable socio-economic development.*

Hence, the Ethiopian government, NGOs, the community, and the private sector have undertaken maximum efforts to improve the low level of water supply and sanitation of the country.

According to the Annual Progress Report (APR) on the second year of PASDEP (2006/07), access to clean water supply at national level increased from 19.1% in 1995/96 to 52.5% in 2006/07.

Problems

- *Limited physical access of the population to health facilities.*
- *The available health care facilities are unevenly distributed across regions.*

- *Inadequate budgetary allocation and low levels of management.*
- *The distance from, or the absence of, health care facilities.*
- *Low quality of the facilities.*
- *Maternal, infant, and child mortality rates are still high.*
- *The country has a low resource utilization capacity.*
- *Inadequate and poorly maintained infrastructure and equipment, shortage of trained health personnel, and the unavailability of drugs and pharmaceutical supplies.*

Possible Remedies

- *Strengthen and expand existing health programs.*
- *Provide family planning services at all levels of health service delivery stations.*
- *Strengthen reproductive health content in health education programs.*
- *Strengthen and expand training of health personnel in collaboration with relevant institutions.*
- *Set standards for the provision of family planning services.*

Impacts of HIV/AIDS

Through its impacts on the labor force, households, and enterprises, AIDS has played a more negative role in human development than any other single factor. One aspect of this impact has been the damage that the epidemic has done to the economy, which, in turn, has made it more difficult for the country to respond to the crisis.

One way in which AIDS affects the economy, in Ethiopia and other countries, is by reducing the labor supply through increased mortality and illness. Even among those who are able to work, productivity is likely to decline as a result of HIV-related illness. Government income also declines, as tax revenues fall and it is forced to increase its spending to deal with the spread of the HIV epidemic.

The abilities of African countries to diversify their industrial bases, expand exports and attract foreign investment are integral to economic progress in the region. By making labor more expensive and reducing profits, AIDS limits the ability of African countries to attract industries that depend on low-cost labor and makes investment in African businesses less desirable. HIV/AIDS therefore threaten the foundations of economic development in Africa.

The impact that AIDS has had on the economies of African countries is difficult to measure. The economies of the worst affected countries were already struggling with development challenges, debt, and declining trade before the epidemic started to affect the continent. AIDS has been huge addition to these factors further aggravating the situation. It is thought that the impact of AIDS on the gross domestic product (GDP) of the worst affected countries is a loss of around 1.5% per year. In othr words, after 25 years the economy would be 31% smaller than it would otherwise have been.

Activity 4.7

Discuss the following:

1. Among the eight millennium development goals, which goals are directly linked with the health sector?
2. Explain the major health sector problems in Ethiopia.
3. Identify the possible solutions for the health sector problems.

Content Check 4.3

1. Which of the following conditions is the major cause of health problems in Ethiopia?
   - A Contaminated water supply
   - B Nutritional deficiency
   - C Over-crowded housing conditions
   - D all
2. List out the major health indicators.

4.5 THE TRANSPORT SECTOR

At the end of this section, you will be able to:

- examine the transport sector policies and strategies for road transport, railway, air transport and the Ethio-shipping line.

Key Terms and Concepts

- Road
- Railway
- ESL
- Air transport

What do you know about modes of transport?

4.5.1 Policies and Strategies of the Transport Sector

Transportation can be defined as the movement of commodities, materials, people and animals from one place to another with a specified objective. Transportation is fundamental to civilization. The roles of transportation in socio-economic development are that it allows for:

- *Division of labor and labor specialization,*
- *Procurement of raw materials from various sources,*
- *Dispatch of goods to marketplaces, etc.*

In Ethiopia, the early means of transportation were foot and pack animals like donkeys, horses, and camels. These means of transportation are important even today, especially in rural areas. However, this set of transportation constrains the socio-economic development of the country because it is time-taking and tiresome.

During the Military Government, the transport sector was put under close state regulation and control. The entire commercial truck and passenger transport system was under strict control of the government through Proclamation No.107/1976.

The policy changes in the sector that occurred on May 8, 1992 heralded the deregulation of the freight transport industry. Major liberalization of the transport industry began with government Proclamation No. 14/1992. It emphasizes the promotion of efficiency and equitable distribution.

Following the 1992 Proclamation, many of the private commercial freight and passenger transport activities left the corporation and formed their own independent association. Some, however, continued as associates of government enterprises.

The other content of the new policy allows:

- *Free entry into existing associations,*
- *Obtaining licenses to form new associations.*

4.5.2 Performance of the Transport Sector

I Road Transport

The Ethiopian Road Transport Authority (RTA.) is a public authority responsible for the use of all roads within Ethiopia, vehicles using these roads, and all matters relating to road transport activities.

The Road Transport Administration was established in 1967 by Proclamation No 256/67 to administer the control and regulation of road travel and transport in 1976, after having undergone restructuring, it was reorganized as the Road and Transport Authority (RTA) by Proclamation No 107/76. The authority replaced and took over the rights and obligations of the former Roads Transport Administration. It was again road restructured and replaced by Proclamation No. 14/92.

Poverty reduction and addressing vulnerability have been and still are the overriding agenda of the government. It is well known that the success of development strategies heavily depends on the efficiency of the infrastructure sector in general and the road sub-sector in particular. Accordingly, substantial improvements have been achieved in the expansion of road infrastructure.

According to the 2006/07 Annual Progress Report (APR), in the second year of PASDEP implementation (MOFED, 2007), the stock of road network, proportion of road network in good condition, and road density per 1000 sq. km increased as follows:

- *By the end of 2006/07, the total length of road network (paved and unpaved) increased from 23,812 km in 1996/97 to 44,539 km, and road density increased from 22 km/1000 sq. km in 1996/97 to 40.3 km/ 1000 sq. km by the end of 2007/08;*
- *The proportion of roads in good condition increased from 18 percent in 1995/96 to 73 percent by the end of 2007/08. By the end of PASDEP (2009/10), the target was to increase road density to the Sub-Saharan Africa (SSA) average of 54 km/1000 square kilometers;*

- *In 2006/07, 992 km of new rural roads were constructed and added into the network;*
- *In 2006/07, with community participation, 24,353 km of low-level rural roads were constructed in different regions of the country;*
- *The average time taken to reach all-weather roads reduced from about 7 hours in 2001/02 to 4.5 in 2006/07. For 2009/10, the target was to reduce the average time taken to reach the nearest all-weather road to 3.5 hours;*
- *The proportion of area farther than 5 km away from all-weather roads was reduced to 68 percent by the end of 2006/07 from 72 in 2004/5.*

See the details in Table 4.9 below.

Table 4.9: **Recent Trends in Road Conditions in Ethiopia**

Indicators	2004/05	2005/06	2006/07	2007/08
Stock of road network (km)	37,018	39,477	42,429	44,359
Road density (per 1000 square km)	34	30.8	38.6	40.3
Roads in good condition (%)	64	69	71	73
The proportion of area further than 5 km away from all-weather roads (%)	72	72	68	-
Average time taken to reach all-weather roads	5.7	5.3	4.5	4.2

Source: *Ministry of Finance and Economic Development, 2007.*

II *Railways Transport*

For more than a century, the Ethio-Djibouti Railway has been the nation's the only railway and one of the most important means of transportation and link to the outside world for Ethiopia. The railway company plays an important role in transporting import, export, and internal freight, and passengers (international and local). In contrast to air transport, Ethiopia has a limited railway service that stretches 781 km, linking Addis Ababa with the port of Djibouti via the eastern Ethiopian cities of Dire Dawa and Adama.

Table 4.10: **Operations Of Ethio-Djibouti Railway**

Cargo \ Year	2005/06	2006/07	2007/08	2008/09
Passenger	6,000	77,00	2,450	700
Freight	27,400	15,600	7,050	7,200
Others	2,600	3,000	9,700	23,600
Total Revenue Expenditure('000)	36,000	26,300	19,200	31,500
Personnel	21,700	25,200	33,200	29,000
Material and Others	19,300	1,8700	6,400	6,100
Total Operating Expenses	41,000	43,900	39,600	35,100
Provision for works and Renewal of Equipment	2,000	2,000	3,200	1,400
Interest	-	-	-	-
Total Expenditure	43,000	45,900	42,800	36,500

Source: *Ethio-Djibouti Railway Company,2008/09*.

Financial operations of the company in the period 2005/06-2008/09 indicate that it gained more from freight than passengers and other sources combined. The data in Table 4.10 reveals that total operating expense the biggest share of income in 2006/07. However, company expenditures exceeded revenue in all of the years. As a result, the company experienced losses from 2005/06 to 2008/09.

III *Air Transport*

According to Ethiopian Airlines Annual Report 2008/09, Ethiopian Airlines was founded on December 29, 1945, by Emperor Haile Selassie I with assistance from Trans-Continental and Western Airlines (TWA). It commenced operations on April 8, 1946, with weekly service between Addis Ababa and Cairo with five Douglas DC-3 propeller-driven aircraft.

The airline started long-flight services to Frankfurt in 1958 and inaugurated its first jet service in January 1963 from Addis Ababa to Nairobi. In the early 1960s it provided some initial aviation support to the Ethio-United States Mapping Mission in its operation to provide topographic maps of Ethiopia. It is wholly owned by the government of Ethiopia and had 4,700 employees as of March 2007.

Although it relied on American pilots and technicians at the beginning, by its 25th anniversary in 1971, Ethiopian Airlines was managed and staffed by Ethiopian personnel. Ethiopian Airlines provided basic pilot and aviation maintenance training to trainees from African countries including Rwanda, Tanzania, Chad, Djibouti, Madagascar and the Sudan. Other training was given to employees of Kenyan Airways, Air Zimbabwe, Cape Verde Airlines and Air Madagascar.

Ethiopian Airlines has a very good reputation. In its 64 years of service, it has offered excellent passenger and cargo air transport. The airline and all its technical and training activities have provided an opportunity for building Addis Ababa as a regional hub for air transport.

Ethiopia had three international and 18 domestic airports. Its international flights link the country with over 45 cities in four continents: 26 in Africa, 12 in Asia, five in Europe and two in North America. It has been expanding its intercontinental services to realize its motto of being "Africa's Link to the World." In 2010, Ethiopian Airlines traveled to 59 international destinations, 39 of which were in Africa. According to Ethiopian Airlines Annual Report (2008/09), the operational aircraft of Ethiopia airline was 41.

Financial Performance of the Company

Revenue

The total revenue generated during the year 2008/09 grew by 33% compared to the revenue of the previous year.

A ***Passenger Revenue***

The actual passenger revenue, including excess baggage, realized in 2008/09, was 29% higher than in the preceding year, mainly as a result of increased passengers.

B ***Flight Revenue***

Freight revenue earned in the 2008/09 fiscal year was higher than that of the previous year by 49%. This was mainly because charter operations to and from Europe increased.

C ***Operating Expenses***

The total operation expenses in 2008/09 increased 28% compared to the previous year. The major contributor for this was the increase of costs of aviation fuel, aircraft leases, and maintenance.

D *Cash Position*

The airline generated a net cash inflow of ETB 1.4 billion from operating activities, raised ETB 15 million from financing activities, and spent ETB 1.1 billion for investments.

In 2008/2009, the airline transported 2.8 million passengers and generated 12.2 billion birr in revenue with a net profit of 1.345 billion birr (a 165% increase over the previous year). In the same period, Ethiopian Airlines hauled 101 thousand tons of cargo, a 38.4% increase over the previous year. These results were the best yet for the 64-year-old airline, and were attributed to an aggressive marketing campaign and major cost-cutting measures.

An Ethiopian Airlines aircraft

IV *Ethiopian Shipping Lines S.C.*

Ethiopian Shipping Lines (ESLSC) was established in March 10, 1964 under the agreement of the Imperial Ethiopian Government and Taurus Investment Inc., whose head office was in Washington DC, USA. According to the agreement signed, Ethiopian Shipping Lines Share Company was established in Ethiopia with an initial capital of 50,000 Ethiopian Birr, subsequently to be raised to 3,750,000 Ethiopian Birr. Taurus Investment Inc agreed to subscribe to 51% of the capital requirements and designated two directors of the company. The Ethiopian Government underwriote the remaining 49% of the capital required and designated two directors of the ESL.

An Ethiopian Shipping fines ship

After the agreement was singed, the first three vessels were ordered. The two cargo liners, the M.V. “Lion of Judah” and the M.V. “Queen of Sheba” and a 34,000 ton oil tanker m/t “Lalibela” were ceremoniously launched at Rotterdam in 1966. Since then, the Etho-Shipping Lines Share Company (ESLSC) has undertaken an extensive fleet expansion program to keep pace with the nation’s rising need for shipping services.

The ESLSC, which was again established, under the decree of Council of Ministers Regulation No. 196/1994, had authorized the company a capital of 122,000,000 Birr.

The main purpose of the establishment of the company has been to:

- *Render coastal and international marine transport service, and*
- *Engage in other related activities necessary for the attainment of its charter.*

Besides its former and current fleet, ESLSC has made slot charter arrangements agreements with a number of other shipping companies. This global practice enables ESLSC to give weekly service from any of its trading routes.

Ethiopian Shipping Lines Enterprise is a domestic company, which is mainly engaged in transporting commercial goods from country to country through its international routes.

Pertaining to the continuous growth of the country’s economy, in general, and foreign trade cargo, in particular, ESLSC’s performance registered steady growth during 1995, 1996, 1997, 1998, 1999, 2000, 2001, and 2002 (Ethiopian fiscal years), as indicated in Table 4.11.

Table 4.11: **Performance indicators of Ethiopian Shipping Lines.**

Indicator	Measurement (Unit)	EFY 1995	EFY 1996	EFY 1997	EFY 1998	EFY 1999	EFY 2000	EFY 2001	EFY 2002
Cargo lifting's	'000 tons	699.8	903.3	1,154.7	1,453.7	1,484.8	2,224.6	21,71939	2,477,377
Revenue	Million Birr	756.7	849.6	1,147.0	1,571.9	1,903.2	2,393.2	2,660,730	3,692,121
Profit	Million Birr	97.8	102.9	180.4	260.0	287.7	426.8	392,334	641,363
Market Share (Dry Cargo)	%	30	35	38	41	38.6	48,3	36.2	28.4
Manpower	No's	536	554	570	560	643	597+53	687	716

Source: *Ethiopian Shipping Lines S.C. Report, 2010.*

The financial operation of the Ethiopian Shipping Line Enterprise for the years EFY 1995-2002 is presented in Table 4.11. Revenues and expenditures of the enterprise for that period were at their peak in 2002 EFY, and were at their lowest in 1995/96. The company gained a profit of Birr 64,1363 million in 2002 EFY.

Activity 4.8

1 How do you measure the performance of the railway transport sector?
2 Which mode of transportation is the fastest but most expensive in Ethiopia?
3 Which mode of transportation is the most common in Ethiopia?

Content Check 4.4

1 Explain the role of the transport sector in socio-economic development.
2 What are indicators of road condition in Ethiopia?
3 What are the performance indicators of Ethiopian Shipping Lines?

4.6 THE COMMUNICATION SECTOR

At the end of this section, you will be able to:

- review the historical background of the communication sector;
- examine the communication sector policies and strategies;
- evaluate the performance of the communication sector; and
- assess the problems of and identify remedies for the communication sector.

Key Terms and Concepts

- Media
- Ethiopia Telecommunication Corporation (ETC)
- Postal service

What services does the Ethio Telecom provide?

What are the major problems of the communication sector in your locality?

4.6.1 Historical Review of the Communication Sector

Communication is one of the most fundamental elements necessary for the economic, social, and political development of any country. Communication services include telecommunication, postal and media services.

Upgrading and expanding the telecommunications network and services have been essential to modernizing the sector and bringing about national growth as well as greatly supporting the rural economy. For example, having basic telephone access in villages:

- *allows farmers to get information on prices for their crops and livestock products;*
- *improves the efficiency of local administration;*
- *encourages the development of trade and small businesses;*
- *facilitates the provision of social services such as health, education, and agricultural extension.*

The history of the communication service in Ethiopia dates back to 1894 when various innovations were introduced in Ethiopia during the time of Emperor Menelik II.

A telegraph line from Addis Abeba to Djibouti was installed parallel to the construction of the then Franco-Ethiopian Railway, which was commenced in 1898 and completed in 1917.

Until 1904, communication services were supervised by a foreign adviser but later, as telephone and telegraph lines were found to be vital for administrative and foreign-relation purposes and for the dissemination of news, communication facilities began to be run by an office in the Imperial Palace and were accorded the direct attention and supervision of Emperor Menelik II himself, assisted by a foreign expert, M. Chefneux.

The first telecommunication and postal administration started in 1909 and was completed in 1911. It was the cornerstone of the establishment of the Ministry of Postal, Telegraph and Telephone (MOPTT).

After the establishment of MOPTT, Ethiopia became a member of the Universal Postal Union (UPU) and the International Telecommunication Union (ITU) in the years 1908 and 1932, respectively.

In the period from 1915 to 1932, there were only 200 telephone subscribers in Addis Abeba. The first telephone subscriber in Addis Abeba was the then Bank of Abyssinia.

Following the end of the Italian occupation of Ethiopia (in 1941), the first automatic telephone exchange system was installed in Addis Abeba and Asmera.

In 1981, the Board of Telecommunication was renamed as the Ethiopian Telecommunication Service Organization without much change in its functions. This name lasted for over 5 years and in 1981, the organization came to be known as the "Ethiopian Telecommunication Authority".

As to postal services, Proclamation No. 240/1996 set the administrative infrastructure for the improvement, expansion, and modernization of the Ethiopian postal system. Under this Proclamation, the post office was organized as an independent department of the MOPTT.

As to the development of media service in Ethiopia, the press was the pioneer in this area. And it is one of the media used for relaying information to the public and to exchange news, views, ideas, etc.

As the data shows, the numbers of copies of Addis Zemmen and the Ethiopian Herald sold were 4.4 million and 2.6 million in 1998/99, respectively, and it rose to 5.8 million copies of Addis Zemmen and 3 million copies of the Ethiopian Herald in 2002/03, (Ministry of Information and Culture, 2002/03 EFY).

Television service was established in 1964. The service was confined to Addis Ababa. Additional TV stations were not installed until 1992. Television service coverage had reached up to 35% of the total area of the country by the end of the Derg regime. After the downfall of the Derg, 39 additional towns got TV services. By the year 2006, the TV penetration rate in Ethiopia had reached up to 55% of the total area of the country.

4.6.2 Policy and Strategies in the Communication Sector

With regard to the communication sector, a number of reform measures have been undertaken consistent with overall economic policy. The new economic policy vis-à-vis communication emphasized the need for maintaining telecommunication and postal services under state ownership as essential public services with the possibility of subsequently exploring private-sector participation.

Table 4.12: Fixed-line Call Tarriffs as of April 1, 2011

The new Revised Enterprise Tariff as of April 1, 2011.

New Tariff for Mobile-to-Mobile, Mobile-to-Fixed and Fixed-to-Mobile local calling rate:

Peak hrs	Off Peak hrs
0.72	0.30

N.B: *- No tariff zones (flat tariff rate)*
- 15% VAT is added to charges

International Calls:

International Calls	Peak hour charge/min	Off-peak hour charge/min
International (except Djibouti)	10.72	10.72
Djibouti	7.72	7.72

N.B: *15% VAT is added to charges*

SMS	
Usage charge Rate (Birr/SMS)	
Local SMS	0.30 cents
International SMS	5.30
Djibouti	3.80

Fixed line:

Types of Fee	Fee	Total amount including VAT
Subscription fee	242	283.30
Monthly rate	17.00	19.55

Table 4.13: **Mobile Tariff as of December 2009**

Call tariff	Price
Mobile-to-Mobile local peak	Birr 0.83 (US$ 0.06) per minute
Mobile-to-Mobile local off-peak	Birr 0.345 ($ 0.03) per minute
Mobile-to-fixed line within a tariff zone	0.83 Birr/minute (US$ 0.06 /minute)
Mobile-to-fixed line between different tariff zones	1.50 Birr/minute ($ 0.20/minute)
International	Birr 11.5 ($ 0.9) per minute

Source: *ETC, Annual Statistical Bulletin, 2008/2009.*

For postal service, the revised tariff had the following price structure for postal boxes:

- *Tariff for small boxes: Birr 48*
- *Tariff for medium private boxes: Birr 85*
- *Tariff for large private boxes: Birr 96*
- *Tariff rate for large enterprise boxes: Birr 340*

4.6.3 The Performance of the Communication Sector

A *Telecommunication*

In today's world, the telecommunication infrastructure of a country is one of the most important factors affecting development. It is therefore important to evaluate a country's national telecommunication infrastructure prior to embarking on a major national development program.

Telecommunication plays a major role in the exchange of views and in information dissemination among various socio-cultural and economic groups. The Ethiopia Telecommunication Corporation (ETC) has been expanding its network within the country and to the rest of the world.

A modern communication system, especially telecommunication, is one of the conditions for attracting foreign capital and encouraging competition in the world market. The Ethiopia telecommunication (ETC) is making continuous efforts to extend its services throughout the country. However, in 2010, for the first time in history, the Ethiopian government outsourced a department of its state monopoly telecommunication service provider to an outside institution – France Telecom Company.

This company, Ethio Telecom, which is totally owned by the Ethiopian government, will handle all the business activities of the former ETC — Ethiopia Telecommunication Corporation.

According to the agreement, France Telecom will strive to improve and modernize Ethio Telecom's over-all business aspect by implementing a new organizational structure and better work processes. For these activities, the Ethiopian government has agreed to pay 30 million Euro (€30 million) to France Telecom Company for the two years 2011/2012.

The following table shows the performance of ETC from 2005 to 2008/09.

Table 4.14: **The numbers of different types of subscribers to ETC from 2005 to 2008/0**

Capacity	2005/06	2006/07	2007/08	2008/09
Fixed Telephone Line	725,046	880,088	897,287	915,058
Digital Line	723,023	878,967	896,036	914,264
Mobile Subscribers	866,700	1,208,498	1,954,527	4,051,703
Internet Subscribers	25,724	31,400	34,100	71,059

Source: *Ethiopian Telecommunication Corporation,2008/09.*

The numbers of digital-line subscribers, mobile subscribers, and internet subscribers showed remarkable changes over these period.

B *Postal Service*

Postal services are important for expanding communication infrastructures. The Ethiopian Postal Service was introduced in 1886 E.C. Even though the service has been in place for a long time, its services are limited to only parts of in the country.

Postal service has been expanding since 1991/92, with increasing volumes of both domestic and international postal traffic. The volume of letters, numbers of parcels, and EMS handled increased in 2008/09. The performance of the postal service is shown in Table 4.15.

Table 4.15: **Performance indicators of the postal service**

Letters('000)	2006/07	2007/08	2008/09
Domestic	11,785.3	9,262.9	12,582.4
International			
In	6,441.9	5,463.4	5,150.1
Out	5,206.1	4,111.1	4,511.1
Total	23,433.3	18,837.4	22,243.6
Parcels('000)			
Domestic	22.9	33.3	38.6
International			
In	23.8	28.3	30.8
Out	13.1	15.0	18.3
Total	59.8	76.6	87.7
E.M.S('000)			
Domestic	75.0	120.4	118.2
Inernational			
In	19.6	17.8	20.4
Out	20.5	36.4	43.3
Total	115.1	174.6	181.9

Source: *Ethiopian Postal Service, 2008/09.*

Financial operations data of the postal authority for the period 2000/01-2002/03 indicates that the authority gained more from sales of postage stamps, carton envelopes, and meter machines than from other sources. In 2002/03, both revenue and expenditure of the authority decreased, by 12.8% and 18.8%, respectively, compared to the levels of 2001/02. However, the authority made a profit of Birr 10,334,700 in 2002/03.

C *Broadcasting and Press*

Broadcasting plays a vital role in reaching the masses living in remote areas. Although owning of a radio and TV is not affordable for many Ethiopians, broadcasting definitely has a much bigger audience than press, as illiteracy and physical inaccessibility do not seriously affect it.

4.7 THE TOURISM SECTOR

At the end of this section, you will be able to:

- review the historical background of the tourism sector;
- evaluate the performance of the tourism sector; and
- assess the problems of and identify remedies for the tourism sector.

Key Terms and Concepts

- Tourism
- Vacation tourist
- Business tourist
- Transit tourist

What do you think about the contribution of the tourism sector to the Ethiopian economy? Suggest mechanisms to promote the tourism sector in Ethiopia.

4.7.1 Historical Development of Ethiopian Tourism

According to the Ethiopian National Income Account classification, tourism is one of the components of the service sector.

Tourism deals with the movement of people away from their normal residence for:

- *Business,*
- *Conference,*
- *Vacation,*
- *Transit,*
- *Visiting relatives,*
- *Other purposes.*

Tourism is the activity of providing services for these people, and it is also an important source of foreign currency and employment for citizens of many countries.

Ethiopia has great tourism potential. It was the recognition of this great potential that encouraged Ethiopia in the 1960's to start a tourism industry. After an initial period of rapid growth, the industry underwent a fast decline and stagnation for many years due to the political and economic problems that prevailed for a long time in the history of the country.

During the Derg government (from 1974 to 1991), Ethiopia's tourism industry suffered from the adverse effects of a prolonged civil war, recurrent drought and famine, strained government relations with tourist-generating countries, and restrictions on the entry and movements of tourists. However, tourism is now operating in a more conducive climate for growth and development, as evidenced by statistics compiled by the Ethiopian Tourism Commission.

Because Ethiopia has so many historical and natural sites and diverse cultural-tourism attractions, tourism should have been one of the country's largest industries, but unfortunately the country has been unable to realize the economic benefits it deserves from the sector. Nonetheless, in recent years, due to the development of infrastructures, like roads and hotels, and to the crucial role of the government in marketing and changing the image of the country through its embassies, tourism has shown significant growth despite the economic crisis in the world. But still there is a long way ahead before we will fully exploit the benefits of the tourism sector efficiently and secure its appropriate position in the economic sectors.

4.7.2 The Role of Tourism

Tourism in Ethiopia contributes to the national economy in:

- *GDP*
- *Employment*
- *Foreign exchange earnings*
- *Development of new infrastructure in ways that complement or help to full fill local needs (for example, water, transport, and electricity)*
- *Improving living standards and reducing poverty.*

4.7.3 Performance of the Tourism Sector

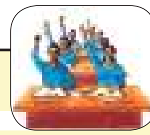
Tourism in Ethiopia accounted for 5.5% of the country's gross domestic product (GDP) in 2006, having increased by only 2% over the previous year (2005). The government is committed to developing tourism through a number of initiatives. Tourism is a featured component of Ethiopia's Poverty Reduction Strategy Paper (PRSP), which aims to combat poverty and encourage economic development.

