## CHAPTER ONE 1: Overview and Structure of the Ethiopian Economy

Ethiopia, with a total land area of about 113,000,000 hectares, is one of the largest countries in Africa. It has diverse physical features ranging from about 500 meters below sea level in the Danakil depression of the Afar region to over 4,600 meters above sea level in the Semien Mountains. The varied nature of the topography coupled with other environmental features resulted in a variety of agro-ecological zones in the country. The country is endowed with huge human resource, arable land, livestock and natural resources. However, much of its potential has not yet been exploited. The population of Ethiopia was estimated at over 63 million in the year 2000, making it the third most populous nation in Africa and twentieth in the world. The annual growth rate of the population is estimated at 3%.

Almost 66% of Ethiopia's landmass is known to have a potential for agricultural development. But only a quarter of this is said to be developed until now. Although the livestock contribution to the economy is limited, its wealth is the largest in the African continent. The forest, water, fish and the mineral resource potential of the country are enormous. These minerals include gold, platinum, marble, tantalum, copper, potash, soda ash, zinc, nickel, iron and natural gas. Of course, these are not yet exploited in the desired and appropriate manner.

The economy is characterized by its dualistic nature: the traditional (subsistence) and modern (technological) sector. The traditional sector consists of mainly peasant agriculture, which is the backbone of the country. The modern sector is composed of underdeveloped industrial and service sector.

The structure of the economy, in general, is decomposed into the three main sectors: the primary-agricultural sector, the secondary-industrial (manufacturing) sector and the tertiary-service sector.
The agricultural sector includes, among other things, such activities as crop production, animal husbandry, fishery, bee keeping and forestry. This sector remains to be the most important sector of the economy since it produces much of the country's annual output, absorbs huge amount of the labor force and generates large proportion of the foreign exchange earnings of the country.

The industrial sector includes such activities like mining and quarrying, construction, energy, water supply, small handicrafts and cottage industries, medium and large-scale manufacturing firms. The level of development of the manufacturing sector is at its infancy and the country's industrial base is at its lowest level. The sector is dependent on imported semi-processed materials, raw materials, spare parts and fuel. It is mainly dominated by the food, textile and beverage sub-sectors.

The service sector, on the other hand, includes all the activities in the production of the intangibles. For the purpose of analysis, it is divided into distributive and other services sub-sectors. The distributive service sub-sector includes such activities as tourism, trade, hotels and restaurants, and transport and communication. The other services sub-sector includes the provision of public administration, defense, finance, banking and insurance, social services (education and health), and real estate development.

The Ethiopian modern transport sector is dominated by road transport accounting for more than 90% of the freight and passenger transport. Air, rail and water transportation also play important roles for the transportation of passengers and freights. Ethiopia's export is mainly dependent on primary products such as coffee, pulses, oil seeds, chat, hides and skin, leather and leather products, meat, live animals, fruits and vegetables. Detailed treatment of these sectors will be given in the subsequent chapters.

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

## The Agricultural Sector in the Ethiopian Economy

### Introduction

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

## Agricultural versus industrial development

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

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

## Uni-modal agricultural strategy

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

### Characteristics of the Uni-modal Strategy

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

### Advantages of Uni-modal Strategy

- ✓ It protects the existence of a differentiated peasant group/class.

- ✓ It protects the peasants from eviction.
- ✓ It creates a huge potential for the government to gain political support.
- ✓ It reduces poverty in the rural economy.
- ✓ It provides individual peasants with access to modern technologies.
- ✓ It reduces outgoing migration from rural areas.

**Limitations of Uni-modal Strategy**

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

**Bi-Modal Agricultural Strategy**

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

**Characteristics of the Bi-modal Approach**

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

**Advantages of Bi-modal Approach**

- ✓ It supports individual rights to acquire land
- ✓ It invites more capital and technology investment for agriculture
- ✓ It promotes large-scale diversification
- ✓ It allows the transfer of technology

**Limitations of Bi-modal Approach**

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

**Roles of the agricultural sector**

**1. Source of Food and Raw Material**

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

**A. Backward linkages:** Productive agricultural sector supplies food and raw material to the industrial sector and its labor force. In turn, it has to be supplied with modern inputs and technologies to cope with responding to the growing demand of the non-farming and farming population. Without such support, the agriculture sector appears weak and non-supportive. It may even risk its own population facing food insecurity. Furthermore, productivity in the agricultural sector improves the level of income received by rural people. Increased income of rural people is believed to generate increased demand for manufactured goods from the industrial sector.

**B. Forward linkages:** productivity in the agricultural sector can promote the following forward linkages.

- First, it reduces the cost of living in the industry-based/urban areas which, in turn, reduces the pressure on wages and makes industrial profit higher.

- Second, increasing the provision of raw materials reduces the cost of raw materials and makes industrial profits higher. These two factors can contribute significantly to increasing industrial savings and investment that leads to the promotion of the sector.

**2. Source of Capital:** Though, agricultural sector provides too little surpluses of savings and taxes to support investment, the **transference** of surplus from the agricultural sector to other sectors is made through the following three modalities:

- Tax;
- Defining the terms of trade to protect domestic agriculture by imposing price controls on agricultural products, and
- Compulsory delivery of agriculture commodities at very fixed prices.

**3. Contribution to Gross Domestic Product:** The share of agriculture sectors including fisheries and forestry contribution to the national GDP of Ethiopia has been declining. This could be attributed mainly due to;

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

4. **Contribution to Employment**: >80% of the Ethiopian population earn their livelihood from agriculture. High population growth and low urbanization have been a major challenge to this sector. Measures should be taken to improve labor productivity in the agriculture

**Structure of the agricultural sector**

The agricultural sector of Ethiopia is composed of the crop-production, livestock, forestry, and fishery sub-sectors.

Three categories of farms practiced in Ethiopia are;

**1. The smallholder farming system, -** It is characterized by mixed farming. Farmlands with areas less than 2 hectare each, and large family size

**2. The pastoral/nomadic system-** rain fed crop production is not possible because of low-level erratic rainfall, and people rely more on livestock for subsistence. Most of the people are nomadic, moving seasonally, together with their livestock, from one place to another in search of pasture and water. Livestock production is much greater than crop production in the pastoral nomadic system. General and empirical observations suggest that this system is characterized by chronic food shortages. Thus, agricultural products and productivity are extremely low. With the possible exception of livestock vaccination, there is virtually nothing that the government (or any other, nongovernmental organization) has provided for long in terms of assistance or support to the pastoral-nomadic system. However, these days, the sub-sector has been the focus of serious concern through the expansion of extension service.

**3. 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 utilized for the establishment of large commercial farms. As a result, many entrepreneurs rented and developed commercial farms in the Awash Valley, the Rift Valley and other areas. After the 1974 revolution, all these farms were confiscated by the government. Additional government lands in many parts of the country were also developed into large-scale state farms. These were organized into enterprises which in turn were grouped under corporations, according to their locations and output specialization. A separate ministry, the Ministry of State Farms Development was set up to manage and expand state farms. Also another separate ministry, the Ministry of Coffee and Tea Development, was established.

