

## Recent Macroeconomic Development Ethiopia

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# Macroeconomic Performance in Post-Reform Ethiopia

*Alemayehu Geda*<sup>1</sup>

This paper makes a quick appraisal of macroeconomic performance in Post-*Derg* Ethiopia. The study attempts to organize the analysis of the macroeconomic performance along four thematic categories which are important in explaining growth and macro development: (i) the political framework under which macroeconomic performance is coached, (ii) the macro growth framework, (iii) the market structures under which economic agents function and (iv) constraints to economic agents. The method employed is the before-after approach. The study revealed that although the performance is very good, when judged in the context of the structural problems of the period under analysis, the sustainability of the results is highly questionable.

## I. Introduction

The modest objective of this paper is to make a quick appraisal of the macroeconomic performance in Post-*Derg* Ethiopia. There are various attempts to review the macro performance in Ethiopia (see for instance Eshetu and Mekonnen (1992) for the period 1974 – 1990; MEDaC (1999), EEA (2000) and Berhanu and Seid (1999) and various papers edited by Alemayehu and Berhanu (1999) for the period 1991–1999). This study, although coincides with the latter group, left to the reader to get the pre-reform performance from Eshetu and Mekonnen (1992). It also differs from the recent reviews by attempting to group them under thematic categories believed to be the source of better macro performance.

The study attempts to organize the analysis by organizing the major macro trends along four thematic categories which are important in explaining growth and evolution of macro variables: (i) the political framework under which macroeconomic performance is coached, (ii) macro growth framework, (iii) the market structures under which economic agents function and (iv) constraints to economic agents<sup>2</sup>. This analysis has the implicit assumption that a positive record on indicators of these thematic issues and their sustainability might show the country is on the right track of growth and development trajectory.

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<sup>1</sup> My colleague/friend Elias Kedir (AAU) deserves thanks for his (usual) assistance in the course of writing this paper and Seid Nuru for providing me the rainfall data.

<sup>2</sup> I am inspired by this idea that has emerged from AERC project on explaining growth in Africa.

### Some Notes on Method of Analysis

Since the 1980s, the World Bank and IMF, and increasingly WTO, inspired programs of liberalization had been carried in almost all-African countries. Evaluating the post-Derg macroeconomic performance is tantamount to evaluating such the structural adjustment programs (SAPs). There is a serious disagreement about the effect of these programs in the literature (See Alemayehu 2000). One major problem is lack of appropriate method to evaluate such liberalization schemes.

There are at least five approaches employed in the literature: the *before-after*, the *with-without*, the *actual-versus-target*, the *modeling/simulation*, and the *econometric* approaches (See Khan 1990; Pio 1994). Evaluation of liberalization programs is dominated by the *before-after* approach<sup>3</sup>. This approach basically compares performance of the economy (or major macro variables) before and after the implementation of Structural Adjustment Programs (SAPs). While easy to apply, it is fundamentally based on the *ceteris paribus* assumption. In this method it is difficult to claim that the independent effect of the reform is captured (Khan, 1990: 201). In other words, the method has no mechanism to filter out the effect of other factors, other than the reform, which might have a bearing on the outcome.

The *with-without* approach is designed to overcome the weakness of the *before-after* approach and hence serves as a supplement to it (Montiel 1986:305; Khan, 1990:201). The approach attempts to distinguish between the program and non-program countries and compares the outcomes. It assumes that countries with and without a (liberalization) program are facing identical environment and, hence, any difference observed in the program countries is attributed to the effect of the program<sup>4</sup>. The major weakness of this approach is that countries with and without program, however accurately they are picked, could not be identical. Moreover, as noted by Khan (1990), program countries are not randomly selected. Instead, they are adversely picked (in the sense of having relatively poor economic performance prior to the program period). Goldestin and Montiel (1986), however, suggested identifying and controlling the specific differences in the initial position of the program and non-program countries could help to overcome this limitation. With this modification they came up with *Modified Control Group* approach.

The other strand in the literature is the *actual-versus-target* approach. This approach allows us to compare the actual outcome of major macro variables to their targets set (See Pio 1994, Khan 1990). Although it is not frequently used, one of the major weaknesses of this approach is the bias that could arise in evaluation because the targets might have been set either below or above what could realistically be attained.

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<sup>3</sup> The first study to use this approach is the one by Rechmann and Sillson (1978). Other works cited include, *inter alia*, Killick (1984), Zulu and Nsouli (1985), Poster (1987) (see Goldestin and Montiel, 1986; Khan 1990).

<sup>4</sup> The *with-without* approach is first used by Donovan (1981, 1982). Latter works using this approach include Loxley (1984), Gylfason (1987) and Pastor (1987) (all cited in Khan 1990).

The *Modeling/Simulation* approach compares the outcome of different policies, such as liberalization, using an economy-wide (usually macro) model. It basically carries a counterfactual analysis. Comparatively speaking this approach is theoretically neat<sup>5</sup>. The problem with this approach is that it is extremely demanding in terms of having an empirical model and is vulnerable to what is called the 'Luca's Critique'<sup>6</sup>. The final approach cited in the literature is the *econometric approach*. This approach makes use of regression analysis, after correcting for socio-economic and external variables, to evaluate policy performance (Pio, 1994:299). The approach is similar to the *Modeling/Simulation* approach. Their difference being the econometric approach is a partial equilibrium based analysis while the modeling approach is closer to a general equilibrium analysis.

As noted above, all these approaches have merits and demerits of their own. This is partly the reason for obtaining a wide range of results, which, more often, are conflicting. Ideally it would have been illuminating to employ all the methods and explore their implications. Neither time nor availability of data and models allowed me to do that in this paper, however. Thus, I will basically use the *before-after* approach.

## II. The Political Economy Framework for the 1992 Reform

Economic performance in Ethiopia is highly correlated with the political process<sup>7</sup>. Ethiopia's history is full of conflicts, drastic policy changes and reversals. Before 1974, the macroeconomic policy was largely informed by a market oriented economic system. The period 1974 -1991 witnessed a centralized economic system ('socialism'), where the state is given a significant role in all spheres of economic activity. The post-*Derg* period is again taking us back to the market oriented system of the imperial regime. Such cyclical political process and regime shifts are not only unpredictable but also violent. Economic insecurity pervades the system as rule of law, enforcement of contracts and property right insecurity are configured on shaky political base. The detrimental impact of such political process on macro performance has to be obvious<sup>8</sup>.

<sup>5</sup> According to Khan (1990) it has three advantages. First, one can draw on wider body of adjustment/liberalization experiences. Second, since the policy simulations can be specific, one does not have to worry that incomplete implementation of the policies will blur the result. Finally, the approach by its very nature focuses on the relationship between policy instrument and policy targets (Khan, 1990: 207).

<sup>6</sup> Parameters of the predicting model could change along policy change/simulation.

<sup>7</sup> This has been noted and analytically described at the turn of the last century by the famous` Ethiopian economist Gebrehiwot Baykedgne (See Alemayehu 1998 for his model).

<sup>8</sup> A preliminary assessment can be made using the quantifiable dimension of the impact of political process. For instance defense budget was nearly half of the total recurrent expenditure during the *Derg* regime. This had dramatically dropped in the post-*Derg* period. Once more, Ethiopia is currently confronting another round of war, the configuration of which is likely to influence resource allocation (already the defense budget has shot up). Haile (1997) used a model-based simulation to quantify the impact of military expenditure. He found, for instance, manufacturing, agricultural and total output would have increased, over the sample period, by about 0.3, 0.1 and 0.75 per cent per annum, respectively, if the size of the armed forces and the ratio of military expenditures to total output had been maintained at their 1973 levels. In terms of its social impact his simulation shows that expenditures on education and on health would have increased, on average, by about 94.1 per cent and 86.5 per cent, respectively, over the simulation period (See Haile, 1997 for other simulation results).

Having this general context let us resort to the political configuration (relevant for the analysis of macro performance) of the ruling party, EPRDF, under the auspices of which the post-*Derg* reform, which is the subject of this paper, is conducted. Such analysis is important because the evolution of macroeconomic outcomes cannot be understood in a political vacuum. Interest groups, through policy and using institutions, do influence macroeconomic outcome so that it accords to their interest.

In terms of macroeconomic policy 1991 witnessed a marked departure from the previous 'Socialist' system—the '*Derg* regime'. Its difference lies on openly adopting a market-oriented economic policy. In fact much of the policies adopted by the new government in Addis in 1991 had been initiated by the *Derg* virtually at the end of its reign. The interesting political question is what are the political economy preconditions for the policy shift? There are at least three fundamental political trajectories that informed the political basis of the 1991 reform.

Firstly, there was a challenge to 'socialism' both in domestic and international context. Although the ideology of EPRDF (which assumed power overthrowing the *Derg*) is informed by 'socialism' before it comes to power, it has to confront the domestic dissent towards 'socialism' and the failure of that system in the international context, following the collapse of the USSR. Such political landscape leaves the power to be with no choice than to accept the reform that basically is the anti thesis of socialism<sup>9</sup>.

The second political factor relates to the deep-rooted dichotomy in Ethiopian elites' politics about the nature of the country's unity<sup>10</sup>. The ruling EPRDF takes the position of 'self determination including cessation' for regions organized along language and cultural lines<sup>11</sup> while many political groups, including the majority of the inherited bureaucracy, oppose this framework. In such political landscape it was 'rational' for EPRDF to accept the reform not only to get external endorsement (in the face of domestic opposition) but also to use the macro policy instruments (such as expenditure reduction) to fight the 'hostile' bureaucracy (witness the implementation of the retrenchment program).

Finally, a related issue to the second point above, is that one of the packages of the liberalization scheme, decentralization, did give the opportunity for EPRDF to realize its ideologically informed decentralization process. It is noted here that although decentralization as such is in the Breton Woods institutions' package, the particular form that it took in Ethiopia is EPRDF's preference.

The government's propensity to accept the reform is informed not only by these political factors alone but also by the fact that it has inherited a shattered 'socialist' economy with no foreign exchange reserve to speak of. Accepting reform does directly address the latter

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<sup>9</sup> The only issue at which EPRDF seems to win the bargain (in the light of its ideology) is the question of land.

