***Bonga University***

***Undergraduate Program*** ***Department of Agricultural Economics***

Course title: **Ethiopian Economy** *Course Code**: AgEc3126***

*Program**: BSc in Agricultural Economics*** *Cr.Hrs:* ***two***

*Instructor**: Mr. Fami A.*** *Semester**: 2nd***

***Module Name:** Applied Economics ( AgEc-**M3121**)* ***Target Group:** Year III*

***Status of the course:** Compulsory*

***Course objectives***

*After successful completion of this course students will be able to:*

- *Explain the structure of the national income and national income account of Ethiopia*
- *Evaluate the performance of different sectors in the Ethiopian Economy*
- *Analyze the Ethiopian Economy and different socio-economic conditions*
- *Examine import and export performance*
- *Comprehend the situation of financial sector and public finance*
- *Review the contemporary development policies and their effects on the economy*

**Chapter 1. Introduction to the Ethiopian economy**

1.1. Structure of the Ethiopian economy

1.2. National Income Account (NIA)

1.3. Reading the NIA of Ethiopia

**Chapter 2. Recent Performance of the different sectors in the Ethiopian economy**

2.1. Agricultural sector

2.2. Industrial sector

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**Chapter 3. Ethiopian Economy Socio-economic Conditions**

3.1. Production and Capital Formation

# 1 INTRODUCTION TO THE ETHIOPIAN ECONOMY

This chapter presents an overview of the structure and the national income account of the Ethiopian economy.

## 1.1 An Overview of the Structure of the Ethiopian Economy

The Ethiopian economy has experienced changes in economic systems over time. Under the Monarchy (up to 1974), the economy of Ethiopia was primarily agricultural. The economy was based on a feudal system under which land ownership was highly inequitable. The major portion of farmland was in the hands of wealthy landlords. There were very few industries, most them 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.

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.

Currently, though the contribution of the service sector and the industrial sector is improving, the Ethiopian economy is based on agriculture.

### 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. Ethiopian agriculture is predominantly rain-fed subsistence agriculture, troubled by recurrent droughts. Agricultural commodities also dominate the export sector, mainly coffee, chat, and hides and skins. Agriculture plays a significant and decisive role in the social and economic development of the country. However, owing to natural and man-made causes, the country has not properly benefited from its abundant natural resources conducive to agricultural development, and consequently failed to register the desired economic development that would enable its people pull out of the quagmires of poverty. The major impediments to agricultural development are the predominance of subsistence agriculture and lack and /or absence of more business/market-oriented agriculture; adverse climatic changes; failure to use agricultural land according to appropriate land use management plan and resource base; limitation in information base; lack of provision of supply and dissemination of appropriate technology; failure to integrate relevant activities; and lack of adequate implementation capacity.

The agricultural sector produces both crops and livestock. The crops produced include food crops, cash crops, fruits, and vegetables.

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.

**The Industrial Sector**

Industrial development in Ethiopia is still in its infancy and has a narrow base. Its linkage with the agricultural sector is also weak. The integration between the agricultural and industrial sectors plays a key role to accelerate the country's economic development and to bring about socio-economic transformation. The agricultural sector plays a major role in supplying inputs to the industrial sector as well as creating the market for outputs of the industrial sector. The linkages between the agricultural and industrial sector also provides the opportunity for the expansion of the service sectors.

The sector contributes about 13% of GDP and 9.5% of employment. 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 subsectors, mining and quarrying, etc., constitute the remaining 19%.

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.

**The Service Sector**

The service sector includes wholesale and retail trade, hotels and restaurants, transport and communication, banking and insurance, public administration and defence, education, health and other services.

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. The service sector grew by an impressive 10.2% in 2014/15, mainly due to improvements in hotels and tourism (29.2%), transport and communications (13.3%), wholesale and retail trade (9.9%) and financial intermediation (6.9%).

**Resource Base of Ethiopia**

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. The country has also good potential for tourism and mining. However, the country is not realizing these potentials.

## 1.2 National Income Account of Ethiopia

National Income Accounting refers to the process of record keeping for the overall economic activities of a given country. The main measures of aggregate economic activity are GDP and GNP.

**Gross Domestic Product** is the total/aggregate market value of all final goods and services produced in an economy in a one year period. This means it measures/calculates the value of final goods and services produced within a geographic boundary regardless of the nationality of the individual or firm.

**Gross National Product** is the total/aggregate market value of all final goods and services produced of citizens and firms of an economy/country in a one-year period. That is this measure includes only citizens and domestic firms including the value of their production generated outside of the economy/country.

GDP can be calculated using either the *expenditure approach* which focuses on the expenditures made by the households, firms, the government and foreign sector for goods and services or the *income approach* which focuses on the income households receive (wages and salaries, rent, interest incomes and profits) for supplying their factor services.

Ethiopia's GDP reached $55 Billion with per capita GDP of $631 by end of 2013/14. Agriculture, industry and services sectors respectively contributed 40%, 14% and 46% to the GDP. Real GDP grew by 10.3% in 2013/14 and 5.3% of this growth came from the service sector, 2.7% from industry and the balance from agriculture. In 2014/15, real GDP grew by 10.2%, keeping the momentum of the 10.3% growth rate of 2013/14. The services sector contributed 4.7 percentage points of this growth followed by industry and agriculture contributing 3 and 2.5 percentage points, respectively. While the share of agriculture in the GDP declined over ten years from 47% in 2004/05 to 39% in 2014/15 that of the services sector increased from 40% to 46% in the same period. Meanwhile, the contribution of the industrial sector remained low, at 15% of GDP in 2014/15. The strong economic growth has been underpinned by the country's public sector-led development strategy, with its focus on heavy investment in infrastructure.

Despite its declining contribution to GDP over the years, agriculture remains the leading sector in terms of contribution to the country's overall economy.

# 2 RECENT PERFORMANCE OF THE DIFFERENT SECTORS IN THE ETHIOPIAN ECONOMY

## 2.1.The Agricultural Sector in Ethiopian Economy

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 (source of foreign currency), and employment. It also provides raw materials for the various industries in the country to a great extent. It serves as source of food, and source of capital (transference of surpluses of savings and taxes from the agricultural sector to other sectors).

### 2.1.1. Structure of the Agricultural Sector

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.

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

- *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.
- *The pastoral/nomadic 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 rain fed crop production is not possible because of low-level erratic rainfall, and people rely more on livestock for subsistence.
- *The modern 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.

### 2.1.2. Specific Policies and Strategies of the Agricultural Sector Since 1960s

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.

#### 2.1.2.1.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, 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 cooperativization process.

### 2.1.2.2. 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.

#### 2.1.2.3.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:

- o 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 strategy 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. 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.

### 2.1.3. The Performance of The Agricultural Sector

The performance of the agriculture 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 poor, drought has forced people to depend on food aid.

**The Crop Production:** involves the production of food crops and cash crops.

**Food crops**: include grains, root and tuber crops, pulses and oil seeds. About 97 percent of the food crops are produced by smallholders. Cereals are the most dominant food crops in terms of areal coverage and total output. 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.

**Cash crops**: 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.

**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.

In 2001/02, 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.

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.

**The Livestock Production:** Livestock resources in Ethiopia mean 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 overall 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.

**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.

According to FAO, 2003, 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.

### 2.1.4. Problems of and Possible Remedies for the Agricultural Sector

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?

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

**a.** Natural problems – Unpredictable Weather Conditions

**b.** Human-Made Problems- These are negative effects that result from the social and economic practices. These problems include: land fragmentation, lack of infrastructure, lack of credit facilities, lack of effective land-ownership entitlement, erosion and land degradation, traditional practices, the use of backward technology and inadequate rural markets.