Developed in the 1960s, tourism declined greatly in the late 1970s and the 1980s under the Military Government. Its recovery began in the 1990s, but growth has been constrained by lack of suitable hotels and other infrastructure, (despite a boom in the construction of small-and medium-sized hotels and restaurants) and by the effects of drought and political instability.

One encouraging aspect is the growing popularity of eco-tourism, which has significant potential for growth in Ethiopia. Travel retail sales are expected to continue to grow. They posted an increase of 7% in 2006.

In 2007, a total of 357,841 tourists came to Ethiopia. Among them, about 311,943 came via Addis Ababa Bole International Airport, while the rest, an estimated 45,898, entered through other entry ports of the country, namely Dire Dawa, by air, and Moyale, Galafi and Metema, by road.

In terms of world regions that are Ethiopia's sources of tourists, the proportions of tourist arrivals that came through Bole International Airport in 2007 were: Africa 30.3%, Europe 26.3%, America 21.9%, the Middle East 10%, Asia 10.3% and Oceania 1.2%. Therefore, Africa, Europe and America were the main tourist-generating countries for the year under review. Africa was the first, due to tourists coming for business and transit, while from Europe and America most tourists came dominantly to vacation. When the year's performance is compared with the those of the preceding two years, the rate of growth for tourist arrivals was lower, compared with the 2005 and 2006 achievements.



Activity 4.9

Discuss the following questions in your group.

1 Metnion the performance indicators of postal services?

2 How do you measure the perfomance of Ethio Telecom?

Table 4.16: **Inbound tourists, by region of residence and purpose of visit, indicating 2007**

Region of Residence	Business	Conference	Vacation	Transit	Visiting Relatives	Not Stated	Total	%
Africa	11,281	5,293	14,614	44,542	5,226	13,455	94,411	30.3
Europe	9,412	4,883	46,172	4,994	7,515	9,149	82,125	26.3
America	6,171	3,884	41,546	3,975	7,200	5,513	68,289	21.9
Middle East	4,355	1,501	14,460	2,513	4,507	4,001	31,337	10.0
Asia	11,813	2,067	9,941	2,698	1,284	4,176	31,979	10.3
Oceania	423	254	1,800	194	605	526	3,802	1.2
Total	43,455	17,882	12,8533	58,916	26,337	36,820	311,943	100.0

Source: *Ministry of Culture and Tourism Annual Report, 2008/09.*

The 2008 tourist-arrival figure was 383,399, increases of 68.6%, 16.2%, and 7.1%, compared to the 2005, 2006, and 2007 achievements, respectively.

In spite of the economic crises in the world, Ethiopia has achieved growth in the sector. In 2008, the best performance was 9% of the arrivals of the year, registered in the month of July.

The year 2008 witnessed a significant drop in tourists coming for vacations, compared with 2007. The reason could be the world economic crisis.

As indicated in Table 4.16 the years of 2005/04, 2006/05, 2007/06 showed double-digit growth rates for vacation tourists. On the other hand, as seen in Table 4.17, vacation tourists for 2008 decreased by 22.7%, which is a significant slowdown, compared with the 2007 accomplishment.

Table 4.17: **Increase/decrease in vacation tourist arrivals in Ethiopia**

Year	Vacation	Yearly Increase/ Decrease (percent) compared with previous year
2001	41,083	-
2002	49,339	20.1
2003	53,315	8.1
2004	56,790	6.5
2005	63,246	11.4
2006	80,184	26.8
2007	128,533	60.3
2008	99,394	-22.7

Source: *Ministry of Culture and Tourism Annual Report, 2008/09.*

Although the Americas are one of the major tourist-generating countries for Ethiopia, their performances of 2008 declined by 3.4% and 13.3%, compared with those of 2006 and 2007. This could be attributed to the slowdown in the Americas economy in the year under review.

According to the World Tourism Organization (UNWTO, November 2008/09), despite the decline in the world economy, tourist arrivals in Ethiopia in 2008 showed growth, as mentioned above, demonstrating an exception to the growth for most other countries in the world.

As a proportion of Ethiopia's gross domestic product (GDP), tourism declined from 1.09% in 2007 to 0.77% in 2008. Growth in tourism consumption was driven by increases in the number of tourist arrivals, especially increases in the number of vacation tourists.

In 2008, the growth rate in tourism receipts dropped by 4.2%, unlike the continuous growth from 1998 to 2007, reflecting the slowdown in the world economy.

Table 4.18: **Growth rate of tourism and its income**

Year	Receipts		%
	Birr	Us$	Growth
1997	279,000,000	43,000,000	–
1998	225,000,000	32,700,000	-24
1999	252,000,000	33,600,000	2.8
2000	577,800,000	68,000,000	102.4
2001	631,800,000	73,808,411	8.5
2002	676,100,000	77,100,000	4.5
2003	778,000,000	89,946,355	16.7
2004	994,408,062	114,627,850	27.4
2005	1,202,368,339	138,599,940	20.9
2006	1,494,811,899	169,975,086	22.6
2007	1,987,241,388	213,936,063	26.9
2008	1,979,539,071	204,855,489	-4.2

Source: *Ministry of Culture and Tourism Annual Report, 2008/09.*

Not all of Ethiopia's attractions are widely known, but some are quite famous. Indeed, eight national attractions have been recognized by UNESCO as world heritage sites: Axum's obelisks, Gondar's castles, the island monasteries on Lake Tana, Hadar (where Lucy was discovered), Tia's carved standing stones, the walls of Harer, the Semien National Park and rock hewen Lalibela Church.

Ethiopia's policy welcomes all tourists, regardless of their national origin, creed or belief, color or economic standing. However, in light of the tourist facilities available at present and the probable carrying capacities of some of the well -known attractions, much promotion is aimed at the moment at the rather affluent market. Future developments and promotions will include a wider spectrum of the international market.

4.7.4 Major Obstacles to and Possible Remedies for the Development of Ethiopian Tourism

Challenges

- *The present constraints on the growth of the tourism sector are largely the shortage of tourist facilities, limited promotion, and lack of professional and skilled personnel.*

Remedies

With regard to possible remedies, the following measures and activities should be implemented to enhance the quality of the sector:

- *Improve transportation facilities*
- *Allocate an adequate government budget*
- *Improve management to enhance the quality of the sector*
- *Provide manpower training*
- *Promote the country's tourism resources*

Activity 4.10

1 What are the major problems of the tourism sector in Ethiopia.

2 Outline the performance indicators of the tourism sector in Ethiopia.

Content Check 4.5

1 What are the role of the tourism sector to national economy?

2 What is tourism?

3 List some of the tourist facilities required to enhance the activity of the sector.

4 Mention some of the historical heritagesites of Ethiopia.

Unit Review

UNIT REVIEW

UNIT SUMMARY

- The service sector consists of trade, transport and communications, banking, insurance and real estate, public administration and defense, education, health and domestic and other services.
- The service sector became the dominant sector, passing the agriculture sector, and its contribution to GDP was about 45% and 46.1% in the years 2008/09 and 2009/10, respectively.
- With regard to the role of the service sector, it contributes output, employment, and foreign exchange to the country's economy.
- The service sectors are constrained by a number of problems in Ethiopia.
  - *Some of the education sector problems are inadequate inequality, accessibility, equity, facilities, training of teachers. The sector is also characterized by overcrowded classes and the shortage of books and other teaching materials.All these indicate the low quality of education provided.*
  - *The health care subsector is constained by many problems. For example, health facilities are unevenly distributed across regions, maternal, infant, and child mortality rates are high, the quality of the facilities is poor, and there is the problem of low resource utilization capacity.*
  - *With regard to the transport sector, the transport facilities are underdeveloped and most rural areas are inaccessible by commercial transport.*
  - *The communication sector is also not well-developed in the country.*
  - *The tourism sector faces the lack of tourist facilities and limited promotional work.*

REVIEW EXERCISE FOR UNIT 4

I *Choose the best answer from the given alternatives.*

1 Which sector is the second largest sector in the Ethiopian economy?

A Agriculture C Industry

B Service D None of the above

2 The communication sector in Ethiopia includes:

A Media service C Postal service

B Telecommunication D All of the above

3 Which of the following is included in the service sector?
- A Mining
- B Construction
- C Agriculture
- D Transportation
- E None of the above

4 Which of the following are major problems of the health sector?
- A The quality of the facilities
- B Low resource utilization capacity
- C inadequate management performance
- D All of the above

5 Which one is different from the rest?
- A Infant Mortality Rate (IMR)
- B Child Mortality Rate (CMR)
- C Maternal Mortality Rate (MMR)
- D Pupil-Teacher Ratio (PTR)
- E None of the above

6 Which of the following is categorized under the service sector?
- A Education
- B Health care
- C Mining
- D Communication
- E All except 'C'

7 Which sector is the least important sector?
- A Agriculture
- B Industry
- C Service sector
- D None of the above

8 Which sector is the second largest sector, in terms of contribution to GDP?
- A Service
- B Agriculture
- C Industry
- D None of the above

II *Answer the following briefly.*

9 List at least three major problems of the health sector in Ethiopia.

10 How do you measure the performance of the health sector?

11 What are the general health sector strategies of the current government?

12 What are the major focuses of the health sector policies of Ethiopia?

13 What are the possible remedies for the health sector's problems?

14 How do you measure the performance of the education sector in Ethiopia?

15 What remedial measures are possible to improve the educational sector in Ethiopia?

UNIT 5

TRADE IN THE ETHIOPIAN ECONOMY

Unit Objectives

After completing this unit, you will be able to:

- state and explain the role of trade and its importance in the Ethiopian economy;
- distinguish the domestic and foreign policies and strategies applied by the Imperial, Derg and EPRDF regimes; and
- construct balances of payments.

Main Contents

INTRODUCTION

In this unit, we will study the Ethiopian trade sub-sector. According to the Ethiopian National Income Account classification, trade is a component of the service sector. It is a very important component of today's economy.

People buy hundreds of items, such as food, clothing, transport services, health services, etc. Other people sell these items. This process of buying and selling is called trade. Trade can be of two types. These are domestic and international trade. Domestic trade involves the exchange of goods and services among citizens in a country, whereas international trade is the exchange of goods and services among the citizens of independent or sovereign nations.

5.1 ROLE AND IMPORTANCE OF TRADE IN ECONOMIC DEVELOPMENT

At the end of this section, you will be able to:

- explain the importance of trade in economic development.

Key Terms and Concepts

- Balance of payments
- Trade
- Debt servicing
- Integration
- Globalization
- Growth
- Development
- Domestic trade
- International trade
- Absolute advantage
- Comparative advantage

Are you aware of the historical emergence of trade in Ethiopia? What role do you think trade can play in Ethiopia?

5.1.1 Historical Background of Trade in Ethiopia

Ethiopian trade was started during the time of the Axumite Kingdom. During this time, the state obtained considerable income from both domestic and international trade. Trade took its modern shape under the regime of Emperor Menilik II. Trading activities that took place once a week in traditional markets were supplemented with the opening of small shops in towns. A particular impetus in domestic trade was attained with the construction of railway lines from Djibouit to Addis Ababa, thereby increasing the number and types of commodities available for sale. Due to cultural influence, and lack of adequate capital and knowledge, almost all of the modern shops were owned and run by foreign nationals (Armenians, Arabs, etc.). International trade was facilitated through a network of trading routes from Adulis and other trading posts on the Red Sea coast. These trading routes were frequently used by both domestic and international traders and made the flow of goods and services to and from the country possible.

After the end of the Italian invasion, the modernization of domestic trade achieved a landmark. A responsible ministry, aware of its duties and responsibilities, backed by various rules and regulations for efficient operation, was set up. Institutions were also set up to provide training to Ethiopians who might enter the fields of trade and commerce. Above all, a commercial code was introduced in order to enforce laws governing business transactions. The business environment advanced greatly until the 1974 Revolution.

After the takeover of power by the Derg, the whole system of economic management, including domestic trade, changed greatly. Mass nationalization took place. Every activity of the national economy was guided under central planning: profit motives gave way to social objectives. Every measure to strengthen the socialization process was encouraged and, if necessary, subsidized.

The economy ultimately stagnated and demanded change. The reform measures that were started during the last years of the Military regime were not adequate enough to bring about the demanded change. And, as a necessity, a radical change in all spheres (economic, political and social) took place with the overthrow of the Derg in 1991. Since then, many important reform measures have been undertaken, based on the economic policies of the transitional period and on a number of most recent policy measures, rules, regulations and directives were issued to bring back a business environment governed by market law.

5.1.2 The Role and importance of Trade in Economic Development

Trade deals with business transactions that take place between households, firms, and governments. It can be divided into two: *domestic* and *international trade*.

Domestic trade refers to pure exchange activities within a national boundary. Domestic trade encourages the diffusion of knowledge, culture, and religion. As such, domestic trade fosters specialization in which each locality or region specializes in the production of specific commodities, thereby creating interdependence among regions. The whole basis of domestic trade rests on the fact that localities or regions differ in their resource endowments and in their economic and social features and capacities for growth and development.

International trade, on the other hand, can be defined as the exchange of goods and services among citizens of independent or sovereign countries. People are better off when they have trade than when they are without trade.

There are many factors accountable for the rise of international trade. Some of them are differences in resource endowment, demand, and economies of scale and specialization. For example, the differences in resource endowments lead to differences in relative costs in the production of goods and services among countries. Economies of scale provide additional cost incentives for specialization in production. That is, instead of manufacturing only a few units of each and every product that domestic consumers desire to purchase, a country specializes in the manufacture of large amounts of a limited number of goods and trades for the remaining goods. Specialization in a few products allows a manufacturing sub-sector to benefit from longer production runs, which leads to decreasing average costs.

While demand patterns seem to be similar throughout the world, especially among similar socio-economic income classes, differences in tastes and preferences certainly exist. For example, in country A, where demand is oriented toward steel, the price of steel that intensively uses the relatively abundant factor is relatively higher than its price in the trading country B. With the opening of trade, country A would find itself exporting cloth and importing steel from country B because B's steel is relatively cheaper at international prices. This occurs because demand in country A for the product using the abundant factor intensively leads to a high price for that product and the factor used intensively in its production that the physically abundant factor is the scarce factor from the standpoint of price definition. Because this is the result of a particular set of demand conditions, it is referred to as demand reversal.

International trade allows a country to specialize and export those goods and services that it can produce at relatively low cost and import those goods and services whose domestic production is relatively costly. As a consequence, international trade enables a country to consume and produce more than would be possible without trade. In other words, international trade enlarges the consumption choice of people by allowing them to consume those goods which they cannot produce. Unlike domestic trade, international trade provides foreign goods and services that cannot be produced within the domestic economy. International trade also encourages the diffusion of knowledge and culture because trade serves as a point of contact between people of different countries. International trade also encourages specialization, and creates interdependence among countries.

Activity 5.1

1 What are the causes and salient features of international trade?

2 What are the differences between domestic and international trade?

In general, there are two guiding principles that determine which commodities should be produced locally and which ones should be imported from abroad. These principles are

- *Absolute advantage and,*
- *Comparative advantage.*

A A nation is said to have an absolute advantage over another nation if either of the following two conditions exists:

i The country must be a sole producer of something due to factors such as climate, natural resources, and level of technology. For example, there is an abundant supply of diamonds in South Africa.

ii The country should produce the commodity more cheaply than others. For example, Brazil can produce coffee and forest products more cheaply than the USA can.

B Comparative advantage, on the other hand, says that a nation should produce and sell to other nations those products that it produces most effectively and efficiently, and should buy from other countries those products which it cannot produce as effectively and efficiently. In other words, a country will tend to produce and export those goods in which it has the greatest comparative advantage and to import those goods in which it has the least comparative advantage.

5.1.3 Restrictions and Modes of Payment in Foreign Trade

Because of its special features, foreign trade has been a serious area of debate. Since it involves trade among nations of different levels of economic development, capacity, currency, economic policy, etc., there are some issues which arise from international trade. Among these issues, trade restrictions and modes of payment are the two important ones.

A *Restrictions on International Trade*

Trade restrictions have a long history in world economy. Trade restrictions are basically designed to protect a local economy from foreign competition, and they also serve as an important source of government revenue.

There are different types of restrictions used by governments. Some of them are:

Quotas

These are some of the oldest trade restrictions used. Quotas are a strong and very serious kind of restriction. Aquota places a limit on the amount of a product that can enter into a country. Quotas usually have a limit, so that the entrance of the goods into a country is stopped when the quota is met.

Tariffs

These are duties or taxes imposed by the government of a nation on goods entering that country. Tariffs may take different forms, but in general they raise the prices of the imported goods. Tariffs serve for two general purposes: they generate revenue for the government, and they protect local products from foreign competition. Unlike quotas, tariffs can be overcome by reducing prices. There are three forms of tariffs:

- ***Specific tariff:*** *specific tariffs are tariffs imposed on each unit imported or based on physical quantities.*

- ***Ad valorem tariff:*** *this is imposed on the basis of the monetary value of the product.*
- ***Compounded tariff:*** *this is a combination of the specific and ad valorem duties. That is, some products are taxed on both quantity and value.*

  Example: Birr 5 per quintal and 5% on the value of the good.

Exchange Controls

Restrictions on the amount of a certain currency that can be bought or sold are called exchange controls. The government can use exchange control to limit or avoid the import of some goods by not giving the foreign currency that the importers of these goods need.

B *Modes of Payment in International Trade*

Payments in domestic trade are quite simple. In international trade, payment is an important area of concern. Payments in international trade can be made in one of the following ways:

- *Banker's transfer,*
- *Bill of exchange, or*
- *Letter of credit (LC).*

A **Banker's transfer:** This is a simple transfer of money from the bank account of the buyer (importer) in his/her own country to the bank account of the seller in the seller's country.

B **Bill of exchange:** This is an order in written form addressed by a creditor to a debtor and signed by the creditor, requiring the person to whom it is addressed (the debtor or buyer) to pay either on demand, or at a fixed date, or at a determinable future time, a certain sum of money to the person named on the bill or to his order. The bill is drawn by the creditor on the debtor and is sent to the debtor (or his agent) for the latter to pay or accept. The debtor accepts by signing his name on the face (front) of the bill together with the date, at which point the bill now becomes legally binding, and the accepter must meet it on or before the due date.

C *Letter of Credit (LC):* This is the most common mode of payment for imports in Ethiopia today. A letter of credit is a letter addressed by a banker to an exporter, undertaking to make a payment to him against documents relating to the dispatch of goods. The letter of credit includes different documents that specify the nature, unit price, and total price of the good and the shipment of the good, insurance, and other supplementary documents.

Activity 5.2

1 Discuss the rationale and benefits of foreign trade.

2 Discuss absolute and comparative advantages in relation to the Ethiopian economy and the rest of the world.

3 What different restrictions can a nation use to control the import of goods?

4 What are the major modes of payment in foreign trade?

Content Check 5.1

1 Trade involving the exchange of goods and services among citizens of independent /sovereign countries is ________.

2 Difference in production cost is the cause of resource endowment variation. True/False (*Give reasons*).

3 People are better off when their countries engage in trade than when they do not. True/False (*Give reasons*).

4 Identify the similarity between domestic and international trade:

A Both enlarge the consumption choice of people.

B Both bring goods that can't be produced locally.

C Both encourage the diffusion of knowledge and culture.

D None of the above

5 ________ is a kind of restriction that places a limit on the amount of product that can enter into a country

A Quota

B Tariff

C Exchange control

D All are possible answers

5.2 TRADE POLICIES AND STRATEGIES IN ETHIOPIA

At the end of this section, you will be able to:

- examine Ethiopian domestic trade policies and strategies, based on ownership policy;
- understand distribution policy, pricing policy, and licensing policy; and
- examine the Ethiopian foreign trade policy

Key Terms and Concepts

- Duty drawbacks scheme
- Duty-free importation scheme

The development of trade in a nation is affected by the policies and strategies adopted. In Ethiopia, different policies and strategies have been adopted by different governments. We will see both the domestic and foreign trade policies and strategies that have had an influence on the development of commerce internally and externally.

5.2.1 Domestic Trade Policies and Strategies

The domestic trade policy of Ethiopia has different components which determine the trade environment and its development. Some of the components of the domestic trade policies are given below.

Ownership Policy

During the Imperial Period, most of the trading activities were controlled by the private sector. But, motivated by socialistic ideology, the Dreg nationalized both the wholesale and retail trading enterprises, which were mainly owned and run by foreign nationals, and restructured those which were not nationalized in order to meet the socialist-oriented objectives of the government. In other words, the dominance of the government in manufacturing, distribution, transportation and finance was the order of the day. This measure of nationalization stifled the rising participation of national entrepreneurs in all sectors. After nationalizing and restructuring trade organizations, the government reorganized them into wholesale and retail trading corporations and enterprises under the supervision of the then Ministry of Domestic Trade.

The participation of private organizations in domestic wholesale trading activities was very limited. For instance, in food grain marketing, merchants in Arssi, Bale and Gojam were banned altogether. In Gondar and Wollega, grain merchants had to surrender all their purchases to the government-owned Agricultural Marketing Corporation (AMC), while in other surplus-producing areas, such as Shoa, they surrendered 50 percent of their annual purchases to the corporation. In the domestic wholesale trade of manufactured products, the Ethiopian Domestic Distribution Corporation (EDDC) had a monopoly, and private traders were forced to take part in the trading of items with slow rates of turnover allocated to them by the corporation.

Activity 5.3

1. Explain the ownership structure of domestic trade during the Derg.
2. Discuss how private traders participated in trade during the Derg.

Distribution Policy

The distribution policy followed during the Derg was mainly a direct reflection of its ownership policy. As the ownership policy was based on socialist ideology, the distribution policy was in favor of socialized sectors. Those sectors under public ownership and cooperatives were given priority in the distribution of goods and services. The private sector, on the other hand, was only entitled to the residual. For instance, from 1985/86 to 1991/92, EDDC sold, on the average, 31 percent of its sales to private traders, while the rest went to socialized sectors. Moreover, all of AMC sales were directed to government institutions and urban-dweller associations.

The most important strategies employed in the distribution of basic or essential goods for which shortage was common were quota allocation and rationing. Basic commodities such as sugar, wheat flour, salt, etc. were under strict quota allocation. The then existing administrative regions received their quotas by EDDC, depending on supply. After the quota allocation, rationing was implemented, mainly through urban-dweller associations and service cooperatives, to final consumers, depending again on supply and on family size. But urban dwellers who were not registered in kebele associations were not entitled even to rationing and, as a result, they were forced to buy those basic commodities at very high prices from private shops. Likewise, the movement of food grains from region to region by private traders was strictly forbidden. Only AMC had the mandate to move grains between regions, although other public organizations got permission to do so when a need arose.

Restriction on the movement of food grains by private traders had the following impacts:

- *It adversely affected the consumers in deficit areas by pushing up grain prices.*
- *It eroded incentives for producers in surplus areas by depressing prices.*
- *It hindered both the expansion of marketed supplies and the development of an integrated national market, which were very important for the country's economic development.*

In January 1988, the government announced that private traders would be issued permits to move grain as long as they agreed to sell half of their purchases to AMC at AMC buying prices. As of late 1988, there were reports of some private traders moving grain in some areas. However, there was a disincentive to trade in cases where the official prices at which traders had to sell to AMC were lower than the local prices at which they purchased the grains.

Activity 5.4

1 Discuss the distribution policy during the Derg period.

2 Explain what mechanisms were used to distribute goods and services during the Derg period.

Pricing Policy

During the Derg Regime, price determination through the free functioning of market forces of demand and supply was disturbed by the government's intervention. There were, by and large, administratively managed pricing practices. However, there were no uniform pricing policies or procedures across sectors or commodities. In this section, the pricing policies followed with regard to manufacturing and agricultural commodities will be reviewed.

The prices of manufactured products, which were considered very basic and in short supply were determined by the Ministry of Domestic Trade and announced to consumers through public notices. These commodities could be imported and/ or domestically produced. After price determination, price control was the next step. The prices of other manufactured products were determined on a cost-plus basis. However, this mechanism of price determination had its own limitation as it allowed inefficiencies of manufacturing and trading enterprises to be transmitted to consumers in the form of additional costs.

More problems were observed in the pricing mechanism of agricultural commodities or food grains. Based on the cost-of-production study undertaken by the Ministry of Agriculture, national farm-gate and wholesale prices of food grains were introduced in 1980/81. These fixed prices continued to be operational in the purchasing activity of AMC until 1987/88, when a minor increase in price modification was introduced. The upward price revision ranged from 6 to 10 percent, depending on the type of crop. Official marketing of food grains with fixed prices ended with the introduction of the mixed economic policy in March 1989/90.

Activity 5.5

1. Discuss the pricing policy of the Derg.
2. Explain how the prices of agricultural and manufactured goods were determined during the Derg.

Licensing Policy

Domestic trade licensing involves the issuance of licenses to wholesale, retail and service trading activities. The licensing policy during the Derg regime aimed at limiting the participation of private traders as depicted in Proclamation No. 76/1976. According to the proclamation:

- *Trading activity was allowed only to proprietorships;*
- *There was no licensing to government employees;*

- *Wholesaling was limited to the capital ceiling of Birr 300,000 and retailing to Birr 200,000;*
- *An individual could get licensed only in the region in which he/she resided;*
- *Only one business license and one business undertaking were permitted to an individual. Branch establishment was prohibited; and*
- *License provision was tied to supply conditions.*

These restrictive licensing conditions for private traders were relaxed with the introduction of mixed economy policies during the dying hours of the Derg Regime. Following the relaxation of restrictive licensing conditions, a great many new wholesale, retail, and service licenses were issued to individuals and business associations. For instance, new licenses issued in 1988/89 before the relaxation of licensing restrictions were 3,163, and this number went up to 30,729 in 1990/91— that is, after the relaxation of those restrictive licensing conditions.

With the overthrow of the Derg by the EPRDF and the establishment of the Transitional Government of Ethiopia (TGE) in mid-1991, changes took place in the political, economic, and social conditions of the country. Rules that encouraged the functioning of the market were institutionalized, with some government intervention when necessary. The importance and constructive role of the private sector in the national economy was better appreciated and an enabling environment for its operation was created. The foundation for the changes observed was laid down with the adoption of the country's new economic policies during the transitional period. Subsequently, various proclamations, regulations, and directives, as well as reform measures, were introduced so as to create a favorable legal framework for the implementation of the adopted policies.

Liberalization Measures: Trade liberalization, particularly that for food grain marketing, was started during the Derg regime as part of the reform measures envisaged in the polices of mixed economy. However, there was public doubt regarding the continuity of the system because there was still a heavy government hand in all sectors of the economy.

The first most important step taken after the Derg was the removal of restrictions on traders. Private traders were allowed to operate side-by-side with government parastatals. Controls on inter-regional grain movement were also removed and, as a result, price differentials between surplus and deficit areas narrowed. The quota system for grain purchases was abolished.