State farms have been the most pampered of all production systems in Ethiopia. There had been no limit for these farms in terms of receiving land, agricultural inputs, credits, price incentives and marketing facilities. Despite all these advantages, they were unproductive and inefficient. The major characteristics of many of them were mismanagement, abuse of assets, corruption, etc. It must be noted that some of these farms were developed without adequate studies, resulting in huge financial losses. In fact, most of the state farms were run on government financial resources. This system, comprising about 5% of the total cropland area, together with cooperatives, accounted for less than 10% of total agricultural production.

The efficiency of state farms is extremely low, relative to the high expenditure made in establishing and operating them. The major crops grown in these farms include cotton, coffee, tea, sugarcane, fruits and vegetables. The size and role of state farms declined after 1992 when the new government granted some of the state farms to nearby farmers and investors. At present, there are only 13 state farms. They produce mainly wheat, maize, cotton, coffee, and tea on 156,040 hectares of land. Under the current economic policy attempted have been made establish commercial farms.

Out of the total investment permits issued between 1992/93 and 1997/98, 1148 or 26.8% of them were in agriculture. However, only 508 projects became operational. With the advent of market economy, the Federal Government has recognized the decisive role that private capital can play in the expansion and development of large-scale modern farming in order to enhance the supply of food and raw materials and to create employment opportunities. As a result, the role of state farms is expected to fall significantly. The state may operate those state farms that are strategic to the economy, jointly with domestic or foreign private capital. In order to encourage domestic and foreign private capital, without any capital limitation, the government is committed to creating an enabling environment.

**Specific Policies and Strategies of the Agricultural Sector Since 1960s**

**Pre–1974 agricultural policies and strategies-** There were two policy paths for the development of the agricultural sector.

**1. Large-Scale Mechanized Commercial Farm-** The main objective of this path was to facilitate agricultural exports and to create new employment opportunities. As the name implies, LSMCF (Large Scale Mechanized 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 labor, in contrast to the family labor 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.

**2. 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.**

**A. Comprehensive package projects:** 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.

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 program, known as the minimum package program, was launched, substituting for the comprehensive package projects which covered larger areas.

**B. Minimum package program-** 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. Relatively small amount of resources allocated made the projects unsuccessful.

## 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 Arsi Rural Development Unit (ARDU) and then to Bale-Arsi 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 programs. 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 collectivization 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.

**Post-1991 Agricultural Policies and Strategies**

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 labor-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 labor force in rural areas. It has internal forward and backward linkages with the industrial sector. This strategy has been adopted by the government to fit in the Ethiopian context.

These linkages can be explained as follows:

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

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

Agricultural extension services are the basis for raising the productivity of the smallholder farmers, who are the participants at the grass-roots level. Thus, a new system of agricultural extension activities, named "Participatory, Demonstration and Training Extension System" (PADETES), was formulated. The system is based on demonstrating to and training farmers in proven technologies in line with the philosophy of bottom-up development approaches. This strategy gives special emphasis to human resource development along with efforts to transfer appropriate technologies that are suitable to conditions in rural areas. Human resource development in this context implies improving the status of agricultural labor 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 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. One of the basic goals of the program is ensuring accelerated economic growth through a rural-cantered development program strategy which mainly focuses on the development of the agricultural sector's output using "a package program" 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 favorable land-use policy;
- ✓ Establishing agricultural marketing services;
- ✓ Encouraging private sector development;
- ✓ Expanding the economic and social infrastructure; and

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 program also targets adopting an effective education strategy which:

- ✓ 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 program 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, labor, 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

**The Performance of the Agricultural Sector**

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

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

## Problems of and possible remedies for the agricultural sector

Think of the various agricultural policies and strategies adopted, such as package programs and extension services. To what extent did they transform the agricultural sector? Has the country achieved self-sufficiency in food production? It has become an every-day saying that agriculture has been the mainstay of the Ethiopian economy for decades. However, its performance in achieving food security and generating capital for the other sectors is poor. This situation has attracted the concern of policy makers, experts, and international organizations, who hope to change the situation. Why is this so? What are the problems? What are some possible remedies?

Agricultural sector’s problems identified fall into two major categories:

i) **Natural problems –** Unpredictable Weather Conditions - These problems relate to recurrent drought and its negative effects. Almost all the farming and livestock practices in the highlands of Ethiopia depend on rainfall. The variability of rainfall in time and amount affects the country’s crop production and live-stock rearing; millions of cattle have died of the hazard.

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

- **Land fragmentation**: In rural Ethiopia, where the average landholding size is shrinking over time, land fragmentation and over-cultivation are inevitable.
- **Lack of infrastructure:** Transportation and communication facilities are poorly developed in rural Ethiopia. About 75% of rural household farms are located far away from transportation and communication lines, and this that prevents farmers from accessing proper markets and information about prices for their products.
- **Lack of credit facilities**: This prevented farmers from using even the meagre resources available at hand. Now, however, reforms have created accesses to micro-finance loans, opening the gate to increasing small holder productively.
- **Lack of effective land-ownership entitlement**: Without it we have poor work attitudes, the improper use of common resources, and poor output.
- **Erosion and land degradation**: rate of erosion and degradation which in turn, contribute to the recurrence of drought. Without preventative measures; this situation will accelerate in the near future, putting millions of hectares out of use.

- **Traditional practices**: These are rural practices that result in misusing work time, unproductive consumption and retaining resources especially livestock resources unscientifically, resulting in very low output per ox, sheep, goat, etc.
- **The use of backward technology.**
- **Inadequate rural markets.**

**Possible Remedies:**

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

- Promoting the use of local streams and lakes for irrigation purposes of various scales.
- Promoting and expanding the storage of rain water in shade to reduce the rate of evaporation and to enable people to store water for longer periods of time.
- Expanding the number of afforestation and reforestation schemes through a structured and financed agency or office.

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

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

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

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

Vi. Promote infrastructure facilities as per their availability.

**The Industrial Sector in Ethiopia**

Industrial sector in Ethiopia classified into sub sectors:

- Manufacturing,
- Mining, quarrying,
- Construction,
- Water and energy supply

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

The two major early 20th century events contributed to the introduction of modern manufacturing industries in Ethiopia:

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

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

**Definition of Industrialization**

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

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

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

- Industrialization is not a **one-time or sudden occurrence but rather a sustained process. This means it is a continuous** process taking place over a long period of time.

- Industrialization **requires the application of modern science and technology** to the production process.

- The **manufacturing sector** plays the most important and dynamic role in the industrialization process;

- Industrialization brings about a structural transformation of the national economy, especially in the composition of output and the pattern of employment.

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

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

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

**Arguments of industrial sector versus the rest of the economic sector**

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

**A. The Development Argument:** economic development goes with industry: the more developed nations are better industrialized, and the less developed nations are less industrialized.

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

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

**D: The Linkage Argument:** If industrial development is directed to use local raw materials, it can create strong linkages among the different sectors of the domestic economy. For instance, the industrial sector can create backward linkages with the agricultural sector for its raw materials instead of depending on imported raw materials. This gives the sector assured sources of supplies. Similarly, the sector can also create linkages with the market in order to assure market for its products. This is what is called forward linkage.

**E: The Saving/Surplus Argument:** Profit margins in the industrial sector are higher than those in agriculture, and this may lead to higher levels of saving.

**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. 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.

**Employment Contribution:** the manufacturing sub-sector, in particular, serves as important sources of employment, especially for the rapidly growing urban population in Ethiopia.

