UNIT SEVEN

MACROECONOMIC REFORMS IN ETHIOPIA

INTRODUCTION

- Economic reform began throughout Africa in the mid-1990s.
- During the mid- 1990s, several civil wars ended and a wave of democratization started.
- Ethiopia appears to be one of the poorest countries in the world. To reverse this image, a number of economic reforms were taken by different governments.

7.1 National Development Objectives and Strategies- Historical Review

- Ethiopia is the oldest independent country in Africa and one of the oldest countries in the world.
- The ancient monarchy maintained its freedom from colonial rule with the exception of a short-lived Italian occupation effort from 1936–1941.
- In 1974, a military junta, the "Derg", deposed Emperor Haile Selassie I and established a socialist state.
- In 1941, the Italians left behind a country whose economic structure was much as it had been for centuries.
  - There had been some improvements in communications, area of road building, and attempts had been made to establish a few small industries.
- During the late 1940s and the 1950s, much of the economy remained unchanged.

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- By the early 1950s, Emperor Haile Selassie I had renewed calls for a transition from a subsistence economy to an agro-industrial economy.
- Between 1945 and 1957, several technical missions, including one each from the United States, the Food and Agriculture Organization of the United Nations (FAO), and former Yugoslavia, prepared a series of development plans.
- In 1954/55 the government created the National Economic Council which helped to prepare Ethiopia's three five-year development plans.

The First Five-Year Plan (1957 – 1961)

- Main Objectives were:
  - Development of a strong infrastructure, particularly in transportation, construction, and communications.
  - Establishment of a cadre of skilled and semi-skilled personnel to work in processing industries.
  - Acceleration of agricultural development by promoting commercial agricultural ventures.
    - ✓ During the plan period, the gross national product (GNP) increased at a 3.2% annual rate,
    - ✓ This Development Plan promoted improved production of cash crops, including coffee.

The Second Five-Year Plan (1962 –1967)

- The second Five-Year Development Plan (1962-1967) continued to prioritize industrial development.
- Large-scale commercial farms for production of cotton, coffee and sugar were promoted as a source of income, which accounted for about 80% of cereal production.
- The second plan's objectives were:
  - To change ethiopia's predominantly agricultural economy to an agro-industry alone.
  - Diversification of production, introduction of modern processing methods, and expansion of the economy's productive capacity to increase the country's growth rate.

The Third Five- Year Plan (1968–1973)

- The third Five-Year Development Plan shifted its focus to the development of the agricultural sector in order to address the rising problem of food shortages in Ethiopia.
- It predominantly focused on improving the distribution of agricultural inputs, such as fertilizers and seeds used by commercial farmers, and expanding rural health services.

- The third plan's objectives:
  - Raising manufacturing and agro-industrial performance.
  - Expansion of educational opportunities.
  - Improvement in peasant agriculture.
- Between 1960 and 1970, Ethiopia enjoyed an annual average growth rate of 4% in percapita gross domestic product.
- The manufacturing sector's growth rate more than doubled, and the growth rate for the wholesale, retail trade, transportation, and communication sectors increased from 9.3% to 15.6%.

7.1.2 National Development Plan under the Socialist Period (1974-1991)

- The 1974 revolution by the Derg resulted in the establishment of a socialist state.
- The Derg changed the previous national development strategy, placing the emphasis on a centrally planned economy. Industry-led development was deployed as the main development strategy.
- Rural land and other productive assets were nationalized, and land was distributed among farmers.
- Commercial farms were put under government control, and land tenancy was abolished.

- Economic planning and development in the post-revolution period had four distinct phases.

I. 1974-1978: during this period, there was little economic growth.
   - The highly unstable political climate caused economic dislocation in sectors such as agriculture and manufacturing.
   - Additionally, the military budget consumed a substantial portion of the nation's resources.
   - Gross domestic product increased at only an average annual rate of 0.4%.

II. 1978-1980: during this period, the economy began to recover as the government consolidated and new Development through Cooperation Campaign "Zemecha.
   - Consequently, gross domestic product grew at an average annual rate of 5.7%.
   - agricultural production increased at an average annual rate of 3.6%, and manufacturing increased at an average annual rate of 18.9%.