<sup>10</sup> This political factor implicitly addresses the so called the Eritrean question. Where EPRDF opted for its independence while many other political groups opposed to that.

<sup>11</sup> In Ethiopian politics (especially of the ruling party) these groups are referred as nations, nationalities and people without any conceptual basis for distinction.

(foreign exchange problem) and promises to address the former (revitalizing the economy). Having accepted the reform the government has implemented the typical IMF/World Bank (albeit with minor bargaining power) packages. The evolution of the major macro variables following this reform is the subject of the next section.

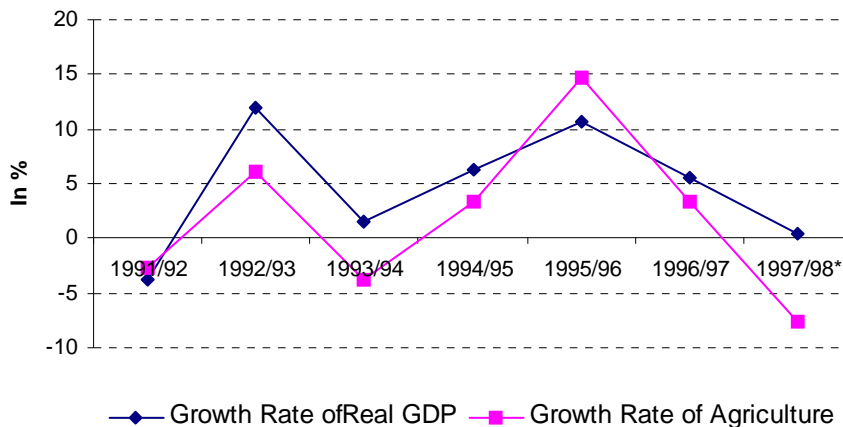
### III. Macro-Growth Framework

#### 3.1 GDP and Sectoral Growth Trends

As a predominantly agriculture based economy (where agriculture employs more than 85 percent of the population and contributing nearly half to GDP), the economic performance in Ethiopia is largely determined by what happens in the agricultural sector. The performance can be seen along three distinctive periods. During the 'Imperial regime' (before 1974) growth was satisfactory. The GDP at constant factor cost has grown by 4.6, 3.8 and 1.9 percent during 1953-59, 1960-65 and 1966-73 periods, respectively. Clearly a downward trend is observed. This growth rate further decelerated in the subsequent period of the *Derg* (1974-1990) to a mere 1.9 per cent - a growth rate far below the estimated population growth of 2.9%. Various factors can be cited for this poor performance. This can easily be seen if we disaggregate this period in rather short time intervals. During the period 1974-1978 the growth rate was 0.4%. Among other things the civil war, the instability induced by the emerging new policy (following the 1974 revolution) as well as the war with Somalia could explain a good part of this growth performance. In 1979-83 growth rate rose to 4.2% - a period characterized by relatively stable and good weather conditions. In 1984-85 growth plummeted to -5.3%. These were periods of sever drought. This rate picked up to 7.9% in 1986-87, only to decline back to 1% in 1988-89.

This is basically the structure inherited by the government in Addis in 1991. During the post-*Derg* period (1992-1998) the real GDP has grown by an average of 6.1 percent (if the abnormal year of 1991 is included the figure drops to 4.7%). Figure 1 below shows this pattern of growth.

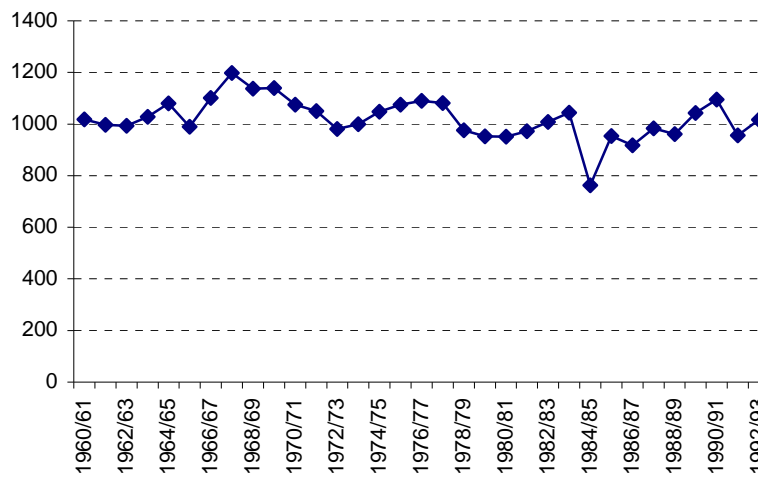
Figure 1: GDP and Agricultural Growth Rates



Source: Alemayehu (1999a)

Figure 1 shows not only the rhythmic co-movement of GDP and Agricultural growth but also the erratic nature of both. This is the direct result of the extreme dependence of the Ethiopian economy on rain-feed agriculture. The GDP registers the highest figure when there is good rain and the lowest (sometimes negative) when it is not<sup>12</sup>. Although I couldn't come up with a complete data on rainfall, Figure 2 corroborates the claim that rain-feed agriculture is the fundamental problem. The sharp decline in the level of rainfall in 1984/85, in 1991/92 and also 1993/94 (shown in Figure 2) and now 1999-2000 is accompanied by a sharp decline in output (see Figure 1).

Figure 2: Mean Annual Rainfall (1960-1993)



Source: CSA: Statistical Abstract (Various years)

This dependence on rain-feed agriculture has a direct implication on agricultural policy. Unless a fundamental action is taken against it, the sustainability of good macro performance is not warranted. The GDP growth rate in the year 1997/98 vividly illustrates this point. In this particular year the industrial sector grew by 10%, the distributive sector (trade, transport etc) by 8.2 percent and other services (bank, insurance, public administration and social service) grew by 7.9 percent. This is an impressive record. However, total GDP grew only by 0.5 percent owing to the poor performance in the agricultural sector that has registered -7.6 percent growth rate (See Alemayehu 1999d).

Such dependence on rain-feed agriculture has a negative multiplier effect on level of production in subsequent years. That is, the shock in one period is carried over into the next since the early years of the drought deprives peasants not only of current income but also of wealth (selling and/or losing assets, in particular oxen, being the case in point). Thus a more

<sup>12</sup> The poor growth performance in 1984/85 with the decline of real value-added in the agricultural sector by more than 20% and real GDP by more than 9% (the highest in the past four decades), and the high growth rates in GDP in 1986/87 and 1997/98 are achieved due to bumper harvest which in turn are results of good and timely rainfall and recovery from a very small base.

auspicious weather out-turn during the next agriculture may not see an increase in harvest as the farmers have been dislocated in terms of capital and perhaps also physically when they are forced to migrate in search of food (See Alemayehu and Befkadu 2000). The above analysis entails the need for a detailed research in explaining growth and relevant policy in Ethiopia<sup>13</sup>.

In terms of agricultural policy the post-*Derg* period witnessed a major shift from the previous controlled economy. Dismantling the marketing boards and cooperatives and de-emphasizing the state farms are cases in point. Various liberalization schemes are implemented although the formal market for land is still controlled. The new government has also came up with strategy of Agricultural Development Led Industrialization (ADLI), which basically emphasize raising the productivity of smallholder agriculture and the importance of labour intensive industrialization. The policy towards the smallholder farmers (which produce nearly all the agricultural produce) is believed to work through appropriate incentive structure using agricultural extension as a vehicle. Government documents claim that the approach has yielding good results (See MEDaC 1999). It is imperative to note, however, that the central problem of agricultural - rain-feed agriculture - is not squarely confronted in this strategy. For instance the share of agriculture in the recurrent budget of the government was only 9.3 percent in 1997/98<sup>14</sup>. Similarly the share of agriculture in capital expenditure was fairly constant in the post-*Derg* period - that share in 1997/98, for instance, stood at 8.8 percent. The comparative figure for transport and construction sector (the highest share) is 21 percent. To conclude, in the face the cyclical nature of the problem of dependence in rain-feed agriculture, it is an important area that needs the lion share of resources and energy. The issue of Agriculture and macro policy is discussed at length in Alemayehu (2001).

Another area of concern, which is central for explaining sustainable macroeconomic performance, is structural change in the economy. Figure 3 shows the evolution of sectoral value-added in the post-*Derg* period. Except for the service sector it is reasonable to conclude that the period under analysis does not show major change in the structure of the economy.

In 1973/74 the share of agriculture in GDP was 52.5 percent and this has declined to 43.6 percent in 1989/90. The share of industry during this two periods rose from 15.1 to 16.6 percent. The reminder share being for services (See Eshetu and Mekonnen 1992). In the light of this figures, it can be seen that although the share of each sector fluctuates in a very narrow band, it is fundamentally unchanged in the last four decades. Thus, the macro

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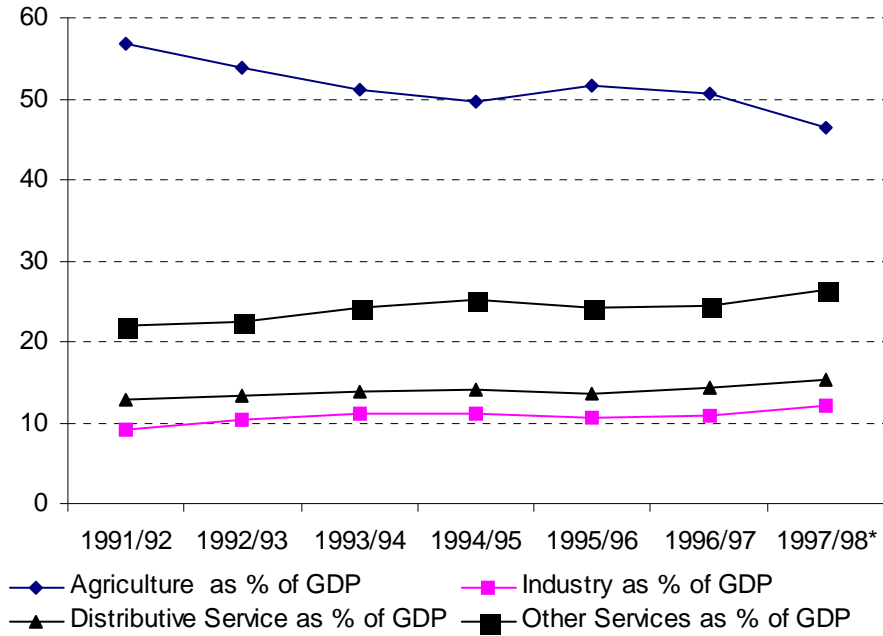
<sup>13</sup> To my knowledge there is no comprehensive empirical study that attempts to explore the growth process in Ethiopia. The only exceptions are Netsante (1997) and Seyoum (1997). Both attempted to estimate an augmented Solow growth model. The nature of the augmented model used is informed by the interests of the authors (human resource in Netsanet's case and pure choice of the model in Seyoum). Their regression result shows the importance of labour (in particular the level of education). This is found to be insignificant in Seyoum, however. Capital doesn't have strong impact in both studies (See Alemayehu and Befekadu (2000) for critical analysis).