The adoption of the new economic policy and the subsequent measures taken under the New Economic Reform Program further consolidated the reform measures started in 1990 and introduced additional ones. This time, the reform measures were well rounded, ranging from macroeconomic to sectoral policies, and they were radical enough to bring structural change to the whole economy.

As a result of the liberalization measures undertaken so far in domestic trade:

- *New entrants as well as established traders can move food grains freely from market to market;*
- *Obtaining licenses and legal recognition are relatively easy;*
- *The activities of parastatals a shrinkage in their purchase and distribution network;*
- *the traditional private marketing system has revived;*
- *types of markets and market channels in both rural and urban areas are diversified;*
- *private trade appears to be deficient in making goods available in time and place, compared with public sector trade;*
- *better quality grains are shipped to the central markets as prices are permitted to reflect widely accepted perceptions of quality differences;*
- *the producer-consumer price margin has narrowed, due to a sharp increase in producer prices, without change in the already inflated consumer prices;*
- *markets have started to experience price fluctuations related to supply and demand; and*
- *as can be observed from the trend in the number of new domestic trade licenses issued, (for both wholesale and retail trade) the volume of commodities handled and the number of participants in private trade have increased since the launching of the reform.*

Privatization Measures: Nationalization and socialization were the basic economic principles of the Derg government. In the new economic policies adopted by the then TGE and the now FDRE government agencies have had only limited participation in wholesale trade and their complete withdrawal from retail trade activities has been well expressed. The role of the private sector in running wholesale and retail trading more efficiently is well-appreciated.

The Ethiopian Privatization Agency started privatizing public enterprises in February 1995 by selling retail trade shops and stores as well as small and medium-size hotels through tenders. So far, a total of 126 retail trade shops and stores have been offered for privatization, out of which 108 have been sold. Of these, 69 sold. On tender basis, while 39 sold directly to employees organized under safety-net programs.

In addition, the private sector has been investing in wholesale and retail trade activities. This indicates significant changes in the attitudes of the business communities that had been accustomed to "air to air" trading practices for almost two decades. In general, the participation of the private sector in domestic trade, in particular, and in the national economy at large has been encouraging. The following table depicts the profile of private sector participation in wholesale trade for the period July 1992 - April 1997.

Table 5.1 **Operational and Under-Implementation Projects (July 1992 - January 1997)**

Project status	Total	Wholesale and Retail trade	Share of wholesale an Retail Trade from total (in %)
1 **Certified**			
Number of projects	3,306	117	3.5
Capital (in '000)	25,653,317	387,454	1.5
Employment creation	202,266	5,408	2.7
2 **Operational**			
Number of projects	663	12	1.8
Capital (in '000)	470,9258	33,178	2.7
Employment creation	27,416	343	1.3
3 **Under implementation**			
Number of projects	475	12	2.5
Capital (in '000)	3,501,304	54,007	1.5
Employment creation	35,013	352	1.0

Source: *Ethiopian Investment Authority*

Activity 5.6

1 Explain the different trade liberalization measures undertaken post-1991.
2 Discuss the likely effects of liberalization measures.
3 Explain what is meant by privatization.
4 Describe privatization measures taken so far by the government since 1991.
5 What do you infer from the information given in Table 5.1?
6 Discuss how domestic trade licenses were issued during the Derg period.
7 What restrictions were imposed on private traders?

5.2.2 Foreign Trade Policy

The foreign trade policy of the Derg had four major objectives.

- *Mobilizing government revenue by imposing taxes on imports and exports,*
- *Protecting domestic economy participants from foreign competition,*
- *Maintaining a favorable balance of payments at a sustainable level, and*
- *The gradual prevention of the private sector from foreign trade participation.*

Consistent with the last objective, the government discouraged private importers and exporters from exporting traditional export items, such as coffee, pulses, oil seeds, and the like. Public enterprises were established to run such activities. During this regime:

- *Exporters were not allowed to export commodities at prices less than the reference prices provided by the government.*
- *Exporters were also forced to surrender 100 percent of the foreign exchange they obtained to the government.*
- *There was a restrictive foreign exchange licensing system for private use.*
- *The exchange rate was fixed at Birr 2.07 for a dollar for quite a long period of time.*
- *The government provided marketing channels for all imports and major exports of the country.*

However, after the overthrow of the Derg, the TGE started taking a number of foreign trade policy measures in 1992. The government

- *changed the fixed exchange rate regime to that of a managed floating exchange rate regime (that is, a rate determined by the market).*
- *introduced a bi-weekly foreign exchange auction market in May 1993.*

Currently, this auction system is changed on a daily basis. The marginal rate (the market clearing rate) established at the auction used to be used as a secondary rate applicable to all current and capital account transactions until the next auction, with the exception of a limited number of payments for which the foregoing exchange rate was made available at the official rate. However, the two rates were unified on July 25, 1995, and a weekly foreign exchange auction was introduced a year later.

In August 1998, the government replaced the retail auction market with wholesale auctioning in which commercial banks, the foreign exchange bureau, and investors in need of large amounts of foreign exchange (above USD 500,000 per auction) could participate. An inter-bank market for foreign exchange has also been introduced and is still practiced.

The other main external trade reform measure was the suspension of taxes and duties levied on exports, except on coffee. It was introduced in January 1993. But the tax on coffee was also removed after the recent historic coffee price decline in order to reduce the adverse effects of this price decline on coffee growers and other citizens participating in the coffee market. This tax removal on export of all commodities together with the devaluation, provides a strong incentive to exporters because it allows them to receive the equivalent of world prices for exports. Government subsidies to exporters were also terminated when export taxes were lifted.

Complementary to this measure, the government introduced an export duty-drawback scheme in August 1993 to further encourage investment in the production of exportable item. There were two versions in this incentive scheme.

i The first was the duty draw-back scheme. It provided persons or enterprises that were wholly, partially, or occasionally engaged in exporting their products, refunds of the duty paid on raw materials (whether imported or locally produced) used in the production of the exportable item. The duty draw-back scheme has had two terms of condition.

- *The first term states that when the raw material or commodity on which duty is to be drawn-back is re-exported in the same condition, 95% of the duty will be refunded.*
- *The second term stipulates that if the raw material or commodity on which duty is to be drawn-back is exported after being processed or used for packing or containing, 100% of the duty will be refunded. However, this scheme is applicable only if the commodity produced using the raw material is exported within one year from the date on which such raw material has been imported or purchased locally.*

ii The second version of the scheme is known as the duty-free importation scheme. This scheme authorizes organizations and persons wholly engaged in supplying their products to foreign markets to import or locally purchase raw materials they use in production of such commodities free of duty. Similar to the earlier scheme, this scheme requires exporters to export their commodities within one year from the date on which the raw materials used have been imported or locally purchased.

Furthermore, within the framework of promoting exports, the following measures were undertaken:

- *Reducing license fees for coffee exporters and simplifying the procedure for getting licenses.*
- *An action program for the liberalization of the coffee sector has also been developed.*
- *Since 1996/97, the government has reduced the 100 percent foreign exchange surrender requirement on exporters to the National Bank of Ethiopia to 50 percent and allowed the exporters to open foreign exchange saving accounts at commercial banks and save 10 percent of their proceeds for a given transaction. The remaining 40 percent of their earnings is to be exchanged for Birr within three weeks at a rate they find favorable. This saving is to be used for investment and other expenditures related to the development of the export sector.*

With respect to import trade liberalization, the government has been introducing policies step-by-step or gradually. For example,

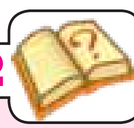
- *Maximum import duties were lowered from 280 percent to 80 percent during the first move of import liberalization and currently stands at 50 percent.*
- *In addition, efforts are being made to correct legal and administrative impediments to import liberalization through a simplification of the system of granting import licenses and permits.*

In line with the government's policy to build a market-based economy, the external sector has also benefited from the abolition of monopolistic operations of public enterprises, which used to dominate the export and import sector alike. Since then, the private sector has been encouraged (including by the simplification of entry to market) to participate in the external sector.

Activity 5.7

1 Discuss the various reform measures taken in the external sector.
2 Explain what is meant by duty-free importation scheme.
3 What were the limitations of the trade policy during the Derg period?
4 What are the major differences between the trade policies of the Derg regime and of the current government?

Content Check 5.2



1 The distribution policy that was followed during the Derg Regime was mainly a direct reflection of its ________ policy.

2 Restrictions on the movement of food grains by private traders

A Raised grain prices in deficit areas

B Depressed prices in surplus areas

C Hindered expansion of market supplies and the development of an integrated national market

D All of the above

3 "Mobilizing government revenue by imposing taxes on imports and exports was one of the foreign trade policies of the Derg regime". True/ False (Explain).

4 Commodities under strict quota allocation during the Derg Regime included

A Sugar

B Wheat flour

C Salt

D All of the above

5 Suspension of taxes and duties levied on exports, except on coffee, was one of the reform measures taken by the Transitional Government of Ethiopia. True/False (Explain).

5.3 THE STRUCTURE AND PERFORMANCE OF TRADE

At the end of this section, you will be able to:

- evaluate the structure and performance of trade;
- analyze the structure of domestic trade;
- evaluate the structure and performance of foreign trade, as compared to export and import performance; and
- identify the major trading partners of Ethiopia.

Key Terms and Concepts

- Wholesale trade
- Retail trade
- Export earning

What can you say about the structure of trade in Ethiopia? Has the recent financial crisis affected its performance?

5.3.1 The Structure of Domestic Trade

The concept of 'structure' here refers to the relative magnitude of wholesale trade activities under public and private enterprises, including retail trade in domestic trade activities.

Wholesale Trade under Public Enterprises

Wholesale trade in manufactured and agricultural products was more or less under government monopoly during the Derg Regime. Both imported and domestically produced manufactured products could be distributed only under the sole monopoly of EDDC, and agricultural products mainly through AMC. Even though there were licensed private wholesale traders, they were forced to take commodities that were less in demanded from EDDC.

A **_Wholesale trade in manufactured products:_** EDDC was established by merging together nationalized trading organizations under Regulation Number 13/1975 with authorized and paid-up capital of Birr 10 and 5 million, respectively. The main objective of the corporation was to strengthen the arm of government in the socialization of wholesale trade in manufactured products. At the time of its establishment, it had a storage capacity of 28,000 square meters, 8 cargo vehicles, 18 branches, 338 workers and an annual sales turnover of Birr 40 million. The position of the corporation was further strengthened by Regulation Number 104/1987, which reflected the intention of the government to fully socialize wholesale trade in industrial products. This time, its authorized capital was raised to Birr 90 million and its paid-up capital to Birr 20 million.

After the downfall of the Derg, the corporation was restructured as Merchandise Wholesale and Import Trade Enterprise, and its paid-up capital has risen to Birr 50 Million through Regulation Number 103/1992. The enterprise has had no monopoly power and has been left to operate under a competitive environment. Stabilizing consumer markets and becoming profitable have been the two main objectives of the enterprise.

B **_Wholesale Trade in Agricultural Products:_** AMC was established with Proclamation No. 105/1976 with the principal objective of executing government policy in the field of wholesale food grain marketing, procurement, and distribution of inputs and maintaining national grain reserves. At the time of its establishment, its authorized and paid up capital stood at Birr 100 million and 21.1 million, respectively. With Regulation No. 103/1987, its authorized capital was raised to Birr 130 million and its paid-up capital to Birr 90 million. The intention behind this regulation was to fully socialize the wholesale trade in food grains and coordinate wholesale trade in manufactured products with wholesale trade in food grains.

After the downfall of the Derg Regime, AMC was restructured as the Ethiopian Grain Trade Enterprise (EGTE) in 1992. At this time its authorized and paid-up capitals remained the same as in 1987. However, major changes in its form of management and objectives were effected. The management was made autonomous and its objectives mainly became stabilizing grain markets.

Activity 5.8

1 Do you think EGTE (previously AMC) was operating up to its expectations this time around?

2 Do you think EDDC currently operates up to its expectation?

Wholesale Trade Under Private Enterprises

Private traders have the flexibility and efficiency to move goods more easily than government parastatals where and when they are needed. Besides, they can efficiently supply consumers at lower costs. However, the extent to which they are able to compete effectively in the market is dictated by the capacity they have in terms of access to capital, storage, and transportation as well as in terms of the various laws governing the economy.

Before the 1974 revolution, trade was predominantly in the hands of the private sector, and the role of the government was limited to the regulation and promotion of the private sector. After the revolution, however, the nature of trade completely changed and the economic environment as a whole became hostile to private-sector participation. Private businesses were made owner-operated, and were limited to only one type of business with no branches, and the government set a capital ceiling to limit their expansion.

After the downfall of the Derg, the Transitional Government of Ethiopia adopted a new economic policy during the second quarter of the 1991/92 fiscal year. The new economic policy brought about fundamental changes in economic outlook, management, and structure. In May 1992, the TGE undertook another big step: It legalized and broadened the scope of private-sector participation by issuing Proclamation No. 15/1992 — a proclamation issued to provide encouragement, expansion, and coordination of investment. These measures are believed to have caused attitudinal changes in business people who thought trade was the only area of participation. They therefore decided to take part in other economic sectors.

Retail Trade

In addition to controlling whole sale trade, the Derg Regime wanted to control retail trading. To this end, it organized publicly-owned retail trade enterprises like the Ethiopian Retail Trade Corporation (ERTC) and the Ethiopian Households and Office Furniture Enterprise (ETHOF) and by giving priority to commodity distribution to organized consumers such as urban-dweller associations in urban areas and service cooperatives in rural areas.

With the regime change in the 1990s, the government withdrew from retail trade activities. Accordingly, measures have been taken since 1994/95 to privatize government-owned retail trade organizations. Due to this and other conditions created by the TGE, the number of new retail trade licenses issued reached as high as 43,911 in 1991/92, an average growth rate of 264.5 percent compared to the preceding year. The new economic policy recognized the participation of voluntarily organized cooperatives in retail trading, but they are not being given any special privileges now.

5.3.2 Structure and Performance of Foreign Trade

In this section we will examine the performance and the relative share of commodities in Ethiopia's foreign trade activities. We will also discuss the trade partners of Ethiopia.

Activity 5.9

What measures do you think should be taken to change the current structure of export activities from being dependent on a single commodity?

Exports

Because Ethiopia's economy is underdeveloped heavily depends on agriculture, the structure of Ethiopia's exports is dominated by agricultural products, which alone accounted for more than 90% of the export proceeds of the country. As shown in Table 5.2, among the agricultural products, coffee accounted for the lion's share — about 70% — of agricultural exports and for 60% of total export earnings. Hides and skins and chat distantly follow second and third, and they account, on average, for 12% and 7% of total exports, respectively.

Coffee was the dominant export item as far back as the 1960's, constituting, on average, 55-60% of total exports. From 1994/95 – 1996/97, coffee alone accounted for 66% of total exports on average. Hides and skins were the second-most important export items, and they showed a general trend of improvement until their share peaked at 21% of total exports in 1991/92. From this year onwards, the available evidence indicates that hides and skins (as a proportion of total exports) exhibited consistently declining trends. Pulses and oil seed were important export items of Ethiopia.

When we look at the 2008/09 figures, we find that the same commodities dominated in the export activities of Ethiopia, as in the 1990's but with different shares. For instance, in 2008/09, coffee contributed only 26% of the total value of exports. This was due to a very large decline both in the price of coffee and in the volume of export, which resulted from the huge increase in the supply of coffee in the international coffee market offered by some new and old suppliers. However, coffee was the single most important contributor to the foreign exchange earnings of Ethiopia in 2008/09. The second and the third places were occupied by oil seeds and chat, with 24.6% and 9.6% shares, respectively (see Table 5.2).

Table 5.2 **Value of Exports, by Major Commodity Group (in millions of USD)**

Major Commodity	2006/07	% share	2007/08	% share	2008/09	% share
Coffee	424.2	35.8	524.5	35.8	375.9	26.0
Oil seeds	187.4	15.8	218.8	14.9	356.1	24.6
Leather and leather products *	89.6	7.6	99.2	6.8	75.3	5.2
Pulses	70.3	5.9	143.6	9.8	90.7	6.3
Meat and meat products	15.5	1.3	20.9	1.4	26.6	1.8
Fruits and vegetables	16.2	1.4	12.8	0.9	12.1	0.8
Live animals	36.8	3.1	40.9	2.8	52.7	3.6
Chat	92.8	7.8	108.3	7.4	138.7	9.6
Gold	97.0	8.2	78.8	5.4	97.8	6.8
Flower	63.6	5.4	111.8	7.6	130.7	9.0
Others	91.8	7.7	106.3	7.2	91.3	6.3
Total Export	1185.1	100.0	1465.7	100.0	1447.9	100.0

* *Previously known as hides and skin*

Source: *NBE, 2008/09*

The dominance of agricultural commodities makes the country's external sector susceptible to adverse shocks that affect both the agricultural and the industrial sectors. The shock experienced in the beginning of the 21st century by coffee-exporting countries is good evidence for this. Also the shock that hit the oil market is recent evidence of the problem of dependence on the export of primary products.

Export Earnings

The performance of the export sub-sector during the 1980's was characterized by stagnation with some sporadic erratic fluctuations. During the late 1980's and early 1980's, however, a clear trend of decline in export earnings was observed. Export earnings during this period declined so drastically that they financed only 17 % of imports in 1991/92. In absolute terms, export earnings declined from USD 443.6 million in 1988/89 to USD 154.2 million in 1991/92.

The introduction of the reform measures in 1992 seemed to have a positive impact on export performance. Export earnings showed continuous revival in the years following the reform, reaching a level of USD 453.6 million in 1994/95, restoring export earning and the capacity of financing imports back to the 1988/89 level, 43 %. The relative importance that a considerable growth in export earnings was particularly registered in 1994/95. It was documented that a considerable growth in export earnings was occurred in 1994/95, mainly due to windfall gains from an increase in the world price for coffee. A marginal decline in export earnings was observed in 1995/96, which was mainly attributed to the decline of world coffee prices in that year. Export earnings, on average, showed an increasing trend during the post-reform period. For instance, total export earnings increased from Birr 923.8 million in 1985/86 to Birr 3,511.6 million in 1998/99. Moreover, non-coffee earnings accounted for 34.5 % of the total export earnings, while coffee accounted for the remaining earning's during the post-reform period.

In the year 2003, export earnings were Birr 4,470.9 million indicating a close to 27% increase from its level in 1998/99. But they could finance only around 19.4% of the import bills in 2003. Total merchandise exports reached USD 1.45 billion in 2008/09, about 1.2 % lower than the previous years exports. Earnings from coffee, pulses, leather products, and fruits and vegetables tended to falter. Export receipts from coffee declined by 28.3% as a result of lower volume and international price. The volume of coffee exports went down to 21.5% due to problems associated with the domestic trading system, to lower demand in the international market following the global economic recession, and to the import ban by Japan, the second largest buyer of Ethiopian coffee. Consequently, the share of coffee in total exports fell to 26% from 35.8% a year earlier.

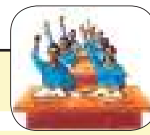
Similarly, export revenue from pulses dropped to 36.8% because of the 40.8% fall in the volume of exports, despite a 6.7% increase in international prices. Thus, the share of pulses in total exports shrank from 9.8% to 6.3% during the period under consideration.

The global economic downturn worsened. Export earnings from leather and leather products fell to 24.1% as the volume of exports went down by 51% in spite of a significant rise in international prices. On the other hand, export earnings from oil seeds, the second largest export item, increased by 62.8% due to 88.7% surge in volume, offsetting the 13.7% decline in international price.

Consequently, the share of oil seeds in the total exports rose to 24.6% from 14.9% in the preceding fiscal year.

Similarly, due to increased export to the Middle East and better international prices, revenues from meat and meat products and from live animals went up by 27.3% and 28.9%, respectively. Despite fears of the global economic crisis, export revenue from flowers improved by 16.9% in 2008/09 as a result of higher volumes of exports to different destinations, despite a marginal decline in international prices. Exports of chat and gold also fared well. Revenue from these items rose by 28.1% and 24.2%, reaching USD 138.7 million and 97.8 million, respectively in 2008/09.

Activity 5.10



1. What problems could a country encounter because it relies on the export of a single or very few primary products?
2. Whom do you think benefits the most from the international market: the primary product exporters or the industrialized ones? And why?

I Public Versus Private Exports

The private sector development initiative that began to thrive during the Imperial Regime was thwarted with the advent of the totalitarian moves of the Derg. Private-sector participation in the export sector was marginalized, and government enterprises took the dominant role. For instance, the share of the private sector in total export earnings never exceeded 16 percent.

Following the introduction of the economic reform program, which encouraged a market-oriented system through reducing the role of the state in the economy and encouraging private-sector participation, the share of the private sector in export marketing grew continuously, increasing from 16% in 1990/91 to 48.2% in 1994/95, and then to 63% in 1996/97. This trend continued in 1997/98 when private exporters produced about 80 percent of the country's exports.

The general improvement in private-sector participation in the export sector was not accompanied by either a significant increase in the volume or in the diversification of export products. Just as in the case of overall export, the composition of private-sector exports is dominated by coffee, oil seeds, pulses, and chat, which altogether accounted for 85% of the private sector's annual export earnings. Coffee dominates the private sector's export earnings, accounting for 55% of the total revenue from exports.

Table 5.3 **Annual Foreign Exchange Earnings from Merchandise Export**

Operators	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98 (5 months)
Private sector	125.8	93.4	74.2	158.9	264.4	1317.8	1344.4	2084.0	923.6
Government	649.2	504	318.6	393.3	367.2	1418.4	1150.5	1223.8	252.6

Source: *MEDaC, 1999*

Activity 5.11

1 Discuss the structure of exports in Ethiopia.

2 Compare the share of the private sector during the 1980's and the 1990's.

II *Coffee Exports and Earnings*

Volume of Arrival and Export

As shown in Table 5.4, the export volume of coffee decelerated after it reached its peak in 1988/89, when 109.3 thousand tons of coffee arrived at the central auction market. It declined by 17% and 15% in the subsequent two years, falling to 60.2 thousand tons in 1991/92. From 1992/93 onwards, however, a strong resurgence in the export of coffee (volume of arrival) was observed, showing rises of 46% and 30% in 1992/93 and 1993/94, respectively. Indeed, the supply of coffee surpassed the 1988/89 peak and stood at 113.7 thousand tons in 1993/94, although this peak was followed by a slight decline to 102.3 thousand tons in 1994/95. The supply increased significantly to 141.4 thousand and 1165.5 thousand tons in 1995/96 and 1996/97, respectively. The growth momentum was slightly halted in 1997/98 as volume of arrival reduced to 155.4 thousand tons.

Table 5.4 **Volume of Domestic Supply and Actual Export of Coffee (in tons)**

Year	Domestic Supply		Actual Export		Actual exports as % of domestic supply
	Level	% Growth	Level	% Growth	
1987/88	83,411	-5.5	72,262	-0.8	86.6
1988/89	10,9299	31.04	77,707	7.5	71.1
1989/90	90,650	-17.06	83,251	7.1	91.8
1990/91	77,316	-14.7	534,57	-35.8	69.1
1991/92	60,155	-22.2	36,078	-32.5	60.0
1992/93	87,699	45..7	69,362	92.2	79.1
1993/94	113,680	29.7	73,004	5.2	64.2
1994/95	102,302	-10	78,420	7.4	76.6
1995/96	141,361	38.2	101,823	29.8	72.0
1996/97	165,536	17.1	117,979	13.7	71.3
1997/98	155,377	-6.1	121,365	2.9	78.1

Source: *MEDac, 1999.*

Not all of the coffee that is supplied to the central auction market is exported. The actual volume of export depends on the quality of the domestic supply, which must meet the demand specifications of the importers. In 1988/89, for example, only 78 thousand tons 71% of the domestic supply — was actually exported. Although the quantity supplied to the ceutal auction market was lower in 1989/90, the actual export was higher than the previous year — level, making up 92% of the domestic supply. A significant slowdown in coffee export was registered in the years 1990/91 and 1991/92, when it constituted 60% of the domestic supply.

Since 1992/93, coffee exports recovered consistently over the years. In 1992/93, the volume of coffee exports almost doubled from the previous year's level (showing a 92% increase). In 1993/94 and 1994/95, the volume of coffee exports increased further, though at a slower pace. It increased significantly in 1995/96, to 102 thousand tons, showing a growth rate of 30% over the previous year. It further increased to 118 thousand tons in 1996/97. Actual coffee exports in recent years ranged between 70-75% of supply, which was below the level that was reached during the late 1980's — in the range of 80-85% of domestic supply. This might be due to reform measures undertaken during the 1990's such as the devaluation of the Birr, market liberalization, regulation of prices, and the like.

Earnings from Coffee Exports

Coffee is the major export item, contributing, on average, around 35% to the overall foreign exchange earnings of the country. Data on coffee exports indicates that foreign exchange earnings from coffee drastically declined during the period 1988/89 to 1991/92. This was the period in which an overall decline across all export commodities was registered. The earnings from coffee was USD 90 million in 1991/92, a mere 36.5% of the 1988/89 level. A quick recovery was recorded in 1992/93, when earnings from coffee jumped to USD 217 million, which was comparable to those of the late 1980's. Earnings dropped to USD 153 million in 1993/94, but reached USD 300 million in 1994/95. The leap in 1994/95 was partly explained by the coffee price boom of the period. Although the volume of coffee increased by 30% in 1995/96, earnings from coffee declined slightly to 279.5 million, due to the immediate reversal of the price boom of the preceding fiscal year. In 1996/97, earnings from coffee increased to USD 359 million because of the moderate increase in the price as well as in the exported volume of coffee.

World Prices of Ethiopian Coffee

Ethiopia is a price taker in almost all of its export commodities. The world price for Ethiopian coffee usually depends on the price performance of the major coffee suppliers (like Brazil and Colombia) in the world market. In most cases, Ethiopian coffee-price booms have been associated with some form of supply shortfalls from major coffee suppliers. The price of Ethiopian coffee has been characterized by erratic fluctuations over the years. For instance, in 1988/89, the price of Ethiopian coffee was 151 U.S. cents per pound. It dropped to 99 U.S. cents per pound in 1989/90 and further to 93 U.S. cents per pound in 1990/91. A modest recovery was recorded in 1991/92 but immediately reversed in the following year. Then, the price of Ethiopian coffee registered a significant leap in 1994/95, when a pound of coffee fetched 182 U.S. cents. This resulted in a windfall gain in foreign exchange earnings to Ethiopia.

Activity 5.12

1 How can we increase our competence in the international market and maximize our benefits?

2 What measures could Ethiopia take to add value on every item it exports to the international market?

However, the windfall gain was short-lived as the price immediately declined to 125 U.S. cents per pound in the following year (1995/96). Beginning from the year 2000 or thereabouts the coffee price was at its lowest level since the Second World War. This reduced both the foreign currency that coffee exporters collected and the income that farmers received.