**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
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.

## 2.2. Industrial sector in Ethiopian Economy

The national income account of Ethiopia classifies the industrial sector into these sub sectors: manufacturing, mining and quarrying, construction, and 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.

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.

According to Sutcliff, there are three criteria for a country 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.

### 2.2.1. 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.

**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 manufacturing sector can be classified into groups of food and beverage, textiles, leather and footwear, wood and furniture, paper and printing, chemicals, non-metal and metals. According to CSA, 2008, during 2007/08, 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.

**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%, and 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.

**Foreign Exchange Contribution**: The poorly developed industrial sector of Ethiopia contributes very little to the foreign currency earnings of the nation.

According to CSA, 2009, 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.

### 2.2.2. Industrial Development Strategies since 1960s

The policies 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.

### 2.2.2.1.Industrial Development Strategies During The Imperial Period

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-substitution, 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. 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.

Manufacturing can be classified into different categories by using different criteria. The criteria vary from country to country. 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 substitution, was pursued as a matter of government policy. As a result, a good number of manufacturing enterprises were established, including 80 factories, mostly by private businessmen of foreign origin. Only eight of these eighty establishments were fully government-owned, while another five were joint ventures where the government had over 50% ownership. By 1974, 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.

#### 2.2.2.2.Industrial Development Strategies During The Derg Period

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 handcrafts 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.

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.

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 was 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.

#### 2.2.2.3.Industrial Development Strategies During The Post- Derg Period

After replacement of the socialist government 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 capitalism''. 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. The basic assumption is that 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.

According to the CSA, 2010, there were 1,930 large- and medium scale, 43,338 small-scale, and 974,676 cottage/handicraft establishments during 2007/08. 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 1.

Table 1: 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, 2010.

As shown in Table 1, 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 2, 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 2: 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: Distribution of Large- and Medium-Scale Manufacturing in Ethiopia, 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: CSA, 2009

From Table 3, 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 takes the 3$^{rd}$ place in establishments, value added and employment shares. 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.

### 2.2.3. 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;
- *Value added at current market price* (VACMP), which is the sum of value added at factor cost and indirect taxes, regardless of any subsidies.
- *Value added per person employed* (VAPPE), which refers to the ratio of value added generated in a given period to the 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 4.

Table 4: 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: CSA, 1999, 2009

As indicated in Table 4, 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 thereafter. ‘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 5 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 5: 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 medium-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 6.

Table 6: 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: CSA, 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 7: Value Added of the Large- and Medium-scale Manufacturing Subsector (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: CSA

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 value added by 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 (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.

### 2.2.4. Problems of and Possible Remedies for the Industrial Sector

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.

**Lack of Finance**: The possible sources of this finance have been agricultural- and non-agricultural-commodity producing sectors in the economy. The agricultural sector 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, are 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.

**Market-Related Problems**: According to CSA, 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.

**Technology-Related Problems**: It is argued that it is impossible to think of industrial development without the application of modern science and technology.

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

- Lack of sufficient information on appropriate technology.

- 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.
- The technology we use is also capital intensive. This approach is basically not recommended for economies like Ethiopia where unemployment is rising.

**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.

## 2.3.Service Sectors in Ethiopian Economy

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 MOFED, 2009/10, 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.

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:

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, theatre performances, art shows, and musical performances.

**The Role of the Service Sector in the Ethiopian 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.

**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, wholesale and retail trade, hotel and restaurant sub sectors. Moreover, relatively large investment is expended on the sector.

**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.

**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.

**The Education Sector in Ethiopia**

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 4th 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 19th 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. One of the characteristics of the Derg was its spending on defence rather than expanding the education sector. Between 1987 and 1991, only 8.94% of the annual budget was allocated for education.

But, according to Education Statistics Annual Abstract, 2007/08, the budget allocation for education between 2003/04 and 2007/08 was 22.6%. 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.

**The Health Sector in Ethiopia**

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; and nutritional disorders and insufficient access to health services.

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 socioeconomic development effort of the country.

Then a comprehensive rolling 20-year Health Sector Development Plan (HSDP) was formulated in 1997. Both the 1993 National Health Policy and the 1997 HSDP are the results of the critical assessment and analysis of the nature and causes of the country's health problems. 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, and 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.

**The Transport Sector**

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, and 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, and obtaining licenses to form new associations.

The transport sector in Ethiopia includes road transport, railways transport, air transport and marine transport (shipping lines).

**The Communication Sector**

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; and 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 Ababa 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 Ababa. The first telephone subscriber in Addis Ababa 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 Ababa 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. 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).

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.

## The Tourism Sector

Tourism deals with the movement of people away from their normal residence for: business, conference, vacation, transit, visiting relatives, and 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. 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.

## 3. ETHIOPIAN ECONOMY SOCIO-ECONOMIC CONDITIONS

There are various indicators of development employed to compare the level of development countries or regions. The following are widely/frequently used in the Ethiopian context. GDP or GNP (Gross Domestic Product/Gross National Product) per capita, Illiteracy rate, Infant mortality rate, expected life expectancy, Population growth rate, Percentage of population who have access to clean water and Level of infrastructural development, etc.

Based on the above indicators, Ethiopia's present socio-economic features are treated as follows.

1 GDP per capita: It is believed that Ethiopia's GDP per capita is one of the lowest in the world. PASDEP's target has achieved a growth rate of Ethiopia's GDP per capita status will join the middle in group countries with in the coming five years (2010-2015). The current status of Ethiopia's GDP per capita is estimated to be US $344 per annum (source: wikipedia, the free encyclopedia).

2 Literacy rates: Like many of the less developed countries, the illiteracy rate in Ethiopia has been high. The literacy campaign that had under taken before 1991 contributed much to the ongoing task to eradicate illiteracy. Since 1996, the illiteracy rate has decreased by 50%. Welfare Monitoring Surveys Undertaken so far exhibits a sharp rise in gross school enrollment that considerably confirm the decline of illiteracy rate in the country. The current literacy rate of Ethiopia is said to be 42.7% in the year 2009

(Source: wikipedia, the free encyclopedia).

3 Infant Mortality Rate: Like in many developing countries, IMR in Ethiopia has been high. The UNDP 1997 census reveal that Ethiopia's infant mortality rate was 111/000 which even above the average of subsharan countries (97/1000). The recent development strategies adopted to achieve growth and sustained development, has target to lower down the IMR to 47/1000 with in the coming five years.

4 Expected life expectancy: the life expectancy of any country is the reflection of varied social, economic, psychological and other factors. In most developing countries life expectancy does not exceed 55 years. Likewise, in Ethiopia, it was 43 about ten years ago due to the prevalence of HIV impacts. The recent strategies adopted both in the primary health care services and supply of HIV/AIDS medicines extensively, the expected life expectancy in Ethiopia has reached to 55.8 years in 2009/10.

5 Population growth rates: Rapid population growth with an average rate per annum has been one of the many threats to Ethiopia's development pace. Estimates or surveys reveal that 38,000 people are added to the population each week incurring high costs of providing additional services. Addressing this issue GTP the continuation of PASDEP has designed to slow the rapid population growth by applying spacing of births through health service institutions and extension package services

6 Percentage of population with access to clean water: for many decades lack of access to clean water has been our people's serious problem. Most illness caused both in urban and rural areas are related to unsafe water.

7 Based on the surveys made by a welfare monitoring organization, a greater proportion of rural population had been very far away from sources of drinkable water. Mothers and daughters were travelling long distances to fetch for water.