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

**Output Contribution**: 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.

Industrial sector showed 12.6 percent growth and constituted 28.1 percent of the total GDP. Manufacturing sector grew 7.7 percent and constituted 24.3 percent of the industrial output. Construction industry showed a 15 percent expansion and contributed 72.5 percent to the industrial output, signifying the leading role of the sector in roads, railways, dams and residential houses construction. Electricity & water and mining & quarrying had 2.7 and 0.5 percent contribution to the industrial production, respectively

Table 1: Growth and Percentage Distribution of Major Industrial Sub-sectors in Ethiopia

| | Sectors | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|---|
| **Share in industry** | Mining and Quarrying | 2.2 | 1.8 | 1 | 0.7 | 0.5 |
| | Manufacturing | 26.8 | 25.9 | 26.9 | 25.3 | 24.3 |
| | Electricity and Water | 3.4 | 3.2 | 2.8 | 2.6 | 2.7 |
| | **Construction** | **67.5** | **69.1** | **69.3** | **71.4** | **72.5** |
| **Growth rate** | Mining and Quarrying | -25.6 | -3.3 | -29.8 | -20.8 | -21.9 |
| | Manufacturing | 18.2 | 18.4 | 24.7 | 5.5 | 7.7 |
| | Electricity and Water | 4.5 | 15 | 4.9 | 3.3 | 4 |
| | Construction | 31.6 | 25 | 20.7 | 15.7 | 15 |

Source; National Bank of Ethiopia 2018-19 annual report

## 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.

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.

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. As a result of the existing polices and the enabling investment environment, a number of manufacturing establishments were created. There was, however, an obvious neglect of small-scale industries during that period as the investment incentives benefited only the medium- and large-scale manufacturing establishments. Although 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.

**Size, Ownership and Regional Distribution of the Manufacturing Sector**

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

Ethiopia also has its own criteria. According to the Central Statistical Authority (CSA), the Ethiopian manufacturing sector is classified into three, namely large- and medium-scale, small-scale and cottage/handcraft manufacturing. This categorization is mainly based on the number of people employed and use or non-use of power-driven machinery:

**Large- and medium-scale manufacturing** establishments use power-driven machinery and employ 10 persons and above. **Small-scale industries** are those establishments that employ less than 10 persons and use power-driven machinery. **Cottage/handcrafts** units are those establishments that produce goods and services primarily for sale but do not use power-driven machinery in performing their main activities, regardless of the number of persons employed.

According to the Ethiopian Economic Association (EEA) report, during the Imperial period, industrialization, with an inward looking orientation based on import 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.

## Industrial Development Strategies during the Derg Regime

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

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

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

To support small-scale industrial enterprises, the government established the Handicrafts and Small-Scale Industrial Development Agency (HASIDA) in 1975. But this did not help much in achieving the required pace of growth 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.

**Size, Ownership, and Regional Distribution of the Manufacturing Sector during derg regime**

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**, was caused by the unfavorable government policies towards private activities to obtain foreign exchange to buy (raw materials, spare parts and replacements), credit and licences. Therefore, some of the establishments fell below the “10 and above” employee category.

- 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.

## Industrial Development Strategies during the Post-Derg Period

### Development strategies

After the over-throw of the socialist government and its replacement by the Ethiopian Peoples Revolutionary Democratic Front (EPRDF) in 1991, the government sought to rationalize its role in the economy while enhancing the active participation of the private sector. Accordingly, the transitional government of Ethiopia announced an economic policy which could be described as "cautious captialism''. Believed to be conducive for investment, the government accepted the Structural Adjustment Programs (SAPs), though with some reservations.

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

In general, these measures were designed with the long-term objective of raising the share of the industrial sector in the economy, both in terms of output and employment creation and of enhancing the development of strategic industries which were expected to have multiplier effects through contributing to the expansion and development of other economic activities. Laws were enacted to give enterprises management autonomy, a more flexible labor code was proclaimed, prices were largely decontrolled, foreign trade and financial institutions, including the foreign exchange market, were particularly taken to encourage private sector participation in the economy. These include:

- ✓ The lifting of the restrictions on private-sector investment capital
- ✓ The easing of licensing requirements and regulations;
- ✓ The enactment of an investment code. In addition, investment incentives were offered in the form of tax holidays, duty-free importation of investment goods and the like designed to favor investment in selected sectors and regions; and
- ✓ The downward revision of taxes and tariffs from the extremely high levels. 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%.

**Problems and Possible Remedies of the Industrial Sector during Post-Derg Period**

**1. Lack of Finance:** agricultural sector not been capable of generating the required surplus for the industrial sector. Industries 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.

**2. Marketing Problems: the market problems arises due to;**

- 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.

**3. Technological Problems:** Technological problems may reveal themselves in one of the following ways:

- Lack of sufficient information on appropriate technology. This is related to the shortage of local institutions involved in technological support services.
- The technology we have today is not developed based on available local raw materials. This limits the linkage. It rather makes the shortage of foreign currency of the country. The ratio of imported raw material is too high for Ethiopian local manufacturing to flourish. The situation is worse in basic iron and steel, and motor vehicles, trailers, and semi-trailers
- The technology we use is also capital intensive. This approach is basically not recommended for economies like Ethiopia where unemployment is rising.

**4. Input-Related Problems:** high cost and shortage of foreign exchange for imported inputs. Shortage of raw materials as the second most serious problem, the most serious of which were market-related problems.

- 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.

## The Service Sector in Ethiopia

This sector is composed of various sub-sectors likes: **trade, hotels and restaurants, transport and communication, education, banking and insurance, public administration and defense, health, and other services**. The service division includes a wide variety of industries, but they can be categorized into primarily consumer-oriented (**providing a service directly to a consumer**), **primarily business-oriented** (providing a service directly to another business) or **mixed** (providing services to both businesses and individual consumers). Alternately, the activities of the services division can be described in reference to their economic activities as: **physical, intellectual and aesthetic**

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

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

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

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

The service sector plays an important role in the country's economy.

**1. Output contribution:** According to NBE (2019/20) Report service sector contributes about 39.8% of country GDP. This mainly the result of the fast growth of education, health, socio services, tourism, transport service, construction and related engineering services, wholesaler and retail trade, hotel and restaurant sub sectors.

**2. 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.

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

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

**3. Foreign exchange contribution:** 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.

**Education as component of service sector**

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

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

The economic and social development of any country depends on the scope and level of the peoples education. Education in Ethiopia dates back to the 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. Education system in Ethiopia suffered from shortcomings in quality, coverage, efficiency, and relevance, due to the following four key problems.

**1st**, 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.

**2nd**, children especially **girls were not encouraged** to attend school.

**3rd**, **neither the student nor the teacher had a clear vision of what and why they** were learning or teaching.

**4th, 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.

**Education Sector Policies and Strategies**

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

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

**Post-1974:** the Military Government dismantled the feudal socioeconomic structure through a series of reforms that also affected the educational sector. By the early 1975, the government closed Haile Selassie I University and all senior secondary schools and had deployed some 60,000 students and teachers to rural areas to participate in the government's Development through Cooperation Campaign (commonly referred to as zemecha). In 1975, the Derg Regime nationalized all private schools. Education for socialist consciousness, education for production and education for science and research' became the objectives and directives set during the Military Government. The Military Government also worked towards a more even distribution of schools by concentrating its efforts on small towns and rural areas that had been neglected during the Imperial Regime.