III. 1980-1985: still the economy experienced a setback as gross domestic product declined, manufacturing took a downturn, and agriculture reached a crisis stage.

- This happened due to four reasons:
  - Widespread drought all over the country,
  - Manufacturing sector stagnated as agricultural inputs declined,
  - Lack of foreign exchange and declining investment
  - High rise in defense expenditure.

IV. 1985-1990: the government prepared a ten-year perspective plan for the period 1984-1994, which aimed at the development of agriculture, enhancement of exports, and improvement in the quality of livestock.

- The agricultural decline was reversed and the manufacturing sector also grew.
- Gross domestic product increased at an average annual rate of 5%.
- However, the lingering effects of the 1984/85 droughts undercut these achievements.

7.1.3 National Development Plan under FDRE

- The Ethiopian People's Revolutionary Democratic Front's (EPRDF's) rise to power in 1991.
- Many of the previous governments' policies were reversed, agricultural price controls were removed, and state farm assets were privatized.
- In 1994, the home-born Agricultural Development-Led Industrialization (ADLI) was launched as the foundation for national development, with the main objective of attaining food self-sufficiency by increasing agricultural productivity and output.
- The programme entailed three main strategies:
  - Expansion of agricultural technologies;
  - Investment in agricultural infrastructure, including inputs; and
  - Boosting rural non-agricultural sectors.
- A series of investment plans were made under the ADLI, including rural technical and vocational education and training services (TVETs), the development of water resources (hydro power and irrigation), improvements in microfinance institutions, improvements in the marketing of agricultural products, and the restructuring of smallholder co-operatives.

- The government introduced the Participatory Demonstration and Training Extension System (PADETES).
  - PADETES was used to distribute fertilizers, seed and credit, as well as to spread information on better agricultural practices, to smallholder farmers.
- The ADLI remains the key pillar and guiding framework for other successive development plans.
- The major goals and objectives of the programme were as follows:
  - Poverty alleviation through rapid economic growth.
  - Ensuring peace and security by strengthening a political system.
  - People's participation in the democratic governance of the country.
  - Implementation of an efficient educational system and improvement in the quality of education.
  - Development of a governance system that ensures social justice.
  - Implementation of a prevention-oriented health care system based on cooperation and participation of the private sector.

Development Programs of EPRDF

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a. Sustainable Development and Poverty Reduction Programme (SDPRP)

- The program was launched in 2002 following wide-ranging public consultations in 2001
- It was built on the following goals and concepts:
  - ✓ Agricultural development-led industrialization – ADLI
  - ✓ Food security
  - ✓ Decentralization and empowerment
  - ✓ Capacity building in the public and private sector, and
  - ✓ Reforms in both the justice system and the civil service.
- The first year of the program was marked by a drought which led to an 11.6% fall in agricultural productivity.

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

- The development policies and strategies pursued during the three year Sustainable Development and Poverty Reduction Program (SDPRP) (2002/03-2004/05)
- The PASDEP was Ethiopia's second poverty reduction strategy, covering the periods between 2005/06 and 2009/10.

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- The country's vision, specifically for the economic sector, set the following goals:
  - to build an economy which has a modern and productive agricultural sector with enhanced technology
  - to sustain economic development and secure social justice
  - to increase per capita income of citizens so that it reaches at the level of middle-income countries in 2025.
- To achieve these objectives, the PASDEP was built on the following eight strategic goals:
  1. Building all-inclusive implementation capacity.
  2. A massive push to accelerate economic growth.
  3. Creating the balance between economic development and population growth.
  4. Unleashing the potentials of Ethiopia's women.
  5. Strengthening the infrastructural backbone of the country.
  6. Strengthening human resource development.
  7. Managing risk and volatility
- Based on these strategic pillars, two alternative economic growth scenarios were considered.
  - The base case scenario, it was considered that to achieve the MDGs, an average economic growth rate of 7%.
  - The high case scenario, a 10% annual average economic growth target was set so as to lay the foundation.

c. Growth and Transformation Plan I (GTP I) (2010/11-2014/15)