<sup>14</sup> This might be compared with the share of general services (defense and others) of 45 percent, social services 24.3 percent. This figures are preliminary actual but the pattern is fairly similar to the preceding years (See MEDaC, 1999).



performance still hinges on fragile agricultural sector with no structural change in the overall economy.

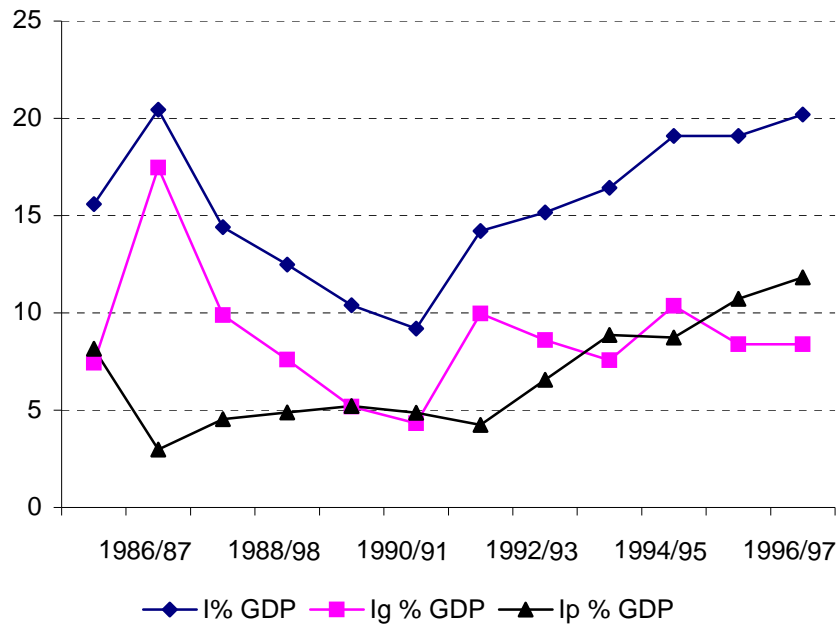
Figure 3: Structure of Value-Added in the Post-*Derg* Period



Source: Alemayehu (1999a)

Bringing about positive and sustainable macro performance depends on investment and its financing. Figure 4 shows the evolution of these aggregates in the post-*Derg* period.

Figure 4: Trend of Gross Fixed Capital Formation

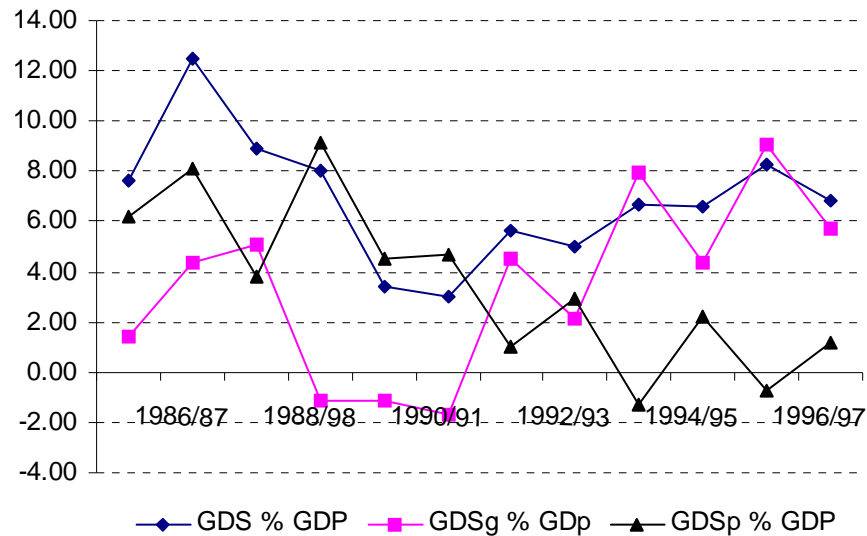


Source: Alemayehu (1999a)

There are two important facts that emerge from Figure 4. Firstly, the immediate period before the reform witnessed a downward trend of gross capital formation. This shows the extreme deteriorating condition of the economy during the last days of the *Derg*. This downward trend has picked up in the post-*Derg* period (witness the rift which is associated with the violent political change). It should be noted, however, that the level of investment (which in both periods did not exceed 20 percent) is very small, even by African standard. The second important point about investment in the *Derg* and post-*Derg* period is the institutional shift of investment from public towards private. This is the direct result of the reform that favors the latter. In fact the private investment took over the public's share after 1995/96.

The next important question that follows from the previous analysis is whether this growing level of investment is financed domestically. Figures 5, 6 and 7 throw light on this issue.

Figure 5: Evolution of Gross Domestic Saving (% of GDP)



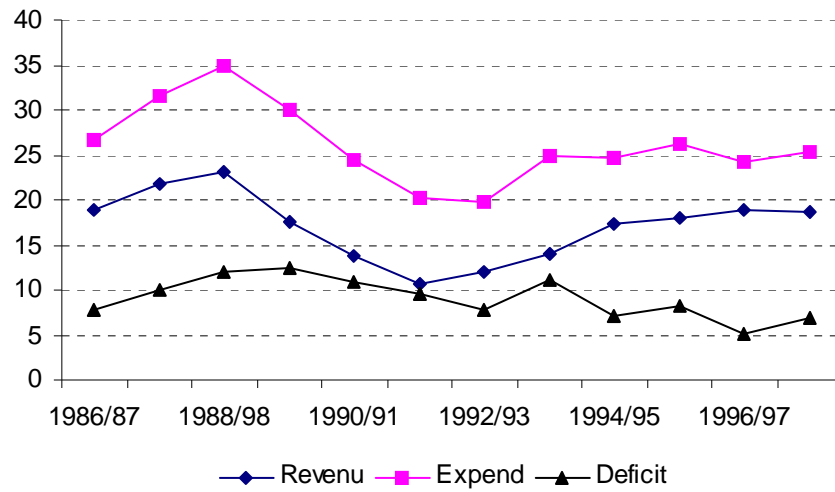
Source: MEDaC (1999)

Some comments are in order about data in Figure 5. GDP at market price and gross domestic saving (GDS) data is taken from MEDaC (1999). The government saving (GDSg) is defined as the difference between the current government revenue (including grants) and current expenditure. The private saving is derived as residual. Thus, the private saving figure is highly restrictive because the gross domestic saving it self is derived as a residual (as the difference between GDP and consumption) in the National Accounts Statistics. The data show that all types of savings have drifted in 1990/91 and recovery has taken since then. It is interesting to note that public saving is showing quite a remarkable recovery. Thus, the government's fiscal policy in this respect seems promising<sup>15</sup>. However, the total saving is far below the level of investment which itself is the lowest by African standard. This had resulted in the level of government deficit in the vicinity of 10 percent of the GDP per annum (See Figure 6). The government has registered a modest achievement in terms of fiscal policy chiefly by raising revenue. However, the sustainability of this result is highly questionable given the looming war and natural disaster in the backyard. The deficit also points to the country's dependence on external resource to bridge its resource gap. This is quite apparent in the financing of government capital expenditure than anywhere else. This is shown in figure 7.

<sup>15</sup>

A simple regression suggests the possibility of crowding-in in Ethiopia.

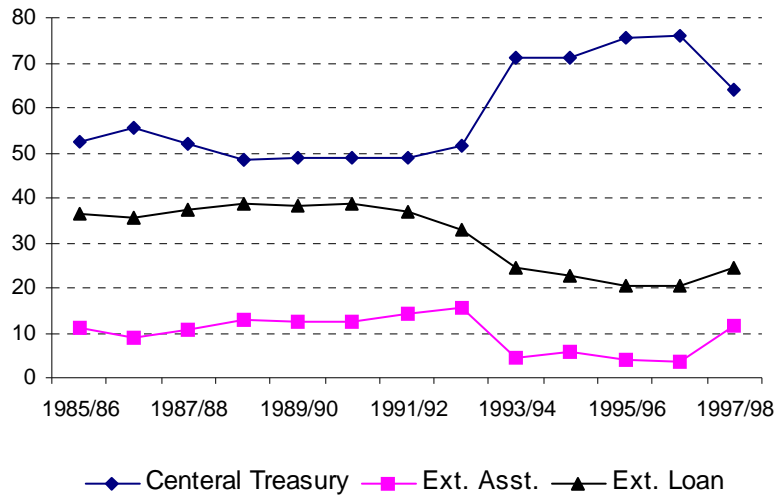
**Figure 6. Government Revenue, Expenditure and Deficit (% of GDP)**



*Source: MEDaC (1999)*

The external assistance is largely concentrated in financing of capital expenditure. The current expenditure of the government is largely financed by its revenues, which is an interesting fiscal policy success. For instance external assistance constitutes only an average of 8 percent of the total recurrent expenditure in 1985/86 to 1990/91. This figure rose sharply to 12% in 1991/92 and dropped to an average of 3.05 percent in 1991/92-1997/98, the 1997/98 figure being 2.2 percent. On the other hand the share of the external sector in financing capital expenditure, as can be read from Figure 7, remained around 20 percent in terms of loan and around 10% in terms of assistance. An interesting development in this period is the sharp rise in the treasury financing of capital expenditure (which rose from around 50 to 70 percent- this is a commendable achievement) (See Figure 7).