8 Level of infrastructural development: This indicator of development includes a vaguely of elements that promote the living standard of people. In our context; we here by examine the road networks, electric power supply, rehabilitation/ resettlement of pastoralists, access to health services and strengthen the urban-rural link.

### 3.1.Production and Capital Formation

Ethiopia is becoming one of the prime destinations for foreign investment. The country is attracting investors with tax incentives, low-cost labour, strategic location for trade, and improved transport infrastructure.

In recent years, the Government of Ethiopia has made considerable effort to improve the country's business and investment climate through the issuance of targeted legislative measures. The revised Investment Code of 1996, as well as the Investment Proclamation, provide incentives for development-related investments and have gradually removed most of the sectorial restrictions on investment. Furthermore, the 2012 amendment to Ethiopia's Investment Proclamation introduced provisions for the establishment of industrial development zones, both state-run and private, with favourable investment, tax and infrastructure incentives. Other measures include the revision of regulations for potential investors, standardization of appropriate accounting practices (to more accurately assess tax and other operating liabilities), increased protection for shareholders, provisions for bankruptcy filings, and the modernization of trade and registration processes.

These measures have paved the way for increased foreign direct investment (FDI) flows to the country. Ethiopia ranked as the third largest FDI recipient in Africa in 2013, a 240 percent increase from 2012 (UNCTAD, 2015). The country also registered a significant increase in FDI stock – the amount of investment from abroad held within the economy. FDI inflows reached USD 1.2 billion in 2014, up from USD 279 million in 2012. As a share of GDP, FDI raised from 0.4 percent in 2008 to 2 percent in 2013.

The sectors that have attracted the most FDI are floriculture, horticulture, textiles and leather. Recently, commercial farming has attracted Indian, Saudi, European, and U.S. investors.

The private sector and foreign investors are playing an increasingly important role in the economy. The country has comparative advantages in agriculture, agro-processing, leather and leather products, and textiles and garments.

### 3.2.Poverty

Poverty is reflected in low GNP per capita. It is not relative poverty but absolute poverty that is more important in assessing poverty. Absolute poverty is a state of poverty where an individual's daily income is below one dollar. Absolute -poverty is measured not only by low income but also by malnutrition, poor health, clothing, shelter, and lack of education. Thus, absolute poverty is reflected in low living standards of the people.

In the mid 1980s, the poverty situation in Ethiopia 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.

However, poverty in Ethiopia has declined at an annual average of 1.94% since 1995. The population share of persons living below the national poverty line fell from a baseline of 48% in 1990 to 45.5% in 1996 and 29.6% in 2011, and is estimated to have further declined to 23.4% in 2015, which is below the MDG target of 24%. The sharp decline in poverty is attributable to the implementation of welfare programmes such as the Productive Safety Net Programme (PSNP), other food-security programmes as well as of urban food-distribution and subsidies. In 2015, Ethiopia was facing drought due to the effects of El Niño, and 10.2 million persons were in need of emergency aid into 2016.

### 3.3.Infrastructure

In recent years, Ethiopia has made significant progress in infrastructure development. Public investment rose from about 5 percent in the early 1990s to 18.6 percent of gross domestic product (GDP) in 2011, making it the third highest in the world (Moller and Konstantin, 2015). Its infrastructure indicators compare relatively well with other low-income countries. In an analysis of 124 countries over four decades, Ethiopia ranked among the fastest 20 percent in terms of infrastructure growth (World Bank, 2015).

**Railways**: Railway infrastructure development was one of the priority programmes of the first Growth and Transformation Plan (GTP I) and the Addis Ababa Djibouti corridor was given priority. A new 756 km electrified railway route eastward to Djibouti is being constructed, the shortest distance from Addis Ababa to a seaport; it is expected to transport 11.2 million metric tons of freight in 2016. Contracts were also awarded to start the construction of Mekele-Hara Gebeya (Woldya) (268 km) and Hara-Gebeya-Semera Assayita (229 km) railway projects. Construction has already begun for the Awash-Kombolcha-Hara Gbeya (Woldiya). Ethiopia is also actively developing a rail industry to serve the broader region including South Sudan, Somalia (Punt land) and northern Kenya.

In order to improve accessibility to the Djibouti port, the Government of Ethiopia (GoE) initiated the construction of a 5,000 km railway to connect the port with major Ethiopian cities.

The construction of a 34 km Addis Ababa Light Rail Transit project is complete and operations started in 2015. Railways will increase integration within the country and within the region.

**Roads**: As a land-locked country, Ethiopia is highly dependent on road transport for the movement of passengers and freight. The Government has prioritized improving the road network and dedicated more than 5 percent of GDP to road investments, one of the highest shares in Africa. As a result, the road network increased from 48,800 km in 2009/10 to 60,466 km in 2013/14. Under the Universal Rural Road Access Program, 39,070 km of all-weather district roads were constructed. As a result, the proportion of Kebeles (lowest administrative unit) connected by all-weather roads increased from 39 percent in 2009/10 to 68 per cent in 2013/14. At the same time, road density increased from 44.5 km/1000 km$^2$ to 90.5 km/1000 km$^2$ in the same year. Thus, the average time to reach the nearest all-weather road was reduced from 3.7 hours in 2009/10 to 1.8 hours by 2013/14 (National Planning Commission, 2015).

**Air transport**: Ethiopia is a regional leader in air transport. Ethiopian Airlines is one of the three main sub-Saharan African airlines and Bole International Airport serves as a regional air transport hub for passenger and commodity transport. Ethiopian Airlines is the largest airline group in Africa, with an active fleet of almost 80 aircraft and a network of 92 international and 19 domestic destinations.

It is the largest African carrier with revenue topping USD 2.3 billion in 2013, according to the airlines ranking of the International Air Transport Association (Ethiopian Airlines, 2014).

**Sea transport:** The Government has established the Ethiopian Shipping and Logistics Enterprise to ensure efficient, cost effective and reliable import and export movement of cargo to and from the seaports of neighboring countries. The enterprise is currently operating two dry ports, which are located at Modjo and Semera, 73 kms and 588 kms from Addis Ababa, respectively. The enterprise is also operating another four sub-terminals, which are located at Dire Dawa, Mekele, Kombolcha and Gelean, 515 kms, 783 kms, 376 kms, and 34 kms from Addis Ababa, respectively.

Addis Ababa is linked by road and railway lines to the Port of Djibouti (910 kms) at the Gulf of Aden. The ports of Barbara (964 kms) in Somaliland and Port Sudan (1881 kms) in Sudan are other external trade routes that provide services for export-import trades between the countries. Another potential port accessible to Ethiopia (in the south) is Port Mombasa in Kenya (2077 kms).

Ethiopian Shipping Lines (ESL) also provides a sea transport service using its own fleet. The main focus of the shipping sector of ESL is to provide coastal and international marine transport services to and from Djibouti Port, through the Ports of Indonesia, Japan, Republic of China, Republic of Korea, Singapore and South Africa.

**Telecommunication:** Telecommunication is another area that has seen major investment aimed at improving service quality, expanding service coverage and enhancing institutional capacity. The number of subscribers in the overall telecom services increased from 7.7 million in 2009/10 to 29.63 million in 2013/14. The number of mobile subscribers increased from 6.25 million in 2009/10 to 28.3 million in 2013/14. Similarly, the percentage of the rural population with access (within a 5 km radius) to telephone services increased from 62.1 percent in 2009/10 to 96 per cent in 2013/14.

**Energy supply**: Ethiopia has also invested significantly in the development of its energy sector. Large investment projects were initiated to support on-going efforts to ensure sustainable development. The Great Renaissance Hydro Electric Power Project (6000MW), Gilgel-gibe III (1,870MW) and Genale-Dawa III (254MW) and other wind power projects (Adama and Ashegoda), were distinctive features of the first GTP. The projects are all well in progress. Wind power projects, Ashegoda and Adama No. I and II have already begun generating electricity.