- GTPI was the third national development plan covering the period between 20 10/11 and 20 14/15.
- GTPI advanced the Ethiopian national agenda towards becoming a lower middle-income economy by 2025.
- It introduced new agricultural technologies which aimed at helping to improve soil productivity, and it provided support to small-scale farmers through training and fertilizer provisions.
- The first Growth and Transformation Plan (GTP) was articulated through the following four overarching objectives:
  i. Maintaining at least an average real GDP growth rate of 11% per annum and attaining the Millennium Development Goals (MDGs) by 2014/15.
  ii. Expanding access and ensuring the qualities of education and health services
  iii. Establishing conditions for sustainable nation building through the creation of stable democratic.
- The achievements of the first GTP, lessons drawn from its achievement, and challenges faced during its implementation.

d. Growth and Transformation Plan II (GTP II) (2015/16-2019/20)

- The overarching objective of GTP II is to sustain the accelerated growth and establish a springboard for economic structural transformation thereby realizing the national vision of becoming a lower middle-income country by 2025.
- To this end, GTP II has set out the following specific objectives:
  i. Achieve an annual average real GDP growth rate of 11% within a stable macroeconomic environment by 2025.
  ii. Develop the domestic engineering and fabrication capacity and improve productivity, quality, and competitiveness of the domestic productive sectors.
  iii. Further solidify the on-going public mobilization and organized participation to ensure the public become both owners and beneficiaries from development outcomes.
  iv. Deepen the hegemony of developmental political economy by strengthening a stable democratic developmental state.

Pillar Strategies

- The pillar strategies of GTPII are built on that of GTP I complemented by additional pillar strategies that serve as foundation for sectorial plans. Therefore, in order to achieve the objectives of GTP II set out above, the following pillar strategies were pursued:
  i. Sustain the rapid, broad based and equitable economic growth and development.
  ii. Increase the productive capacity and efficiency to reach the economy's production possibility frontier.
  iii. Speed up and catalyse transformation of the domestic private sector and render them a capable development force.
  iv. Build the capacity of the domestic construction industry, bridge critical infrastructure gaps with particular focus on ensuring the quality of infrastructure services sector.
  v. Properly manage and administer the on-going rapid urbanization to unlock its potential for sustaining growth and structural transformation of the economy.
  vi. Accelerate human development and technological capacity building and ensure its sustainability.
  vii. Establish democratic and developmental good governance.

GTP I and II Performances and their Major Challenges

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- During the implementation of the two Growth and Transformation Plans (GTP I and II), Ethiopia has registered rapid and high economic growth.
  - GDP grew on average by 9.2% per year and the volume of real GDP rose from Birr 828 billion in the 2009/10 fiscal year to Birr 1.99 trillion in2019/20 fiscal year.
  - Compared to an average of 11% annual growth target during the period, the actual growth performance was 9.2%.
  - Major economic sectors, agriculture, industry and services respectively registered an average annual growth rate of 5.3%, 17.2% an 9.7%.
  - The agricultural sector, contributed 24% and the service sector has contributed 40.8% to the GDP growth.
- The economy registered an average growth of 9.2% per year from 2009/10 to 2019/20 years, and nominal GDP increased from Birr 395.9 billion in 2009/10 to Birr 3.37 trillion in 2019/20.
- Total investment, exports and imports of goods and services, on average, were 35.1%, 10.1% and 25.9% of GDP, respectively.

- The share of gross domestic investment (as% of GDP) increased from 31.1% in 2009/10 to 38.4% in 2015/16.
- Because of the prevailing political instability during much of 2016/17, domestic and foreign direct investment slowed down,
- In 2019/20, however, due largely to the COVID-19 pandemic, the share of total investment declined to 30.8%.
- The rate of gross domestic savings rose from 17.3% of GDP in 2009/10 to 20.9% of GDP in 2019/20.
- The poverty headcount ratio at the national poverty lines reduced from 29.6% in 2009/10 to 23.5% in 2014/15.
- Gini Coefficient has increased from 0.30 in 2009/10 to 0.33 in 2014/15.
- The unemployment rate increased from 18% in 2009/10 to 18.7% in 2019/20.