Imports

I *Trend in the Value of Imports*

In the second half of the 1980's, Ethiopian imports had stabilized at around USD 1 billion, except for slight declines to USD 874.8 million and USD 915 million in 1991/92 and 1993/94, respectively. The level of imports remained more or less stable within the same order of magnitude until 1994/95. A growth in imports, however, was registered in 1995/96, when imports increased to USD 1.4 billion, showing a nominal growth of 32.9% over the previous year. The preliminary estimates for 1996/97 and 1997/98 indicated that imports stabilized within the ranges of the 1995/96 level. Imports were estimated at USD 1.4 billion for 1996/97 and at USD 1.45 billion for 1997/98. As a share of GDP, imports consistently increased from 8.7% in 1991/92 to 23% in 1995/96 but slightly declined to 20% in 1996/97.

As indicated in Table 5.5, in 2009, the value of imports was about Birr 9 billion, which was 5.1 times more than exports for the year. The annual average growth rate for the Reform Period far exceeded the performance during the 1980's. The construction and rehabilitation efforts following the initiation of the reform and the balance-of-payment support from external financiers enhanced the growth of imports.

Activity 5.13

What factors are responsible for the widening of our balance of payments from time to time?

II *Imports for End Use*

Ethiopian imports are usually classified into five major categories, based on their final use: raw materials, semi-finished goods, fuel, and capital and consumer goods. The data for the period 1991/92 to 1996/97 shows that imports of capital goods were dominant throughout the period except for the years 1993/94 and 1994/95, when imports of consumer goods accounted for a slightly larger share. The third import category was the import of fuel until 1993/94, when it overtaken by expanding imports of semi-finished goods. The share of imports of raw materials was quite insignificant and stood at 2% of total imports during the whole period.

As indicated in Table 5.5, total imports went up to USD 7.7 billion in 2008/09 from USD 6.8 billion in 2007/08. The ratio of imports to GDP, however, declined to 24.5% in 2008/09 from 26.4% in 2007/08.

Some of the categories of imports by end use are so broad that a detailed analysis is required for a better understanding of the subject under consideration. Beginning with imports of raw materials, they were 37.4% in 2008/09, presumably indicating the increased level of industrial economic activities as reflected in the growing share of raw materials in total imports from 3.8% in 2007/08 to 4.6% in 2008/09. Imports of capital goods also went up — by 29.7% over 2007/08, reaching USD 2.5 billion due to booming investment activities in the country. Hence, the share of capital goods in total exports rose from 28% to 32% in 2008/09.

Similarly, imports of consumer goods increased by 54.7% as a result of higher imports of both durable and non-durable consumer goods. The rise in non-durable consumer goods was due to increased imports of cereals, and of medical and pharmaceutical products. Consequently, the share of consumer goods in total imports in the same year (2008/09) grew to 30.3% percent, compared to 22.3% in 2007/08. Meanwhile, Ethiopia's fuel-import bill declined by 22.5% to USD 1.26 billion, mainly becuase of the drop in international oil prices, offsetting a 3.5%

increase in the volume of oil imports. Accordingly, the share of fuel in Ethiopia's total import bill fell from 23.8% 2007/08 to 16.3% in 2008/09.

Table 5.5 **Imports, by Use (In Millions of USD)**

	2006/07	% share	2007/08	% share	2008/09	% share
Raw Materials	148.6	2.9	257.8	3.8	354.2	4.6
Semi-Finished Goods	800.3	15.6	1,259.7	18.5	1,140.1	14.8
Fertilizers	140.0	2.7	302.1	4.4	270.7	3.5
Fuel	875.1	17.1	1,621.4	23.8	1,256.7	16.3
Petroleum Products	872.3	17.0	1,614.4	23.7	1,247.0	16.1
Others	2.7	0.1	7.0	0.1	9.7	0.1
Capital Goods	1,868.5	36.5	1,907.7	28.0	2,474.4	32.0
Transport	633.8	12.4	380.9	5.6	384.2	5.0
Agricultural	33.0	0.6	40.9	0.6	31.3	0.4
Industrial	1,201.7	23.4	1,485.85	21.8	2,058.9	26.6
Consumer Goods	1,317.0	25.7	1,515.7	22.3	2,344.1	30.3
Durables	520.7	10.2	459.4	6.7	635.5	8.2
Non-Durables	796.3	15.5	1,056.3	15.5	1,708.7	22.1
Miscellaneous	116.6	2.3	231.7	3.6	157.0	2.0
Total Imports	5,126.2	100.0	6,810.7	100.0	7,726.6	100.0

Source: *NBE, 2008/09.*

5.3.3 Major Trading Partners of Ethiopia

The major route of Ethiopia's external trade is towards Europe, followed by Asia. As indicated in Table 5.6, during 2008/09, Europe remained the largest market for Ethiopia's exports, accounting for 41.7% of the country's total exports. Among the European countries, Germany, which mainly imported coffee and flowers, was the largest buyer of Ethiopian goods. The Netherlands, the main destination for Ethiopian flower exports during the review period, was the second biggest market in Europe, followed by Switzerland, the sole importer of gold from Ethiopia. Italy, whose main imports included leather and leather products, coffee, and textiles and garments, held the fourth place. Exports to the Asian market accounted for 35.6%, of which 35.3% went to China, 21.6% to Saudi Arabia, 11.2% to the United Arab Emirates (UAE), and 7.8% to Israel. The major export items to China included oilseeds, leather, and leather products. Meat and meat products, coffee, live animals, and oilseeds constituted the bulk of exports to Saudi Arabia, while meat and meat products, pulses, and live animals were the major items exported to the UAE. Israel mainly imported oilseeds from Ethiopia.

When we consider export destinations by country over the years, some fluctuations have been witnessed. For instance, 16.6% of Ethiopia's exports went to African countries, of which about 88.6% went to three neighboring countries: Somalia, the Sudan, and Djibouti. Chat was the principal export item to Somalia, followed by live animals. The major exports to Djibouti include chat, pulses, fruits, and vegetables. The Sudan mainly imported coffee, pulses, live animals, and spices. The share of the Americas in total exports was 5.7%, of which 73% was to the United States of America, 9.8% to Canada and 1.6% to Mexico. The main export items to the US were coffee and oilseeds.

Table 5.6 **Export by Destination and Imports by country of Origin**

Continent	Export by Destination	Import by Origin
Europe	41.7%	24.8%
America	5.7%	6.5%
Africa	16.6%	3.9%
Oceania	0.4%	0.1%
Asia	35.6%	64.7%
Total	100.0	100.0

Source: *NBE, 2008/09*

As to the origin of imports, Asia remained the largest supplier to Ethiopia, with a share of 64.7%, followed by Europe (24.8%), America (6.5%), and Africa (3.9%). Out of the total imports from Asia, about 71% originated from countries, namely China (26.2%), Saudi Arabia (25.0%), India (10.8%), and the UAE (9.0%). The major import items from China included clothing and textiles, metals, telecommunication apparatus, vehicles, electric materials, and machinery. More than 70% of the imports from Saudi Arabia and 60% from the UAE were petroleum products. Metal and metal manufacturing goods constituted the bulk of imports from India. Regarding imports from Europe, Italy accounted for 24.5%, Russia 9.3%, and Turkey 8.9%. Machinery, metal, and grain were the main import items from Europe. About 76.8% of imports from African countries originated from three countries: Egypt (29.2%), the Sudan (28.1%), and South Africa (19.5%). The Sudan's major export to Ethiopia was petroleum products.

Imports from the Americas accounted for 6.5% of the total imports, of which 97.5% was from three countries – the USA, Brazil, and Canada.

Activity 5.14

1. Describe the nature of the exports and imports of Ethiopia.
2. Identify the major trading partners of Ethiopia.
3. What are the implications of a deficit in our current account balance?

Content Check 5.3

1. Ethiopia is a price maker in some of its export commodities. True/False (Give reasons).
2. Ethiopia's trade with COMESA is very strong. True/False (Give reasons).
3. Identify the major supplier of Ethiopia's imports.
   - A Netherland
   - B Germany
   - C Japan
   - D Brazil
4. World price for Ethiopian coffee depends on
   - A The demand for Ethiopian coffee
   - B Performance of major coffee suppliers to the world market
   - C Supply of Ethiopian coffee
   - D None of the above
5. _________ determines the export structure of a country except for
   - A Past economic policies pursued
   - B Level of development of an economy
   - C Its openness
   - D Resource endownment
   - E None of the above

5.4 DEVELOPMENTS IN THE BALANCE OF PAYMENTS IN ETHIOPIA

At the end of this section, you will be able to:

- define the concept of balance of payments;
- evaluate the development of balance of payments;
- examine Ethiopia's national debt service and its performance; and
- describe the relationship between trade and globalization and integration with economic growth.

Key Terms and Concepts

- Trade balance
- Deficit
- Balance of payments
- Debt servicing
- Globalization/integration

What do you think is the main reason for the widening of the trade deficit in the Ethiopian balance of payments?

5.4.1 Trade Balance

Trade balance refers to the difference between the export and import of goods and services. If the difference is positive, it is called a trade surplus, and if it is negative it is called a trade deficit. A chronic trade deficit has remained the dominant feature of Ethiopia's in external trade in merchandise in the past two decades or so. With relatively small but significantly expanding exports and sizable imports, the trade deficit generally widened between 1991/92 and 1997/98. A clear trend of decline in the trade deficit existed in the period 1991/92-1994/95. However, the trade deficit has been in a general state of expansion since 1995/96, owing to the increase in imports which was much faster than exports. In 2008/09, for instance, the trade deficit was estimated at USD 6.27 billion.

5.4.2 Current Account Balance

The current account records all exports and imports of goods and services and unilateral transfers. It is the combination of the trade account, the service account, and the transfer account.

As indicated in Table 5.7, between 1992/93 and 2008/09, the services account was the only component of foreign trade in Ethiopia that usually registered a positive balance of payments. Net services stood at USD 23.1 million in 1992/93. They subsequently declined and stood at USD 10.9 million in 1993/94. In later years they showed a an overall substantial increase. The increase came particularly from the improvement of earnings from other services (particularly transport-service earnings), on the one hand, and from the decline in the net interest payment, on the other hand.

The successive decline in Ethiopia's net interest payment to the rest of the world is a result of two factors: the decline in the interest payments on external debt, which is attributed to the effects of debt cancellation and rescheduling and the interest received on our foreign reserves in foreign banks and to the rise in interest earned on foreign securities since 1994/95.

Despite substantial private transfer inflow and a small but increasing net receipt from services, the current account balance continued to experience deficit during the years spanning 1992/93 to 2008/09. The balance of payments for the begining of the post- reform period is summarized by Table 5.7.

Table 5.7 **Balance of Payment (in millions of USD)**

Description/Year	1992/93	1994/95	1997/98	2006/07	2007/08	2008/09
Exports	222.4	453.6	600	1185.1	1465.7	1447.9
Imports	1051.8	1063	1450.5	5126.0	6810.5	7726.6
Trade Balance	-829.4	-609.4	-850.5	-3940.9	-5344.8	-6278.7
Net services	-23.1	60.8	88.7	230.0	142.3	385.9
Private Transfers	247.9	311.2	334.1	1728.6	2388.3	2706.8
Current Account Balance	-604.6	-237.4	-427.8	-1982.3	-2814.2	-3185.9
Capital Account	-128	8.6	174.8	676.1	1055.8	1664.9
Errors and Omissions	233.5	-37.1	-145.9	192.3	173.8	346.5
Overall Balance	-98.8	161.6	-107.5	85.2	-263.5	376.8

Source: *National Bank of Ethiopia, several reports*

Activity 5.15

1 Describe the concept of terms of trade.

2 Explain the components of balance of payments.

5.4.3 The Capital Account Balance

Unlike the current account, the capital account covers transactions in financial assets and liabilities. It is different from the current account transactions in that it necessarily involves domestic residents either acquiring or surrendering claims on foreign residents. Hence, it deals with changes in the level of claims on foreign residents.

Ethiopia's surplus in the capital account significantly rose by 57.7%, to reach USD 1.66 billion, by the year 2008/09, reflecting higher official long-term capital inflows and a modest increase in estimated inflow of foreign direct investment. Net official long-term capital increased 123.7 % to USD 739.3 million as disbursement of loans was 107.1% up and amortization payments 10% down during the same period.

Table 5.8 **Balance of Payments**

Particulars	2006/07	2007/09	2008/09
	A	B	C
Trade Balance	-3940.9	-5344.8	-6278.7
Exports	1185.1	1465.7	1447.9
Imports	5126.0	6810.5	7726.6
Net Services	230.0	142.3	385.9
Travel	69.6	149.8	207.9
Transportation	80.6	129.2	223.1
Government (n.i.e.)	258.8	134.6	160.4
Investment income	30.4	16.6	-33.4
Interest	47.5	30.0	-9.1
Cash (net)	47.0	30.0	-9.1
Arrears	0.0	0.0	0.0
Dividend	-17.1	-13.4	-24.3
Other Services	-209.4	-287.9	-172.1
Private Transfers	1728.6	2388.3	2706.8
Current Account Balance (excl. pulblic transfers)	-1982.3	-2814.2	-3185.9
Public Transfers	1199.1	1312.5	1551.4
Current Account Balance (incl.public tranfers)	-783.1	-15017	-1634.5

Particulars	2006/07	2007/09	2008/09
	A	B	C
Non-monetary Capital	676.1	1055.8	1664.9
Long-term (net)	224.6	330.5	739.3
Disbursements	238.8	377.3	781.3
Repayments	14.2	46.8	42.1
Cash	14.2	46.8	42.1
Arrears	0.0	0.0	0.0
Direct Investment (net)	482.0	814.6	893.6
Short-term (net)	-30.5	-89.4	32.0
Net Errors & Omissions	192.3	173.8	346.5
Overall Balance	85.2	-263.5	376.8
Financing	-85.2	263.5	-376.8
Reserves (-: increase)	-85.2	263.5	-376.7
NBE net foreign asset	-39.6	244.4	-429.0
CBs net foreign asset	-45.3	19.1	52.2

5.4.4 National Debt Service and Performance

National debt is an accumulation of annual loans entered between the Ethiopian government and creditor nations and lending institutions. National debt can be domestic or external or both.

Domestic debt is the accumulation of annual loans that the government borrows from domestic financial institutions, whereas external debt refers to the accumulation of annual loans that the government borrows from international financial markets. Domestic debt is the amount of public sector borrowing from different banks and other financial institutions in the country. This might have a crowding out effect (a reduction in private sector borrowing and spending caused by increased government borrowing) when looking into the predomination of the public sector within the financial market and reducing the real credit to the private sector. When deficit persists and is financed by domestic borrowing, the servicing capacity of the public sector will eventually be questionable. The origin of external debt could be traced to the willingness of the debtor countries to borrow and the lenders to lend. National debt service is simply the amount of foreign exchange required to repay the debt and the interest on the debt.

It has been indicated that foreign borrowing allows a country to invest and consume beyond the limit of current domestic production. However, inappropriate and excessive foreign borrowing will generate debt service obligation that will constrain future economic policy and growth. The debt servicing burden is simply the amount of foreign exchange required to pay the external debt and the interest on the debt, which shows an upward trend over time.

The external debt profile of Ethiopia showed remarkable changes in its magnitude in the period between 1991/02 and 2008/09 as shown in Table 5.8.

Table 5.8 **Stock of External Debt (in million USD)**

Years	Total External Debt
1991/02	8,790.19
1994/05	9,973.03
1997/08	9,691.11
1998/99	10,153.50
1999/00	5,452.0
2006/07	2,300.3
2007/08	2,753.6
2008/09	3,304.6

Source: *Compiled from NBE report, several issues.*

As indicated in Table 5.8, the size of external debt grew until 1998/99, thus imposing a higher debt service ratio (the ratio of principal and interest payment on external debt that it had to export goods and non-factor services) that was beyond the service capacity of the country. The available documents indicate that the size of external debt was USD 371 million in 1974/75 and that it had increased to USD 10.2 billion by the end of 1998. However, following the huge discount made by the Russian Federation, the total debt stock of the country was reduced by half and stood at USD 5.45 billion at the end of 1999. By the end of 2008/09, Ethiopia's stock of external debt reached USD 3.3 billion, 20% higher than the previous year.

Table 5.9 **Indicators of Debt Burden**

Debt Stock/Year	1987/88	1989/90	1993/94	1995/96	1996/97	2006/07	2007/08	2008/09
As % of GDP	41.3	43.1	90.8	71.4	63.9	11.8	12.3	10.5
As % of Exports	512.5	560.4	798.1	545.9	411.6	0.9	0.9	0.1
Debt Service	-	-	-	-	-	1.2	2.5	1.4
As % of GDP (Actual)	3.8	2.8	2.9	2.7	4.9	-	-	-
As % of Exports (Actual)	47.6	33.5	25.3	20.4	31.5	-	-	-

Source: *EEA, 1999; NBE, 2008/09.*

As shown in Table 5.9, between 2005 and 2008/09, external debt as a proportion of GDP declined from 12.3% to 10.5%. The ratio of the stock of debt to export of goods and non-factor services, however, showed no significant change over the last year. Debt owed to multilateral creditors constituted 61.4% of the total debt, and increase by 32.5%. Similarly, debt owed to bilateral creditors rose 7.8% and accounted for 30.9% of the total debt. On the other hand, commercial debt, which accounted for just 7.7% of the total debt, showed a 7.6% decline. The debt service ratio fell from 2.5% in 2007/08 to 1.4% in 2008/09 as a result of lower debt service payments.

However, the debt burden did not exhibit a decline. This was mainly because export earnings were less than what the country paid for imports, which created debt accumulation. As indicated earlier, export earnings were much lower than import bills, producing a huge deficit in the current account balance and creating a balance-of-payments problem for the country.

Thus, debt accumulation and repayment retards economic growth. In other words, our economic growth would have been higher had it not been for the draining of foreign exchange to service the debt.

Activity 5.16

1. Distinguish between domestic and external debt.
2. Explain why the external debt of Ethiopia has been growing.
3. What measures do you think should be taken by the government to reduce the debt burden of Ethiopia?
4. What are the implications of borrowing from local financial institutions?

5.4.5 Trade, Globalization, and Economic Integration

In the 1990's "globalization" as a vehicle for development became the strategy used most often in major international initiatives in the world. Ethiopia and its least developed allies went through a broad agenda of reform and voiced optimism in global forums about the potential for reversing decades of socio-economic stagnation.

In a very rudimentary sense, the economic dimension of globalization entails the process of integrating an economy with world markets. The economic interdependence that results from such process encompasses both product market (a market where goods and services are bought and sold) and factor market (a market where resources such as labor, capital, land etc., are bought and sold) and involves transactions in goods and services, investment and finance. The overriding principle underlying globalization is beneficial to all parties in an environment of voluntary exchange on the bases of comparative advantage, which in turn is enhanced through specialization. The source of comparative advantages for a country might be one or a combination of natural endowments and acquired endowments such as superior knowledge and specialization. Least developed countries (LDCs), including Ethiopia, generally possess comparative advantage natural-resource-based and labour-intensive industries.

What challenges does globalization present and the what opportunities does it offer for countries like Ethiopia?

Let us begin with the potential opportunities.

Opportunities

In principle, globalization could offer the following opportunities:

- *Appropriately acquired and correctly channelled, it could*
- *Provide badly needed investment capital that could enhance productive capacity*
- *Enhance facilitate the easy flow of technology transfer*
- *Open markets for domestic products*
- *Make a domestic economy more competitive by imposing work ethics, discipline, and overall productive efficiency; and*
- *Strengthen international division of labour based on comparable advantages.*

Challenges

If proper policies are not in place, especially in the transition period, globalization may be hazardous to less developed countries' economic health. Some of these economic-health risks include:

- *Weakening or destroying whatever little productive capacity there is, particularly in the manufacturing sector, due to world competition.*
- *Complete vulnerability of the domestic economy to external shocks.*
- *Loss of the sovereignty of governments to address distributional and other social issues as they see it fit. This is because World Trade Organization (WTO) rules and the significant role of transnational would directly or indirectly put a constraint on what policies governments could pursue, and*
- *Trigger competitive devaluation and unproductive competition among the least developed countries, since most of them have similar endowments and comparative advantages. For instance, both Kenya and Ethiopia mainly rely on the export of coffee and tea.*

Economic integration is making international trade increasingly free by reducing (in some cases, eliminating) traditional trade barriers. Trade integration is one part of the large range of economic integration activities, which include integration of macroeconomic policies and freedom of factor movements as well as free trade between member nations.

The motives underlying the drive towards economic co-operation among countries are varied. Apart from those shaped by historical and cultural circumstances, the search for economic development and the expression of political solidarity have been prominent among them.

Economic co-operation's attractions are largely due to the advantages it offers through the enlargement of economic size and improvements in efficiency, and through the extension of the range and complementarity of resources available among countries.

Expected economic gains from regional economic integration are:

- *increased production arising from specialization according to comparative advantages,*
- *increased output arising from improved exploitation of scale economies.*
- *improvement in terms of trade with the rest of the world. For example, trade between the EU and the USA, Japan, etc.*

In Africa there are different regional forms of economic integration, which include these collaborations:

- *PTA (the Preferential Trade Area). The PTA was established in 1982. It has 19 member countries, and Ethiopia is one of them.*
- *Another regional integration is the ECOWAS (the Economic Community of West African States). It was founded in 1975 and has 16 member countries.*
- *The SADCC (the Southern Africa Development Coordination Conference), and*
- *The COMESA (the Common Market for East and Southern Africa).*

Activity 5.17

1. What optimal policy options does the country have to challenge the threat of globalization?
2. What is regional integration?
3. What benefits are expected from regional integration?

Content Check 5.4

1. The trade deficit of Ethiopia's merchandise external trade has been declining recently, owing to the increase in exports. True/False (Explain).
2. Debt cancellation and rescheduling tend to reduce the interest payments on external debt. True/False (Explain).
3. The current increase in private transfer inflows has improved the current account balance in Ethiopia. True/False (Explain).
4. One of the components of foreign trade that most often registers a positive balance of payments in Ethiopia is
   - A Capital account
   - B Current account
   - C Service account
   - D None of the above
5. The motives underlying the drive toward economic cooperation among countries are uniform. True/False (Explain).

UNIT REVIEW

UNIT SUMMARY

- According to the Ethiopian National Income Account classification, trade and tourism are components of the service sector. In this connection, trade is classified under distributive services. The main objectives of this chapter have been to examine the role of trade in the Ethiopian economy and to identify the major constraints of these sectors.
- Trade can be domestic or international (external). In both cases people are better off when their governments engage in trade than when they don't. Domestic trade refers to the exchange of goods and services among citizens in a country. It can be local or inter-regional exchange in a country. It refers to pure exchange activities within a national boundary.
- International trade, is the exchange of goods and services among citizens of independent or sovereign countries. Many factors account for the rise of international trade. Some of them are differences in resource endowment, demand, and economies of scale and specialization. For example, the differences in resource endowments lead to differences in relative costs of production of goods and services among countries. Economies of scale provide additional cost incentives for specialization in production. That is, instead of manufacturing only a few units of each and every product that domestic consumers desire to purchase, a country specializes in the manufacture of large amounts of a limited number of goods and trades for the remaining goods. Specialization in a few products allows manufacturing firms to benefit from longer production runs, which lead to decreasing average costs.
- While demand patterns seem to be similar throughout the world, especially among similar socio-economic income classes, differences in tastes and preferences certainly exist. For example, in country A, where demand is very strong for steel, the price of steel that intensively uses the relatively abundant factor is relatively higher than its price in trading, country B. With the opening of trade between the two countries, country A would find itself exporting say, cloth, and importing steel, from country B because B's steel is relatively cheap at international prices. This occurs because the demand in country A for the product using the abundant factor intensively leads to such a high price for that product and the factor used intensively in its production that the physically abundant factor is the scarce factor from the standpoint of the price definition. Because this is the result of a particular set of demand conditions, it is referred to as demand reversal.

- International trade allows a country to specialize and export those goods and services that it can produce at relatively low cost and to import those goods and services whose domestic production is relatively costly. As a consequence, international trade enables a country to consume and produce more than it could without trade. Moreover, international trade encourages the diffusion of knowledge and culture.
- During the Derg Period, both domestic and foreign trade activities were under the control of the government. However, after the downfall of the Derg and the seizure of power by EPRDF, a number of reform measures were undertaken, particularly in the areas of trade and tourism. As a result of the liberalization measures taken by the government, participation of the private sector increased significantly in the trade and tourism sectors. Because of this, the magnitude of export earnings has increased from that of the post-Derg period.
- Balance of payments is a summary statement that summarizes all transactions conducted between Ethiopia and the rest of the world (i.e with its trade partners). As recent datas clearly indicate, the current account deficit is declining due to the significant increase in net capital flows.

REVIEW EXERCISE FOR UNIT 5

I *Choose the best answer from the given alternatives.*

1 Which statement is wrong?

A It would be advantageous, it is but impossible to locally produce all the commodities a country needs.

B International trade increases both consumption and production levels.

C The capital account in a balance of payments records loans received from abroad, among other things.

D All of the above.

E None of the above.

2 Why do nations participate in foreign trade?

A It stimulates economic growth.

B It brings about technological development.

C It raises the welfare of citizens.

D All of the above.

E None of the above.

3 An Ethiopian woman sends money from Europe to her family through a formal financial institution. This receipt of foreign currency will be recorded in Ethiopia under

A Capital Account
B Trade Account
C Current Account
D Service Account
E C and D

4 Which of the following shows the correct order of importance (in decreasing order) of agricultural commodities for Ethiopia's foreign exchange generation?

A Coffee, leather products, chat, oil seeds, and pulses
B Coffee, oil seeds, chat, and flowers
C Coffee, leather products, chat, pulses, and oil seeds
D Coffee, chat, leather products, pulses, and oil seeds
E None of the above

5 Currently the exchange rate of the US dollar against the Birr is determined by:

A The National Bank
B Auction involving all potential importers
C Whole sale involving commercial banks and some big importers only
D Bank-Inter buying and selling
E None of the above

6 ____________ considers physical quantities.

A Specific tariff
B Ad valorem tariff
C Compounded tariff
D None of the above

7 Identify the common mode of payment for imports in Ethiopia today.

A Bill of exchange
B Banker's transfer
C Letter of credit
D All of the above

8 During the Derg regime ownership policy was,

A based on socialist ideology
B in favor of socialized sectors
C favored quota allocation and rationing
D all of the above

9 The objective of the export duty draw-back scheme was

A to boost domestic production

B to encourage import substitution

C to encourage investment in the production of exportable

D none of the above

10 The objective of one of the following was to strengthen the arm of the Derg government in the socialization of wholesale trade. Which is it?