### 3.4.Unemployment and Underemployment

The labour force is one of Ethiopia's competitive advantages. The country has an abundant young and easy-to-train labour force. In 2014, Ethiopia's workforce amounted to 47 million, with around a million people added to the labour force every year.

Unemployment is said to occur when a person actively seeking for jobs and could not find it. It is the amount of labor, which is unused. Most of the time we can see unemployment when the economy fails to perform adequate and well-paying job opportunity for the existing labor force.

The overall economic performance of the country is depending up on job opportunity that every individual may have. In Ethiopia, there is an open unemployment and it is becoming the major problem. Unemployment rate is higher in urban areas compared to the rural areas and among women compared to men.

Unemployment in Ethiopia seems to be urban phenomena. In cities, the majority of the unemployed are young people with modest level of formal education.

Causes for unemployment:

- rural to urban migration

- absence of sufficient employment opportunities
- Fast population growth and stagnant economic performance
- Poor educational system of the country
- The issue of promoting productive education along with sustained private sector investment is believed to be crucial in reducing urban youth unemployment.

In general, according to CSA (2000, 2006, 2014), there is a decline in the national rate of unemployment from 8.2 percent in 1999 to 5.4 percent in 2013. Over the same period, urban unemployment is noted to drop from 26.1 to 21.0 percent.

# 4. IMPORT AND EXPORT PERFORMANCE IN ETHIOPIA

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.

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. This happens on the basis of the principles of absolute advantage and comparative advantage. 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.

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; and 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).

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.

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.

Furthermore, within the framework of promoting exports, other complementary measures such as simplifying procedure for getting licences for coffee exporters were undertaken.

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 then to 50 percent; and the system of granting import licenses and permits were simplified.

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.

### 4.1.Export Performance

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. 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 1960s, 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 8).

Table 8: 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 21$^{st}$ 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 %. 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 year's 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.

**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 9: 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 |

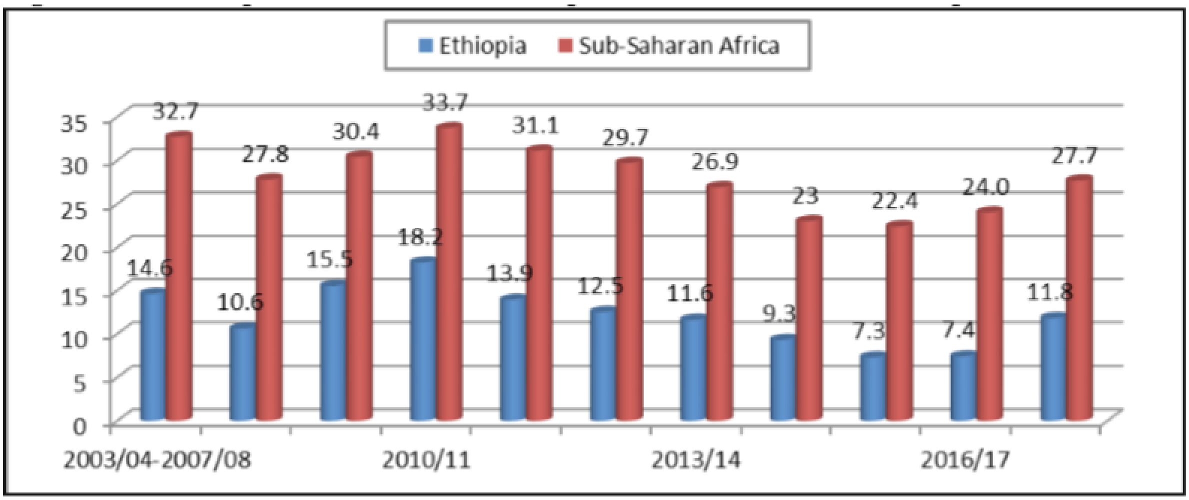
Source: MEDaC, 1999

The major route of Ethiopia's external trade is towards Europe, followed by Asia. According to NBE, 2009, 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.

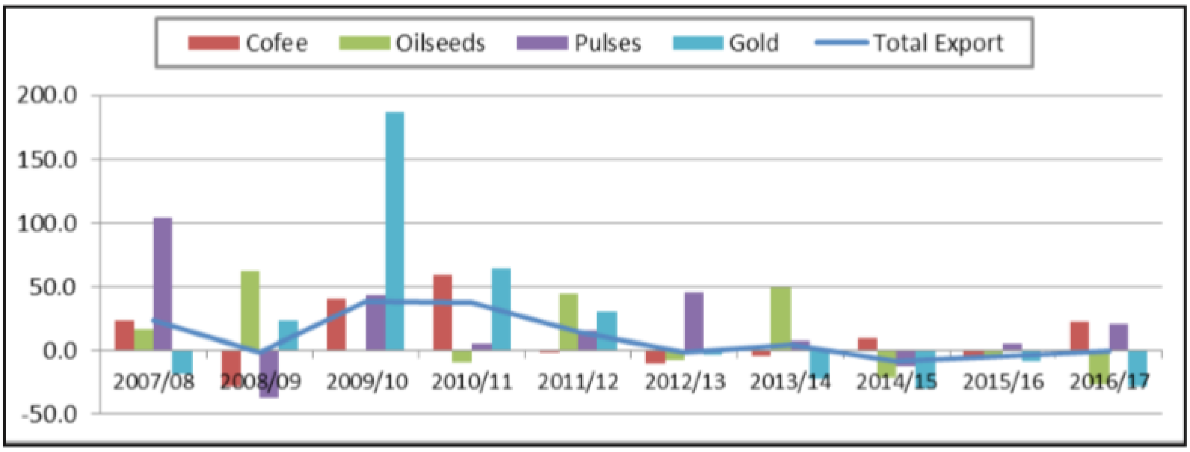
Ethiopia's export performance has not only declined overtime, its position compared to the SSA countries has been very low. As figure below depicts over the last decade Ethiopia's export of goods and services averaged nearly 12 percent of GDP, while the average for SSA countries was 28 percent.




*Source: IMF: Regional Economic Outlook: SSA Restarting the Growth Engine: April 20017*

Among the export commodities the performance of gold significantly accounted both for the positive and negative developments over the last decade. Its enhanced performance contributed for the noticeable overall export growth (38 percent) in 2010/11. As could be recalled in 2011 gold price hit the highest price in the global market. While its price decelerated and reached at very low in 2016. Accordingly, it has become the major source of ups and downs in the overall export performance of the country

**Annual Growth and Value of Major Commodity Export (percent)**




*Source: National Bank Ethiopia of and staff computation, 2017*

Yet the structure of exports hardly changed over the last two decades and the country's export earnings still depend on few agricultural commodities (Table 6.4.2). Though, diversification is still lacking, a shift within the major commodity categories has been evident. Ethiopia's traditional export item coffee represented about 60 percent of the total export item in the 1990s. Its share decelerated to an average of 45 percent in 2000/01 and further to 22 percent in 2013/14. The share of the top five exports (coffee, leather & leather products, oil seeds, pulses and chat) declined on average from about 87 percent during 1990/91-2000/01 to 65 percent during 20011/12- 2016/17. This indicates the emergence of new export items such as gold, flowers, and textiles in recent years. However, although the share of coffee declined over time from its high of the earlier years, its position has stabilised about a quarter of the overall export earnings and even rising in late years. This has a message that the structural shift has not sustained and the performance of the modern sector (manufacturing products) role in the export market is not yet realized.