**Figure 7: Financing of Capital Expenditure (% of Total Financing)**



Source: MEDaC (1999)

Notwithstanding the success noted, the dependence on external financing for capital expenditure needs closer attention. One important implication of a fiscal posture that tends to rely on external finance is a debt problem. In Ethiopia this problem is acute because it is coupled with military based debt. The debt data in Ethiopia is problematic<sup>16</sup>. Be that as it may, as a result of the growing resource gap both the debt stock and the debt to GNP ratio has increased steadily since the 1980s. This makes Ethiopia one of the SSA countries that have a total debt which exceed their GNP, having a debt to GNP and debt to export ratios of 159.0 and 962.3 percent, respectively in 1997 (see Table 1). This has resulted in accumulation of arrears. The accumulation of arrears on debt emerged in the 1980s. Prior to this period, there had been almost no interest arrears and principal arrears were negligible. The interest arrears that had been US 1 million in 1980 reached a peak of USD 481 million, i.e. 8 percent of GNP or 58.4 percent total export in the year 1996. The principal arrears also escalated from a low level of USD 1 million in 1980 to USD 4303 million which means 72.3 percent of GNP or 522.8 percent of total export in 1996, (see Alemayehu and Daniel 1999 for details). In sum, by 1997 the total arrears (principal and interest) reached 83.6 percent of GNP and 506.2 percent of export. This rising level of arrears is due to resources constraint that hindered timely debt-service payments, i.e. meeting the debt-service obligation on schedule could only be accomplished by further debt rescheduling. This has worsened the situation as it resulted in an even larger arrears accumulation in recent years.

**Table 3.1 Indicators of Debt Burden**

G.C.	Total*	Debt/	Debt/	Interest	Debt service	Arrears	Arrears	Interest	Principal
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<sup>16</sup> See Alemayehu and Befekadu (1999) and Alemayehu and Daniel (1999) where this issue is discussed at length.

	Debt Stock in Billion US \$	GNP (%)	Export (%)	/Exports (%)	/Exports (%)	to GNP ratio (%)	to Export ratio (%)	arrears to total arrears (%)	arrears to total arrears (%)
1985	5.21	78.1	932.1	8.8	28.4	0.0	0.3	21.4	78.6
1986	6.13	88	891	8.8	32.6	0.0	0.2	27.3	72.7
1987	7.36	99	1150.4	10.8	38.9	0.7	8.5	6.7	93.3
1988	7.70	100.5	1189	14.8	47.7	0.2	2.4	10.2	89.8
1989	7.84	98.6	1034.8	11.2	40.1	0.9	9.1	23.0	77.0
1990	8.63	126.6	1276.3	8.7	34.9	4.1	41.2	15.3	84.7
<i>After Reform</i>									
1991	9.12	171.6	1666.7	8.3	25.2	20.5	198.8	15.2	84.8
1992	9.34	169.2	2036.9	10.3	23.9	32.2	388.1	14.5	85.5
1993	9.70	157.6	1889.2	5.7	18.5	39.7	475.6	13.8	86.2
1994	10.07	208.5	1788	7.8	19.8	66.3	569.1	12.3	87.7
1995	10.31	180.3	1276.5	7.8	19.1	71.1	503.6	10.7	89.3
1996	10.08	168.9	1224.4	6.7	42.2	80.2	581.1	10.0	90.0
1997	10.08	159.0	962.9	4.5	9.5	83.6	506.2	10.2	89.8

\* Includes Debt owed to the former USSR estimated around 4 to 5 billion US \$

Source: Global Development Finance 1998/99 (World Bank CD).

Generally the increasing debt to GNP and debt to export ratios, in addition to interest and principal arrears, show an unprecedented increase in the level of the country's debt. The indicators listed above revealed that the total debt is well above the nation's GNP and more than 12 fold of total export in 1996 implying that the debt burden, as compared to the country's capacity, is too heavy to take care of itself. Similarly, the debt service ratio, which is the ratio of total amortization and interest payments to total export of goods and non-factor services that was around 3% (per annum) during the period 1973-1983 jumped to 28 percent in 1985, 34.9 percent in 1991, dropped to 19 percent in 1995 and picked to a staggering 42.2 percent in 1996 only to drop to 9.5 percent in 1997. This trend is largely attributed to the rise in exports and rescheduling possibilities (See Alemayehu and Daniel 1999).

Regarding net transfer on debt, there was an increasing and positive trend until very recently (except in 1994/95 where Ethiopia had recorded a negative inflow of ETB- 74.6 million). In general the figure computed for the whole of Africa shows that there is a net resource outflow starting from 1980s. For instance the net inflow to Africa was -1.71 billion, -4.41 billion -4.68, -7.47 and -6.75 billion U.S dollar in 1985, 1990, 1992, 1996 and 1997 respectively (See Alemayehu, 2000). The aggregate net resource flows on debt in Ethiopia (which is the sum of net resource flows on debt, foreign direct investment (FDI), portfolio equity flows, and official grants excluding technical co-operation) has exhibited an increasing trend, even if there was almost no FDI, excepting MIDROC' s (the dominant company), and portfolio equity flow. This is mainly because of the rising level of financial grants (See Table 3.2).

**Table 3.2: Net Resource and Aggregate Resource Flows (in million ETB)**

	1976/77	1980/81	1986/87	1989/90	1994/95
Net Resource flows on debt (NRFD)*	109.1	366.0	395.5	951.8	425.8
Net transfer on debt (NTD)**	97.3	350.2	284.3	844.6	-74.8
Aggregate Net Resource flows (ANFR)***	141.5	369.2	475.3	1018.6	1094.5

\* NRFD = loan disbursed minus principal repayments \*\* NTD = NRFD minus interest payments

\*\*\* ANRF = NRFD plus FDI, portfolio equity flows, and financial grants

Source: Calculated from Ministry of Finance Documents

Most financial flows come from official creditors (i.e. multilateral and bilateral sources). The private creditors such as suppliers credit constitutes a small fraction of the total financial flow (less than 10 percent in the period 1987-94). Out of the total outstanding debt (DOD), the average share of the multilateral and bilateral lenders was 45 and 55 percent, respectively, during the period 1973-1990/91. During the post-*Derg* period there is a shift towards multilateral lenders as major sources of external finance owing to adjustment funds. In the period 1991/92-1994/95 from the total loan and grants extended to Ethiopia 46 percent has been mobilized from multilateral sources, 53 percent from bilateral and 8 percent from UN agencies. Among the multilateral lenders, the World Bank group had been Ethiopia's main creditor. The breaking down of the total share of bilateral lenders into OECD and CMEA countries exhibited that during the period 1973-80 the share of CMEA countries was 7 percent of the total bilateral DOD while the OECD countries' share was 87 percent. Subsequently CMEA' share rose for obvious political reason and reached 37 percent of the bilateral DOD during the period 1981-1991/92. This share collapsed, owing to the political winds of change, to 18 percent in 1994/95. OECD's share remained fairly stable at around 51 percent in 94/95 (See Alemayehu and Daniel 1999 for detail).

The terms and condition of this debt creating flow is given in Table 3.3. In general the terms of borrowing in the post-*Derg* period were good. Thus, the average interest rate, compared to 1970, had declined by about 64 percent in 1997, the grace period increased and the grant element had risen. In terms of institutional category loans from the official creditors, in particular of multilateral lenders, are softer than that of the private.

**Table 3.3: Average Terms and Conditions of all Creditors**

	1970	1980	1989	1990	1991	1992	1993	1994	1995	1996	1997
Interest (%)	4.4	3.6	3.2	6.6	4.7	1.0	1.7	1.1	1.0	2.2	1.8
Maturity (Year)	31.8	19.2	21.6	21.8	20.3	40.1	40.7	40.4	36.3	30.4	39.5
Grace period (Year)	6.6	3.8	5.9	3.5	6.0	9.8	9.2	9.3	9.3	7.6	8.0
Grant element (%)	43.3	39.5	42.7	23.8	36.0	73.7	72.5	71.6	76.1	62.1	68.5

Source: World Bank, *Global Development Finance, 1998/99* (World Bank CD-ROM)

Grants, which may take the form of financial flows and technical co-operation, had also increased in the post-*Derg* period; this is excluding relief and rehabilitation grants, which are also very high (See Table 3.4 and also Annex). It is interesting to note from Table 3.4 that the total grants from both multilateral and bilateral sources in the periods 1976/77-1994/95 add up to be ETB 8.31 billion, of which the technical co-operation accounts for about 69.1 percent. The latter figure, however, has declined in the period 1992/93-1994/95 to 34.6 percent. The analysis in this section shows the serious debt problem the country is facing.

The country does qualify for the HIPIC initiative and it is high time that such initiatives become practical<sup>17</sup>.

**Table 3.4: Development Related Grants, (in millions of Ethiopian Birr)**

	1975/76	1976/77	1979 /80	1984 /85	1989 /90	1992 /93	1994/95
1. Total Grants	77.2	82.5	174.1	631.3	401.4	466.1	1132.2
2. Financial Grants*	-	39.3	4.0	12.6	16.6	52.0	59.1
3. Technical Co-operation Grants*	-	60.7	96.0	87.4	83.4	43	40.9
4. Grants as a percentage of GDP	1.3	1.2	2.04	4.55	2.25	1.8	3.4

*Source: Ministry of Finance: Budgetary Revenue and Expenditure (various years).*

*Note: \* are as % of total grants (See Annex for a World Bank based Data which is different from this).*

## IV. Markets and the Growth Process

Market in the context of this study may refer to either internal or external. The latter fundamentally analyzes the export and import structure of the country and its impact on the growth process. In particular, examining the sustainability of growth in the context of the external market (which includes the rules of the game such as WTO as well as SAPs provisions) is very important. Internal markets are also crucial in determining macroeconomic outcomes. Thus I will examine below the financial market and the related issue of monetary policy as well as the external market from macro perspective.