**Post-1991:** The gross enrollment ratios for primary and secondary education have since showed an upward trend:

Table 2: Trends in Primary Enrolment

| 2004 E.C. (2011/12) | | | 2009 E.C. (2015/16) | | |
|---|---|---|---|---|---|
| Male | Female | Total | Male | Female | Total |
| 8,865,491 | 8,124,293 | 16,989,784 | 11,029,506 | 9,753,572 | 20,783,078 |

Source: MOE, 2009 E.C. (2016/17). Education Statistics Annual Abstract

Table 3: Trends in Secondary Enrolment

| 2004 E.C. (2011/12) | | | 2009 E.C. (2015/16) | | |
|---|---|---|---|---|---|
| Male | Female | Total | Male | Female | Total |
| 805,658 | 960,353 | 1,766,011 | 1,358,168 | 1,201,009 | 2,559,177 |

Source: MOE, 2009 E.C. (2016/17). Education Statistics Annual Abstract

Post 1991 the ESDP (Education Sector Development programme) was launched. The program has the following six components:

1. Primary Education: include: construction, expansion, and rehabilitation of primary schools; curriculum revision and development; upgrading of teachers' skills; and increasing the supply of textbooks.

2. Secondary Education: include: expansion of school services; curriculum revision and development; and increases in the supply of educational equipment and material.

3. Technical-Vocational Training: Under this component, there are plans to expand programs that train students in technical and vocational fields.

4. Teacher Training: This component includes: the upgrading and expansion of training institutions; in-service (on-the-job) training of primary school teachers; curriculum revision and development; introduction of distance learning and alternative education methods; and the training of school directors or coordinators in school management.

5. Tertiary Education: the goal is to meet growing demand for teachers, engineers, health specialists, public administrators, and others.

6. Institutional Capacity Building: upgrading the Ministry's and Regional Education Bureaus' skills in planning, financial management, implementation, monitoring and evaluation of policies and strategies.

**Problems, of education sectors are;**

- Great **disparity** between the relatively developed and undeveloped regions and between rural and urban areas;
- **Enrollment of girls** at every level of education **is lower** than that of boys;
- **Inadequate facilities**, insufficient training of teachers, overcrowded classes, and shortage of books and other teaching materials all indicate the low quality of the education provided;
- It is known that our country's education has complex problems of **relevance, quality**, accessibility, and equity;
- Financial and resource constraints;
- Lack of alternatives in resource mobilization in addition to the public budget;
- High drop-out and repetition rate

**Possible remedies**

- Expand the participation of parents, teachers and communities in policy formulation.
- Provide adequate student textbooks, teaching materials and various school facilities.
- Narrow the gap or disparity among regions.
- Inspect the private education sector to ensure the minimum necessary quality, standard of certification, service fees, etc.
- Improve the quality of teachers, in terms of training and motivation

## Health Sector

The health status of many Ethiopians remains very poor. The major limitations of progress in the sector are:

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

**The Health Sector Policies and Strategies**

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.

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

The national health policy focuses on a comprehensive health service delivery system to address: **Communicable diseases, Malnutrition, Improving maternal and child health**. The health service delivery system is decentralized with the responsibility for implementation being largely devolved to the districts, which operate on the basis of block funding for the sector. The policy emphasizes inter-sectoral collaboration, particularly in ensuring family planning for efficient family health and population planning, in formulating and implementing an appropriate food and nutritional policy, and in accelerating the provision of safe and adequate water for the urban and rural populations.

The health policy has also identified the priority intervention areas and strategies to be employed to achieve the health policy objectives. Major components of the health care strategies are:

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

The most significant childhood and maternal illnesses and communicable diseases are:

- HIV/AIDS, Malaria and Tuberculosis (TB)

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

1. **Infant mortality rate (IMR):** it indicates the number of deaths of babies under one year of age per 1,000 live births.

2. **Maternal Mortality Ratio (MMR):** is the ratio of the number of maternal deaths per 100,000 live births.

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

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

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

**Problems of and Possible Remedies for the Health Sector**

**Problems**

- Limited physical access to health facilities, the absence of health care facilities. .
- The available health care facilities are unevenly distributed across regions.
- Inadequate budgetary allocation and low levels of management.
- Low quality of the facilities.
- Maternal, infant, and child mortality rates are still high.
- Inadequate and poorly maintained infrastructure and equipment, shortage of trained health personnel, and the unavailability of drugs and pharmaceutical supplies.

**Possible Remedies**

- Strengthen and expand existing health programs.
- Provide family planning services at all levels of health service delivery stations.

- Strengthen reproductive health content in health education programs.
- Strengthen and expand training of health personnel in collaboration with relevant institutions.
- Set standards for the provision of family planning services.

**The Transport Sector**

Transportation can be defined as the movement of commodities, materials, people and animals from one place to another with a specified objective. Transportation is fundamental to civilization. The roles of transportation in socio-economic development are that it allows for: Division of labor and labor specialization, Procurement of raw materials from various sources, Dispatch of goods to marketplaces, etc. In Ethiopia, the early means of transportation were foot and pack animals like donkeys, horses, and camels. However, this set of transportation constrains the socio-economic development of the country because it is time-taking and tiresome.

During the Military Government, the transport sector was put under close state regulation and control. The entire commercial truck and passenger transport system was under strict control of the government through Proclamation No.107/1976. The policy changes in the sector that occurred on May 8, 1992 heralded the deregulation of the freight transport industry. Major liberalization of the transport industry began with government Proclamation No. 14/1992. It emphasizes the promotion of efficiency and equitable distribution. Following the 1992 Proclamation, many of the private commercial freight and passenger transport activities left the corporation and formed their own independent association. Some, however, continued as associates of government enterprises. The other content of the new policy allows:

- ✓ Free entry into existing associations,
- ✓ Obtaining licenses to form new associations.

Transport sector includes road transport, Railways Transport, Air Transport and Ethiopian Shipping Lines S.C

**i. Road Transport**

The Ethiopian Road Transport Authority (RTA.) is a public authority responsible for the use of all roads within Ethiopia, vehicles using these roads, and all matters relating to road transport activities. The Road Transport Administration was established in 1967 by Proclamation No 256/67 to administer the control and regulation of road travel and transport in 1976, after having undergone restructuring, it was reorganized as the Road and Transport Authority (RTA) by Proclamation No 107/76. The authority replaced and took over the rights and obligations of the former Roads Transport Administration. It was again road restructured and replaced by Proclamation No. 14/92. Poverty reduction and addressing vulnerability have been and still are the overriding agenda of the government. It is well known that the success of development strategies heavily depends on the efficiency of the infrastructure sector in general and the road sub-sector in particular. Accordingly, substantial improvements have been achieved in the expansion of road infrastructure.

**ii. Railways Transport**

For more than a century, the Ethio-Djibouti Railway has been the nation's the only railway and one of the most important means of transportation and link to the outside world for Ethiopia. The railway company plays an important role in transporting import, export, and internal freight, and passengers (international and local). In contrast to air transport, Ethiopia has a limited railway service that stretches 781 km, linking Addis Ababa with the port of Djibouti via the eastern Ethiopian cities of Dire Dawa and Adama.