**Share of major export items in total export (percent)**

| Export Products | 2000/01 | 2005/06 | 2009/10 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 |
|---|---|---|---|---|---|---|---|---|---|
| Coffee | 45 | 35.4 | 26.5 | 26.5 | 25 | 22 | 26.3 | 25.6 | 30.4 |
| Leather & Leather Products | 18.8 | 7.5 | 6.4 | 3.5 | 4.1 | 4 | 4.4 | 4.1 | 4 |
| Oil Seeds & Pulses | 10.2 | 24.8 | 19.6 | 20.1 | 26.8 | 31.1 | 28.9 | 29.2 | 21.7 |
| Chat | 15.1 | 8.9 | 10.4 | 7.6 | 9.1 | 9.1 | 9.1 | 9.2 | 9.6 |
| Gold | 7 | 6.5 | 1.4 | 19.1 | 19.4 | 14 | 10.7 | 10.2 | 7.4 |
| Flower | 0 | 2.2 | 8.4 | 6.2 | 6.3 | 6.1 | 6.8 | 7.9 | 7.7 |
| Live Animals & Meat | 0 | 3.7 | 4.5 | 6.5 | 5.6 | 5.7 | 5 | 5.2 | 6 |
| Others | 4 | 11 | 22.7 | 10.5 | 3.8 | 7.3 | 8.7 | 8.7 | 12.3 |

*Source: National Bank of Ethiopia*

## 4.2.Imports in Ethiopia

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 10, 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.

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 10, 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 nondurable 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 because 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 10: Imports, by Use (In Millions of USD)

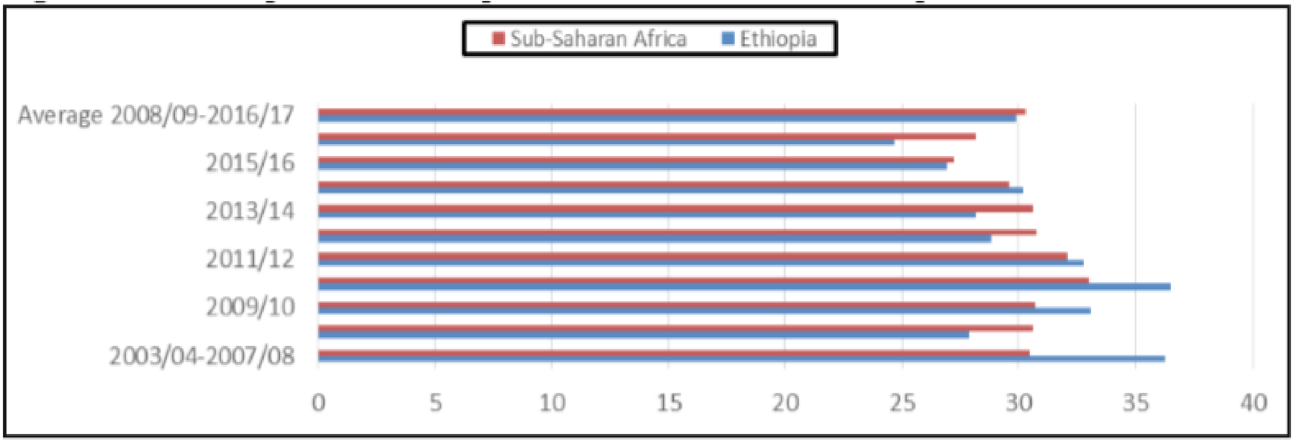
| | 2006/07 | % share | 2007/08 | % share | 2008/09 | % share |
|---|---|---|---|---|---|---|
| **Raw Materials** | 148.6 | 2.9 | 257.8 | 3.8 | 354.2 | 4.6 |
| **Semi-Finished Goods** | 800.3 | 15.6 | 1,259.7 | 18.5 | 1,140.1 | 14.8 |
| Fertilizers | 140.0 | 2.7 | 302.1 | 4.4 | 270.7 | 3.5 |
| **Fuel** | 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

According to NBE, 2009, 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.

Despite low export performance the share of imports of Goods and Services averaged 30 percent of GDP between 2008/09-2016/17 which is comparable to average of SSA countries. Figure: Ethiopia and SSA imports of Goods and Services in percent of GDP




*Source: IMF Regional Economic Outlook*

The structure of imported items is dominantly capital goods, raw materials, semi-finished goods, fertilizer and fuel which accounted on the average about 70 percent for the last 8 years; compared to 30 percent of consumer goods as the following table. Fuel imports increased from 17.7 percent in 2001/02 to 19.4 percent of total imports in 2011/12, although its share has been relatively low in recent years owing to the lower international oil price.

Structure of Imports by End-use (percent)

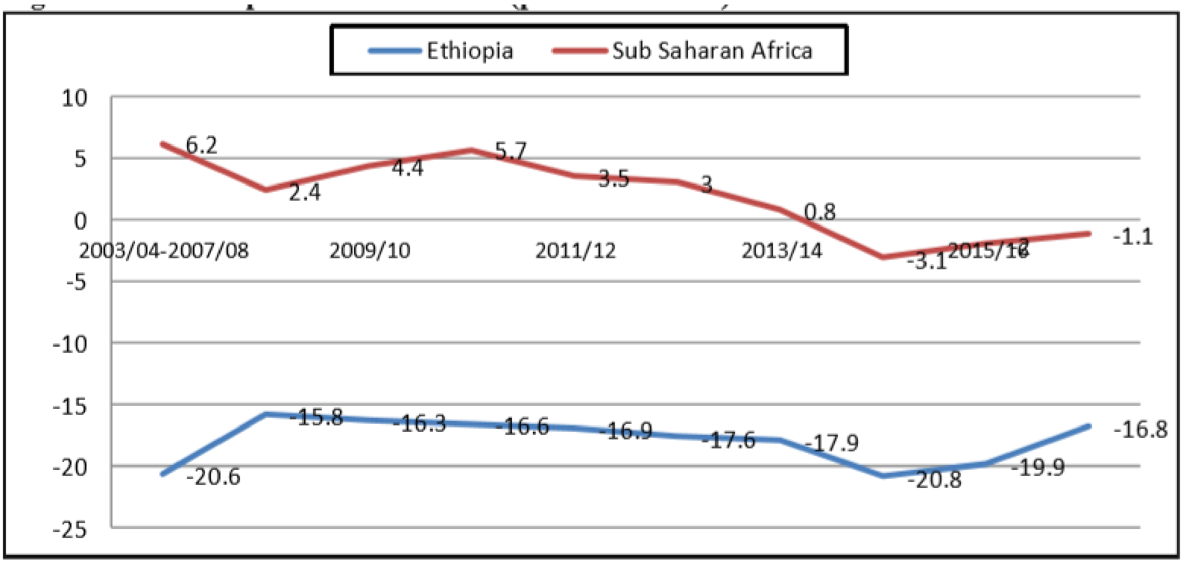
| Items | 2000/01 | 2005/06 | 2009/10 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | Average 2011/12-2016/17 |
|---|---|---|---|---|---|---|---|---|---|---|
| Raw Materials | 1.6 | 1.7 | 2.5 | 1.8 | 1.3 | 1.2 | 1.0 | 0.9 | 0.8 | 1.2 |
| Semi- Processed | 16.0 | 17.9 | 14.5 | 17.7 | 16.2 | 16.3 | 15.7 | 17.3 | 16.6 | 16.6 |
| Fertilizer | 1.0 | 3.0 | 3.0 | 5.5 | 2.7 | 2.9 | 3.1 | 2.6 | 2.3 | 3.2 |
| Fuel | 17.7 | 18.7 | 17.6 | 19.4 | 14.0 | 18.8 | 12.4 | 8.0 | 11.5 | 14.0 |
| Capital Goods | 30.1 | 31.6 | 34.1 | 26.4 | 33.0 | 35.4 | 41.8 | 40.8 | 38.2 | 35.9 |
| Consumer Goods | 31.7 | 27.9 | 29.9 | 31.3 | 31.9 | 26.9 | 27.4 | 31.5 | 31.0 | 30.0 |
| Others | 2.9 | 2.1 | 1.4 | 3.4 | 3.5 | 1.5 | 1.7 | 1.5 | 1.9 | 2.2 |

## 4.3.Balance Of Payment In Ethiopia

**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 external trade in merchandise in the past two decades or so. With relatively small but significantly expanding exports and sizable imports, the trade deficit is 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.