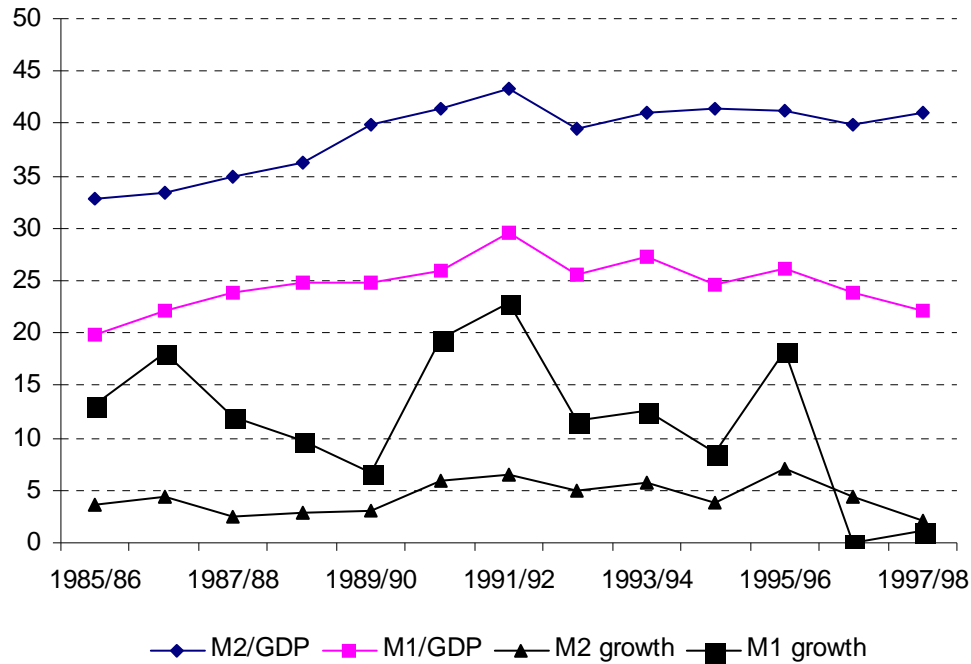
### 4.1 The Money Markets and Monetary Policy

In terms of monetary policy, as could be inferred from the money supply, the post-Derg performance is commendable, in particular in maintaining fairly stable M2 growth and pursuing increasing monetization of the economy. However, Figure 8 below shows quite distinct pattern between narrow (M1) and broad money (M2). The M1 fluctuated wildly during the period under investigation. This is chiefly attributed to the growth of currency in circulation in 1991, growth of both demand deposit and currency in circulation in 1994/95 and growth of demand deposit in 1997. The 1991 jump in currency in circulation perhaps points to the possibility that the new government must have issued a huge currency when it seized political power. Quasi money grew fairly stable except in 1992/93 and 1994/95 when it registered a huge jump (in particular in the latter period).

<sup>17</sup> See Alemayehu and Daniel (1999) for details of the HIPIC initiative both in African and Ethiopian context.



Figure 8: Evolution of the Money Supply



**Inflation**

Price levels are very stable in Ethiopia. In the pre-reform period this is partly attributed to the regulated nature of market prices. The post-reform period price stability, which is remarkably low during the whole post-Derg period as can be read from Table 1.4, is attributed chiefly to conservative monetary and fiscal policy and the performance of the agricultural sector<sup>18</sup>. The latter is particularly important, as ‘the food item’ weight in the CPI is nearly 50 percent. Table 4.1 reveals quite an interesting relationship between the growth of seven major cereal crops and the level of inflation (the former having a one period lag effect on prices). This suggests the importance of structuralist theory of inflation in explaining the phenomenon of inflation in Ethiopia. Obviously this low level of inflation is accompanied by some abrupt changes such as the year 1990/91 when there was a change of government and general disruption in economic activity as well as the hike in the money supply discussed above, and years such as 1994/95 where there was poor harvest.

Table 4.1: Trend of Prices and Exchange Rates

	1990/ 91	1991/ 92	1992/ 93	1993/ 94	1994/ 95	1995/ 96	1996 /97	1997/ 98	1998/99
Volume growth rate of major cereals %	-6.9	-2.7	27.0	-12.4	6.4	40.6	1.0	-20.6	9.4
Inflation %		21.0	10	1.7	13.4	0.9	-6.2	2.3*	na

<sup>18</sup> Very low level of inflation need not necessarily be taken as policy success (as is usually presented in government reports) because possible public expenditure, and hence employment, might have been unnecessarily sacrificed.

							(0.8*)		
Exchange Rate, Birr/US\$ (Ave. Marginal rate)	2.07	2.07	5.01	5.77	6.25	6.32	6.47	6.80	~ 8.15
Exchange Rate, Birr/US\$ (Ave. Parallel Market rate)			7.6	7.05	7.30	7.64	7.16	7.23	~8. 20

\* Based on the new country level general CPI (otherwise the Addis Ababa retail price index is used)  
*Source: Alemayehu (1999a) MEDaC (1999)*

### Interest rate, Exchange Rate and the Inter-bank Money Market

The pre-reform period was characterized by discriminatory interest rate, foreign exchange as well as credit allocation policies. The interest rate was deliberately set at a very low level (repressed) and depending on the degree of socialization, different sectors did face different interest rates. Currently the interest rate is fairly liberalized and the NBE has set only a floor for deposit rate, leaving all other rates to be determined by market forces. Moreover, pursuant to the strategy of gradualism, the NBE has implemented this policy step-by step. Details about interest rate are given in the annex (see also Alemayehu 1999d for more detail).

In the pre-reform period all foreign exchange earnings were surrendered to the NBE. The latter used to ration this limited supply of foreign exchange to sectors that were accorded priority in the national plan. In general the priority is for the socialized sectors - the private sector being the least preferred. Ethiopia had a fixed exchange rate of Birr 2.07/US\$ for nearly two decades before the 1992 reform. At the beginning of the reform period it devalued its currency to 5 Birr/US\$ and subsequently introduced an auction-based exchange rate system.

When the auction-based exchange rate is introduced in 1993 it used to be conducted on fortnight basis and takes the form of the 'Dutch Auction' system (discriminatory price), where the marginal rate, which clears the market, is taken as the ruling rate for the coming two weeks. The supply of funds for this market comes from export earnings, loans and grants. The auction-based exchange rate system was initially working side by side with the official exchange rate. A committee composed of the NBE, Ministry of Finance, Ministry of Economic Development and External Cooperation (MEDaC) and two representatives of the private sector oversee the system.

In the course of its implementation more liberalization efforts (such as reducing the bid cover requirement, abolishing of negative import list and the ceiling on demand for foreign exchange) were made. Moreover, after the 86<sup>th</sup> auction (in July 1996), the NBE introduced a weekly auction. By August 1995 the official or fixed exchange rate (that was used for importation of fertilizer, petroleum and pharmaceutical products as well as Ethiopia's contribution to international organizations and external debt-service payments) unified with the auction rate. The NBE has also replaced the retail auction system by a wholesale auction system where banks are taken as wholesale bidders (See Alemayehu 1999d for details). This is a clear indication of the government's policy of gradualism towards liberalizing the exchange rate market. Since the introduction of the auction-based exchange rate system in 1993 (discussed at length in Alemayehu 1999d), the exchange rate is showing a remarkable stability. Table 4.1 shows that the premium between the auction-based exchange rate (which

is the official rate) and that of the parallel (unofficial or illegal but tolerated market rate) is increasingly declining. These annual figures actually hide a lot of details. A more elaborated data shows that there are periods of even an alignment between the two rates. In general the monetary policy pursued towards the exchange rate is quite satisfactory.

A related monetary policy pursued is the introduction of inter-bank foreign exchange and money markets. The establishment of this market is primarily motivated by the recognition that the foreign exchange supply by NBE through the auction system is not sufficient to satisfy the demand by banks. The 'inter-bank foreign exchange market' (IBFEM) is a wholesale market, where the amount traded is large and the spread between buying and selling rates is narrower than the norms for commercial transaction. It is an exclusive market for banks to trade foreign exchange with each other. A related liberalization policy pursued is the establishment of the 'inter-bank money market' (IBMM). The establishment of the IBMM facilitates borrowing and lending of funds between banks, micro financing institutions, and non-bank financial institutions at the interest rate that are freely determined by borrowers and lenders themselves. The directive issued to establish this market specifies how this market should function.<sup>19</sup>

### **The Financial (Banking) Sector**

In terms of the financial sector the 1992 reform required an enormous change in the role of the state. The state has not only going to serve the private sector, which hitherto had been demonized, but also new private financial institutions were emerging. Equally the role of Ethiopia's central bank needed to be reformulated. In undertaking this task the post-*Derg* government adopted a strategy of (a) gradualism: gradual opening up of private banks and insurance companies alongside the public ones, gradual liberalization of the foreign exchange market etc and (b) strengthening domestic competitive capacity before full liberalization: restrict the sector to domestic investors, strengthening the regulatory and supervision capacity of the NBE, providing autonomy to banks as well as opening up inter-bank money market. In line with this strategy various proclamations and regulations were passed since 1992 (See Alemayehu 1999d and 1999e for detail).

In the banking sector the Commercial Bank of Ethiopia (CBE), followed by the Development Bank of Ethiopia (DBE) is the dominant bank. Before the 1992 reform, on the average, the CBE alone comprises more than 90% of total deposit (while DBE's share is 1.3%), and 71% of the total loans advanced (DBE's share being 16%). In this period, the NBE was actively involved in direct controlling of all financial institutions by (a) fixing interest rates, (b) directly controlling the foreign exchange and credit allocation in a discriminatory manner, by favoring the public sector, and (c) by directly financing government deficit. Bank supervision/regulation has been largely limited to on and off inspection on a few number of branches (See Alemayehu, 1999d).