**iii. Air Transport**

According to Ethiopian Airlines Annual Report 2008/09, Ethiopian Airlines was founded on December 29, 1945, by Emperor Haile Selassie I with assistance from Trans-Continental and Western Airlines (TWA). It commenced operations on April 8, 1946, with weekly service between Addis Ababa and Cairo with five Douglas DC-3 propeller-driven aircraft. The airline started long-flight services to Frankfurt in 1958 and inaugurated its first jet service in January 1963 from Addis Ababa to Nairobi. In the early 1960s it provided some initial aviation support to the Ethio-United States Mapping Mission in its operation to provide topographic maps of Ethiopia. It is wholly owned by the government of Ethiopia and had 4,700 employees as of March 2007.

Although it relied on American pilots and technicians at the beginning, by its 25$^{th}$ anniversary in 1971, Ethiopian Airlines was managed and staffed by Ethiopian personnel. Ethiopian Airlines provided basic pilot and aviation maintenance training to trainees from African countries including Rwanda, Tanzania, Chad, Djibouti, Madagascar and the Sudan. Other training was given to employees of Kenyan Airways, Air Zimbabwe, Cape Verde Airlines and Air Madagascar. Ethiopian Airlines has a very good reputation. In its 64 years of service, it has offered excellent passenger and cargo air transport. The airline and all its technical and training activities have provided an opportunity for building Addis Ababa as a regional hub for air transport.

Ethiopia had three international and 18 domestic airports. Its international flights link the country with over 45 cities in four continents: 26 in Africa, 12 in Asia, five in Europe and two in North America. It has been expanding its intercontinental services to realize its motto of being “Africa’s Link to the World.” In 2010, Ethiopian Airlines traveled to 59 international destinations, 39 of which were in Africa. According to Ethiopian Airlines Annual Report (2008/09), the operational aircraft of Ethiopia airline was 41.

**iv. Ethiopian Shipping Lines S.C.**

The main purpose of the establishment of the company has been to: Render coastal and international marine transport service, and engage in other related activities necessary for the attainment of its charter.

**The Communication Sector**

Communication is one of the most fundamental elements necessary for the economic, social, and political development of any country. Communication services include telecommunication, postal and media services. Upgrading and expanding the telecommunications network and services have been essential to modernizing the sector and bringing about national growth as well as greatly supporting the rural economy. For example, having basic telephone access in villages:

- ✓ Allows farmers to get information on prices for their crops and livestock products;
- ✓ Improves the efficiency of local administration;
- ✓ Encourages the development of trade and small businesses;
- ✓ Facilitates the provision of social services such as health, education, and agricultural extension.

**a. Telecommunication**

In today’s world, the telecommunication infrastructure of a country is one of the most important factors affecting development. It is therefore important to evaluate a country’s national telecommunication infrastructure prior to embarking on a major national development program. Telecommunication plays a major role in the exchange of views and in information dissemination among various socio-cultural and economic groups. The Ethiopia Telecommunication Corporation (ETC) has been expanding its network within the country and to the rest of the world. A modern communication system, especially telecommunication, is one of the conditions for attracting foreign capital and encouraging competition in the world market. The Ethiopia telecommunication (ETC) is making continuous efforts to extend its services throughout the country

**b. Postal Service**

Postal services are important for expanding communication infrastructures. The Ethiopian Postal Service was introduced in 1886 E.C. Even though the service has been in place for a long time, its services are limited to only parts of in the country. Postal service has been expanding since 1991/92, with increasing volumes of both domestic and international postal traffic.

**c. Broadcasting and Press**

Broadcasting plays a vital role in reaching the masses living in remote areas. Although owning of a radio and TV is not affordable for many Ethiopians, broadcasting definitely has a much bigger audience than press, as illiteracy and physical inaccessibility do not seriously affect it.

**The Tourism Sector in Ethiopia**

Tourism deals with the movement of people away from their normal residence for: Business, Transit, Conference, Visiting relatives, Vacation, Other purposes.

Tourism is the activity of providing services for these people, and it is also an important source of foreign currency and employment for citizens of many countries. Ethiopia has great tourism potential. It was the recognition of this great potential that encouraged Ethiopia in the 1960’s to start a tourism industry. After an initial period of rapid growth, the industry underwent a fast decline and stagnation for many years due to the political and economic problems that prevailed for a long time in the history of the country.

During the Derg government (from 1974 to 1991), Ethiopia’s tourism industry suffered from the adverse effects of a prolonged civil war, recurrent drought and famine, strained government relations with tourist-generating countries, and restrictions on the entry and movements of tourists.

However, tourism is now operating in a more conducive climate for growth and development, as evidenced by statistics compiled by the Ethiopian Tourism Commission. Because Ethiopia has so many historical and natural sites and diverse cultural tourism attractions, tourism should have been one of the country's largest industries, but unfortunately the country has been unable to realize the economic benefits it deserves from the sector. Nonetheless, in recent years, due to the development of infrastructures, like roads and hotels, and to the crucial role of the government in marketing and changing the image of the country through its embassies, tourism has shown significant growth despite the economic crisis in the world. But still there is a long way ahead before we will fully exploit the benefits of the tourism sector efficiently and secure its appropriate position in the economic sectors.

**Tourism in Ethiopia contributes to the national economy in:**

- ✓ GDP
- ✓ Employment
- ✓ Foreign exchange earnings
- ✓ Development of new infrastructure in ways that complement or help to full fill local needs (for example, water, transport, and electricity)
- ✓ Improving living standards and reducing poverty.

**Challenges to tourism** sectors are; shortage of tourist facilities, limited promotion, and lack of professional and skilled personnel.

**Remedies:** Improving transportation facilities, Allocating an adequate government budget, Improving management to enhance the quality of the sector, providing manpower training and promoting the country's tourism resources

## CHAPTER 3: ETHIOPIAN ECONOMY SOCIO-ECONOMIC CONDITIONS

### Production and Capital Formation

**Capital formation-** means of increasing the stock of real capital in a country. In other words, capital formation involves making of more capital goods such as machines, tools, factories, transport equipment, materials, electricity, etc., which are all used for future production of goods. For making additions to the stock of capital, **saving and investment** are essential.

**Process of Capital Formation**

In order to accumulate capital goods some current consumption has to be sacrificed. The greater the extent to which the people are willing to abstain from present consumption, the greater the extent that society will devote resources to new capital formation. If society consumes all that it produces and saves nothing, future productive capacity of the economy will fall as the present capital equipment wears out.

In other words, if whole of the current productive activity is used to produce consumer goods and no new capital goods are made, production of consumer goods in the future will greatly decline. To cut down some of the present consumption and wait for more consumption in the future require far-sightedness on the part of the people. There is an old Chinese proverb, "He who cannot see beyond the dawn will have much good wine to drink at noon, much green wine to cure his headache at dark, and only rain water to drink for the rest of his days."

**Three Stages in Capital Formation:**

Although saving is essential for capital formation, but in a monetized economy, saving may not directly and automatically result in the production of capital goods. Savings must be invested in order to have capital goods. In a modern economy, where saving and investment are done mainly by two different classes of people, there must be certain means or mechanism whereby the savings of the people are obtained and mobilized in order to give them to the businessmen or entrepreneurs to invest in capital.

Therefore, in a modern free enterprise economy, the process of capital formation consists of the following three stages:

**A. Creation of Savings**: An increase in the volume of real savings so that resources that would have been devoted to the production of consumption goods, should be released for purposes of capital formation.