While the export performance declined over the years, the trade deficit widened as import continued to rise. Moreover compared to the SSA countries performance Ethiopia's trade balance on goods is more pronounced as observed in figure below

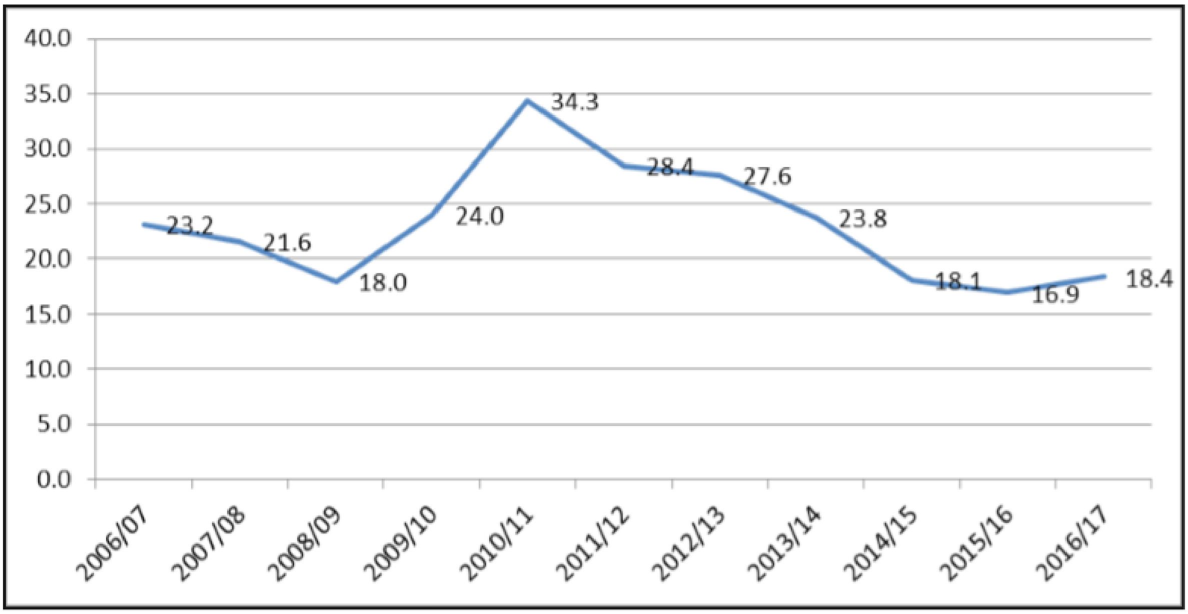
**Figure: Ethiopia's Trade Balance (percent of GDP)**




*Source: IMF: Regional Economic Outlook: SSA Restarting the Growth Engine: April 20017*

Obviously poor performance of export value which is not commensurate with an increased import value results in availing insignificant level of hard currency. As a result the share of exports earnings in financing imports exhibits a declining trend over years. The only highest ratio registered was 34.3 percent in 2010/11, whereas it declined to nearly 17 percent in 2015/16.

**Figure: Export Capacity in Financing Imports (percent)**




*Source: National Bank of Ethiopia: 2015/16 Annual Report*

**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 11, 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 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 beginning of the post- reform period is summarized by Table 11.

Table 11: 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

**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 12: 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 |

**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 13.

Table 13: 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: NBE

As indicated in Table 13, 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 14: 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 14, 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.

### 4.4. Exchange Rate

The exchange rate can be defined as the amount of domestic currency (let's say Birr) that must be paid per unit of foreign currency (may be US$).

Ethiopia had been following fixed exchange rate regime during both the Imperial period and the Derg period. During the Derg regime, the government restricted 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.

However, after the overthrow of the Derg, in 1992, the TGE changed the fixed exchange rate regime to that of a managed floating exchange rate regime (that is, a rate determined by the market), and 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.

# 5. PUBLIC FINANCE AND FINANCIAL SECTORS IN ETHIOPIA

## 5.1. 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 as:

- ✓ 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.

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. According to Ministry of Finance, 2009, government revenue increased from 21,797,100 in 2006/07 to 30,802,400 in 2007/08 and 40,644,000 in 2008/09.

More than 90% of the total government expenditure is absorbed by the following sectors: 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.

*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.

SOURCE OF GOVERNMENT REVENUE

*A. Ordinary revenue*

The total of ordinary revenue is made up by tax revenue and non-tax revenue. Tax revenue is further divided into three parts – direct tax, indirect tax, and foreign trade tax.

A tax is generally defined as a compulsory payment that the citizens of a country have to make to the government without a quid pro quo, i.e., the taxpayers cannot expect to get any direct benefit in return for the tax paid by them. Those who are liable to pay tax have to pay the tax; otherwise they can be prosecuted and penalised by the state.

*i Direct tax:* The term direct tax means a tax paid directly to the government by the persons on whom it is imposed. The burden of the tax cannot be shifted onto anybody else. 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. These include income of the government by way of sale of goods and services by various departments of the government. Examples include: • charges and fees • sales of government goods and service • government investment income • privatization proceeds

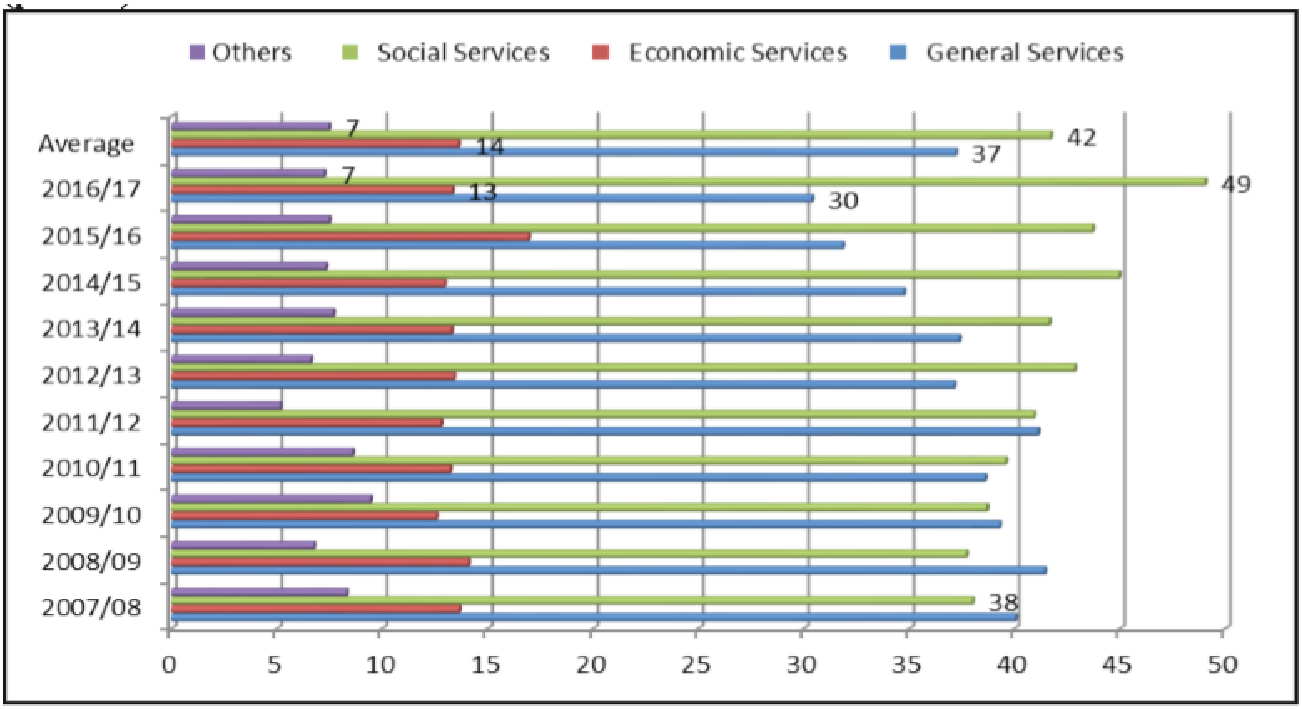
***B External Assistanc:*** Grants received in cash, or some other form, from outside the country are known as external assistance. These receipts form an important source of financing the deficit budget of the government and play an active role in economic development of the country. External assistance received from friendly countries is called bilateral assistance; whereas assistance (grant) received from multilateral or international institutions is known as multilateral assistance. Generally, It comprises of grants, loans and technical assistance from bilateral or multilateral agencies.