Proclamation No. 84/1994 that allows the private sector (owners have to be Ethiopian nationals, however) to engage in the banking and insurance businesses marks the beginning of a new financial sector in Ethiopia. Following this proclamation the country witnessed a proliferation of private financial institutions. Today there are six new private banks and eight

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<sup>19</sup> The specific regulations and their evolution are discussed in detail in Alemayehu (1999d and 1999e).

insurance companies in operation. This took place in a matter of 4 years. Despite the proliferation of such privately owned companies, their relative share remained extremely small (See Alemayehu 1999d for details).

The dominant position is still held by the CBE although its dominant position is increasingly declining (leaving its place to the emerging private banks). The private banks are catching up relatively faster especially in the disbursement of loans. The desegregation of the disbursed credit by institutional category also shows the increasing role of the private sector that can chiefly be attributed to the on going liberalization. Among the new private banks the most important is the Awash International Bank followed by Abyssinia and *Dashen* Banks. In fact the share of Awash International Bank in terms of disbursement of credit is even larger than one of the public banks (CBB). Clearly the trend of the existing data shows that the share of the private banks both in deposit mobilization and lending could increase significantly in the years ahead. The available data also shows that the share of credit extended to the private sector has jumped from 72 to 84 percent in the last three years while that of the public sector's share has declined from 15% to 3.6 percent (the share of cooperatives remaining fairly stable). This is a clear demonstration of the impact of the liberalization scheme pursued by the government (See Annex and Alemayehu 1999d for details).

#### **4.2 The External Market: Imports and Exports**

An examination of the external trade policy of the three successive regimes in Ethiopia (the pre-1974, 1974-1991 and the post-1991) reveals that the country's external trade policy has moved from a 'free trade policy' to 'a controlled trade policy regime' and back to 'a free trade policy' one. Before 1974, various measures aimed at improving the quality and quantity of imports and exports as well as facilitating trade both by the public and private sector were made. In terms of imports, imports of capital goods and raw materials were free of duty while others were taxed (See Alemayehu 1999b). The period 1974 -1991 was on the other hand characterized by a centralized economic system, where the state is dominant in the external sector. The period was characterized by: (a) an attempt to control the participation of private capital in trade and strengthening the state's role both in export and import trade; (b) an attempt to closely monitor the price, quantity and distribution of goods; (c) giving special emphasis to external trade sectors deemed essential for economic growth and in the trading of medical equipment and goods that ensure the health and security of the population; and (d) an attempt to diversify the type and destination of goods (especially from developed capitalist countries towards socialist countries) externally traded (See Alemayehu 1999b).

The post-*Derg* government's foreign trade policy has the following objectives: (a) ensure private sector participation; (b) manage the sector by issuing foreign exchange and import-export regulation; (c) design and provide adequate incentive to the export sector; (d) replace quantitative restriction with tariffs; (e) encourage diversification of exports and minimize illicit trade and; (f) carry-out restructuring of the state owned trading enterprises. To realize these objectives the government has designed and implemented various policies and institutional measures. The most prominent ones are: (a) liberalization of the exchange rate market using the auction system which will provide foreign exchange both to the private and the public sectors; (b) licensing procedure is enormously simplified; (c) supportive services to private exporters is designed in areas of transport, package training, overseas market research

etc; (d) In addition, a simplified tariff structure and foreign exchange retention scheme, as described below, is also designed (See Alemayehu 1999b).

In relation to point (d) above most goods which used to be imported duty free and those with specific duty rates are replaced by ad valorem rates. Goods dutiable or not are given a tariff code and classified on the basis of their type and characteristics into 21 sections and 99 chapters. These chapters contain 5291 goods classification of which 169 are duty free, 5119 with ad valorem rates from 5 -50 percent and 3 with specific rates (worn clothing, worn textiles and rags). Currently the weighted average tariff rate is 24.6 percent. The smallest tariff rate being 5 percent and the maximum being 50 percent. These rates were used to be as high as 230 percent in the previous regime. Apart from customs duty there are payments of sales and excise taxes on imported goods. The sales tax ranges from 5 to 12 percent of the value of goods depending on the nature of the good. Similarly excise tax varies from item to item. The highest is 200 percent and the lowest 10 percent (See Alemayehu 1999b).

With regard to exports an attempt to facilitate export licensing procedure is made. Currently there is no export duty except on coffee. The amount of customs duty on coffee is Birr 15 per 100 kg. There is also a transaction tax of 2 percent and cess tax of Birr 5 per 100 kg. Sur tax is also collected on coffee based on the daily sur tax rate of the international coffee market prices (See Alemayehu 1999c for detail). The post-*Derg* government also established two types of duty incentive schemes. 'Duty draw back schemes' for those who wholly or partially or occasionally engage in export sector and 'duty free importation scheme' to those wholly engaged in supplying of their products to foreign market. Moreover, exporters have the right to retain 50 percent of their export earning and remittance in foreign currency in retention account. From the 50 percent, the account holder shall offer 40 percent for sale no later than 21 days from the date of entry to commercial banks at negotiated rates, or to the auction market through their banks. The remaining 10 percent should be used by the account holder for the purpose of import of goods and services, export promotion and any other payment specifically approved by the National Bank (See Alemayehu 1999b).

In general, compared to pre-1991 period there is a major policy shift in the post-1991 period. Essentially the policy regime has shifted from a 'controlled regime' towards a 'more liberalized' one. It is interesting to examine what the impact of this was on exports and imports.

## Exports

As can be read from Table 4.2, the export sector is characterized by over-dependence on few commodities such as coffee, which constitutes nearly 65 % of export earning, followed by hides and skins. On the average the combined share of six major export items constitute more than 80% of total exports. Recently this figure shows a declining trend (from nearly 90% in 1998 to 80% in 1997).

**Table 4.2: Share of Major Exports in the Total Value of Exports (in %)**

Year	Live Animals	Haricot Bean	Sugar	Coffee	Hides & Skins	Petroleum & Petrol	Combined Share
1988	3.43	2.32	1.73	64.96	14.44	3.03	89.91
1989	1.54	1.37	1.81	65.05	14.60	4.00	88.36

1990	1.63	7.02	5.95	44.35	20.50	6.91	86.36
1991	0.37	0.93	0.94	61.63	13.29	0.68	77.83
<b>After the Reform</b>							
1992	-	0.48	0.82	54.44	16.38	6.68	78.79
1993	0.48	0.96	2.46	64.09	16.10	3.98	88.07
1994	0.46	2.47	0.11	65.26	14.34	5.20	87.84
1995	0.20	3.34	-	60.50	12.67	2.65	79.35
1996	0.04	3.64	-	66.45	12.48	3.40	86.02
1997	0.42	2.72	-	65.26	10.10	0.65	79.15

Source: Computed from Data Obtained from Customs Authority

In view of the acute demand for foreign exchange discussed above, one sustainable source of financing is growth of the export sector. As can be read from Table 4.3, however, exports as percentage of GDP were in the vicinity of 15 percent which is a good performance compared to nearly 8 percent in the immediate past before the reform. However, imports jumped from around an average of 16 percent in the five years immediately before the reform to 28 percent by 1998. Thus exports do cover only half of the imports. This has an obvious implication on debt.

**Table 4.3: Exports and Imports (% of GDP)**

	Exports/GDP	Imports/GDP	Exports/Imports
1985/86	9.4	17.1	54.7
1986/87	8.2	16.2	50.8
1987/88	8.1	16.0	50.3
1988/89	9.0	14.6	62.1
1989/90	7.7	12.2	62.9
1990/91	5.5	12.5	44.3
<b>After Reform</b>			
1991/92	4.5	10.7	42.2
1992/93	8.3	16.9	49.2
1993/94	11.4	21.5	52.9
1994/95	14.3	24.1	59.5
1995/96	13.1	25.6	51.1
1996/97	15.5	26.3	59.0
1997/98	15.0	28.4	52.9

Source: Alemayehu (1999a)

Table 4.4 shows the annual growth rate of major exports. The growth rates are characterized by an extreme fluctuation. This is aggravated by concentration of exports in few commodities. This pattern is the major factor behind export earning instability in the country. This in turn has implication on capital formation instability. Various factors are responsible for such performance. Some of the major reasons are poor weather condition, production and marketing problems as well as the impact of the world market<sup>20</sup>.

**Table 4.4: Annual Growth Rates of Export Items (Selected Years, Volume)**

	Annual Growth Rates
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<sup>20</sup> Readers interested in the details of the impact of liberalization on the coffee sub sector and its implication for food security may consult Alemayehu (1999c).

Year	Total Exports	Coffee	Hides & Skins	Petroleum & Petrol	Live Animals
1989	-4.67	21.25	18.76	4.16	-56.36
1990	-7.09	-37.03	-22.47	-3.15	-31.67
1991	-70.91	-20.45	-54.74	-96.21	-89.64
1992	92.49	-14.12	23.21	1715.11	-
1993	19.39	58.86	78.98	2.79	-
1994	45.98	15.02	6.07	41.57	95.23
1995	-27.60	-4.91	3.07	-40.90	-74.10
1996	26.09	44.05	-11.28	7.12	-73.21
1997	7.33	7.74	24.56	-65.10	1389.44
Average Rate of Growth (1989-1997)	9.00	7.82	7.35	173.93	165.67

Source: Computed from Data Obtained from Customs Authority

In terms of the destination of exports the bulk of Ethiopia's exports are destined to industrialized countries (Germany, USA, Italy, France, UK, Japan and Saudi Arabia). This pattern seems to remain unchanged over the past ten years. The only exception could be the increasing importance of Asian countries (in particular Japan and Saudi Arabia). It can also be noted that a few countries such as Germany, Japan and Italy and recently Saudi Arabia are increasingly becoming important destination to exports. Table 4.5 shows the need to increasingly diversify the destination of exports so as to avoid over-dependence on few countries.