- The level of savings in a country depends upon the power to save and the will to save. The power to save or saving capacity of an economy mainly depends upon the average level of income and the distribution of national income. The higher the level of income, the greater will be the amount of savings.

- Savings may be either voluntary or forced. Voluntary savings are those savings which people do of their own free will. On the other hand, pension cut from employee salary by the Government represent forced savings.
- The greater the amount of taxes collected and profits made, the greater will be the government savings. The savings so made can be used by the government for building up new capital goods like factories, machines, roads, etc., or it can lend them to private enterprise to invest in capital goods.

**B. Mobilization of Savings**: A finance and credit mechanism, so that the available resources are obtained by private investors or government for capital formation

**C. Investment of Savings**: The act of investment itself so that resources are actually used for the production of capital goods. There must be a good number of honest and dynamic entrepreneurs in the country who are able to take risks and bear uncertainty of production.

- The two determinants of incentive to invest are **the marginal efficiency of capital and the rate of interest**
- The size of the market for goods determine expectations regarding profits(marginal efficiency) and low interest rate forced investors to choose investment rather than depositing money in Bank.

**Foreign capital:** Capital formation in a country can also take place with the help of foreign capital, i.e., foreign savings. **Foreign capital can take the form of:**

(a) Direct private investment by foreigners, (b) Loans or grants by foreign governments, (c) Loans by international agencies like the World Bank.

There are very few countries which have successfully marched on the road to economic development without making use of foreign capital in one form or the other.

**Deficit financing:** is the method of Capital formation on which the government can fall back to obtain funds, funding can be done by borrowing, selling bonds when excess expenditure as compared to revenue generated. This method used where Poor saving, to very low standard of living and taxation beyond limit becomes oppressive. However, the danger inherent in this source of development financing is that it may lead to inflationary pressures in the economy. But a certain measure of deficit financing can be had without creating such pressures. There is specially a good case for using deficit financing to utilize the existing under-employed labor in schemes which yield quick returns. In this way, the inflationary potential of deficit financing can be neutralized by an increase in the supply of output in the short-run.

**Disguised Unemployment**: Capital formation in which Surplus agricultural workers can be transferred from the agricultural sector to the non-agricultural sector without diminishing agricultural output, to mobilize these unproductive workers and employ them on various capital creating projects, such as roads, canals, building of schools, health centers and bunds for floods, in which they do not require much more capital to work with

**Poverty in Ethiopia**

- **In 1973 during imperial period about** 3 million Ethiopians were affected by food shortages. A prolonged drought between 1984 and 1986 plunged the country into famine. During the 1980s, an estimated 1 million Ethiopians died from starvation as a result of famine.
- The present government of Ethiopia has taken various steps of reduction of poverty especially in rural areas, such as, Agricultural Development-Led Industrialization (ADLI), Sustainable Development and Poverty Reduction Program (SDPRP), etc. The government has stressed on the development of agriculture, food security and vulnerability, export development, private sector development, tourism, mining, infrastructure, health and education. The **main causes of poverty** in Ethiopia are as follows:
  1. The dynamics of population growth.
  2. Very low productivity, structural bottlenecks.
  3. Dependence on unreliable rainfall.
  4. Being land locked combine to pose serious challenges.

**Infrastructure in Ethiopia**

**Roads:** without an extensive rail network, road transportation in Ethiopia is paramount. Over the last seven years there has been a massive increase in funds allocated for road construction. State spending on roads accounts for a quarter of each year's infrastructure budget and the government has earmarked the equivalent of $4 billion to build, upgrade and repair roads over the next ten years under the Road Sector Development Program (RSDP). This reflects the government's recognition of the importance of the road sector for national economic growth and for profiting to a maximum from the country's assets.

**Airports:** Ethiopia's new and upgraded airports facilitate the transport of goods and encourage investment. There are now two international airports – Addis Ababa and Dire Dawa –and other 19 local destinations. In order to encourage tourism five major airports – Arba Minch, Lalibela, Mekele, Axum, bahird dar, hawassa , jimma and Gondar have been singled out for upgrading. Upgrading works have also been completed at Semera, Robe (Goba) and Jijiga airfields. Upgrading of Asosa, Kebri Dar, Humera, Gambella , Shire, dembidolo, gode, and dessie also on progress

**Unemployment and under employment in Ethiopia**

- Underemployment refers to people who are working in a lower capacity than they are qualified for, including in a lower-paid job or for fewer hours than they would like to work, part-time job instead of a full-time one, or if they are overqualified and have education, experience, and skills that exceed the requirements of the job.. person is in fact, working, just not as much as they'd like or to the full extent of their abilities, skills, or education.
- When you try to change jobs competing with underemployed you have less bargaining power when it comes time to negotiate salary.

**Unemployment**: a person who is actively searching for employment is unable to find work

**Reasons for Being Underemployed**

- **Lack of Skills**: workers with skilled backgrounds in low-wage or hourly jobs that do not require such prerequisites.
- **Lack of Experience**: Recent graduates may find themselves underemployed while looking for their first job after college. Even entry-level jobs sometimes require more experience than students may have to offer right after graduation. Take part-time work while doing internships, taking classes, or networking their way to a new position.
- **Credentials Aren't Acceptable**: In many cases, highly skilled individuals come to work in a new country, but face underemployment because their foreign credentials are not be accepted nor considered to be an equivalent fit for the position in question. Few employers are willing to send foreign documents for evaluation by a third party, so many professional

individuals such as doctors, lawyers, or engineers take necessary jobs that would otherwise be seen as inferior positions.

- **Discrimination Issues**: In addition to students, foreign nationals, and trade workers, those with disabilities, mental illnesses, or former inmates are often discriminated against and are forced to take the first job available for fear of not finding another.
- **Low Demand**: Some individuals with acceptable experience and skills are underemployed because of low demand in their local job market. For example, computer science BSc graduate may employed as secretary because there is no demand for computer science
- **Poor Economy**: During a recession, many skilled workers who would ordinarily have little trouble landing a good job in their field may wind up underemployed.
- **Market Changes**: Underemployment can also be caused by larger market changes. For example, automation has affected workers in industries, as employers cut hours and workers lose bargaining power in the market.

**Problems of unemployment in Ethiopia**

- Employment is expected to play the sustained political and economic stability of the country
- Unemployment rate in Ethiopia averaged 19.88% until 2015, but the actual figure may go up further than projected by government
- Urban unemployment is more severe than rural unemployment, rural youth lacks land which support his living thus migrate to urban create overcrowded cities.
- Effects of unemployment in Ethiopia
- immediate effect is starvation
- Create very serious social problem, crime, violence
- Vulnerable to substance abuse
- Youth hopeless in education
- Easily manipulated by armed rebel groups

# CHAPTER FOUR: TRADE, IMPORT AND EXPORT PERFORMANCE

## Trade

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, which is a business transactions take place b/n households, firms, and gov'ts 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 in national boundary, whereas **international** trade is the exchange of goods and services among the citizens of independent or sovereign nations. A particular impetus in domestic trade was attained with the construction of railway lines from Djibouit to Addis Ababa, with increasing the number and types of commodities available for sale. Due to cultural influence, and lack of adequate capital and knowledge, almost all of the modern shops were owned and run by foreign nationals (Armenians, Arabs, etc.). International trade was facilitated through a network of trading routes from Adulis and other trading posts on the Red Sea coast.