***C Capital revenue****:* It comprises the money received by the government from the sale of government assets, collection of loans, counterpart fund and external loans.

***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. Recurrent budget expenditure consists of expenses that repeated in nature like salaries of civil servants. The capital budget is usually financed by external loans and grants.

Recurrent Expenditure: Recurrent expenditure represents expenses made by the government which are recurrent in nature, i.e., they are repeated. Normally, it is an expense on consumables that facilitate productive activities, for example, salaries of civil servants, purchase of raw materials, fuels and other factors of production. The recurrent expenditure is classified in Ethiopia under four functional categories: Administrative and General Services; Economic Services; Social Services; and Other Expenditures. Administration and general service are Organ of state, Justice, Defence, Public order, General service. Economic servise include agriculture and natural resource, trade and industry, mining and energy, tourism, transportation and communication, construction. Social service: education and health, culture and sport, labor and social affairs, prevention and rehabilitation. Others are transfer payment, repayment of public debt, contingency and pension payments, provision of unforeseen expenses and similar items.

**Figure1: Share of sectoral recurrent expenditure from total recurrent expenditure (percent)**




Source: Ministry of Finance and Economic Cooperation

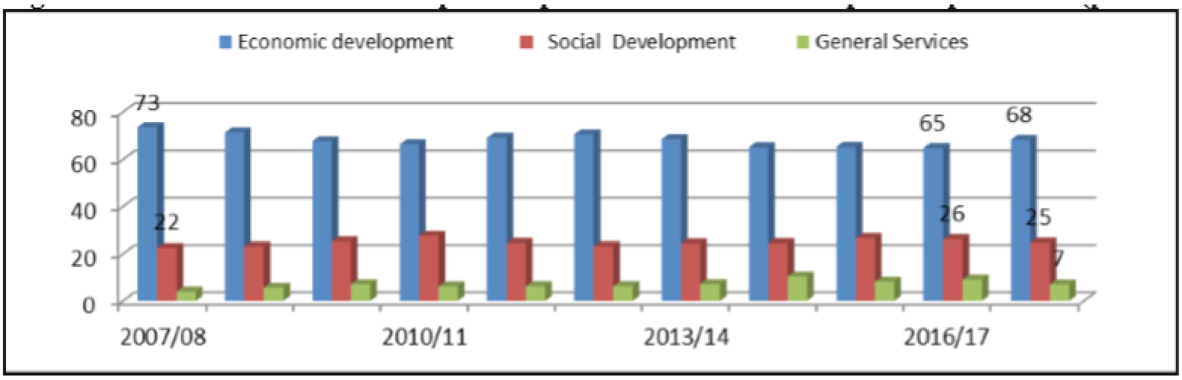
Among the recurrent expenditure components, the share of social service expenditures averages 42 percent, followed by general services (37 percent) and economic services (14 percent) over the last decade. Other expenditures largely dominated by external debt servicing averaged 7 percent of the aggregated recurrent expenditure in the same period.

The trends of recurrent expenditure during the last ten consecutive years have shown significant shift to the social sector. In 2016/17, expenditure on social services had the largest share from the total recurrent expenditure (49 percent), compared to 38 percent a decade ago. The share of administrative and general service on the other hand declined to 30 percent from a high of 40 percent in the same period. Such developments demonstrate Government's commitment to expand social services including education and health services as an important tool in achieving its development target.

Capital Expenditure: Capital expenditure represents expenses made by the government for the implementation and expansion of development projects. These are in the nature of acquisitions of fixed assets like buildings, machinery, equipment, etc. Government expenditures on construction of infrastructure, industries, and research and development programs are also part of capital expenditure. The capital expenditure is classified in Ethiopia under three categories: Economic Development; Social Development and General Development. Economic Development includes production activities in the agricultural and industrial sectors and economic infrastructure in mining, roads, energy, commerce and communication. Social Development includes such activities as education, health, urban development and social welfare. General Development includes services in statistics, cartography, and public and administrative buildings. In most developing countries, recurrent expenditure is mostly financed from domestic revenue sources — that is, from tax and non-tax revenues, whereas capital expenditure is usually financed by external borrowing and grants. The annual budget for the Federal Government of Ethiopia is prepared by the Ministry of Finance and Economic Development (MoFED) and the budgets for the regional governments by the respective regional finance bureaus.

As it has been discussed earlier in Ethiopia over the last decade, the share of capital expenditure exceeded that of the recurrent except fiscal year 2016/17 outturn. The overall Government expenditure in fiscal year 2016/17 amounted to Birr 329.3 billion in 2016/17, surpassing by Birr 48.4 billion (17.2 percent) and grew by 5.6 percent from the preceding fiscal year performance. However, the actual execution rate of capital expenditure was about 86.2 percent of its budget. A number of factors can be cited for low actual performance of the capital expenditure. Revenue generated during fiscal year 2016/17 was below expectation. Thus to maintain reasonable level of deficit the Government has to curtail capital expenditures. From total capital expenditure, about 75.9 percent was financed from treasury sources. Besides, the Government capital expenditure is supposed to enhances economic growth by encouraging private sector investment attributable through facilitating role of government in the provision of public infrastructure. In this case, capital expenditure on economic infrastructure averaged 68 percent over the last decade. The share of social capital expenditure averaged 25 percent over the same period (Fig2). It is obvious that Ethiopia has a huge challenge to eliminate poverty and improve the livelihood of its citizens. This entails designing appropriate polices, investing in social sectors and building infrastructure as well as creating conducive environment for the private sector. In this regard, providing emphasis for the rural development and food security where the majority involves is highly decisive. Provision of basic services and infrastructure such as education, health, water, and road are equally important in boosting the living standard of the population. Consequently, government expenditure in financing such vital basic services and infrastructure building over the last decade substantially increased, albeit starting from low aggregated expenditure shares in percent of GDP.

**Figure 2: Share of Sectoral Capital Expenditure from total Capital Expenditure (percent)**




According to Ministry of Finance, 2009, the total government recurrent expenditure shows an increment by 28.8% in 2007/08 and 18.24% in the year 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.