Major Development Challenges

- Despite the faster and high economic growth, the economy has encountered several challenges. The major challenges are identified below:
  - Failure to ensure quality economic growth**:** although high economic was registered, there were gaps in terms of creating adequate job opportunities, ensuring equitable distributions, ensuring structural transformations, and creating sectoral linkages and synergies. trade widened.

- External debt distress: besides the lack of or limited competitiveness in international markets, our domestic products were also not able to compete with imported commodities.
  - The bulk of Ethiopia's export commodities come from a limited number of agricultural products without significant value additions.
  - The economy largely depended on import, and the demand for imported commodities increased from year to year and the gap between export and import trade widened.
- Imbalance between domestic savings and investment: Ethiopia experienced a high rate of growth in investment between 2010 and 2020.
  - Domestic savings were unable to satisfy the domestic investment demand, causing large investment-savings imbalance.
  - To realize the objective of boosting domestic saving, a host of reform measures were undertaken during the GTP-I and GTPII period in Ethiopia.
  - The share of gross domestic investment in GDP increased from 22.3% in 2009/10 to 34.1% by 2017/18.
    - This made a significant contribution to the rapid economic growth registered during the planning period.

- Challenges to stabilize inflation: high and persistent inflation is evidently highly associated with macroeconomic instability.
  - Historically, the Ethiopian economy was known for its low inflation.
  - Prior to 2003/04, the country had not suffered from high inflation.
  - Ethiopia has experienced the highest inflation and higher inflation rate of 55.2% was recorded during 2008.
  - The highest prices were for food, housing, fuel and transport services, making the urban poor the most vulnerable to the effects of inflation.
- Rise in unemployment: the high economic growth registered over the past 10 years(between 2010 and 2020) was unable to create sufficient job opportunities, and failed to bring the desired increase in the standard of living for most citizens.
- Sluggish structural transformation and weak sectoral linkages: between 2010 and 2020, the process of transition from a low productivity agricultural sector to sectors with high productivity was very weak.
  - Ethiopia's export has always been dominated by a small number of agricultural products and has failed to transit to exports led by manufacturing products in order to secure sustainable and reliable export earnings.

- Poor capacity to mobilize domestic resources: although Ethiopia's capacity to collect taxes improved, the tax to GDP ratio dwindled.
  - The government's commitment to improve the overall public resource management and its efforts to minimize misallocations of public expenditure minimal.
- Limited accessibility of financial institutions: between 2010 and 2020, state-owned commercial and development banks channeled a significant amount of long-term loans to state-owned development enterprises.
  - Although the financial infrastructure shown growth, it was not commensurate with the level of growth of the economy and its accessibility was low.
- Deficient and low quality provisions of social services and basic infrastructure: between 2010 and 2020.
  - Although particular attention was paid to the expansion of roads, railways, energy, irrigation and various infrastructure development activities, there were still significant deficiencies in the supply.
  - There was also a wide gap in terms of quality infrastructure provisions.
  - There were also deficiencies in social service provisions, particularly in health and education.

7.1.4 National Development Plan after a Reform (2021-2030)

- The ten-year development plan lays a long-term vision of making Ethiopia an "African Beacon of prosperity".
- Ensuring high per capita income through rapid economic growth is one of the sources of prosperity.
- Prosperity is largely defined in terms of happiness, improvement in standard of living and quality of life, and the level of complete satisfaction.
- Development outcomes can be expressed as follows:
  1. Improvement in income levels and wealth accumulations so that every citizen will be able to satisfy their basic needs and aspirations.
  2. Basic economic and social services such as food, clean water, shelter, health, education, and other basic services should be accessible to every citizen.
  3. Creating an enabling and just environment where citizens will be able to utilize their potentials and resources so that they can lead a decent quality life.
  4. Improvement in social dignity, equality, and freedom where citizens can freely participate in every social, economic, and political affairs of their country.