A Ethiopian Grain Trade Enterprise

B Agricultural Marketing Corporation

C Ethiopian Domestic Distribution Corporation

D None of the above

II *Say True or False and give reasons.*

11 We should import those goods in whose production we are relatively efficient.

12 Domestic trade enables a country to consume and produce more than it could without trade.

13 A rise in the price of Ethiopian coffee is associated with some form of supply shortfall from the major coffee suppliers.

14 Economic integration makes international trade freer by reducing traditional barriers.

15 Ethiopia's import structure is characterized by the dominance of semi-finished products.

16 The underlying principle of globalization is that all parties benefit from it, as long as exchange is based on comparative advantages.

17 Weakening or destroying work ethics, discipline, and efficiency are some of the challenge globalization poses.

III *Answer the following briefly.*

18 Discuss the differences between foreign trade and domestic trade.

19 Distinguish between domestic and external debt.

20 What are the indicators of debt burden?

21 Explain the difference between current accounts and capital accounts.

22 What is balance of payments?

UNIT 6

FISCAL POLICY AND PUBLIC DEVELOPMENT IN ETHIOPIA

Unit Objectives

After completing this unit, you will be able to:

- distinguish the different sources of government revenue;
- report how fiscal policy is applied in Ethiopia; and
- classify taxes and appreciate their significance to the development of the economy.

Main Contents

6.1 ECONOMIC ROLE OF THE GOVERNMENT

6.2 HISTORICAL BACKGROUND OF PUBLIC FINANCE IN ETHIOPIA

6.3 STRUCTURE AND PERFORMANCE OF REVENUE AND EXPENDITURE

6.4 ANALYSIS OF GOVERNMENT BUDGET AND DEFICIT FINANCING

6.5 FISCAL DECENTRALIZATION AND PUBLIC SECTOR REFORM IN ETHIOPIA

- *Unit Summary*
- *Review Exercise*

INTRODUCTION

This unit deals with the major fiscal policies and public developments in Ethiopia. Among them, the economic role of the government, structure and performance of revenue and expenditure, government budget and deficit financing and fiscal decentralization and public sector reform will be discussed.

In the first topic of this unit, you will learn about the economic role of the government. In the second topic historical background will be discussed. The third topic mainly emphasizes on the structure and performance of revenue and expenditure. The fourth topic will concentrate on evaluation and analysis of the structure and performance of government budget and deficit financing. The last topic in this unit deals with fiscal decentralization and public sector reform in Ethiopia and also taxes will be discussed in this section of the unit.

6.1 ECONOMIC ROLE OF THE GOVERNMENT

At the end of this section, you will be able to:

- explain the economic role of the government.

Key Terms and concepts

- Fiscal policy
- Taxes
- Revenue
- Expenditure
- Public goods

What do you think about the economic role of governments?

Discuss the role of good governance relative to economic development in a country.

The role of the government played in the sector is provision of goods and services which private firms are either unwilling or for some reason are not allowed to produce. Therefore, the government takes the responsibility of:

- *providing of public goods and social services;*
- *regulating the economy as its role.*

The other functions that the government serves are as follows:

- *Alteration of the structure of private production. In order to conform to some conception of the allocation of resources; this is considered 'better' than the resulting from private market transactions. This aim will be* *reflected in the choice of taxes levied on goods and services (example, taxes on expenditure), in corporation taxes and in current subsidies.*

- *Intervention in the distribution of income generated by private market transactions in order to conform to some acceptable criterion of equity; for example, a minimum income guarantee. This will be reflected in the national accounts principally in the choice of taxes and in the provision of transfer payments to households against which there is no counter flow of current services. For example, state pension payments are transfer payments, and though pensioners do not render current services in order to receive them, they may have contributed to their finance through compulsory levies on their past incomes. Transfer payments do not form a direct link between government and industry but major efforts by government to alter income distribution have considerable influence on the structure of household purchases and, therefore, on the pattern of demand for industrial products.*
- *Stabilization of the economy by attempting to reduce fluctuations in income and employment and to control movements in the general price level. The effects of this action can be seen in both the volume and the mix of transactions between the government and the rest of the economy.*

In general, government roles can be summarized as follows:

- *Promoting economic growth;*
- *Providing public goods and service, such as defence, judicial service highways, streetlight, education and health care service and others;*
- *Bring about equitable distribution of income;*
- *Stabilize the economy, through such measures as controlling inflation, reducing unemployment, avoidance of regional imbalance, fair or equitable distribution of income, and promoting economic growth;*
- *Regulating the externalities;*
- *Promoting efficiency;*
- *Maintenance of law and order; and*
- *Reduction of poverty.*

Activity 6.1

1. Outline the principal role of a government in an economy.
2. What is the difference between taxes and subsidies?
3. Discuss when a government intervenes in the economy of a country ______.

Content Check 6.1

1 What are the major economic role of government?
2 What should be the role of private firms in the economy of the country?
3 List down public goods and services provided by government?
4 What should be the government role to stabilize the economy of the country?

6.2 HISTORICAL BACKGROUND OF PUBLIC FINANCE IN ETHIOPIA

At the end of this section, you will be able to:

- review the historical background of the public finance in Ethiopia.

Key Terms and concepts

- Public sector
- Private sector

Start-up Activity

What do you know about the history of public finance in Ethiopia?

Public finance deals with the financial activities of the government such as collection of taxes from those who benefit from the provision of public goods by the government, and the use of those tax funds toward production and distribution of the public goods and social services.

Whereas, private finance deals with individual financial activities. Both Public and private finance are important, as both are the main determinant in the policy matters of any nations.

The status of public finance in Ethiopia during Derg was directed towards expanding the public sector. The government adopted special tax increase policies in both direct and indirect taxes to discourage the private sector. In this period ,the rise in government expenditure on defense , strong involvement of government into the economy, overall expansion of the public sector, high degree of centralization and mismanagement of economic resources have led to considerable increase in government expenditure.

After the fall of the Derg EPRDF has been forced to take different measures. Most of these measures focused on the revenue and expenditure reform which increase government revenue and reduce government expenditure. The measures taken helped to remove the budget deficit.

Fiscal policy is a policy of government that guides the revenue and expenditure of a government. Fiscal policy instruments are tax and expenditure items.

The roles and functions of fiscal policy in the economy can be outlined in the following ways:

- *The allocation of resources into the production of public and private goods.*
- *The distribution of income in order to reduce inequality and poverty.*
- *The promotion of economic growth and the stabilization of the economy by reducing fluctuation in the level of prices, output and employment.*

Content Check 6.2

1 What is fiscal policy?

2 What kinds of economic problems can be solved by using fiscal policy instruments?

6.3 STRUCTURE AND PERFORMANCE OF REVENUE AND EXPENDITURE

At the end of this section, you will be able to:

- evaluate the structure and performance of revenue and expenditure.

Key Terms and Concepts

- Revenue
- Expenditure

6.3.1 Government Revenue

Start-up Activity

What do you understand about tax and non-tax revenue?

Sources of government revenue can be classified into tax and non-tax revenue. Though the revenue sources are numerous, those items which form the bulk of the total revenue are few. Taxes from wages and salaries, agricultural income tax, rural land-use fees and business profit tax are the major sources of revenue.

Tax Revenue

Table 6.1 **Government revenue in million Birr**

Total \ Year	2006/07	2007/08	2008/09
Tax revenue	17353.0	23800.4	28997.4
Income and profit tax	4868.0	6626.0	9288.0
Rural land-use fee	130.0	149.0	239.0
Urban land-use fee	170.0	239.0	331.0
Domestic indirect taxes	3997.0	5093.0	7325.0
Import duties/taxes	8188.0	11693.4	11814.0
Export taxes	0	0	0
Total non-tax revenue	4444.1	7002.0	11647.0
Grand Total revenue	21797.1	30802.4	40644.0

Source: *Ministry of Finance, Central Accounting Department, 2008/09.*

The above Table 6.1 shows government revenue increased from 21,797,100 in 2006/07 to 30,802,400 in 2007/08 and 40,644,000 in 2008/09.

6.3.2 Government Expenditure

It is necessary to identify sectors to be included in the estimation of region's expenditure need. These sectors are determined by taking the biggest sectors that account for more than 90% of the region's total public expenditure. Using regional budget expenditure data obtained from the National Account Department of the (Ministry of Finance and Economic Development) MoFED, the following sectors were found to absorb more than 90% of the total expenditure in all regions.

- *General administration (organ of the state, public order and security, and justice);*
- *Primary and secondary education (including TVET);*
- *Public health;*
- *Agriculture and natural resources;*
- *Clean water supply; and*
- *Rural road construction and maintenance.*

Although they appear to have lower shares, the development of micro- and small-scale enterprises and urban development are crucial to addressing urban problems, particularly unemployment and poverty reduction. As of recently, these areas are getting more attention in government policy.

Table 6.2: **Recurrent government expenditure (in million Birr)**

Expenditure type / Year	2006/07	2007/08	2008/09
General service	7041.0	9129.0	11261.0
Economic service	2198.0	3110.0	3829.0
Social service	6193.0	8662.0	10250.0
Public debt	2429.8	1965.8	2046.7
Total Current Expenditure	18347.8	23626.8	27936.7

Source: *Ministry of Finance, Central Accounting Department, 2008/09.*

Table 6.3 **Capital government expenditure (in million Birr)**

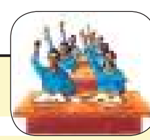
Capital expenditure / Year	2006/07	2007/08	2008/09
Economic development	11367.0	17728.9	21812.1
Social development	5997.0	5426.1	7067.9
General service	1033.0	966.0	1718.7
Others	-	-	-
Total capital expenditure	18397.0	24121.0	30598.7

Source: *Ministry of Finance, Central Accounting Department, 2008/09.*

Table 6.2 below shows the government expenditure type from 2006/07 to 2008/09.

The total government recurrent expenditure shows an increment by 28.8% in 2007/08 and 18.24% in the year 2008/09. While table 6.3 shows, government capital expenditure from 2006/07 to 2008/09.

As compared to 2006/07, the total government capital expenditure increased by 31.1% in 2007/08 and 26.9% in 2008/09.



Activity 6.2

1 What is the function of fiscal policy in the economy?
2 What is public finance?

6.4 ANALYSIS OF GOVERNMENT BUDGET AND DEFICIT FINANCING

At the end of this section, you will be able to:

- analyze government budget and deficit financing.

Key Terms and concepts

- Deficit
- Surplus

What do you think about government revenue sources?

6.4.1 Structure of Government Budget

Government budget is a financial plan of government revenue and expenditure for a specific period, usually for one fiscal year. Ethiopia's fiscal year starts on Hamle 1, and ends on Sene 30, based on the Ethiopian calendar.

The usual objectives of the government budget include relating expenditure decision to policies, to current and future resources and to efficiently implement programs.

Most of the time government budget is divided into two major areas such as, revenue and expenditure budget. Revenue budget consists of the annual forecast of government budget from tax, non-tax, external assistance and capital source of revenue.

Tax-Source of Government Revenue

A *Ordinary revenue*

i **Direct tax:** The term direct tax means a tax paid directly to the government by the persons on whom it is imposed. Examples include income taxes, such as the following.

- ***Personal income tax:*** *Every person deriving income from employment in any government or other private organization or non-governmental organization and income from employment including any payments or gain in cash or in kind which he/she received from employees.*
- ***Business Income Tax:*** *Is a tax imposed on business enterprises, professional or vocational activity or any other activity recognized as trade pays tax based on their profit.*
- ***Corporate tax:*** *refers to a direct tax levied on the profits made by companies or associations and often includes capital gains of a company.*
- ***An inheritance tax (also known as an estate tax):*** *is a tax which arises on the death of an individual. It is a tax on the estate, or total value of the money and property, of a person who has died.*
- ***Transfer tax:*** *a tax on the passing of title of property from one person (or entity) to another.*

- ***Tax on dividends:*** *is an income tax on dividend payments to the stockholders (shareholders) of a company.*
- ***Income from games of chance:*** *Every person deriving income from winning at games of chance – for example, lotteries, tombolas, and other similar activities, are subject to tax at the rate of fifteen percent /15%/ except for winnings of less than 100 Birr.*
- ***Rental income tax:*** *Rental income is any payment you receive for the use or occupation of property.*
- ***Interest Income on Deposits:*** *Every person deriving income from interest on deposits shall pay tax at the rate of five percent.*

ii ***Indirect tax:*** a tax levied indirectly, as one levied on commodities before they reach the consumer but ultimately paid by the consumer as part of the market price. Examples includes sales tax or value added tax (VAT).

- ***Value added tax (VAT):*** *is a sales tax based on the increase in value or price of product at each stage in its manufacture and distribution and the cost of the tax in added at the final price and eventually paid by consumer on the purchase price of 15%.*
- ***Sales tax:*** *a consumption tax charged at the point of purchase for certain goods and services. The tax amount is usually calculated by applying a percentage rate to the taxable price of a sale.*
- ***Turnover tax (TOT):*** *It is an indirect tax which is similar to a sales tax or VAT, with the different that (TOT) tax imposed on those who are not register for VAT which their annual taxable transaction is under the total value of 500,000 birr.*
- ***Withholding tax:*** *is a government requirement for the payer of an item of income to withhold or deduct tax from the payment, and pay that tax to the government.*
- ***Stamp duty:*** *is a tax that is levied on documents. This include the majority of legal documents such as cheques, receipts, marriage licenses and land transactions. A physical stamp (a tax stamp) had to be attached to or impressed upon the document to denote that stamp duty had been paid before the document was legally effective.*
- ***Excise duties:*** *This tax is imposed on selected goods, such as luxury goods and basic goods which are demand-inelastic.* Tax on gasoline and other fuel and tax on tobacco and alcohol.

iii ***Foreign trade tax:*** It comprises both import and export taxes.

- ***Import tax:*** *An import tax collected on imported goods. Such as a tariff is a tax levied on imports or exports.*
- ***Export tax:*** *An export tax is a tax collected on exported goods.*

iv ***Non-tax source of government revenue***: are government revenue not generated from taxes. Examples include:

- *charges and fees*
- *sales of government goods and service*
- *government investment income*
- *privatization proceeds*

B *External Assistance*

It comprises of grants, loans and technical assistance from bilateral or multilateral agencies.

C *Capital revenue:*

Domestic source collection of loans and sales of government asset.

6.4.2 Government Expenditure Budget

Government expenditure is divided into two principal headings: *Recurrent* and *Capital expenditure*. The recurrent budget is mostly financed from domestic revenue sources, i.e., from tax and non-tax revenue. The capital budget is usually financed by external loans and grants.

Recurrent budget expenditure consists of expenses that repeated in nature like salaries of civil servants. The recurrent budget in Ethiopia is structured under four functional catagories.

Recurrent Budget Category

Functional classification:

- *Administration and general service*
- *Economic service*
- *Social and other services.*

Sub-functional classification:

- *Administration and general service*
  - *Organ of state*
  - *Justice*
  - *Defence*
  - *Public order*
  - *General service.*

- *Economic*
  - *agriculture and natural resource*
  - *trade and industry*
  - *mining and energy*
  - *tourism*
  - *transportation and communication*
  - *construction*
- *Social*
  - *education and health*
  - *culture and sport*
  - *labor and social affairs*
  - *prevention and rehabilitation*
- *Others*
  - *transfer payment*
  - *repayment of public debt*
  - *contingency*
  - *miscellaneous*

Capital Budget Category

- *Economic development*
  - *The economic development includes production activities in all sectors of the economy.*
- *Social development*
  - *It constitutes activities like education, health and social welfare.*
- *General development*
  - *services in statistics*
  - *cartography*
  - *public and administrative buildings*

6.4.3 Budgetary Deficit Financing

A government budgetary deficit occurs when governmental expenditure is greater than government revenue, whereas government budgetary surplus occurs when government revenue exceeds government expenditure.

- *Domestic borrowing*
- *External borrowing*
- *Issuing currency (money printing)*

Trends in Fiscal Deficit to GDP Ratio and Financing

The overall fiscal deficit improved to –2.9 percent of GDP in 2007/08 from –3.6 percent in the previous fiscal year (see Table 6.4). The deficit was financed by domestic and foreign loans. In the next few years, expenditure management is expected to remain prudent, with cuts in recurrent expenditure and priority given to key social sectors such as health, education, agriculture, as well as support for infrastructure development.

In the past years, fiscal deficit has shown a declining trend with a –7.2 percent of GDP in 2001/02 to –2.9 percent of GDP in 2007/08.

Table 6.4 **Public Finances (percentage of GDP)**

Item \ Year	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Total Revenue and Grant	19.3	21.4	20.7	18.9	17.7	17.1	16.2
Domestic Revenue	15.6	15.2	16.1	14.6	14.8	12.7	12.1
Tax Revenue	11.9	11.2	12.6	11.6	10.8	10.1	9.7
External Grant	3.6	6.2	4.6	4.3	2.8	4.4	4.0
Total Expenditure	26.5	27.9	23.7	23.3	22.3	20.7	19.1
Fiscal Deficit Including Grants	-7.2	-6.5	-3.0	-4.4	-4.6	-3.6	-2.9

Source: *Ministry of Finance and Economic Development (MoFED), year*.

Fiscal Deficit Financing

Table 6.5 **Fiscal Deficit Financing (In Percent of GDP)**

Item \ Year	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Financing	7.2	6.5	3.0	4.4	4.6	3.6	2.9	4.6
External (net)	7.4	5.3	2.8	2.2	1.1	1.1	1.0	3.0
Domestic (net)	7.2	6.6	2.5	3.3	2.1	3.5	2.7	4.0

Source: *Ministry of Finance and Economic Development (MoFED), year*.

There are three main ways the government can finance a deficit.

- *Firstly, the government can borrow funds from the other sources of the economy. When the government borrows from domestic sources it competes with the private sector and creates what is referred to as "crowding out effect". A shortage of funds in the domestic market can result in the rise of cost of credit and hence discourages private investment.*

- *The second possible method used to finance a budget deficit is to borrow funds from international financial markets .But it widens the balance of payments in current account deficit.*
- *The third possible method of financing a deficit is issuing currency; this form of financing basically means that the government prints money to finance the deficit. But this method is not advisable. It is because it is highly inflationary: when the government increases money supply, if the economy is near full employment, demand pull inflation occurs rapidly, as there is too much money chasing a limited supply of goods.*

Activity 6.4

1. Identify tax and non-tax sources of government revenue.
2. How the recurrent and capital budget financed?
3. Mention the means of budgetary deficit financing.
4. When does government budgetary deficit occur?

6.5 FISCAL DECENTRALIZATION AND PUBLIC SECTOR REFORM IN ETHIOPIA

At the end of this section, you will be able to:

- describe fiscal decentralization and public sector reform in Ethiopia.
- distinguish the different types of taxes and state their characteristics.
- evaluate foreign trade taxes by taking into account the comparison between import taxes and export taxes.

Key Terms and concepts

- Decentralization
- Export tax
- Import tax

What do you understand about import and export taxes? And what are the reasons that government levied them?

Decentralization

Decentralization is a systematic delegation of authority at all levels of management and in all of the organizations. In a decentralization concern, authority retained by the top management for taking major decisions and formulating policies and the rest of the authority may be delegated to the middle and lower levels of management.

Decentralization is not the same as delegation. In fact, decentralization is an extension of delegation. Decentralization is wider in scope and the authorities are diffused to the lowest levels of management. Delegation of authority is a complete process and takes place from one person to another, while decentralization is complete only when fullest possible delegation has taken place.

Fiscal decentralization, which involves the sharing of revenue between regions and central governments, and introduced transfers and subsidies, is part of the decentralization process.

Fiscal decentralization is intended to assist regional governments by boosting their capacity for developing their localities through self-initiative. It is also meant to narrow the existing gaps in economic growth and development among regions. Despite this, fiscal imbalances between regions and heavy dependence of the regional governments on the federal government's transfer and subsidies have persisted.

Fiscal decentralization in Ethiopia emanates from federal and regional governments' constitutions. It has the objectives of devolving fiscal decision-making power to lower governments, and narrowing the vertical fiscal gap as well as ensuring horizontal equalization. Accordingly, the regional governments are empowered to the extent of levying taxes, and preparing and administering their own budgets. They are also entitled to collect their defined revenues, draw budget subsidies from the federal government and borrow from domestic sources.

As the devolution process was initiated prior to the adoption of the constitution, the transitional government issued Proclamation 33/92 which defined the nature of fiscal relations between the federal and regional governments.

The proclamation has had the objectives of enabling both levels of governments to carry out their respective duties and responsibilities effectively, assist regional governments to develop their regions on their own initiatives, narrow the gap in development and economic growth between regions and encourage their common interest.

Moreover, Proclamation 7/92 which affirmed the rights of Federal and Regional Governments and the Constitution of the Federal Democratic Republic of Ethiopia ratified powers and responsibilities of all levels of governments.

The major driving factor for assigning expenditure responsibilities and decision-making powers to the lower level governments is to improve their ability of efficiently identifying and addressing their citizens' needs. Being closer to the beneficiary population, sub-national levels of governments have informational advantage over the federal government as they can better see their constituents' needs. In line with these assumptions, regional governments have greater incentive to improve service delivery on the one hand, and on the other, beneficiaries and citizens can easily monitor their actions and evaluate them constantly and timely.

In Ethiopia, the federal government's powers and functions are more clearly defined in the constitution and generally encompass all national public goods such as:

- *defence,*
- *foreign policy,*
- *fiscal and money policy,*
- *designing of economic and social policies, and,*
- *building major infrastructure such as those of air, railway, shipping, postal, telecommunication and electric power.*

Regional governments, therefore, are responsible for duties related to basic service delivery, such as primary and secondary education, health, water and sanitation, rural roads, agriculture and natural resources.

It is apparent that regional and wereda administrations (the lowest level of administration) have significant responsibility for the provision of basic services targeted to reduce poverty, by way of generating income and empowering the local people.

The economic system in the Military Government was characterized by a high degree of centralization the decision-making and responsibility, and economic power was concentrated in the hands of few government officials. The new government, on the other hand, is based on the principle of decentralization. We have now federal and regional governments and each of them have their own duties and responsibilities. Regional states exercise their power over their jurisdictions by using their own plans and budgets. This way of administration gives economic freedom to properly manage and efficiently use resources at the disposal of the regional state. And there are other measures taken by the government sine 1992/93, such as,

- *rationalization of tax structure;*
- *broadening of tax base;*
- *reduction of government expenditure by narrowing public sector, selling loss-making public enterprises to generate revenue from the sale as well as to reduce expenditure; and*
- *reduction of the marginal tax rate. A marginal tax rate is the tax rate that applies to the last dollar of the tax base (taxable income or spending).*

6.5.1 Personal Income Tax

Every person deriving income from employment in any government or other private organizations or non-governmental organizations pays tax.

Personal income tax is the component of direct tax which is levied on income of a person. According to proclamation No. 286/2002 G.C the first 150 birr from employment shall be exempted from payment of income tax in all cases with the highest marginal tax rate on income to be 35%.

Table 6.6: **Percentage change of personal income tax based on the income level in Ethiopia**

No	Monthly income (Birr)	Percentage of Income tax (%)
1	1 - 150	No charge
2	151 – 650	10
3	651 - 1400	15
4	1401 – 2350	20
5	2351 – 3550	25
6	3551 – 5000	30
7	Above 5000	35

As shown in Table 6.6 above, the percentage of the personal income tax increases as personal earnings increase. An individual who earns 1 – 150 Birr is not required to pay an income tax.

Based on the above Table 6.6, parsonal income tax of Ms Hana would be computed as follows:

Ms Hana monthly salary = Birr 3000

The first 150 birr shall be exempted from payment of income tax.

- *(150 - 0) × 0% = 150 × 0% = 0*
- *(150 - 650) × 10% = 500 × 10% = 50*
- *(650 - 1400) × 15% = 750 × 15% = 112.5*
- *(1400 - 2350) × 20% = 950 × 20% = 190*
- *(2350 - 3000) × 25% = 650 × 25% = 162.5*

Total income tax = 0 + 50 + 112.5 + 190 + 162.5 = 515

Total income = 3000

Income after income tax = 3000 - 515 = 2485 birr

Income taxes are of three types in nature:

- ***Progressive:*** *is a tax by which the tax rate increases as the taxable amount increases.*

This type of income tax hurts more those people with relatively high income brackets. This is employed to collect more tax revenue from the people who are in high income brackets.

- ***Regressive income tax:*** *is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases.*

  It hurts more those people in low income brackets, and it affects their purchasing power significantly and hence reduces aggregate demand.

- ***Proportional income tax:*** *is a tax rate which levies certain fixed percentages on income received, or the amount of the tax is fixed in proportion to the amount subjected to taxation.*

6.5.2 Business Income Tax

According to Proclamation 286/2002, a tax is imposed on commercial, professional or vocational activities or any other activity recognized as trade by the commercial code of Ethiopia and carried on by any person for profit.

6.5.3 Indirect Taxes

A tax, such as a sales tax or value-added tax, that is levied on goods or services rather than individuals and is ultimately paid by consumers in the form of higher prices is referred to as an indirect tax.

6.5.4 Foreign Trade Taxes

Import tax: is the type of tax imposed on imported goods on specific values or ad. volarum or on a compounded basis.

Export tax: an export duty, or export tax, is a tax imposed on commodities leaving a customs area.

Strengthening Institutional Framework

The administrative capacity of the existing institutions should be improved in order to enforce tax compliance so that tax collection can be facilitated and strengthened.

In 2007/08, total revenue and grants as the share of GDP has reached to 16.2 percent (Table 6.7). Tax collection remained weak, with tax revenue declining marginally from 10.8 percent of GDP in 2005/06 to 9.7 percent in 2007/08. This calls for further strengthening of revenue collection institutions.

In order to achieve fiscal sustainability, fiscal policy has been targeted at reducing the fiscal deficit in percentage of GDP, while focusing on expanding the provision of socio-economic services and expansion of critical infrastructure.

To this end, several measures including rationalizing public expenditure, adjusting public sector salaries, limiting the number of zero-tariff related items and import exemptions, broadening the tax base such as the introduction of new tax bases, for example value added tax (VAT), introducing rental income tax and other similar measures have been taken.

Table 6.7 **Fiscal revenue/GDP (%)**

Year / Revenues	1998/99	2003/04	2004/05	2005/06	2006/07	2007/08
Total revenue and grants	18.1	20.78	18.9	17.7	17.1	16.2
Tax revenue	9.7	12.6	11.6	10.8	10.1	9.7
Grants	2.8	4.6	4.6	2.8	4.4	4.0

Content Check 6.3

1. What do you understand from the information given in Table 6.7?
2. What is marginal tax?
3. List the three types of income tax and which one is more hurt low income brackets?