There are many factors accountable for the rise of international trade. Some of them are **differences in resource endowment**, **demand**, and **economies** of scale and specialization.

- The differences in resource endowments lead to differences in relative costs in the production of goods and services among countries, thus trade starts. As more produced cost per unit decline this operational efficiency is economies of scale. Specialization in a few products allows a manufacturing sub-sector to benefit from longer production runs, which leads to decreasing average costs.
- Demand difference also leads to the transaction of goods and services from surplus to deficit area.

Here are two guiding principles that determine which commodities should be produced locally and should be imported from abroad. These are;

- **Absolute advantage**: A nation is said to have an absolute advantage over another nation if a sole producer of something due to factors such as climate, natural resources, and level of technology and If produce the commodity more cheaply than others, (fewer input per output)

- **Comparative advantage:** able to produce at lower opportunity cost (give up something and shift resource to produce other).

**Restrictions on International Trade**

Trade restrictions have a long history in world economy. Trade restrictions are basically designed to protect a local economy from foreign competition, and they also serve as an important source of government revenue.

There are different types of restrictions used by governments. Some of them are:

**1. Quotas:** places a limit on the amount of a product that can enter into a country.

**2. Tariffs**: are duties or taxes imposed by the government of a nation on goods entering that country. There are three forms of tariffs:

> **Specific tariff:** specific tariffs are tariffs imposed on each unit imported or based on physical quantity
>
> **Ad valorem tariff:** this is imposed on the basis of the monetary value of the product.
>
> **Compounded tariff:** this is a combination of the specific and ad valorem duties. That is, some products are taxed on both quantity and value.
>
> Example: Birr 5 per quintal and 5% on the value of the good.

**3. Exchange Controls:** Restrictions on the amount of a certain currency that can be bought or sold are called exchange controls. The government can use exchange control to limit or avoid the import of some goods by not giving the foreign currency that the importers of these goods need.

**Modes of Payment in International Trade**

Payments in international trade can be made in one of the following ways: **Banker's transfer, Bill of exchange, and Letter of credit (LC).**

- **Banker's transfer:** transfer of money from the bank account of the buyer (importer) in his/her own country to the bank account of the seller in the seller's country.
- **Bill of exchange:** This is an order in written form addressed by a creditor to a debtor and signed by the creditor, requiring the person to whom it is addressed (the debtor or buyer)

to pay either on demand, or at a fixed date, or at a determinable future time, a certain sum of money to the person named on the bill or to his order. The bill is drawn by the creditor on the debtor and is sent to the debtor (or his agent) for the latter to pay or accept. The debtor accepts by signing his name on the face (front) of the bill together with the date, at which point the bill now becomes legally binding, and the accepter must meet it on or before the due date.

- **Letter of Credit (LC):** This is the most common mode of payment for imports in Ethiopia today. A letter of credit is a letter addressed by a banker to an exporter, undertaking to make a payment to him against documents relating to the dispatch of goods. The letter of credit includes different documents that specify the nature, unit price, and total price of the good and the shipment of the good, insurance, and other supplementary documents.

**Export-import performance**

- Ethiopia's exports is dominated by coffee 32.1%, flower (16%) and chat (12%).
- The major destinations for Ethiopian exports were Asia, Europe and Africa where Asia accounted for 37.3 percent of the total exports with Saudi Arabia being the main destination for Ethiopia's export having a 20.5 percent share in Asia, followed by Japan (12.2 percent), Israel (10.1 percent), United Arab Emirates (8.7 percent), India (8.3 percent), China (7.2 percent), Yemen (6.9 percent),South Korea (6.2 percent), Indonesia (3.9 percent) and Singapore (2.8 percent). All these countries accounted for 86.6 percent of Ethiopia's total export to Asia.
- Europe constituted 30.2 percent of Ethiopia's total export revenue, with the Netherlands taking a 37.2 percent share, followed by Germany (22.5 percent), Belgium (10.3 percent), Italy (5.1 percent), United Kingdom (4.8 percent), Switzerland (3.2 percent), France (2.8 percent), Spain (1.9 percent), Turkey (1.7 percent), Russia (1.7 percent) and Norway (1.6 percent). These European countries together had a 92.8 percent share of Ethiopia's total exports to Europe.
- About 20.4percent of Ethiopia's export earnings originated from markets in Africa, mainly Somalia (53.4 percent), Djibouti (23.9 percent), Sudan(6.6 percent), Kenya (4.1 percent), Nigeria (2.2 percent) and South Africa (1.4 percent)which altogether accounted for 91.5 percent of the total exports to Africa.

- America had 11.1 percent share in Ethiopia’s total export earnings, of which 53.0 percent was from exports to the United States and 3.4 percent to Canada. Both countries accounted for 56.4 percent of Ethiopia’s total exports to America.
- During the first quarter of 2019/20, Asia accounted for 64.3 percent of the total imports of Ethiopia with the major imports coming from China (38.8 percent), Kuwait (17.5 percent), India (13.7 percent), U.A.E (4.1 percent), Japan (3.4 percent), Indonesia (3.0 percent), Saudi Arabia (2.3 percent), South Korea (1.6 percent), Malaysia (1.6 percent) and Thailand (1.1 percent) whose combined share was 86.9 percent.
- Imports from Europe constituted 23.6 percent of Ethiopia’s total imports with the major countries being Turkey (17.1percent),Ukraine (15.9 percent), Netherlands (10.8 percent), Italy (8.1 percent), Germany (7.7 percent), United Kingdom (5.9 percent), Russia(5.2 percent), Belgium (4.9 percent), Rumania (4.4 percent), France (4.2 percent), Switzerland (3.6 percent), Sweden (3.2percent), Spain (2.0 percent) and Ireland (1.2 percent).These countries jointly accounted for 94.2 percent of Ethiopia’s total imports from Europe.
- Imports from America comprised 8.5 percent of the total import bill, of which the share of United States was 96.2 percent followed by Canada (1.5 percent) and Brazil (1.2 percent).
- Africa accounted for about 3.4 percent of Ethiopia’s total merchandise import. The major countries of origin were Egypt (33.7 percent), South Africa (27.5 percent), Sudan (20.5 percent), Kenya (10.2 percent) and Djibouti (6.0 percent) which altogether represented 97.9 percent of the total imports from the continent.
- The major import items from **China** included clothing and textiles, metals, telecommunication apparatus, vehicles, electric materials, and machinery.
- From Saudi Arabia and the UAE petroleum products imported.
- Metal and metal manufacturing goods constituted the bulk of imports from India.
- Machinery, metal, and grain were the main import items from Europe.