Objectives of the Development Plan

- To achieve the national long-term plan of making Ethiopia an African beacon of prosperity, the following major development objectives are:

1. Building a prosperous country by creating a pragmatic market-based economic system.
2. Maintaining macroeconomic stability, ensuring rapid and sustainable economic growth, and creating decent jobs.
3. Ensuring structural economic transformation by promoting overall productivity, and competitiveness.
4. Creating an enabling environment where every citizen will become the owners and beneficiaries of the development.
5. Ensuring a competent, independent, and quality civil service system.
6. Building strong and inclusive institutions that will ensure peaceful society, access to justice and upholding the rule of law and human rights.

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Strategic Pillars and Key Priority Areas

- The overall development goal is to achieve improved welfare of the society by improving the standard of living and quality of life. The key strategic pillars of the ten-year development plan are:
  1. Quality economic growth and shared prosperity
  2. Economic productivity and competitiveness,
  3. Technological capability and digital economy
  4. Sustainable development financing
  5. Private sector-led economic growth
  6. Resilient green economy
  7. Institutional transformation
  8. Gender and social inclusion
  9. access to justice and efficient civil Services
  10. Regional Peace Building and Economic Integration
- The priorities are set for the medium-term to provide substantial milestones for long-term development plan.

- These key priority areas are:
  1. Multi-sectoral and diversified sources of growth and job opportunities
  2. Sustainable and inclusive financial sector development
  3. Harnessing the demographic dividend
  4. Quality and efficient infrastructure development
  5. Sustainable urban development
  6. Peace, justice, and inclusive institutions

7.2 Overview of Home-grown Economic Reforms in Ethiopia

- The rapid and sustained economic growth that Ethiopia registered between 2010 and 2020 mainly driven by aggregate demand.
- Despite its rapid growth, the economy failed to raise productivity and create adequate job opportunities.
- The home-grown economic reform (HGER) with the central objectives of sustaining rapid growth, maintaining stable macroeconomic environment by reducing debt vulnerabilities and creating adequate.
- The economic reforms are being translated into action through policy that enhances the supply side of the economy.

- The main aim and focus of the HGER is the enhancement of productivity and competitiveness of the overall economy, and a gradual transition from public to private sector-led growth.
- The HGER plan is classified into macroeconomic reforms, sectoral reforms, and structural reforms.

7.2.1 Macroeconomic Reforms

- In order to eliminate macroeconomic imbalances and create a stable macro economy, strict macroeconomic management has been put in place.
- The following key focus areas have been identified in the macroeconomic reform plan.
  - Ensuring fast, sustainable and broad-based economic growth. Reform efforts have been underway across various sectors of the economy to ensure high economic growth.
  - The efforts are being implemented in the way that involves several actors in the economy including the private sector and development partners.
  - Evaluation of past development plans has been thoroughly done in order to learn from past strengths and rectify the weaknesses through the experiences gained from the challenges so as to design and implement inclusive development plans in the future.

- New operational mechanisms are taking effect to modernize and enhance tax collection capacity as well as citizens' awareness about tax paying duties and responsibilities.
  - The operational dimensions of the fiscal reform process mainly focused on making the overall tax administration fair, transparent and accountable.
  - Strict justice sector reforms and operations have targeted the informal sector and contraband, which has a detrimental impact on domestic income, and the business community.
  - These measures have already started showing encouraging results.
- Budget administration and auditing system have given due attention.
  - Strict auditing and monitoring is necessary in order to ensure that the allocated budget is utilized for the intended social and economic purposes
  - Proper administrations and systems have also been designed to facilitate support, monitoring and accountability.

Sectoral Reforms

- The country will follow a multi-sectoral growth approach by diversifying sources of economic growth and job creation and undertaking necessary and substantive policy reforms across the different sectors.
- In this context, particular attention has been given to the following sectors as sources of growth.

1. Agriculture: in the past, the agricultural sector has received particular attention.
   - During the HGER process, there have been significant political commitments to improve research and development in agriculture and to improve all-rounded support given to all actors in the agricultural sector.
   - The HGER agricultural sector reform aims to improve the role and participation of the private sector, expanding of small- to large scale irrigation development, improving supply of inputs and finance, enhancing the productivity of livestock, etc
2. Mining: existing mining policies and legal frameworks have been under the reform process so as to create a conducive investment climate and attract a large number of foreign and domestic investors into the subsector.
   - In Ethiopia the role of the government in terms of infrastructure development and other targeted support in the subsector is vital for boosting private sectors' confidence and trust.