UNIT REVIEW

UNIT SUMMARY

- Government provides public goods and social services.
- Government involvement in the economy in Ethiopia was high during the Military Regime due to the command economy system it followed.
- Sources of government revenue can be divided into two: tax and non-tax.
- Tax revenue consists of direct, indirect, and foreign trade tax, whereas non-tax revenue consists of charges, fees, fines and sales of government assets or properties.
- Government expenditures are classified as recurrent and capital
- Recurrent expenditures involve repeated types of expense occurring frequently, for example, payments of wages and salaries of government employees and public debt.
- Capital expenditure involves expenses incurred for the purpose of adding to the capital stock by way of investment in social and economic development.
- Government budget is an instrument and financial plan of revenue and expenditure for a specified period of time.
- Revenue budget is decomposed into ordinary, external assistance and capital revenue.
- Expenditure budget is decomposed into recurrent and capital budget.
- Budget deficit occurs when government expenditure exceeds revenue.
- Deficit financing can take different forms: borrowing from domestic as well as foreign sources, and issuing currency.
- Fiscal decentralization refers to sharing government power with local and regional governments in decision-making regarding their revenue and expenditure.
- The recent reform measures taken have the objective of increasing revenue and reducing government expenditure.

REVIEW EXERCISE FOR UNIT 6

I *Choose the correct answer from the given alternatives.*

1 Which of the following is not an indirect tax?

A Sales tax
B VAT
C Excise tax
D None

2 Which of the following is not a component of fiscal policy?

A the way the government mobilizes its revenue
B the way the government sets exchange and interest rates
C determination of tax burden
D the policy of the government employed to raise revenue
E none

3 The Ethiopian income tax system is based on ____________.

A regressive
B progressive
C proportional
D none

II *Label the following questions as True or False.*

4 Deficit can be financed by borrowing from external sources but not domestic sources.

5 Capital budget expenditure is usually made on the acquisition and improvement to fixed assets.

6 The direct tax of ordinary revenue consists of business income tax and personal income tax.

7 Recurrent budget expenditure consists of expenses that are repeated in nature like salaries of civil servants.

8 Tax free income is Birr 120 per month, and the highest marginal tax rate on income is 35%.

III *Answer the following briefly.*

9 Discuss the major economic role of government.

10 Distinguish between progressive, regressive and proportional taxes.

11 List the components of capital expenditure.

12 Discuss the macroeconomic and other consequences of the different deficit financing methods.

IV *Workout*

13 Given the following hypothetical data for a country, answer the questions that follows (*the numbers are in millions of dollar*).

- *Import tax = 1725*
- *Business profit tax = 1400*
- *Personal income tax = 225*
- *Value Added Tax(VAT) = 2000*
- *Excise tax = 800*
- *Recurrent expenditure = 5500*
- *Capital expenditure = 4000*
- *Taxes on export = 1725*
- *Non-tax revenue = 3000*

i Now Calculate:

a the total amount of indirect tax,

b the total direct tax revenue,

c the foreign trade tax,

d the total government revenue for the year, and

e the total government expenditure,

ii Is there a surplus or deficit? How large is it?

UNIT 7

MONETARY POLICY AND FINANCIAL SECTORS IN ETHIOPIA

Unit Objectives

After completing this unit, you will be able to:

- report on how monetary policy is applied in Ethiopia; and
- understand the different policies and strategies applied by the Imperial, Derg, and current governments.

Main Contents

INTRODUCTION

Monetary policy refers to the management of the money supply and its link to prices, interest rates and other economic variables. More generally, monetary policy is a bundle of actions and regulatory stances taken by the central bank including all of the following:

- *Setting a minimum interest rate on deposit*
- *Setting reserve requirements on various classes of deposit*
- *Increasing or decreasing commercial bank reserves through open market purchase and sales of government securities.*
- *Constraining commercial bank financial activities by setting minimum capital requirement*
- *Intervening in foreign exchange markets to buy and sell domestic currency for foreign exchanges*
- *Decide the level of total-deposit required reserve of commercial banks*

The principal objective of the monetary policy of the National Bank of Ethiopia (NBE) is to maintain price and exchange rate stability and support sustainable economic growth of Ethiopia. Price stability is a measure for macroeconomic stability which is important in private sector economic decision-making about investment, consumption, international trade and saving. Macroeconomic stability also fosters employment and economic growth. Maintaining exchange rate stability, on the other hand, promotes competitiveness in international trade.

Financial institutions (FIs) such as commercial banks, credit unions, insurance companies, etc. perform the essential functions of channelling funds from those with surplus funds (suppliers of funds) to those with shortage of funds (users of funds). Hence, the existence of such kinds of institutions helps to facilitate domestic saving and investment.

7.1 HISTORICAL BACKGROUND OF MONEY AND THE FINANCIAL SECTOR IN ETHIOPIA

At the end of this section, you will be able to:

- review the historical background of money and the financial sector in Ethiopia;

Key Terms and Concepts

- barter system
- the evolution of money
- types of money
- evolution of banking system

What is your opinion about the historical and recent development of money?

7.1.1 Historical Development of Money

Figure 7.1 **A Picture of bars of salt**

Before the invention of money, trade was based on the barter system. It is a system of transaction where goods and services are directly exchanged with goods and services. The barter system had many pitfalls. Among others, the need for double coincidence of wants was the prominent problem of barter system. People have to find someone who has a good or service they want and who also wants the good or service they have to offer.

Figure 7.2 **Pictures of coins used in Ethiopia**

Money is anything that people are willing to accept in payment for goods and services or to pay off debt. Some form of rudimentary financial activities and exchange with the help of money in Ethiopia is dated back to the Axumite kingdom. Coins were mainly minted to facilitate external trade transactions. Usually, these coins were made of precious metals such as gold, silver, and bronze. Iron and salt bars were used to conduct domestic trade transaction. Later on, due to the fact that the intrinsic value of some precious metals and coins was greater than their face value, and hence used for making ornaments and other purposes, exchanges of goods and services were replaced by commodity money.

In addition to the intrinsic value, the downfall of the Axumite kingdom eliminated the circulation of coins, and trade was conducted by the traditional form of exchange, using commodities that served as medium of exchange. This is what is known as the stage of commodity money. Commodities such as bars of salt, pieces of cloth, bars of iron and different types of shells were used as a medium of exchange.

Other currencies that were issued and circulated in and around Harar city after the Axumite coins were the “Mahalek” and the “Ashrafi” that existed from 1789-1887. These were hand-made currencies for local use by the habitats of Harar.

Later the entire region used “Amole Chew” (Salt Bar) for many years. In the nineteenth century and early twentieth century, Austrian thaler (the Maria Theresa dollar) served as a medium of exchange together with the use of Amole.

The thaler was first minted in Vienna, the capital city of Austria in 1741 and named after the Empress Maria Theresa of Austria. It had a silver purity of 800 karats, which means it contained 80% of pure silver. Hence, after a long time the country was back to metallic money. Thaler was a widely acceptable means of exchange until it was replaced by the national currency in 1945. During the Italian short occupation (1935 – 1941) there were about 50 million Marie Theresa thalers circulating in the economy.

Activity 7.1

Collect information on the evolution of money from the nearby relevant institutions and discuss in groups.

Figure 7.3 **The Present Ethiopian currency notes and coins**

In 1894 coins bearing the image of Emperor Menelik II appeared, these were. Made of silver and copper, the first national currencies after the fall of the Axumite kingdom. In 1908, "Birr", containing the image of Emperor Menelik II, was declared as a medium of exchange and a legal tender throughout Ethiopia by proclamation.

Historical Note

In 1933, the first coins under Emperor Haile Sellasie's regime replaced Menelik's coins. The new dollar notes were printed with denominations of Birr 5, Birr 10, Birr 20, Birr 50, Birr 100 and Birr 500 values. These currencies bore the image of Emperor Haile Sellasie I. The coins were made of copper with denominations of one cent, five cents, ten cents, and twenty five cents. Also, there was a coin made of silver for fifty cents ("Shilling").

These notes and coins served for a long time until the fall of the Imperial regime in 1974. The Millitary regime (Derg) introduced a new legal tender in 1976 with the same denomination without the twenty and five hundred Birr.

In 1998 the new government (EPRDF) slightly changed the currency notes but not the coins, using the same denominations as they were also circulating in Eriteria after independence in 1991. Paper currency decreed by governments as legal tender (meaning that legally it must be accepted as payment for debts) but not convertible into coins or precious metal is known as ***Fiat Money***.

7.1.2 The Financial Sector in Ethiopia

Historical Note

Modern banking in Ethiopia started in 1905 with the establishment of Abyssinian Bank, which was based on a fifty year agreement with the Anglo-Egyptian National Bank. In 1908 a new development bank (called Societe Nationale d' Ethiope Pour le Development de l'Agriculture et du Commerce) and two other foreign banks (Banque de l'Indochine and the Compagnie de l'Afrique Orientale) were also established. These banks were criticized for being wholly foreign owned.

Table 7.1: **Banks in operation during the brief period of Italian occupation (1936-41)**

Year of establishment	Bank name	Number of branches
1934	Banco di Italy	9
1934	Banco di Roma	18
1939	Banco di Napoli	4
1939	Banco Nacionale (De'sVoro)	4
1939	Casa de Creito	1
1939	Society Nacionale di Ethiopia	1
	Total	37

Source: *Gedey, B. (1990) Money, Banking and Insurance in Ethiopia, Addis Ababa: Berhanena Selam Printing Press (in Amharic).*

After independence from Italy's brief occupation, where the role of Britain was paramount owing to its strategic planning during the Second World War, Barclay's Bank was established and it remained in business in Ethiopia between 1941 and 1943. Following this, in 1943, the Ethiopian government established the State Bank of Ethiopia. The establishment of this bank by Ethiopia was a painful process because Britain was against it. The Bank of Ethiopia operated as both a commercial and a central bank until 1963 when it was split and remodelled into today's National Bank of Ethiopia (re-established the Central Bank, as in 1976) and the Commercial Bank of Ethiopia (CBE). After this period, many other banks were established during Emperor Haile Sellasie I's regime. Just before the 1974 revolution, the banks listed in Table 7.2 were in operation.

Table 7.2: **Banks in Operation before 1974 in Ethiopia**

Years of establishment	Name of the bank	Number of Branches before 1974	Capital before 1974 (in millions Birr)
1939	Banco di Napoli	1	2.0
1963	Imperial Saving and Home Ownership Public Association	1	0.6
1963	National Bank of Ethiopia, NBE	4	10.0
1963	Commercial Bank of Ethiopia, CBE	65	35.0
1963	Addis Bank Share Co.	26	5.0
1964	Addis Bank Share Co.	2	3.0
1964	Ethiopian Investment Corporation S.C.	1	20.0
1966	Banco di Roma (Ethiopia) S.C.	8	4.0
1969	Agricultural and Industrial Development Bank	5	100.0

Source: *Gedey, B. (1990) Money, Banking and Insurance in Ethiopia, Addis Ababa: BerhanenaSelam Printing Press (in Amharic).*

All privately owned financial institutions, including three commercial banks, thirteen insurance companies, and two non-bank financial intermediaries, were nationalized on 1 January 1975 under the Derg regime. The nationalized banks were reorganized into one commercial bank (namely, the Commercial Bank of Ethiopia), two specialized banks – the Agricultural and Industrial Development Bank (AIDB), and Housing and Saving Bank (HSB), and one insurance company.

Following the regime change in 1991 and the liberalization policy in 1992, these financial institutions were reorganized to work in a market-oriented-policy framework. The CBE, EIC and NBE have retained their names and functions, whereas the AIDB was renamed as Development Bank of Ethiopia (DBE), and the HSB was renamed as Construction and Business Bank (CBB).

Currently the major financial institutions operating in Ethiopia are banks, insurance companies and micro-finance institutions. A number of commercial banks and insurance companies have also been established in the reform period. In 2008/09, the number of commercial banks operating in the country reached 13, of which ten were private commercial banks, and the remaining three were state owned.

Figure 7.4 **Commercial Bank and National Bank of Ethiopia**

Table 7.3: **Public and private banks currently working in Ethiopia**

Banks	Branch Network 2008/2009		
	Addis Ababa	Regions	Total
1 Public banks			
Commercial Bank of Ethiopia	160	49	209
Construction and Business Bank	17	15	32
Development Bank of Ethiopia	1	31	32
Total public banks	178	95	273
2 Private banks			
Awash International Bank	29	31	60
Dashen Bank	28	26	54
Abyssinia Bank	22	25	47
Wegagen Bank	26	23	49
United Bank	15	26	41
Nib International Bank	17	28	45
Cooperative Bank of Oromiya	23	3	26
Lion International Bank	11	9	20
Zemen Bank	1	0	1
Oromia International Bank	16	4	20
Total Private banks	187	176	363
Grand Total Banks	354	282	636

Source: *National Bank Ethiopia, Annual Report (2008/2009).*

Activity 7.2

List and discuss the advantages of Banks for economic growth.

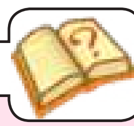
In 2008/09, with the launching of new insurance companies, namely Ethio-Life and Oromia Insurance Company, the number of insurance companies in the country expanded to 12. In terms of ownership, all insurance companies, except the Ethiopian Insurance Corporation (EIC), are privately owned.

Table 7.4: 008/2009

Insurance Companies	Numbers of Branches		
	Addis Ababa	Regions	Total
Ethiopian Ins. Cor.	11	28	39
Awash Ins. S.C.	13	9	22
Africa Ins. S.C.	6	7	13
National Ins. Co. of Eth.	8	8	16
United Ins. S.C.	14	7	21
Global Ins. S.C.	4	3	7
Nile Ins. S.C.	11	9	20
Nyala Ins. S.C.	8	8	16
Nib Ins. S.C.	13	8	21
Lion Ins. S.C.	6	4	10
Ethio-life Ins. S.C.	-	-	-
Oromia Ins. S.C.	4	5	9
Total	98	96	194

Source: *NBE, Annual Report (2008/2009).*

Content Check 7.1



1 The management of money supply and its link to prices, interest rates and other economic variables by a government regulatory body is known as ____________.

2 Which one of the following government institutions is directly responsible for the conduct of monetary policy?

A Ministry of Finance and Economic Development

B Ministry of Trade and Industry

C Commercial Bank of Ethiopia

D National Bank of Ethiopia

3 List the major pitfalls of barter systems.

A ______________________________

B ______________________________

C ______________________________

D ______________________________

4 Briefly discuss the evolution of money.

5 What was the first modern bank in Ethiopia?

Match those in Column 'B' with those in 'A'.

	"A"		"B"
6	Commercial Bank of Ethiopia _____	A	1964
7	Bank di Roma (Ethiopia) S.C._____	B	1966
8	Ethiopian Investment corporation S/C _____	C	1969
9	Bank di Napoli _____	D	1963
10	National Bank of Ethiopia _____	E	1939

7.1.3 The Roles and Functions of the National Bank of Ethiopia and Commercial Banks of Ethiopia

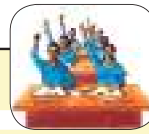
Roles and Functions of the National Bank of Ethiopia

Among the most important players in financial markets throughout the world are national banks, which are the government authorities in charge of monetary policies. National banks' actions affect interest rates, the amount of credit available, and the money supply, all of which have direct impacts not only on financial markets, but also on aggregate output and inflation. A national bank is a financial institution established to act on behalf of the government to control and regulate activities of the financial sector. It has different names in different countries. It is usually referred to as Central Bank, which is the apex of the banking sector. For instance, in Kenya it is "Central Bank of Kenya", in the U.S.A., "The Federal Reserve Bank.", in the U.K, "The Bank of England"

Unlike commercial banks, the objective of national banks is not generating profit by transacting with the general public in depositing, borrowing, and lending activities. The duties and responsibilities of national banks are far more extensive than those of commercial banks or of any other financial institutions.

The National Bank of Ethiopia (NBE) was established with capital of Birr ten million. It was owned and operated by the government and managed by a board of directors. The NBE was restructured by the government with Proclamation No 206/1963 and began its operation in 1964. After the fall of Emperor Haile Sellasie I, it was restructured by Proclamation No 99/1976. The roles and functions of the NBE were redefined again after the downfall of the Derg in Proclamation No 83-84/1994. The bank has now, among other things, the following responsibilities. It

- *has the exclusive right to mint coins and print (issue) currency notes that circulate in the national economy;*
- *issues government debt instruments or securities such as bonds, treasury bills, and promissory notes on behalf of the government;*
- *promotes the existence of balanced and accelerated economic growth;*
- *reduces the level of unemployment and maintains low levels of inflation;*
- *encourages the formation of micro and other financial institutions and supervises and regulates the activities and operations of these financial institutions in general and of commercial banks in particular;*
- *acts as the banker of the government: deposits government money and provides direct advances to the government;*
- *acts as a last resort for commercial banks that need to borrow money at times of shortage;*
- *regulates the money supply, interest rates and other charges, and the creation of credit by commercial banks;*
- *formulates the monetary policy framework for the country;*
- *manages and administers the international reserve of the country;*
- *regulates the foreign exchange of the country and organizes the foreign exchange auction market for the determination of the exchange rates; and*
- *prepares regular reports on the money supply, production of goods and services, and official international economic transactions carried out by the country.*



Activity 7.3

Discuss the economic rationale for the existence of different denominations; particularly the choice of metallic coins that represents one Birr which we are using it at present.

Roles and Functions of Commercial Banks and Insurance Companies

A *The Commercial Bank of Ethiopia (CBE)*

The Commercial Bank of Ethiopia is the biggest and the leading commercial bank in Ethiopia. It had 32.9 % of the banking sector in Ethiopia in 2008/09. It had 209 branches throughout the country and 5 billion Birr capital in the same year. It was incorporated as a share company in December as per the Monetary and Banking Proclamation No 207/1995. It took over the banking activities of the former State Bank of Ethiopia and began operation in January 1964. The initial capital of the bank was Birr 20 million.

The first private bank that was in operation together with the Commercial Bank of Ethiopia was Addis Bank S.C. It was established in October 1964 as a joint venture (JV) between Ethiopians and National and Grindlays Banks of London. The bank was established with a paid up capital of 2 million Birr. Its capital increased to 5 million Birr by the year 1968 with a total of 26 branches and 300 employees. By 1976, Addis Bank was merged with other banks, of Italian origin, under Proclamation No 69/1975. The capital had increased to 20 miilion Birr, and there were 34 branches and 480 employees, making it the second largest commercial bank in the country.

Due to the change of regime and the Derg economic policy, the Addis Bank and the former Commercial Bank of Ethiopia were merged to form the present day Commercial Bank of Ethiopia on August 2, 1980. In the same year, the bank had 65 million Birr capital and 155 branches throughout the country.

Roles and functions of CBE:

- *Help to encourage households to save money, since saving is important for investment;*

- *Accept Deposits of different kinds, such as saving, time, and demand deposit;*
- *Advance loans, credit, overdrafts, and other services for individuals and firms;*
- *Conduct supervision and follow-up on the use of credit and loans provided to customers;*
- *Maintain safe-deposit vaults and lockers and receive valuables and securities for safe custody;*
- *Sell and purchase foreign currencies;*
- *Issue letters of credit (LC), travellers cheques, etc;*
- *Issue bonds and participate in the buying and selling of treasury bills, bonds, and other negotiable instruments and securities;*
- *Conduct the transfer of money from one place to another;*
- *Prepare regular financial reports to the NBE;*
- *Accelerate the process of monetization in the economy.*

Broadly speaking, the following are the major types of bank, classified based on their functions:

- ***Commercial Banks:*** *advance short-term funds/loans to business people and traders. Their deposits are only for a short period. The loan period extends from 3 to 6 months.*
- ***Industrial Banks:*** *provide long-term loans to industries*
- ***Agricultural Banks:*** *meet the requirements of the agricultural community, particularly in a predominantly agricultural country.*
- ***Foreign Exchange Banks:*** *specialize in facilitating foreign trade by making international payments.*

B *Development Bank of Ethiopia (DBE)*

One of the two specialized banks established in the 1940s, during the Imperial region, was the Agricultural Bank. It was initially established in 1945, and it was replaced by the Development Bank of Ethiopia in 1951. The purpose of the bank was to foster the development of the agricultural sector. On the other hand, the Investment Bank of Ethiopia (IBE) was established in 1963 for the purpose of developing the industrial sector. The Agricultural and Industrial Development Bank (AID Bank) was established in 1974 with the paid up capital of 100,000 Birr by the government to take over the activities of the former DBE and IBE. The objectives, functions, and roles of the AID bank include the following:

- *To advance loans and credit for the development of both the agricultural and industrial sectors;*
- *To act as agent or representative of individuals and firms to effect payment on their behalf;*
- *To act as a guarantor to viable agricultural and industrial projects;*
- *To supervise and control the activities of projects financed by the bank;*
- *To engage in investment of equities; and*
- *To perform other similar functions and responsibilities like the commercial banks.*

C *The Construction and Business Bank (CBB)*

The other specialized bank was the Housing and Saving Bank (HSB) which was established in November 1975. The bank was created by amalgamating the former Imperial Saving and Home Ownership Public Association and the Saving and Mortgage Corporation S.C. The purpose of the bank was to encourage the construction of residential houses by providing long-term loans at a low rate of interest in urban areas. The working capital of the bank in 2008/09 was 196 million Birr. It had 32 branches by the same year.

The objectives, functions and roles of the bank are, among other:

- *Provision of long-term loans and credits in the construction and acquisition of buildings;*
- *Accepting saving, demand, and time deposit so as to mobilise funds for investment in construction;*
- *Conducting, monitoring and following up end uses of loans advanced;*
- *Discounting promissory notes and other securities issued by other parties; and*
- *Performing similar other functions as commercial banks as per the Commercial Code of Ethiopia.*

D *Insurance Services in Ethiopia*

Every day we face the possibility of the occurrence of certain problems leading to uncertainities that could lead to large financial losses. A spouse's earnings might disappear due to death or illness; a car accident might result in costly repair bills or payments to an injured party. Because financial losses from crises could be large relative to our financial resources, we protect ourselves against them by purchasing insurance coverage that will pay a sum of money if the uncertainty occurs. Life insurance companies sell policies that provide income if a person dies, is incapacitated by illness, or retires.

History tells us that insurance services in Ethiopia have been known since the Axumite era. However, the collapse of the Axumite kingdom led to the formation of local and indigenous self-help groups, such as “Idir”, “Ekub”, and “Mahiber”. These informal institutions are serving the peoples of Ethiopia up to now.

- *Modern forms of insurance service are said to have been introduced in Ethiopia by Europeans.*
- *The practice of modern insurance services started in the 1920s when the Bank of Abyssinia started underwriting fire and marine insurance as an agency to a foreign bank.*
- *The first insurance company was established in 1923 by an Austrian named Muzinger, which served as an agency for a foreign Fire Insurance Company.*
- *During the Italian invasion, no insurance company was allowed to operate except the Italian insurance companies.*

Historical Note

The first insurance company owned by the Ethiopian government was established in 1951 with the name of Imperial Insurance Company of Ethiopia.

There were about 13 insurance companies operating in Ethiopia before 1974.

The nationalization of foreign and local private insurance companies in 1975 led to the formation and establishment of the Ethiopian Insurance Corporation (EIC) in January 1976 by Proclaimation No. 68/1975 with a paid capital of 11 million Birr with the aim of providing all kinds of insurance services in Ethiopia. In 2008/09, EIC had 39 branches and 249.4 million Birr capital.

Content Check 7.2

1 A financial institution established to act on behalf of the government to control and regulate the activities in the financial sector is known as ______.

2 What is the major role of financial institutions?

3 Mention at least five major functions and roles of the NBE.

4 Which of the following cannot be regarded as function of central banks?

A Issuing notes

B Acting as custodian of cash reserves

C Acting as custodian of foreign exchange

D Acting as controller of credit

E None of the above

5 Mention some of the functions and roles of CBE.

6 What is the basic difference between NBE and CBE?

7.2 FINANCIAL SECTOR POLICIES AND REFORMS IN ETHIOPIA

At the end of this section, you will be able to:

- examine the financial policies that existed during the Monarchy, Derge and EPRDF.

Key Terms and Concepts

- Financial policies
- Performances
- Imperial
- Derg
- EPRDF

What is your opinion about the major financial economic policies that are undertaken by the current government?

Following the McKinnon and Shaw (1973) paradigm, financial liberalization has been high on the agenda of developing countries. The financial repression school argues that government intervention in the finance sector, in particular through subsidized interest rates and credit allocation, not only distorts the financial market but also depresses savings and leads to inefficient investment. The policy prescription that follows is liberalization. This has been endorsed by international financial and development institutions, such as the World Bank (WB) and the International Monetary Fund (IMF), and was high on the agenda of the reform packages prescribed for most developing countries, called Structural Adjustment Programs (SAPs).

7.2.1 The Financial Policies During the Imperial Period (pre-1974)

The pre-1974 financial sector policy of the government was in line with the pro-capitalist economic system, which allows the participation of the private sector in the economy, particularly in the financial sector. As a result, there were both foreign as well as local private banks and insurance companies operating in Ethiopia until they were nationalized in 1974. There was no capital ceiling requirement by the government. However, the monitoring and regulatory capacity of the National Bank of Ethiopia was limited in the period under discussion.

7.2.2 The Financial Policies of the Derg Period (1974-1991)

The pre-reform period here refers to the Derg period from 1974 to 1991. This was a regime characterized by absolute government control of major economic activities in the country. During this period all private banks were nationalized and converted into institutions organized along socialist principles. It was the duty of the National Bank of Ethiopia to regulate the activities of these institutions on behalf of the government. As noted earlier, CBE, AIDB (DBE), HSB (CBB) were in operation during this period. In addition to these banks, there were also two other financial institutions: Ethiopian Insurance Corporation (EIC) and the Pension and Social Security Authority (PSSA).

The government also attempted to offset its budget deficit by borrowing from the banking system which constrains the amount of money that goes to the private sector; this reduced the participation of the private sector. For instance, the interest on saving deposits made by the private sector remained at 6% on deposits up to 100,000 Birr and 2% over this amount so as to discourage "accumulation of capital". In fact, saving deposits by socialized sectors were not allowed. Interest rates on time deposits were between a minimum of 4% to 7.5%, depending on the sources of the funds.

Lending rates were also discriminatory in nature. Cooperatives were the most favoured customers of banks, followed by public enterprises. The lending rates remained between 9% and 10.5% for most of the activities in the different sectors of the economy: 8.5% for export trade, 3-5% to the central government, and 5-6.5% for banks until June 1986. These rates were revised on July 1, 1986, becoming slightly higher for public enterprises, and were further raised for the private sectors.