**Government Budget**

Budget shows the details of the planned expenditures of the government program and the expected revenues from tax and non-tax sources for a year.

Objectives of a Government Budget The general objectives of a government budget are the following:

Economic Growth: to promote rapid economic growth so as to improve the living standard of the people.

Reduction of Poverty and Unemployment: to eradicate mass poverty and unemployment by creating maximum employment opportunities and providing maximum social benefits to the poor. Social welfare is the single most important objective of the government.

Reallocation of Resources: to reallocate resources in line with social and economic objectives.

Reduction of Inequalities: to reduce inequalities of income and wealth through levying taxes and granting subsidies. Equitable distribution of wealth and income is emphasized. Economic progress in itself is not a sufficient goal but the goal, must be equitable progress.

Price Stability: to maintain price stability and correct business cycles involving depression characterized by falling output, falling prices, and increasing unemployment. Management of Public Enterprises: to manage public enterprises which are of the nature of monopolies like railways, electricity, etc.

**Classification of government budget**

*A government budgetary deficit* occurs when governmental expenditure is greater than government revenue. A deficit budget implies that the government is pumping more money into the economic system than it is pumping out. When it puts in more money into the economy, the level of economic activity expands. This will move the economy further on the growth path. Usually governments of developing economies plan for a deficit budget. A deficit budget is financed by domestic borrowing, external borrowing, and the printing of new currency (money printing).. Government budgetary surplus occurs when government revenue exceeds government expenditure. A surplus budget implies that the government is pumping out more money from the economic system than what it is pumping back in. When the government draws money from the economic system, it has a contractionary effect. The level of economic activity falls. Balanced Budget: If the receipts of the government equal its expenditures, the government will be said to have a balanced budget. A balanced budget will have a neutral effect on the level of economic activity. It will have neither an expansionary effect nor a contractionary effect on the economy.

According to MoFED, 2009, 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. The overall fiscal deficit improved to –2.9 percent of GDP in 2007/08 from –3.6 percent in the previous fiscal year.

## 5.2.The Finance Sector in Ethiopia

Monetary/ financial 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

Financial institutions (FIs) such as commercial banks, credit unions, insurance companies, etc. perform the essential functions of channeling 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.

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.

National banks 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.

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.

Currently, the Ethiopian financial sector consists mainly of banks (three public and 16 private), insurance companies (one public and 15 private) and 31 micro-finance institutions. The banking system accounts for about 80 percent of total assets of the financial sector and is dominated by state-owned banks, mainly the Commercial Bank of Ethiopia. Currently, public banks account for 51.1 percent of bank branches (1,724), 54.6 percent of total capital, 68.4 percent of total deposits and 63.5 percent of outstanding bank loans, although their dominance is declining with the entry of more private banks, as well as the expansion of existing ones.

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.

**Financial Sector Policies and Reforms in Ethiopia**

**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.

**The Financial Policies of the Derg Period (1974-1991)**

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, Commercial Bank of Ethiopia (CBE), Agricultural and Industrial Development Bank (AIDB) (Development Bank of Ethiopia (DBE)), Housing and Saving Bank (HSB) (Construction and Business Bank (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 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.

**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.

Auctioning of securities in the open market was started in January 1994/95 with three types of treasury bills (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.

**Performance of the Financial Sector in Ethiopia**

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.

The annual growth rate of domestic liquidity per year, as measured by broad money (M2), was 21 % and reached 82.5 billion Birr in 2008/09 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.

**Problems Of and Possible Remedies for the Financial Sector in Ethiopia**

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;
- Lack luster 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.

### 5.3.Contemporary Economic Reforms and Development Policies in Ethiopia

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.

The performance of the Ethiopian economy progressively declined during the Derg. This major economic collapse called for substantial reforms in the country. 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** 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 paid 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 and institutional policy reform.

The main policy measures for achieving the country's development objectives were: macroeconomic reforms (include monetary policy, exchange rate policy, fiscal policy and interest rate policy), privatization, transport deregulation, domestic price liberalization, foreign trade liberalization and private sector reform.

**Performance of the Economy after the New Economic Reform Program**

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, on 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.

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.

The average growth rate of agriculture decreased, the industry sector showed improvement, and the service sector increased rapidly in 1996/97 - 1998/99.

The period of the reform program showed an improvement in all indicators (aggregate consumption, public consumption, private consumption, gross capital formation) except in gross domestic saving (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.

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.

Recently, a number of economic reforms have been taken in different sectors and institutions in the country. In this respect, different development plans have also been developed and implemented. The development plans implemented in the country in the most recent years include: the Sustainable Development and Poverty Reduction Programme (SDPRP), which covered the three years, 2002/03-2004/05, and the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) for the five-year period 2005/06-2009/10. To undertake the above plans, Agricultural Development Led Industrialization (ADLI) strategy was applied. Then the Growth and Transformation Plan (GTP I) followed for the five-year period 2010/11-2014/15 to carry forward the important strategic directions pursued in the PASDEP. Now, Ethiopia's economic policy is guided by the second phase of the Growth and Transformation Plan (GTP II, 2015/16 - 2020/21). The ultimate goal is to push the country into middle-income status by 2025.

*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

*The second Growth and Transformation Plan (GTP II)* is Ethiopia‟s medium term development plan covering the period 2015/16-2019/20. As a vehicle towards the realization of the country‟s vision of becoming a lower middle income country by 2025, GTP II is built on sectorial policies, strategies and programs, lessons drawn from the implementation of the first GTP, and the post-2015 Development Agenda. It has also taken into account global and regional economic situations with direct or indirect bearing on the Ethiopian economy.

The overarching goal of GTP II is to sustain the accelerated growth of the country‟s economy and to establish a spring board for economic structural transformation, thereby enabling the nation to realize its vision of becoming a lower middle-income country by 2025.

GTP II has the following objectives:

- ✓ Achieve an annual average real GDP growth rate of 11 per cent within a stable macroeconomic environment, while pursuing comprehensive measures towards narrowing the saving-investment gap and bridging the widening trade deficit.
- ✓ Develop the domestic engineering and fabrication capacity and improve productivity, quality and competitiveness of the productive sectors (agriculture and manufacturing industries) to speed up structural transformation of the economy.
- ✓ Further solidify the on-going mobilization and organized participation of the public in the development process to ensure that the public become both owners of and beneficiaries from the development outcomes.
- ✓ Deepen the hegemony of developmental political economy by strengthening a stable democratic developmental state.

Strategies GTP II in order to achieve the objectives of GTP II were

- ✓ Sustaining the rapid, broad based and equitable economic growth and development witnessed during the last decade or so including the GTP I;
- ✓ Increase productive capacity and efficiency to reach the economy‟s productive possibility frontier through rapidly improving the quality, productivity and competitiveness of productive sectors (agriculture and manufacturing industries);
- ✓ Enhance the transformation of the domestic private sector so as to enable it to become a vibrant development force;
- ✓ Build the capacity of the domestic construction industry and bridge critical infrastructure gaps, with particular focus on ensuring quality provision of infrastructure services;

- ✓ Proactively manage the on-going rapid urbanization to unlock its potential for sustained rapid growth and structural transformation of the economy;
- ✓ Accelerate human development and technological capacity building and ensure its sustainability;
- ✓ Continue to build democratic and developmental good governance through enhancing implementation capacity of public institutions and actively engaging the citizens;
- ✓ Promote women and youth empowerment, ensure their effective participation in the development and democratization process and enable them to equitably benefit from the outcomes of development; and
- ✓ Build a climate resilient green economy.