**Table 4.5: Share of Total Exports and Annual Growth Rates by Destination (1989-1996)**

	Share of Total Exports (1988/89)	Share of Total Exports (1989-96)	Share of Total Exports (1996)
USA	12.4	7.35	6.11
Germany	23.2	26.87	29.72
Italy	6.5	7.73	7.43
France	4.9	4.37	3.39
United Kingdom	1.9	3.93	3.11
Other Europe	-	8.32	7.15
Asia	15.1*	29.59	29.74
Africa	-	10.71	12.43
Rest of the World	-	1.13	0.92

\* Only Japan and Saudi Arabia

Source: Computed from Data Obtained from National Bank of Ethiopia

## Imports

Ethiopia's imports are characterized by imports of capital goods as well as raw material and semi-finished products. Such imported items had the lowest share of 53 percent in 1986. The comparable figure for 1995 is 70 percent<sup>21</sup>. This is the reflection of the country's inability to produce producer goods. The country also imports a considerable amount of consumer goods (32 percent in 1995). When we examine this pattern over the period 1986

<sup>21</sup> The production of import data has usually a lag of one to two years.

to 1995, we observe that the pattern is fairly stable. Compared to the late 1980's, however, there is a declining trend of the share of capital goods (in total exports) in the 1990s mainly because of the increase in non-durable consumer goods imports (See Table 4.6).

**Table 4.6: Share of Selected Import by End Use (In Percent)**

Imports	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
1.Raw Material	2.11	2.31	2.65	2.90	3.40	1.59	1.50	2.09	2.03	2.64
2.Semi-Finished Product	11.05	14.17	12.27	19.97	11.79	1.92	9.51	15.61	14.06	19.71
3.Fuel	8.02	9.96	10.13	11.33	11.90	12.49	22.87	21.64	16.06	11.29
4.Capital Goods (Trans)	13.19	20.22	21.34	8.62	12.88	26.70	12.68	11.57	13.99	15.31
5.Capital Goods (Agri)	2.72	2.25	1.12	1.10	0.76	0.62	0.35	0.25	1.45	1.54
6.Capital Goods (Indus)	16.48	24.57	24.47	26.91	26.53	22.71	16.24	14.71	15.22	18.90
7.Total (1 to 6)*	53.57	73.47	71.99	70.83	67.26	66.03	63.15	65.87	62.81	69.40
8.Consumers Goods (Dur)	5.96	8.12	8.65	10.50	11.73	14.84	9.24	9.75	8.67	9.77
9.Consumer Goods (Non Dur)	26.77	18.28	19.19	18.37	20.84	18.06	27.61	24.17	28.51	20.72
10. Consumer Goods (8+9)	32.73	26.40	27.84	28.87	32.57	32.89	36.84	33.92	37.18	30.49

\*Share of Development or Investment Goods (1+2+3+4+5+6)

Source: Computed from Data Obtained from Customs Authority

## Terms of Trade

There are various approaches to measurements of terms of trade. Table 4.7 presents the simple net barter terms of trade computed using export and import price indices. The deterioration of the term of trade of developing countries is a widely documented issue in international trade literature. The excellent data compile by Grilli and Yang (1988) is also tested using the new time series econometrics. The available evidence suggest that the famous Prebisch-Singer hypothesis is still valid, although the magnitude of deterioration is not as strong as has been claimed in the initial study (See Alemayehu 2000 for detail). Ethiopia's terms of trade given in Table 4.7 gives supporting evidence to the Prebisch-Singer hypothesis. Except in the 1976/77 which is associated with the coffee price hike, the terms of trade is continuously deteriorating especially starting from 1987, reaching its historic low of 79, 63 and 69 from 1992-94. This trend is attributed both to the rising (and declining) import (export) prices.

In sum, this deterioration of terms of trade combined with the instability in the volume of exportables is making the external market an extremely binding constraint for positive development of macro aggregates in Ethiopia.

**Table 4.7 Evolution of the Terms of Trade**

Year	Export Price Index, fob (1987=100, US\$-based)	Import Price Index, cif (1987=100, US\$-based)	Terms of Trade Index (1987=100, US\$-based)	Year	Export Price Index, fob (1987=100, US\$-based)	Import Price Index, cif (1987=100, US\$-based)	Terms of Trade Index (1987=100, US\$-based)
1970	38	23	166	1984	114	95	119



1971	34	24	141	1985	110	95	117
1972	42	28	148	1986	136	104	131
1973	56	34	164	1987	100	100	100
1974	57	55	104	1988	104	106	98
1975	55	57	96	1989	101	110	92
1976	98	59	167	1990	94	119	79
1977	149	64	232	1991	99	116	85
1978	113	73	154	1992	93	118	79
1979	131	84	155	1993*			63
1980	119	101	118	1994*			69
1981	103	104	98	1995*			94
1982	105	100	105	1996*			77
1983	103	97	107	1997*			97

\*The data from 1993-97 is based on Price indices of import and export of goods and services given in African Development Indicator (World Bank CD-ROM) adjusted to fit the 1970-92 data. The latter is based on World Bank, World Tables (Electronic-STARs).

## V. Private agents, Labour Market Issues and the Macro Development: A Brief Note

Political processes, macroeconomic development and the nature of markets largely influence economic agent's behavior. An interesting example in Ethiopia is that the private sector has been virtually excluded from participation in economic activity for about two decades. Thus, by examining the historical process (conflict among interest groups), the politics of policy-making, as well as overall macro and market development it is possible to shed light on the impact of these factors on economic agents that in turn affect growth performance<sup>22</sup>. Thus, in explaining macroeconomic development it would be imperative to examine such constraints faced by rural and urban economic agents. Rural economic agents refers to household's (which are units of production and consumption) behavior in rural areas and mainly focus on agriculture. On the other hand industrial growth is largely an urban phenomenon and needs understanding agents' behavior at this level.

An economy characterized by frequent wars and periodic civil unrest could have a detrimental effect on agents' behavior. It is hypothesized by some economists (See Collier and Gunning 1999 for instance) that economic agents could be uncertain about their investment decisions in the economic environment that prevails in Africa. This might have a detrimental effect on growth. Examining these issues in Ethiopian context is an important exercise. A related issue is to examine the role of private foreign investment in the growth process. Recently there is a surge of such follows (MIDROC's share being nearly 75 percent). Explaining this relatively (relative to the previous period) high level of foreign direct investment and its impact is very important. This could be complemented by analysis of the private and public sector interaction (such as issue of crowding out/in). Finally, an attempt to compare and synthesize the macro and the micro evidence need to be made.

<sup>22</sup> This analysis could be conveniently be classified under the three distinctive regimes discussed in this paper.

This, it is hoped, will provide a comprehensive information on the constraints and opportunities the private sector faces and their growth performance. However, such analysis is constrained by lack of relevant information. Suffice to say this is an important area that needs an in-depth study<sup>23</sup>. A closely related issue is the need to understand the labour market in the country.

Labour market issues are another gray area in Ethiopia's macroeconomic study. This is partly attributed to lack of consistent and complete information in the area. It is however central for understanding one major macro policy objective – employment. Although un/employment is a serious problem in the country, it is hard to read that from existing data because in most government documents the rural area is implicitly assumed to be at full or near-full employment level. Since the economically active population (both in rural and urban areas) has grown by an average of 5.2 percent in the last decade (See MEDaC, 1999), it is implicitly assumed that employment has grown by this rate in rural areas. This in turn implies unemployment is considered largely as an urban phenomenon.

The Central Statistical Authority (CSA) data shows the unemployment rate in rural areas has increased from 0.4 to 0.69 percent between 1984 and 1994 (the two period of census). The comparable figure for urban area is 7.9 and 22 percent, respectively (MEDaC, 1999). The latter figure is based on the 1994 censuses and it is more than six years old. It is safe to assume that things did not improve, if not getting worst, since then. This shows the seriousness of the unemployment problem in urban areas. Although it is not based on a complete nationwide data, the severity of the problem might be read from the ratio of registered job-seekers to the vacancies announced. This ratio had been 3.19 in 1984/85, 3.93 in 1989/90 and shot up to 30.93, 24.68, 8.0 and 6.30 from 1993/94 to 1996/97<sup>24</sup>. Thus, this is one of the areas where the post-reform period registered no success and needs closer attention. A related policy direction is to design appropriate labour market related policies that will focus on the informal sector that employs 50.9 percent<sup>25</sup> of the economically active population (See MEDaC 1999).

## VI. Conclusion

The objective of this paper is to make a quick appraisal of macroeconomic performance in Post-*Derg* Ethiopia. The study attempts to organize the analysis of the macroeconomic performance along four thematic categories which are important in explaining growth and macro development: (i) the political framework under which macroeconomic performance is coached, (ii) the macro growth framework where issues of output growth and its structure as well as major determinants discussed, (iii) the market structures under which economic agents function and (iv) possible constraints to economic agents. The method employed is the before-after approach. Since a modest evaluations and appraisal is given in each section, I have deliberately avoided repeating that here for the sake of brevity. In general, the study

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<sup>23</sup> Alemayehu and Befekadu (2000, forthcoming) is an ongoing research along this line.

<sup>24</sup> Computed based on the data reported in Abebe (1999).

<sup>25</sup> This figure shows an interesting Sectoral variation. The informal sector's share is the highest for agriculture and related activities 70.1 percent, followed by community and perusal services 68.3 percent, and Manufacturing 62.9 percent.

revealed that although the performance is very good, when judged in the context of the structural problems confronted in the period under analysis, the sustainability of the results is highly questionable. Moreover, it is also noted that the performance is not balanced and hence some sectors have performed better than others.

## Annex

(A more detailed similar data can be found in Alemayehu 1999d)

### Annex 1.1 Lending Rate Policy in the Pre and Post Reform Period

	Pre-Reform Through Sept. 30, 1992			Post-Reform		
	Coop erativ es	Public	Private	Oct 1, 1992- Aug 31, 1994		Sept 1, 1994- Jan 1, 1995
Lending Rate (all banks) Sector						
Agriculture	5	6	7	11.0-12	Lending to all sectors	14-15
Industry *	6	8	9	13.0-14		
Domestic Trade	6	8	9.5	14.0-15	Lending to central government	12-13
Transport and Communication	6	8	8	13.0-14		
Export Trade	6	6	6	13.0-14		
Import Trade (agricultural inputs)	5	6	7	14.0-15	NBE Lending to:	
Import trade (others)	6	8	9.5	14.0-15	CBE's**	10.5
Hotels and Tourism	6	8	9	14.0-15	Other Financial Institutions.	10.5
Construction	6	8	9	11.0-12		
House: (1) Purchase	6	6	8.0	11.0-12	Inter Bank Lending	10
(2) Construction	4.5	4.5	7.0	11.0-13		
Central Government	--	3.0-5.0	--	10.0		
Banks and Financial Institutions	--	2.5-4.5	--	14.0-15		
Personal loans	--	--	10.0			

Alemayehu (1999d).