Table 4: Values of Major Export Items (In millions of USD) in Ethiopia

| | Quarter I (2018/19) | | Quarter II (2019/20) | | |
|---|---|---|---|---|---|
| **Items** | Total value | %share | Total value | %share | % change |
| Coffee | 204.4 | 32.6 | 232.1 | 32.1 | 13.5 |
| Oilseeds | 58.2 | 9.3 | 53.9 | 7.5 | -7.4 |
| Leather | 33.3 | 5.3 | 23.6 | 3.3 | -29.1 |
| Pulses | 43.5 | 6.9 | 48.7 | 6.7 | 11.9 |
| Meat & meat products | 24.2 | 3.9 | 18.5 | 2.6 | -23.6 |
| Fruits &Vegetables | 14.8 | 2.4 | 16.4 | 2.3 | 10.6 |
| Live Animals | 14.6 | 2.3 | 24.2 | 3.3 | 65.6 |
| Chat | 78.8 | 12.5 | 92.5 | 12.8 | 17.4 |
| Gold | 15.7 | 2.5 | 6.1 | 0.9 | -60.8 |
| Flower | 52.9 | 8.4 | 115.4 | 16 | 118.2 |
| Electricity | 16.7 | 2.7 | 10.2 | 1.4 | -38.6 |
| Others | 70.9 | 11.3 | 81.4 | 11.3 | 14.8 |
| Total Export | 628 | 100 | 723 | 100 | 15.1 |

**Source;** National Bank of Ethiopia (2019). Quarterly Bulletin First Quarter 2019/20 Fiscal Year Series, Addis Ababa, Ethiopia, 36 (1).

**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. According to NBE (2020) report, the current account balance saw USD 1.5 billion in deficit compared with USD 839.9 million deficit a year ago

**Trade Balance**

Trade balance refers to the **difference** between the export and import of goods and services. it is the calculation of a country exports minus import. If the difference is positive, it is called a trade surplus, and if it is negative it is called a trade deficit. A chronic trade deficit has remained the dominant feature of Ethiopia’s in external trade. To maintain favorable trade balance countries often resort to trade protectionism. They protect domestic industries by levying tarrrifs, quotas or subsidies on import. That doesn’t work for long soon other countries retaliate with their own protectionist measure which called **trade war** reduce international trade

**Capital Account Balance**

Records of the net change of assets and liabilities during particular period. It is different from the current account transactions in that it necessarily involves domestic residents either acquiring or surrendering claims on foreign residents. It sum total of non-financial assets acquired/disposed of insurance for loss and dept forgiveness, copy right and trade mark purchase. FDI (investment made by foreign in domestic business in form of joint ventures) and foreign portfolio investment (investment in financial asset like stock, bonds, mutual fund). In contrast to current account balance, the capital account recorded USD 661.5 million in surplus in 2019/20 first quarter , which was 31.4 percent lower than that of a year earlier.

**Exchange Rate**

Exchange rate is the rate at which one currency will be exchanged for another. It is also regarded as the value of one country's currency in relation to another currency.

- Each country determines the exchange rate regime that will apply to its currency. For example, the currency may be f**ree-floating**, **pegged** (fixed), or a **hybrid**.
- If a currency is free-floating, its exchange rate is allowed to vary against that of other currencies and is determined by the market forces of supply and demand. Exchange rates for such currencies are likely to change almost constantly as quoted on financial markets
- Peg system is a system of fixed exchange rates, but with a provision for usually devaluation of a currency.

# Chapter: 5

# Public finance, financial sector 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.

Fiscal policy is a policy of government that guides the revenue and expenditure of a government. Fiscal policy instruments are tax and expenditure items. The roles and functions of fiscal policy in the economy can be outlined in the following ways:

- ✓ The allocation of resources into the production of public and private goods.
- ✓ The distribution of income in order to reduce inequality and poverty.

- ✓ The promotion of economic growth and the stabilization of the economy by reducing fluctuation in the level of prices, output and employment.

**Government Revenue:**

- Sources of government revenue can be classified into tax and non-tax revenue. Taxes from wages and salaries, agricultural income tax, rural land-use fees and business profit tax are the major sources of revenue.

**Government Expenditure**

- The following sectors were found to absorb more than 90% of the total expenditure in all regions.
    - General administration (organ of the state, public order and security, and justice);
    - Primary and secondary education (including TVET);
    - Public health;
    - Agriculture and natural resources;
    - Clean water supply; and
    - Rural road construction and maintenance.

## Analysis of government budget and deficit financing

**Structure of Government Budget**

**Government budget** is a financial plan of government revenue and expenditure for a specific period, usually for one fiscal year. Ethiopia's fiscal year starts on Hamle 1, and ends on Sene 30, based on the Ethiopian calendar. Government budget is divided into two major areas such as, revenue and expenditure budget. Revenue budget consists of the annual forecast of government budget from tax, non-tax, external assistance and capital source of revenue.

**Tax (Source of Government Revenue)**

**A. Ordinary revenue: -** government budget from tax and non-tax

**i. Direct tax:** tax paid directly to the government by the persons on whom it is imposed. Examples of direct tax

**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:** 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 receipts, marriage licenses and land transactions. A physical stamp (a tax stamp) had to be attached to or impressed upon the document to denote that stamp duty had been paid before the document was legally effective.

**Excise duties:** This tax is imposed on selected goods, such as luxury goods and basic goods which are demand-inelastic. Tax on gasoline and other fuel and tax on tobacco and alcohol.

**iii. Foreign trade tax**

It comprises both import and export taxes.

**Import tax:** An import tax collected on imported goods. Such as a tariff is a tax levied on imports or exports.

**Export tax:** An export tax is a tax collected on exported goods.

**iv. Non-tax source of government revenue: are government revenue not generated from taxes. Examples include:**

- charges and fees
- sales of government goods and service
- government investment income
- privatization proceeds

**B. External Assistance**

It comprises of grants, loans and technical assistance from bilateral or multilateral agencies.

**C. Capital revenue**

Domestic source collection of loans and sales of government asset

**Government Expenditure Budget**

**Government expenditure** is divided into two principal headings: **Recurrent and Capital expenditure**. The recurrent budget is mostly financed from domestic revenue sources, i.e., from tax and non-tax revenue. The capital budget is usually financed by external loans and grants.

The **recurrent budget** in Ethiopia is structured under four functional categories.

**1. Administration and general service:** Organ of state, Justice, Defense, Public order, General Service.

**2. Economic service:** agriculture and natural resource, trade and industry, mining and energy, tourism, transportation and communication, construction,

**3. Social and other services:** education and health, culture and sport, labor and social affairs, prevention and rehabilitation

**4. Other expenditure:** transfer payment, repayment of public debt, contingency, miscellaneous

**Capital Budget Category**

- Economic development: includes production activities in all sectors of the economy.
- Social development: It constitutes activities like education, health and social welfare.
- General development : services in statistics , cartography , public and administrative buildings

**Budgetary Deficit Financing**

A government budgetary deficit occurs when governmental expenditure is greater than government revenue, whereas government budgetary surplus occurs when government revenue exceeds government expenditure. There are three main ways the government can finance a deficit.

**1. Domestic borrowing-** Firstly, the government can borrow funds from the other sources of the economy. When the government borrows from domestic sources it competes with the private sector and creates what is referred to as “crowding out effect”. A shortage of funds in the domestic market can result in the rise of cost of credit and hence discourages private investment.

**2. External borrowing-** The second possible method used to finance a budget deficit is to borrow funds from international financial markets .But it widens the balance of payments in current account deficit.

**3. Issuing currency (money printing)-**The third possible method of financing a deficit is issuing currency; this form of financing basically means that the government prints money to finance the deficit. But this method is not advisable. It is because it is highly inflationary: when the government increases money supply, if the economy is near full employment, demand pull inflation occurs rapidly, as there is too much money chasing a limited supply of goods.