All in all, the financial policy of the Derg favored inefficient public sectors at the expense of private sectors, and it proved to be a failure for the development of the financial sector. The attempt of the government to expand the public sector was very much limited due to the shortage of foreign exchange. This in turn led to borrowing and dependency on foreign assistance. However, it was difficult to get external financial assistance due to political ideology differences, and the funds were allocated in non-development areas such as defences, and military expansion.

The government kept the exchange rate at a low level by establishing a fixed exchange rate regime. Exchange rate, as price of domestic currency expressed in terms of foreign currency, affects the price of both export and import goods. The fixed exchange rate policy was adopted primarily to prevent the domestic cost of imported goods, especially that of imported raw materials and inputs. However, the overvalued exchange rate has affected the growth of the export sector by making the price of exported goods expensive at abroad.

The government also adopted a very restrictive foreign exchange policy in order to reduce aggregate demand for foreign exchange in the economy. It also introduced a high import tariff. This restrictive measure, however, led to the smuggling of goods, both imported and exported, and to the flourishing of a black-market foreign exchange market.

In general, huge government borrowing, restrictive financial policies, and lack of participation of private sector and inefficient use of financial resources by the public sector were the major characteristics of the Derg regime. However, relative macroeconomic stability was achieved at the expense of overall economic growth due to forced measures of saving by the good-performing public enterprises and non-bank financial institutions, and by the draining of the foreign reserve.

7.2.3 The Financial Policies of EPRDF (Post-1991)

Proclamation No. 84/1994, which allowed the private sector (owners have to be Ethiopian nationals, however) to engage in the banking and insurance businesses, marked the beginning of a new era in Ethiopia's financial sector. Following this proclamation the country witnessed a proliferation of private banking and insurance companies.

The attempt to control inflation, to maintain it at a low level was mainly carried out by adopting a monetary policy which kept the pace of growth in money supply in line with the growth rate of the nominal gross domestic product (NGDP). The government has also envisaged ensuring the availability and expansion of credit to the growing private sector and has made some adjustments to interest rates. For instance, the government abolished the discriminatory lending interest rates and fixed minimum deposit and the maximum lending rates since 1994/1995. However, the government later abolished the ceiling rates, freeing them to be determined by market forces of demand and supply in January 1998.

Note:

The government used indirect monetary policy instruments such as Open Market Operation (OMO) for government securities. These are markets for Treasury Bills (TB) and Government Bonds (GB). OMO (Open Market Operation) refers to the purchase and sale of securities such as bonds by the central bank to the public. The purchase of bonds by the central bank is known as Open Market Purchase (OMP), and the sale of bonds by the central bank which is known as Open Market Sale (OMS).

Auctioning of securities in the open market was started in January 1994/95 with three types of TBs maturing in 28, 91, and 180 days, respectively. This marked the start of the development of the money and capital market in the country. Besides, such instruments relate to non-inflationary financing monetary policy which could help to avoid draining the amount of credit available to the private sector.

The government devalued the Birr in October 1992 and introduced the auction market for foreign exchange in May 1993 in an attempt to determine the exchange rates by market forces and to increase exports. Importers, banks and investors participated in the retail market until it was replaced by the weekly wholesale foreign exchange market in 1999 that only allowed the participation of banks and investors. This was replaced by the inter-bank foreign exchange market in 2001 which allows the participation of licensed foreign exchange dealer banks to determine the daily value of a foreign currency in terms of Ethiopian Birr.

In general, the EPRDF government has taken a number of policy measures to enable the financial sector to contribute to the development of the economy since 1992. Among these measures:

- *The adoption of monetary and banking proclamation that enabled the NBE, the licensing and supervision of banking;*
- *The formation and reorganization of the two government owned specialized banks of DBE and CBB;*
- *The transferring of non-performing loans from the existing banks to the Ministry of Finance;*

- *The restructuring of NBE as a separate entity outside the government with the foreign exchange management and other functions; and*
- *The proclamation for the establishing and restructuring of Agricultural Cooperative Societies so as to mobilize savings and allocate credits in rural areas.*

Activity 7.4

Discuss the financial sectors evolution policies in Ethiopia.

7.3 PERFORMANCE OF THE FINANCIAL SECTOR IN ETHIOPIA

At the end of this section, you will be able to:

- evaluate the performance of the financial sector in Ethiopia.

Key Terms and concepts

- Narrow money
- Broad money
- Quasi money
- Interest rates

One of the major objectives and functions of the financial sector is to make credit available and allocate it efficiently to end users. The sector not only distributes the amount of credit needed but also collects back the loan advances with some margin of profit in the form of interest. Therefore, the principal and the interest is to be collected by financial institutions but this is not achieved without many difficulties. Sometimes borrowers are unable to repay their debts, and banks have large amount of non-performing loans (NPLs) and bad debts.

Historical Note

Government owned banks performed poorly during the Derg Regime due to its restrictive and discriminatory policies, lack of institutional arrangement and capacity. Banks were obliged to comply with the government plan by advancing credit and loans to public enterprises, state farms, cooperatives and the central government.

Money, narrowly defined in the Ethiopian context, includes currency in circulation outside the banking sector and demand deposit. A demand deposit is a deposit that can be withdrawn at any time without giving prior notice. In contrast, broad money supply is defined as narrow money plus savings and time deposits. Savings and time deposits together are known as quasi money. Hence, broad money supply is the sum of narrow money supply and quasi money. Between 1972 and 1991, the narrow money supply showed an annual average growth rate of 10%. For the same period, broad money showed an annual average growth of 12.5%. However, the expansion of credit to the non-government sector has shown a declining trend.

Table 7.5: **Components of Broad Money (in millions of Birr)**

Particulars	End of June			Annual Percentage Change		
	2006/07	2007/08	2008/09	2006/07	2007/08	2008/09
Narrow money Supply	2,9617.7	35,350.4	42,112.66	24.4	19.4	19.1
- Currency in Circulation	1,3708.4	17,654.1	19,715.01	20.0	28.8	11.7
- Demand deposit	1,5909.3	17,696.3	22,397.64	28.4	11.2	26.6
Quasi-Money	2,7034.2	32,831.8	40,397.09	19.8	21.4	23.0
- Saving Deposit	2,3715.2	29,477.6	37,148.72	15.8	24.3	26.0
- Time deposit	3,319.0	3,354.1	3,248.37	59.6	1.1	-3.2
Broad Money Supply	56,651.9	68,182.1	82,509.8	22.2	20.4	21.0

Source: *Annual Report of NBE, (2008/09).*

Activity 7.5

What lesson can you drive from Table 7.5? (*Focus on circulation of money*)

The annual growth rate of domestic liquidity per year, as measured by broad money (M2), was 21 % and reached 82.5 billion Birr compared to the 20.4% of 2007/08. The expansion in broad money was largely driven by higher net foreign assets and domestic credit. The growth in domestic credit was attributed to rises in credit to the non-government sector while credit to the government dropped by 0.9 percent. On the other hand, the rise in net foreign assets was due to higher inflows from net services, transfers, and external loans and grants.

The fiscal year 2008/09 witnessed a surge in all components of broad money. Narrow money rose by 19.1 percent to Birr 42.1 billion, driven by 11.7 and 26.6 percent increases in currency in circulation and demand deposits reflecting the growing economic activities and higher transactions demand for money. Similarly, quasi money surged to 23.0%, owing to growing financial intermediation as banks continued to expand their branches throughout the country.

One of the most important functions of commercial banks in the area of financial intermediation is deposit mobilization and lending activities. There has been growth in these activities in the post-reform period.

Minimum interest rates on savings and time deposits remained the same for 2007/08 and 2008/09, at 4%, while the maximum deposit rate rose to 5 percent from 4.5 percent for the same period. Hence, the average interest rate on savings deposits increased to 4.5% from 4.08 percents and that of time deposits increased to 5.26 percent from 5.16 percent. Similarly, the average lending rate rose to 12.25 in 2008/09.

Table 7.6: **Interest rate structure of commercial banks (in percent per annum)**

Rates \ Year	2005/06	2006/07	2007/08	2008/09
Deposit rate				
Saving deposit				
Minimum	3.000	3.000	4.000	4.000
Maximum	3.150	3.150	4.150	5.000
Average	3.075	3.075	4.075	4.500
Time Deposit				
Up to 1 year	3.604	3.639	4.666	4.580
1 – 2 years	4.005	4.112	5.228	6.204
Over 2 years	4.297	4.490	5.588	4.998
Average	3.969	4.080	5.161	5.260
Demand deposit (average)	0.058	0.062	0.041	0.057
Lending Rate				
Minimum	7.000	4.000	8.000	8.00
Maximum	14.000	14.000	15.00	16.500
Average	10.500	10.500	11.500	12.250

Source: *Annual report of NBE (20008/09).*

Content Check 7.3

1 Distinguish the difference between narrow money and broad money supplies.

2 How do you compare the performance of the financial sector of the Derg Regime with that of EPRDF?

7.4 PROBLEMS OF AND POSSIBLE REMEDIES FOR THE FINANCIAL SECTOR IN ETHIOPIA

At the end of this section, you will be able to:

- assess the problems of and identify possible remedies for the financial sector

Key Terms and concepts

- Problems and solutions
- Traditional/informal sector
- Formal sector
- Collateral

The major problem facing the financial sector in the country is under-development. This can take different forms: the economy is less and less monetized; that is, it has limited circulation of money and limited number of financial institutions throughout the country. Dealings and transactions are conducted in the traditional/ informal sector in certain parts of rural areas as well as urban areas.

Hence there are different kinds of bottlenecks for the development of the formal financial sector. These include, among other things:

- *A good part of the economy is not monetized;*
- *Some borrowers, both private and public enterprises, fail to repay back loans at the agreed time in the required amount;*
- *Banks are now forced to sell collateral to enforce repayment of debts which takes time, a long process and effort;*
- *Lack of weak competition in the sector;*
- *Maintenance of large amounts of financial resources by some banks due to high collateral requirements and lack of viable projects;*

- *Shortage of trained and efficient human resources in the sector;*
- *Inadequacy of banks to convert cash into credit;*
- *Lacklustre financial deepening in the country;*
- *Very low level innovation in financial products and services; and*
- *The availability of medium-term financing for activities such as agricultural land development, irrigation, purchase of machinery and equipment, plantation, and food processing and packing are either very limited or unavailable.*

However, the sector has tremendous and unexploited potential for development. The spread of small financial institutions throughout the country can help to channel surplus funds to the formal financial sector. This can be done by mobilizing large amounts of local as well as foreign savings. Efforts are also required to expand the types of financial services provided by the existing institutions. A strong policy framework and a strengthened regulatory government body is required to avoid unfair practices in the banking and insurance services.

Content Check 7.4

1 Explain in detail the major problems of the financial sector in Ethiopia.

2 Explain in detail possible solutions for the problems faced by the financial sector.

UNIT REVIEW

UNIT SUMMARY

- Monetary policy refers to the management of money and its links to price, interest rates and other economic variables. The historical development of money started in barter systems, exchanging goods for goods, and then the market system changed and transactions started using coins and paper money. In different governments, different types of coins and paper money have been used. Leaving the long history aside, modern banking in Ethiopia started in 1905 with the establishment of Abyssinia Bank. Then different banks were established during the Italian occupation time.
- NBE was established and started operation in 1964 with different powers, roles and functions to control all banks in Ethiopia. During EPRDF different public and private banks and insurance companies have been established.
- The Imperial, Derge and EPRDF governments set and reformed different types of policies and reforms.
- The performance of financial sectors in Ethiopia is set to make credit available and to allocate it to end users. In the Derg Regime, government-owned banks performed poorly due to discriminatory and restrictive policies.
- The major problem of financial sectors are limited circulation of money and limited financial institutions to solve this problem, the current government is expanding financial institution at large.

REVIEW EXERCISE FOR UNIT 7

I *Choose the best answer from the given alternatives.*

1 Which one of the following government institutions is directly responsible for the conduct of monetary policy?

A Ministry of Finance and Economic Development

B Ministry of Trade and Industry

C Commercial Bank of Ethiopia

D National Bank of Ethiopia

2 Which of the following cannot be regarded as a function of central banks?

A Issuing notes

B Acting as custodian of cash reserves

C Acting as custodian of foreign exchange

D Acting as controller of credit

E None of the above

II *Answer the following questions briefly.*

3 How do you compare the performance of the financial sector of the Derg regime with that of the EPRDF?

4 What was the first modern bank in Ethiopia?

5 Discuss the currency of Ethiopia in your group and compare it with other currencies like the Dollar, Euro, Sterling and Yen.

6 Explain in detail the major role of financial institutions.

7 Mention at least five major functions and roles of National Bank of Ethiopia.

8 What is OMO? And what are the instruments of OMO?

UNIT 8

THE ECONOMIC REFORM PROGRAM IN ETHIOPIA

Unit Objectives

After completing this unit, you will be able to:

- state the main elements of the New Economic Reform and its important aspects in Ethiopia;
- examine structural adjustment policy measures undertaken in Ethiopia; and
- understand investment policy in Ethiopia.

Main Contents

8.1 THE NEW ECONOMIC POLICY AND THE NEED FOR REFORM

8.2 PERFORMANCE OF THE ECONOMY AFTER THE NEW ECONOMIC REFORM PROGRAM

8.3 INVESTMENT POLICY AND CLIMATE IN ETHIOPIA DURING THE POST-1991 PERIOD

- *Unit Summary*
- *Review Exercise*

INTRODUCTION

From our discussions in the previous units, you have learned about, among other things, the resource base of the country, the structure performance, and constraints of the three important sectorial components of the country: the agriculture, industry and service sectors. You are also learned that the economy has shown no structural transformation for the last three decades or so. Structural transformation refers to the transition from traditional agricultural to modern manufacturing activity.

It has been documented that, as indicated by socio-economic indicators, Ethiopia appears to be one of the poorest countries in the world. To reverse this image, a number of economic reforms were taken by the government during 1990s. Hence, in this unit we will study the need for economic reform programs and the various reform measures taken by the government in the 1990s.

8.1 THE NEW ECONOMIC POLICY AND THE NEED FOR REFORM

At the end of this section, you will be able to:

- explain the new economic policy and the needs for reform.

Key Terms and Concepts

- Economic reform
- Investment
- Structural Adjustment Program (SAP)
- Consumption
- Saving
- Fiscal policy
- Economic growth

What is your understanding of the new economic reform taken by the current government?

In 1974/75 Ethiopia made a transition from a mixed economic system to a totally controlled economy that pushed the economy downward. During the central planned economy, the restrictions and taxation on the Ethiopian economy were substantial.

For instance, farmers in the main cereal growing areas had to supply a predetermined quota of grain to the government at a fixed low price and taxation levies on both rural and urban households were substantial factors of production. Also other markets were restricted, and rural wages and other market factors were repressed, and private sector developments were totally discouraged.

It has been documented that the per-capita income was birr 211.17 in 1973/74 and that it declined to 180.3 in 1990/91. In the mid 1980s, famine and war not only created a huge humanitarian disaster, but also pushed the economy farther back. In terms of growth rate, the average GDP growth rate was less than two percent (2%) in the period 1973/74-1990/91. Population, on the other hand, grew at about 2.9% in the same period, causing a deterioration in the living standard of the society at large. Military expenditures absorbed about 12-16 percent of the GDP, while the fiscal deficit increased from 11.9 percent in 1987/88 to 13.2% in 1990/91.

The poverty situation in the country was among the worst in the world. It has been documented that about 50% of the population in the country cannot afford the minimum food requirement. For instance, 52% of the rural and 36% of the urban population were unable to meet the minimum food requirement. This means that food poverty in rural areas was higher than in the urban ones. On top of this, 47% of the rural population and 33% of the urban population were found to be in absolute poverty.

> **Note**
>
> Absolute poverty is a state of poverty where an individual's daily income is below one dollar.

Furthermore, during the entire Military era, gross domestic saving was between 2.8% and 12.5% of the GDP, which was 14% of GDP in 1973/74. The public deficit became a huge burden on the economy, reaching 8.6 billion USD in 1990/91. The per-capita debt burden (356 birr) was far greater than the per-capita income of the country (18.3 birr).

The reason for the problematic performance of the economy was, among other things, due to:

- *mismanagement of economic resources,*
- *internal instability,*
- *recurrent drought, and*
- *poor performance of the agricultural sector.*

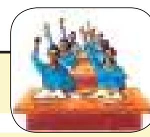
For instance, the annual growth rate of the agricultural sector averaged less than 2% during the Derg. Hence the agricultural sector was serously affected by the economic crisis, and it was totally incapable of protecting itself from the major economic collapse. Therefore, the performance of the Ethiopian economy progressively declined during the Derg.

This major economic collapse called for substantial reforms in the country. In order to lift the economy from its low level of development that had been caused by natural and human-made catastrophes as well as rigid macroeconomic policies, the Transitional Government of Ethiopian (TGE), which came into power on 28 May 1991, took steps to rehabilitate and reconstruct the war-damaged economy by adopting market-oriented economic policies scheme and stabilization and Structural Adjustment Program (SAP).

Note

Budget Deficit - is said to exist when government expenditure's in excess of government revenue.

Activity 8.1



Collect information on macroeconomic variables such as GDP and investment from relevant institutions and authorities.

8.1.1 Introduction to the Structural Adjustment Program

In response to the near collapse of the Ethiopian economy, coupled with unsustainable internal and external imbalances like the high inflation rate, negative interest rate and unviable debt ratio, the government of Ethiopia (GOE) in 1993 initiated a Structural Adjustment Program (SAP) for the period 1993-1996 with the support of the International Monetary Fund (IMF), World Bank (WB), African Development Fund (ADF) and other multilateral and bilateral donors.

The Structural Adjustment Program's refers to the reorganization of institutions, economic activities and the entire social system, in line with market-oriented economic systems. The overall goal of SAP was stabilization and adjustment. The stabilization policy focused on restoring macroeconomic balance and reducing inflation and government budget, controlling the economy and the like. The Structural Adjustment Policy focused also on removing constraints on the supply side and pay a close attention to the production of export crops through depreciation of the real exchange rate and other incentives.

The Structural Adjustment Polices were also aimed at encouraging the development of the private sector, fostering competition throughout the economy and promoting the process of market determination of all prices, including exchange rates and interest rates. The main objectives of SAP include revival of economic growth, reducing macroeconomic distortion, improving economic efficiency and resource allocation and expanding the productive capacity of the economy.

Broadly speaking, the structural adjustment program has three components

- *Expenditure reducing policy*
- *Expenditure switching policy*
- *Institutional policy reform*

A ***Expenditure reducing policys:*** it is a policy of reducing spending level in the economy by adopting stringent monetary policies such as tight money supply, credit control and reducing public deficit. The aim of this policy is to curtail domestic demand so that demand-pull inflation can be prevented and domestic saving can be promoted.

B ***Expenditure switching policy:*** it is a policy of redirecting productive resources from nonproductive sectors to productive sectors or investments. Such a policy incorporates exchange rate devaluation, trade intervention, taxes, tariffs, and deregulation of price.

C ***Institutional policy reform:*** it is a policy of restructuring institutions towards competitiveness and efficiency through a market-oriented economy. The policy reform includes trade liberalization, privatization, reducing the state holdings in the economy, fiscal reform, financial market reform, and the like.

Note

Deregulation of prices refers to leaving the market price for commodities and factors of the production be determined by the market force of demand and supply without any government intervention.

8.1.2 Structural Adjustment Policy Measures Undertaken in Ethiopia

Ethiopia responded to the problem discussed in 8.1 by undertaking appropriate policy measures aimed at correcting imbalances in the economy, promoting the role of market forces in allocating resources, and removing impediments to the development of the private sector. The main policy measures for achieving the country's development objectives were:

1 Macroeconomic reforms include:

- *Monetary policy*
- *Exchange rate policy*
- *Fiscal policy and*
- *Interest rate policy*

> **Note**
>
> External Balance:- refers to an equilibrium achieved in the balance of payment.

A ***Monetary policy:*** the government of Ethiopia pursues a tight monetary policy to ensure consistency in money expansion with low inflation, rapid economic growth and external balances.

B ***Exchange rate policy:*** in 1992, a devaluation scheme was adopted to encourage exports and discourage imports. This helps to narrow the gap between export and import and thereby improve current account. It also helps to narrow the gap between official and black-market rates and abolish illegal trade in the country.

C ***Fiscal policy:*** is defined as the part of government economic policy which deals with taxation, expenditure, borrowing and the management of public debt in the economy. Such policy reform is undertaken to reduce fiscal deficit by greatly reducing government expenditure and expanding the tax base. At a time of depression and unemployment, the government should spend more than its revenue and thus insure a deficit in the budget.

D ***Interest rate policy:*** interest rate ceilings were abolished so as to enable it to reflect the state of the finical sector.

2 **Privatization:** with the objective of economic efficiency and profitability, a number of public enterprises have been privatized, and the process of privatization is still underway.

3 **Transport deregulation:** zonal restriction on transport service was abolished. To improve the financial performance of the sector, transport tariff rates have been revised.

4 **Domestic price liberalization:** price controls were abolished; prices of state-owned industrials and agricultural products were left to be determined by the market force of demand and supply.

5 **Foreign trade liberalization:** restrictions on trade were lifted by introducing a system of open general license. Export taxes on all commodities, except on coffee, were removed. Trade liberalization reacquird removal of import barriers inclining the replacement of quantitative restriction (quota) by tariffs whose rates are to be revised over time. Accordingly tariff rates have been revised and reduced.

6 **Private sector reform:** this measure is undertaken to encourage the participation of the private sector in the economic growth and development endeavors of the country. As a result the investment policy was revised in such a way as to promote both domestic and foreign investments and also to expand production activities and employment in the country. Absorption of foreign technology know-how and technical skills by Ethiopian entrepreneurs were also parts of the investment objective.

Activity 8.2

Discuss the major structural adjustment policy measures undertaken in Ethiopia.

Content Check 8.1

1 What does SAP mean?

2 What is the major objective of SAP?

3 List the three major components of SAP.

A ______________________________.

B ______________________________.

C ______________________________.

4 ____________ is a policy of redirecting productive resources from nonproductive sectors to productive sectors or investment.

5 ____________ policy reforms trade liberalization and privatization.

8.2 PERFORMANCE OF THE ECONOMY AFTER THE NEW ECONOMIC REFORM PROGRAM

At the end of this section, you will be able to:

- evaluate the performance of the economy after the reform program.

Key Terms and Concepts

- Economic performance
- Government finance/investment
- Private sector/investment
- GDP growth
- Population growth
- Economic reform program

What is your opinion about the new economic reform program taken by the government?

The trend of economic growth for the period between 1960 and 1992 was unsatisfactory. This very dismal economic performance was caused by a number of factors, including rigid macroeconomic policies, protracted war, and recurrent droughts, which drained huge amounts of the country's resources and created a hostile external environment. The problem of the drought was the most severe of all.

It has been documented that the extent of drought varies from period to period, and that, between 1960 and 1992, drought and famine occurred at least nine times. The size and magnitude of rainfall has substantial effect on the performance of the entire economy, and so the above-mentioned drought conditions shrank the economy significantly.

Between 1963/64-1998/99, regardless of the policy regime, real GDP grew, on average, by 2.97%, while population grew, average, by 2.9%, resulting in a 0.06% (2.97%-2.91% = 0.06) annual growth rate per-capita income. This indicates that the economy had stagnated for the last three decades or so.

Table 8.1: **General government finance (in millions of birr)**

Year Indication	1989/90	1990/91	19991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998199
Total Revenue	3142.6	2706.7	2207.9	3191.2	3939.1	5912.8	6966.1	7877.4	8412.9	9413.8
Recurrent Expense	3842.6	3640.1	3253.5	3434.5	4399.6	5215.7	5582.3	5717.1	7081.4	8486.4
Capital Expense	14440-1	1214.1	951.8	1784.9	2694.3	3156.5	3562.6	4299.9	4146.6	4307.3
Total Expense	5382.0	4854.2	4205.3	5219.4	7093.9	8372.2	9144.5	10,017.0	11228.0	12793.7
Deficit	2140.4	2147.5	1997.4	2028.2	3154.8	2459.4	2178.8	2139.6	2815-1	3379.9

Source: *MEDAC (Ministry of Economic Development and Cooperation).*

From Table 8.1 you can see that the public sector deficit declined between 1989/90 and 1998/99, except in 1993/94 and 1998/99. In the latter years there was the Ethio-Eriteria war, which resulted in the highest recurrent expenditure. Thus, in the area of public deficit reduction, it can be concluded that the program was a success.

Table 8.2: **Average growth**

Sectorial period	Pre-program 1990/91-1992/93	Program 1993/94-1995/96	Post program 1996197-1998/99
Overall growth rate, real GDP	1.4	6.1	3.6
- Agriculture	2.9	4.8	0.9
- Industry	0.8	6.7	7.1
- Service	0.2	8.0	8.6

Source: *MEDAC (Ministry of Economic Development and Cooperation) year.*

From Table 8.2, notice that the average growth rate of agriculture decreased, the industry sector showed improvement, and the service sector increased rapidly in 1996/97 - 1998/99.

Table 8.3: **Demand-side indicators of economic performance**

Indicators	1980/81-1992/92	1992/93-19998/99
Aggregate consumption	93.4	97.0
Public consumption	16.1	13.0
Private consumption	77.3	81.0
Gross capital formation	13.6	16.3
Gross Domestic Saving (GDS)	6.7	6.3

Source: *National Bank of Ethiopia, (1999/2000).*

From Table 8.3, notice that the period of the reform program showed an improvement in all indicators except in GDS. A higher share in gross capital formation (GCF) was achieved due to the creation of an enabling environment, especially for the development of the private sector, and to the mobilization of available resources.

Table 8.4: **Private investment appraisal and implementation**

Fiscal year	Approved Investment		Commenced operation	
	Number	Million Birr	Number	Million Birr
1992/93	543	4082	123	1908
1993/94	523	3533	149	731
1994/95	686	5237	314	2525
1995/96	905	6514	399	2104
1996/97	794	6806	243	745
1997/98	894	10,093	194	629
1998/99	705	5205	69	141

Source: *Ethiopia Investment Authority, year.*

As shown in Table 8.4, all those measures aimed at developing the private sector bore fruit. The number of approved investment projects has risen rapidly even since the implementation of the program. A total of 50/50 projects were approved between 1992/93 and 1998/99 for a total amount of 41.5 billion birr, of which 1491 have actually commenced operation for a total amount of 8.8 billion birr. This trend is expected to accelerate as the privatization program moves into full capacity.

Activity 8.3

1. Collect some information from newspapers, radio or television that are related to Gross Domestic Product (GDP) and explain your conclusions in class.
2. Collect information related to an investment from newspapers or other different media and briefly explain the investment in class.