**Note:** \*Includes mining, Power, and water resources

\*\* Discount Rate

### Annex 1.2 Deposit and Lending Rates Policy in the Pre and Post Reform Period

	Pre-Reform Through Sept. 30, 1992	Post-Reform Period	
		Oct 1, 1992- Aug 31, 1994	Sept 1, 1994- Jan 1, 1995
<b>Time Deposit</b>			
30 Days Notice	--	10.5	10.5
3 months to less than 6 months	--	10.5	10.5
6 months to less than 12 months	--	11.0	11.0
1 year to less than 2 years	Differ by ownership and maturity [1]	11.5	11.5
2 years and above		12.0	12.0
<b>Savings Deposit</b>	Differ by ownership and maturity [2]	10.0	10.0

Alemayehu (1999d).

**Note:**

[1] Rate differentials for 1 year and over (Through September 30, 1992)

Financial Institutions and Government owned undertakings (1 year): 1.0

Individuals, savings and credit cooperatives self help organizations:

1 year	6.0
2 years	6.5
3 years	7.0
5 years	7.5
Others: 1 year	4.0
2 years	0.8
3 years	5.0
5 years	5.5

[2] Rate differentials for (Through September 30, 1992)

Individuals, savings and credit cooperatives self help organizations

Up to Br 100,000	6.0
In excess of Br. 100,000	2.0
Other	Not allowed to maintain savings account

**Annex 1.3 Deposit Rate Policy in the Pre and Post Reform Period: The Recent Past**

	Jan 2, 1995- Nov 30, 1995	Dec. 1, 1995 - May 30, 1996	June 1 1996 – Sep 25, 1996	Sep. 16, 1996 To date*
Minimum interest rate on Time and Savings Deposit	10.0	11.0	10.0	7.0
Maximum lending rate by commercial banks and other institutions, except for central government	15.0	16.0	15.0	10.5
Central Government loan	12.0	12.0	12.0	12.0

Alemayehu (1999d).

\* **Note:** Since January 1998 the lending rate is fully liberalized while deposit rate floor is set at 6%.

**Annex 1.4 Private Banks and Insurance Companies**

Private Banks			
	Date of License	No. of Branches (including main)	Capital (paid up)* Millions of Birr
1. Awash International Bank	10/11/94	9	24.2
2. Dashen Bank S.C.	20/09/95	14	14.9
3. Bank of Abyssinia	15/02/96	5	18.8
4. Wegagen Bank	30/04/97	10	30.0
5. United Bank S.C.	10/9/1998	1	20.8
Total			
Private Insurance Companies			
	Date of License	Number of Branches (including main)	
1. Africa Insurance Co.	22/12/94	6	
2. Awash Insurance Co	1/10/94	5	
3. Global Insurance	14/1/97	1	
4. Lion Insurance	(In the process)		
5. National Insurance Co.	23/9/94	4	
6. Nile Insurance Co.	11/4/95	7	
7. Nyala Insurance	27/9/95	11	
8. United Insurance Co.	9/11/94	8	
Total			

\* For comparison the paid up capital of CBE, DBE and CBB are 40.6, 250, and 42 millions, respectively.

**Annex 1.5: Percentage Share of Different Types of Deposits**

Distribution of Deposits							
End of Fiscal Year	Percentage Share			Percentage Share banks (of the total deposit)			
	DD	SD	TD	CBE	DBE	CBB	Private Banks
1995/96	52	42	6	93.2	0.1	3.65	3.0
1996/97	53	41	6	91.6	0.3	4.0	4.2
1997/98	54	37	9	87.6	3.6	3.2	5.6
Disbursement of Total Loans							
End of Fiscal Year	Percentage Share			Percentage Share banks (of the total loans)			
	Public Ent	Cooperatives	Private	CBE	DBE	CBB	Private Banks
1995/96	15	13	72	83.9	10.9	5.12	0.0
1996/97	3.6	13	79	73.7	15.7	4.3	6.3
1997/98	3.6	13	84	56.3	21.3	4.9	17.3

Alemayehu (1999d).

**Note:**

DD = Demand Deposit TD = Time Deposit SD = Saving Deposit  
 CBE = Commercial Bank of Ethiopia DBE = Development Bank of Ethiopia  
 CBB = Construction and Business Bank Private Banks = All Private banks

**Annex 1.6 Deposit Mobilization by Commercial Banks (In millions of Birr)**

	End of Fiscal Year			Growth (in %)	
	1995/96	1996/97	1997/98	1996/97	1997/98
<b>Commercial Bank of Ethiopia</b>	<b>11193.5</b>	<b>12704.8</b>	<b>15518.1</b>	<b>13.5</b>	<b>22.1</b>
Demand Deposit	6038.2	7067.9	9197.5	17.1	30.1
Saving Deposit	4584.8	5090.2	5623.1	11.0	10.5
Time Deposit	570.5	546.7	697.5	-4.2	27.6
<b>Development Bank of Ethiopia</b>	<b>9.7</b>	<b>38</b>	<b>632</b>	<b>291.8</b>	<b>1563.2</b>
Demand Deposit	9.4	35.8	29.6	280.9	-17.3
Saving Deposit		2.1	2	-66.7	-4.8
Time Deposit	0.3	0.1	600.4	26.9	
<b>Construction &amp; Business Bank</b>	<b>438.5</b>	<b>556.6</b>	<b>568.1</b>	<b>-2.9</b>	<b>2.1</b>
Demand Deposit	37.8	36.7	26.8	19.4	-27.0
Saving Deposit	218.5	260.8	256.0	42.2	-1.8
Time Deposit	182.2	259.1	285.3	65.1	10.1
<b>Awash International Bank (AIB)</b>	<b>165.4</b>	<b>273.1</b>	<b>350.3</b>	<b>78.6</b>	<b>28.3</b>
Demand Deposit	36	64.3	82.1	51.9	27.7
Saving Deposit	122.3	185.8	242.7	223.9	30.6
Time Deposit	7.1	23	25.5	33.0	10.9
<b>Dashen Bank (DB)</b>	<b>197.8</b>	<b>263</b>	<b>374.6</b>	<b>-3.7</b>	<b>42.2</b>
Demand Deposit	138.7	133.5	153.6	102.9	15.1
Saving Deposit	58.4	118.5	186.5	157.3	57.4
Time Deposit	0.7	11	34.5		213.6
<b>Abyssinia Bank S.C. (AB)</b>	<b>0</b>	<b>44.6</b>	<b>143.6</b>		<b>222.0</b>
Demand Deposit	0	7.7	26		237.7
Saving Deposit	0	30	93.8		212.7
Time Deposit	0	6.9	23.8		244.9
<b>Wegagen Bank (WB)</b>	<b>0</b>	<b>1.8</b>	<b>118.3</b>		<b>6472.2</b>
Demand Deposit	0	1.4	30.6		2085.7
Saving Deposit	0	0.4	79.6		19800.0
Time Deposit	0	0	8.1		
<b>All Banks</b>	<b>12004.9</b>	<b>13374.2</b>	<b>17705</b>	<b>15.6</b>	<b>27.6</b>

Demand Deposit	6260.1	7369.6	9546.2	17.7	29.5
Saving Deposit	4984	5664.4	6483.7	13.7	14.2
Time Deposit	760.8	899.9	1675.1	10.4	99.4

Alemayehu (1999d).

Note: minor gaps with Table 2.2.11a may be attributed to differences in data compilation procedure by CBE and MEDaC

**Annex 1.7 Disbursement of Credit by Commercial Banks (In millions of Birr)**  
(Values in square brackets are percentage shares)

	End of Fiscal Year		
	1995/96	1996/97	1997/98
<b>Distribution by Institutional category (Total)</b>	<b>4093.6</b>	<b>4002.0</b>	<b>4581.3</b>
Public Enterprises	621.0 [15.2]	339.7 [8.5]	163.9 [3.6]
Cooperatives	524.7 [12.8]	510.6 [12.8]	550.3 [12.0]
Private	2947.9 [72.0]	3151.7 [78.8]	3867.1 [84.4]
<b>Disbursement by Source (Total)</b>	<b>4093.6</b>	<b>4002.0</b>	<b>4581.3</b>
CBE	3436.5 [83.9]	2951.2 [73.7]	2586.2 [56.5]
DBE	447.7 [10.9]	628.9 [15.7]	975.3 [21.3]
CBB	209.4 [5.1]	171.1 [4.3]	225.4 [4.9]
AIB	0	154.7 [3.9]	442.4 [9.7]
DB	0	86.4 [2.2]	121.4 [2.6]
AB	0	9.7 [0.2]	190.6 [4.2]
WB	0	0	39.8 [0.9]
<b>Share of all the Private Banks</b>		<b>6.3%</b>	<b>17.3%</b>

Alemayehu (1999d).

*Development Related Grants (in Millions of US Dollars)*

Years (G.C)	Total Grants	Financial Grants (% of total grants)	Technical assistance (% of total Grants)
1985	618.5	83.2	16.8
1986	562.8	79.5	20.5
1987	492.3	70.2	29.8
1988	774.6	74.6	25.4
1989	616.6	62.1	37.9
1990	858.2	70.4	29.6
1991	987	79.1	20.9
1992	1076	82.3	17.7
1993	732.8	76.7	23.3
1994	763.9	83.5	16.5
1995	642.3	74.0	26.0
1996	622.6	67.5	32.5
1997	565.2	70.2	29.8

Source: Global Development Finance 1998/99 (World Bank CD-ROM)

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