Content Check 8.2

1. What do you understand from Table 8.1? Explain in detail
2. What are the causes for the unsatisfactory results of the 1960 and 1992 economic reforms? Explain in detail.
3. Explain in detail the difference between private consumption and public consumption.

4 Explain briefly the indicators you use to assess the performance of the economy after the reform program.

5 Explain in detail the reasons behind the implementation and approval of the government 50/50 projects.

8.3 INVESTMENT POLICY AND CLIMATE IN ETHIOPIA DURING THE POST-1991 PERIOD

At the end of this section, you will be able to:

- describe the investment policy and explain the investment climate in Ethiopia, post-1991.

Key Terms and Concepts

- Investment policy
- Investment areas
- Foreign investors
- Domestic investors
- Investment capital

What is your understanding of the investment policy taken by the current government?

It is widely known that the ancient country of Ethiopia underwent a period of turmoil, economic stagnation and famine during the 1970s and 1980s. In 1991, the Military government was replaced by the Transitional Government of Ethiopia with the introduction of new political and economic policies. In terms of the economic reform policy, a new program was launched with one of its primary objective being to build an economy in which the private sector plays a leading role. To enhance the role of private investment in the development process, various policy measures have been taken by the government. The policy measures were designed to eliminate discrimination against the private sector and to create a conducive environment for private investment.

Investment Proclamation No. 15/1992 was issued as the first policy measure by the Transitional Government of Ethiopia (TGE) for the purpose of encouraging both domestic and foreign investment. This proclamation removed restrictions on private investment and allowed for wide participation of the private sector. Several investment incentives were provided under Article 13 of the proclamation. The proclamation states that domestic and foreign investors shall be entitled to exemption of import and export related taxes and duties, income tax withholding and some other benefits. Further more the proclamation listed available investment opportunities in the country.

The investment areas that are reserved only for government are:

- *Defence*
- *Heavy industry*
- *Large-scale electrical and energy work*
- *Large-scale air and marine transportation*
- *Postal and telecommunication servicese.*

The minimum investment capital requirement for the private investors in the country was also indicated. In the proclamation foreign investors were required to have a minimum investment capital of $USD 500,000 and deposit in cash of not less than 25% of the investment capital. With regard to domestic investors, they were required to have a minimum capital of Ethiopian birr 250,000. However, it is stated that these minimum investment capital requirements could be lowered in areas of special interest such as technology and know-how.

Later, Proclamation No 15/1992 was revised as Proclamation No. 37/1996. The new proclamation solved the shortcomings of Proclamation No. 15/1992, by reducing the minimum capital requirement for foreign investors from the previous $USD 500,000 to as low as $USD 100,000 and by lifting off 25% of the cash deposit.

The new investment Proclamation No. 280/2002 amended by Proclamation No 375/2003 was enacted with a view to:

- *Encouraging and promoting the private sector in the economic development of the country.*
- *Widening the scope of participation of foreign investment.*
- *Creating a transparent and efficient system of investment administration; this investment proclamation provides that a foreign investor can investment either*

- *As a sole proprietor with full equity ownership or*
- *Jointly or in partnership with domestic investor(s) or the government*

The law also stipulates the following capital requirement:

- *A minimum capital of $USD 100,000 for a single investment project in cash and /or in kind for wholly foreign owned inventors.*
- *A minimum capital of $USD 50,000 in cash and /or in kind per project in areas of engineering, architecture, accounting and audit service projects or business management consultancy services.*

Content Check 8.3

1. What indicators do you use to assess the performance of the economy?
2. Explain in detail why the capital requirements for the foreign and local investor are different for same types of project.
3. List some of the views with which Proclamation No. 375/2003 was enacted.
   A ______________________________.
   B ______________________________.
   C ______________________________.
4. How much capital is required to invest in areas such as engineering, architecture, accounting and audit service projects or business-management consultancy services?

UNIT REVIEW

UNIT SUMMARY

- The three important sectorial components are agriculture, industry and service. In terms of the economy as a whole, the sectors have not shown any structural transformation for the last three decades. In an attempt to convert from traditional to modern manufacturing, Ethiopia made a transition from a pro-capitalist economy system to a totally controlled economy that pushed the economy downward In 1974/75. Famine and war created a huge humanitarian disaster.
- The poverty situation in the country was the worst, and 50% of the population could not afford the minimum food requirement.
- The transitional government, which came to power in 1991, took steps to rehabilitate and reconstruct the war-damaged economy by adopting a market-oriented economic policy and Structural Adjustment Program (SAP). Broadly speaking, the Structural Adjustment Program has three components: expenditure reducing policy, expenditure switching policy and institutional policy reform.
- The unsatisfactory performance of the economy was caused by poor macroeconomic policy, drought and war.
- The investment policy and climate in Ethiopia during the post-1991 period introduced new economic and political programs. An investment policy was implemented to encourage local and foreign investors.

REVIEW EXERCISE FOR UNIT 8

I ***Write "True" or "False" for each of the following.***

1 In 1974/75, Ethiopia made a transition from controlled economy to mixed economy.

2 The annual growth rate of the agricultural sector averaged greater than 5%.

3 Expenditure se policy is a policy of redirecting productive resources to non-productive sectors.

4 Private sector reform is undertaken to encourage the participation of the public sectors.

5 No investment areas are reserved for the government only.

II Choose the best answer from the given alternatives.

6 Which one of the following policies reduces the spending level in the economy by adopting a stringent monetary policy.

A Institutional policy
B Expenditure reducing policy
C Institutional policy reform
D Monetary policy

7 One of the following exists when government expenditures in excess of government revenue.

A Fiscal policy
B Monetary policy
C Absolute poverty
D Budget deficit

8 One of the following is the government economic policy which deals with taxation, expenditure, borrowing and management of public debt in the economy.

A Interest rate policy
B Exchange rate policy
C Fiscal policy
D Monetary policy

9 How much investment capital is required for foreign investors by Proclamation No 15/1992?

A $USD 500,000 and 25% deposit in cash
B $USD 100,000 and 25% deposit in cash
C $USD 250,000 and 25% deposit in cash
D $USD 100,000 and 30% deposit in cash

10 One of the following is a state of poverty where an individual's daily income is below one dollar.

A Absolute poverty
B Drought
C Shortage of rain
D Per-capita

III Write the full form of the following.

11 GDP
12 CBE
13 NBE
14 SAP
15 TGE

Glossary

Actual investment – *the amount that firms do invest; equal to planned investment plus unplanned investment.*

Aggregate demand – *a schedule or curve that shows the total quantity of goods and services demanded (purchased)at different price levels.*

Aggregate demand – *aggregate supply model The macroeconomic model that uses aggregate demand and aggregate supply to determine and explain the price level and the real domestic output.*

Aggregate expenditures – *The total amount spent for final goods and services in an economy.*

Aggregate supply – *A schedule or curve showing the total quantity of goods and services supplied (produced) at different price levels.*

Annually balanced budget – *A budget in which government expenditures and tax collections are equal each year.*

Asset – *Anything of monetary value owned by a firm or individual.*

Average propensity to consume – *Fractional (or percentage) of disposable income that households plant to spend for consumer goods and services; consumption divided by disposable income.*

Average propensity to save – *Fraction (or percentage) of disposable income that households save; saving divided by disposable income.*

Average tax rate – *Total tax paid divided by total (taxable) income, as a percentage.*

Balance of payments *(see international balance of payments.)*

Balance-of-payments deficit – *The amount by which the sum of the balance on current account and the balance on capital account is negative in a year.*

Balance-of-payments surplus – *The amount by which the sum of the balance on current account and the balance on capital account is positive in a year.*

Bank deposits – *The deposits that individuals or firms have at banks (or thrifts) or that banks have at the Federal Reserve Banks.*

Barter – *A formal agreement among firms (or countries) in an industry to set the price of a product and establish the outputs of the individual firms (or countries) or to divide the market for the product geographically.*

Barter – *The exchange of one good or service for another good or service.*

Brain drain – *The emigration of highly educated, highly skilled workers form a country.*

Budget deficit – *The amount by which the expenditures of the Federal government exceed its revenues in any year.*

Budget surplus – *The amount by which the revenues of the Federal government exceed its expenditures in any year.*

Business cycle – *Recurring increases and decreases in the level of economic activity over periods of years; consists of peak, recession, through, and recovery phases.*

Central bank – *A bank whose chief function is the control of the nation's money supply; in the United States, the Federal Reserve System.*

Ceteris paribus assumption *(see otber-tbings-equal assumption.)*

Change in demand – *A change in the quantity demanded of a good or service at every price; a shift of the supply curve to the left or right.*

Change in supply – *A change in the quantity supplied of a good or service at every price; a shift of the supply curve to the left or right.*

Circular flow model – *The flow of resources from households to firms and of products form firms to households. These flows are accompanied by reverse flows of many from firms to households and from households to firms.*

Classical economics – *The macroeconomic generalizations accepted by most economists before the 1930s that led to the conclusion that a capitalistic economy was self-regulating and therefore would usually employ its resources fully.*

Command system – *A method of organizing an economy in which property resources are publicly owned and government uses central economic planning to direct and coordinate economic activities; command economy.*

Commercial bank – *A firm that engages in the business of banking (accepts deposits, offers checking accounts, and makes loans).*

Comparative advantage – *A lower relative or comparative cost than that of another producer.*

Competition – *The presence in a market of independent buyers and sellers competing with one another and the freedom of buyers and sellers to enter and leave the market.*

Consumer goods – *Products and services that satisfy human wants directly.*

Consumer prices index (CPI) – *An index that measures the prices of a fixed "market basket" of some 300 goods and services bought by a "typical" consumer.*

Consumption of fixed capital – *An estimate of the amount of capital worn out or used up (consumed) in producing the gross domestic product; also called depreciation.*

Consumption schedule – *A schedule showing the amounts households plan to spend for consumer goods at different levels of disposable income.*

Corporate income tax – *A tax levied on the net income (profit) of corporations.*

Credit – *An accounting item that increases the value of an asset (such as the foreign money owned by the residents of a nation).*

Currency – *Coins and paper money.*

Current account –*The section in a nation's international balance of payments that records its exports and imports of goods and services, its net investment income, and its net transfers.*

Cyclical deficit – *A Federal budget deficit that is caused by a recession and the consequent decline in tax revenues.*

Cyclical unemployment – *A type of unemployment caused by insufficient total spending (or by insufficient aggregate demand).*

Cyclically balanced budget – *The equality of government expenditures and net tax collections over the course of a business cycle; deficits incurred during periods of recession are offset by surpluses obtained during periods of prosperity (inflation).*

Debit – *An accounting item that decreases the value of an asset (such as the foreign money owned by the residents of a nation).*

Demand – *A schedule showing the amounts of a good or service that buyers (or a buyer) wish to purchase at various prices during some time period.*

Demand curve – *A curve illustrating demand.*

Demand factor (in growth) – *The increase in the level of aggregate demand that brings about the economic growth made possible by an increase in the production potential of the economy.*

Demand-pull inflation – *Increases in the price level (inflation) resulting from an excess of demand over output at the existing price level, caused by an increase in aggregate demand.*

Dependent variable – *A variable that changes as a consequence of a change in some other (independent) variable; the "effect" or outcome.*

Determinants of aggregate demand – *Factors such as consumption spending, investment, government spending, and net exports that, if they change, shift the aggregate demand curve.*

Determinants of aggregate supply – *Factors such as input prices, productivity, and the legal-institutional environment that, if they change, shift the aggregate supply curve.*

Determinants of demand – *Factors other than price that determine the quantities demanded of a good or service.*

Determinants of supply – *Factors other than price that determine the quantities supplied of a good or service.*

Devaluation – *A decrease in the governmentally defined value of a currency.*

Discretionary fiscal policy – *Deliberate changes in taxes (tax rates) and government spending by Congress to promote full employment, price stability, and economic growth.*

Disinflation – *A Reduction in the rate of information.*

Dissaving – *spending for consumer goods and services in excess of disposable income; the amount by which personal consumption expenditures exceed disposable income.*

Domestic output – *Gross (or net) domestic product; the total output of final goods and services produced in the economy.*

Domestic price – *The price of a good or service within a country, determined by domestic demand and supply.*

Double taxation – *The taxation of both corporate net income (profits) and the dividends paid from this net income when they become the personal income of households.*

Dumping – *The sale of products below cost in a foreign country or below the prices charged at home.*

Earnings – *The money income received by a worker; equal to the wage (rate) multiplied by the amount of time worked.*

Economic analysis – *The process of deriving economic principles from relevant economic facts.*

Economic cost – *A payment that must be made to obtain and retain the services of a resource; the income a firm must provide to a resource supplier to attract the resource away from an alternative use; equal to the quantity of other products that con not be produced when resources are instead used to make a particular product.*

Economic growth *(1) An outward shift in the production possibilities curve that results from an increase in resource supplies or quality or an improvement in technology; (2) an increase of real output (gross domestic product) or real output per capital.*

Economic law – *An economic principle that has been tested and retested and has stood the test of time.*

Economic model – *A simplified picture of economic reality; an abstract generalization.*

Economic perspective – *A viewpoint that envisions individuals and institutions making rational decisions by comparing the marginal benefits and marginal costs associated with their actions.*

Economic policy – *A course of action intended to correct or avoid a problem.*

Economic principles – Widely accepted generalizations about the economic behavior of individuals and institutions.

Economic profit – *The total revenue of a firm less its economic costs (which include both payments to resource suppliers and the opportunity costs of firm-owned resources); also called "pure profit" and "above-normal profit".*

Economic resources – *The land, labor, capital, and entrepreneurial ability that are used in the production of goods and services; productive agents; factors of production.*

Economic system – *A particular set of institutional arrangements and a coordinating mechanism for solving the economizing problem; a method of organizing an economy, of which the market system and the command system are the two general types.*

Economics – *The social science dealing with the use of scarce resources to obtain the maximum satisfaction of society's virtually unlimited economic wants.*

Employment rate – *The percentage of the labor force employed at time.*

Equilibrium price – *The price in a competitive market at which the quantity demand and the quantity demanded and the quantity supplied are equal, there is neither a shortage nor a surplus, and there is no tendency for price to rise or fall.*

Equilibrium price level – *The price level at which the aggregate demand curve intersects the aggregate supply curve.*

Excess reserves – *The amount by which a bank's or thrift's actual reserves exceed its required reserves; actual reserves minus required reserves.*

Excise tax – *A tax levied on the production of a specific product or on the quantity of the product purchased*

Expenditures approach – *The method that adds all expenditures made for final goods and services to measure the gross domestic product.*

External debt – *Private or public debt owed to foreign citizens, firms, and institutions.*

Factors of production – *Economic resources: land, capital, labor, and entrepreneurial ability.*

Final goods and services – *Goods and services that have been purchased for final use and not for resale or further processing or manufacturing.*

Firm – *An organization that employs resources to produce a good or service for profit and owns and operates one or more plants.*

Fiscal policy – *Changes in government spending and tax collections designed to achieve a full-employment and noninflationary domestic output; also called discretionary fiscal policy.*

Fixed exchange rate – *A rate of exchange that is set in some way and therefore prevented from rising or falling with changes in currency supply and demand.*

Foreign exchange control – *The control a government may exercise over the quantity of foreign currency demanded by its citizens and firms and over the rates of exchange in order to limit its out payments to its in payments (to eliminate a payments deficit)*

Frictional unemployment – *A type of unemployment caused by workers voluntarily changing jobs and by temporary layoffs; unemployed workers between jobs.*

Full employment *(1) the use of all available resources to produce want –satisfying goods and services; (2) situation in which the unemployment rate is equal to the full- employment unemployment rate and there is frictional and structural but no cyclical unemployment (and the real GDP of the economy equals its potential output).*

GDP – *Gap The amount by which actual gross domestic product falls below potential gross domestic product.*

General Agreement on Tariffs and Trade (GATT) – *The international agreement reached in 1947 in which 23 nations agreed to give equal and nondiscriminatory treatment to one another, to reduce tariff rates by multinational negotiations, and to eliminate import quotas. It now includes most nations and has become the World Trade organization.*

Gold standard – *A historical system of fixed exchange rates in which nations defined their currencies in terms of gold, maintained a fixed relationship between their stocks of gold and their money supplies, and allowed gold to be freely exported and imported.*

Government transfer payment – *The disbursement of money (or goods and services) by government for which government receives no currently produced good or service in return.*

Gross domestic product (GDP) – *The total market value of all final goods and services produced annually within the boundaries of the United States, whether by U.S. or foreign –supplied resources.*

Household – *An economic unit (of one or more person that provides the economy with resources and uses the income received to purchase goods and services that satisfy economic wants.*

Human capital – *the accumulation of prior investments in education, training, health, and other factors that increase productivity.*

Import demand curve – *A down sloping curve showing the amount of a product that an economy will import at each world price below the domestic price.*

Imports – *Spending by individuals, firms, and governments for goods and services produced in foreign nations.*

Income – *A flow of dollars (or purchasing power) per unit of time derived from the use of human or property resources.*

Income effect – *A change in the quantity demanded of a product that result from the change in real income (purchasing power) produced by a change in the product's price.*

Incomes approach – *the method that adds all the income generated by the production of final goods and services to measure the gross domestic product.*

Independent variable – *The variable causing a change in some other (dependent) variable.*

Indirect business – *taxes such taxes as sales, and business property taxes, license fees, and tariffs that firms treat as costs of producing a product and pass on (in whole or in part) to buyers by charging higher prices.*

Industry – *A group of (one or more) firms that produce identical or similar products.*

Inferior good – *A good or service whose consumption declines as income rises (and conversely), price remaining constant.*

Inflation – *A rise in the general level or prices in an economy.*

Information technology – *New and more efficient methods of delivering and receiving information through used of computers, fax machines, wireless phones, and the Internet.*

Infrastructure – *The capital goods usually provided by the public sector for the use of its citizens and firms (for example, highways, bridges, transit systems, wastewater treatment facilities, municipal water systems, and airports).*

Interest – *The payment made for the use of money (of borrowed funds).*

Interest rate – *The annual rate at which interest is paid; a percentage of the borrowed amount.*

Intermediate goods – *products that are purchased for resale or further processing or manufacturing.*

International balance of payments – *a summary of all the transaction that took place between the individuals, firms, and government units of one nation and those of all other nations during a year.*

International monetary reserves –*The foreign currencies and other assets such as gold that a nation can use to settle a payments deficit.*

Inverse relationship – *The relationship between two variables that change in opposite directions, for example, product price and quantity demanded.*

Investment – *Spending for the production and accumulation of capital and additions to inventories.*

Investment demand curve – *A curve that shows the amounts of investment demanded by an economy at a series of real interest rates.*

Invisible hand – *The tendency of firms and resource suppliers that seek to further their own self-interests in competitive markets to also promote the interest of society.*

Keynesian economics – *The macroeconomic generalizations that lead to the conclusion that a capitalistic economy is characterized by macroeconomic instability and that fiscal policy and monetary policy can be used to promote full employment, price-level stability, and economic growth.*

Labor – *Intensive commodity A product requiring a relatively large amount of labor to be produced.*

Labor – *People's physical and mental talents and efforts that are used to help produce goods and services.*

Labor productivity – *Total output divided by the quantity of labor employed to produce it.*

Land National resources ("free gifts of nature") – *used to produce goods and services.*

Law of demand – *The principle that, other things equal, an increase in a product's price will reduce the quantity of it demanded, and conversely for a decrease in price.*

Law of increasing opportunity costs – *the principle that as the production of a good increases, the opportunity cost of producing an additional unit rises.*

Law of supply – *The principle that, other things equal, an increase in the price of a product will increase the quantity of it supplied, and conversely for a price decrease.*

Legal tender – *Anything that government says must be accepted in payment of a debt.*

Liability – *A debt with a monetary value; an amount owed by a firm or an individual.*

Liquidity – *The ease with which an asset can be converted quickly into cash with little or no loss of purchasing powder. Money is said to be perfectly liquid, whereas other assets have lesser degrees of liquidity.*

Long run *(1) In microeconomics, a period of time long enough to enable producers of a product to change the quantities of all the resources they employ; period in which all resource and costs are variable and no resources or costa are fixed. (2) In macroeconomics, a period sufficiently long for nominal wages and other input prices to change in response to a change in eth nation's price level.*

Marginal analysis – *The comparison of marginal ("extra" or "additional") benefits and marginal costs, usually for decision making.*

Marginal cost – *The extra (additional) cost of producing 1 more unit of output; equal to the change in total cost divided by the change in output.*

Marginal propensity to consume – *The fraction of any change in disposable income spent for consumer goods; equal to the change in consumption divided by the change in disposable income.*

Marginal propensity to save – *The fraction of any change in disposable income that household save; equal to the change in saving divided by the change in disposable income.*

Marginal utility – *The extra utility a consumer obtains from the consumption of 1 additional unit of a good or service; equal to the change in total utility divided by the change in the quantity consumed.*

Market – *Any institution or mechanism that brings together buyers (demanders) and seller (supplier)of a particular good or service.*

Market economy – *An economy in which only the private decisions of consumer, resource supplier, and firms determine how resources are allocated; the market system.*

Microeconomics – *The part of economics concerned with such individual units as industries firms, and households and with individual market, specific good and series, and product and resource prices.*

Monetary policy – *A central bank's changing of the money supply to influence interest rates and assist the economy in achieving price stability, full employment, and common growth.*

Monopoly – *A market structure in which the numbers and sellers is so small that each seller is able to influence the total supply and the price of the good or service.*

Multinational corporations – *Firms that own production facilities in two or more countries and produce and sell their products globally.*

National bank – *A commercial bank authorized to operate by the U.S. government.*

National income – *Total income earned by resource suppliers for their contribution to gross domestic product; equal to the gross domestic product minus non income charges, minus net foreign factor income.*

National income accounting – *The techniques used to measure to overall production of the economy and other related variables for the nation as a whole.*

Net domestic product – *Gross domestic product less the part of the year's output that is needed to replace the capital good worn out in producing the output; the nation's total output available for consumption or additions to the capital stock.*

Net exports – *Exports minus Imports.*

Net transfers – *The personal and government transfer payments made by one nation to resident of foreign nations less the personal and government transfer payments received from residents of foreign nations.*

Nominal gross domestic product (GDP) – *The GDP measured in terms of the price level at the time of measurement (unadjusted for inflation).*

Nominal income – *The number of dollars received by an individual or group for its resources during some period of time.*

Nominal wage – *The amount of money received by a worker per unit of time (hour, day, etc.); money wage.*

Oligopoly – *a market condition in which a few firms dominate production of a particular type of good or service and have a substantial degree of interdependence.*

Opportunity cost – *the value of the second-best choice that is given up when a first choice is taken.*

Partnership – *a business organization that is owned by two or more individuals under a contractual agreement.*

Patent – *a document registering a new product or process with the government, making it illegal for others to use this product or process for a specified period of time, usually 17 years.*

Personal-income – *the amount of income that household receive due to their own productivity and from other sources.*

Point of equilibrium – *the point where a product's demand and supply curves meet, which indicates the product's equilibrium price.*

Positive balance of trade – *the situation resulting when the value of a nation's exports exceed the value of its imports.*

Price elasticity of demand – *the relationship between a change in price and the resulting change in the quantity of a product that is sold.*

Price-elastic demand – *the type of demand that exists when a change in a product's price results in a larger relative change in the quantity that is sold.*

Price-inelastic demand – *the type of demand that exists when a change in a product's price results in a smaller relative change in the quantity that is sold.*

Prime interest rate – *the rate of interest charged by banks to large business customers.*

Producer price index (PPI) – *a measure of inflation similar to the CPI except that it is based on the cost of roughly 2,500 resources typically purchased by businesses in the factor market.*

Production – *the creation of goods or services.*

Profit – *what results when a firm's revenues are greater than its costs.*

Progressive tax – *a tax that takes a larger share of a person's income as his or her earnings grow.*

Proportional tax – *a tax that takes the same percentage of all people's income.*

Protective tariff – *a tax on an imported good or service that is primarily intended to protect a nation's businesses from a foreign competition.*

Public good – *a government-provided product that is available to all members of a community on equal bases.*

Quota – *a limit on the quantity of a product that may be imported into a country.*

Real GDP – *the value of the GDP adjusted for a change in price, expressed in constant dollar.*

Recession – *a period of time when the level of economic activity is lower than the average trend over time.*

Regressive tax – *a tax that takes a smaller share of a person's income as his or her earnings grow.*

Revenue – *income received.*

Revenue tariff – *a tax on an imported good or service that is primarily intended to generate income for a nation's government.*

Scarcity – *a condition in which it is impossible to satisfy all human wants for goods and services; the central concept in economics.*

Service – *an intangible action that is capable of satisfying human wants.*

Short run – *a period of time that is not long enough for a firm to change the size of its physical plant.*

Specialization – *concentrating labor on a particular task to increase productive efficiency.*

Stagflation – *an economic state in which production is stagnant or falling and prices are increasing.*

Structural unemployment – *layoffs of workers because they lack skills that would them to be employed.*

Substitute goods – *related goods that may be used interchangeably; an increase in the price of one will cause an increase in the quantity demanded of the other, even if its price remains the same.*

Supply – *the quantity of a good or service that firms will offer for sale at each possible price.*

Supply curve – *a graph indicting the product quantities that will be supplied at different possible prices.*

Supply schedule – *a table indicating the product quantities that will be supplied at different possible prices.*

Tariff – *a tax on an imported good or service that increase the price consumers must pay for imported products and therefore discourages their sales.*

Tastes and preferences – *personal feelings toward the value or desirability of various products.*

Three central economic questions – *the basic decisions that must be made in all economic systems; what goods and services should be produced, how these goods and services should be produced, and for whom these goods and services should be produced.*

Time lag – *the time it takes government to form and implement economic policy.*

Total cost (TC) – *the sum of a firm's fixed and variable costs.*

Total physical product (TPP) – *the total quantity of products a firm is able to produce from a given quantity of resources.*

Total revenue – *the amount of income a firm generates from its sales; price times quantity sold.*

Total utility – *the utility that is derived by a person from all the units of a particular product that he or she owns.*

Trade-off – *the act of choosing one alternative at the expense of another.*

Transfer payments – *payments of money by the government to people for social reasons rather than compensation for labour or products.*

Unemployed – *a term describing workers who are over 16, are not institutionalize, and have actively looked for work but are not able to find employment.*

Unit-elastic demand – *the type of demand that exists when a change in the price of a product results in an equal relative change in the quantity sold.*

Utility – *a measure of the value of a good or service.*

Value-added tax – *a tax on the additional value that firms add to the products they produce.*

Variable costs (VC) – *costs that change with the number of products a firm makes or offers for sale.*

Velocity – *the speed at which money circulates through the economy.*

Yield – *the percentage of return a financial instrument pays on its price.*