3. Tourism: although Ethiopia is endowed with abundant tourism destinations, the subsector has not fully utilized the available opportunity.
    - As the subsector has a characterized with high potential for domestic and foreign revenue generation, and job creating opportunities, the tourism reform has paid particular attention to improving and expanding tourism destinations.

Structural Reforms

- It is, very important that the government plays a role in the economy, and in particular, through public investments and lead the overall economy to a desired direction based on market principles.
- Any public development projects, could possibly be handed over to private investors through fair and transparent approach.
- The ultimate goal of government intervention is to create strong private initiatives or investment in the economy.
- The government should support all development forces including private investors.
- The government is determined to put the necessary policies and administrative structures in place to assist the private sector development in priority sectors such as agriculture, manufacturing, mining, tourism and ICT,

Other focus areas of structural reform processes include:

- Ensuring coordinated transport and logistics services:
- Implementing import substituting development strategy:
- Reforming the investment and job creation landscape
- Increasing the role and participation of the private sector in the economy:
- Expediting the privatization of large state-owned enterprises and liberalization of priority sectors:
- Strengthening Ethiopia's global and regional partnership
- Promoting free movement of labour:
- Promoting the development of civic societies:
- Diversifying Ethiopia's development partnerships and the sources of development finances:

7.3 Fiscal Decentralization

- **Fiscal decentralization** generally refers to the devolution of taxing and spending powers from the control of central government authorities to government authorities at sub-national levels.
- Nowadays in the world many governments including that of Ethiopia are structured in to federal systems.
- The extent of centralization can be measured by centralization ration which is direct government expenditure by central government divided total government expenditure.
- In Ethiopia, the federal government makes fiscal equalization payments to local governments with the stated goal of equalizing the fiscal capacity of local governments to provide services.
- Fiscal equalization aims at reducing or eliminating differences in net fiscal benefits which is the difference between the utility.
- It is a companion of fiscal decentralization which ensures economic governance such as equity, efficiency and stability of fiscal policy.
- In the past ten years 2010 to 2020, additional budgetary support has been provided for regional governments.
- For instance, in 2017/18, Birr 7 billion has be allocated to regional states as per the grant formula for the implementation of the Sustainable Development Goals (SDGs).

7.3.1 Disadvantages and Advantages of Decentralized System

- Most economists agree that spending and taxing decision intended to stabilizes should be made by central government.
- Local/ state government too small to affect overall economic activity.
- There are both opponents and proponents.

Disadvantages of Decentralized System

- Interstate/local externalities: there are costs and benefits of local government goods and services to residents who live in other political jurisdictions.
  - Think of localities /state as a firm producing local public goods such as like Education, sewage.
- Loss of scale economics in provision public goods: for certain public services the cost per person may fall as the number of user's increases.
  - Thus consolidation is one way to for communities to take advantage of scale economies.
- Inefficient tax system: efficient tax requires higher a tax rate on inelastic demanded or supplied goods and vice versa.
  - Goods which are inelastic at national level may be elastic at local level.

- Loss of scale of economies in tax collection: individual communities may not be able take advantage of scale economies in the collection of taxes.
  - Each community has ton devote resources to tax administration, made by having a joint taxing authority.
- Ineffectiveness of redistributing program: (equity measures) Suppose the tax and expenditure pattern in a particular community is favorable to the poor.
  - It transfers income to the poor. This attracts more poor to this region and expels the rich out of this region.
    - ✓ Finally. the region left with small tax base which leads to abandonment of the program.

Advantages of Decentralized System

- Decentralization renders a number of benefits. They include tailoring output to local taste/local specific, fostering intergovernmental competition, and experimentation and innovation in locally provided public goods and services.
- Tailoring output to local tastes/local specific: A centralized government tends to provide the same level of public services throughout the country regardless of the fact that peoples tastes differ.
  - Individuals with similar tastes for public goods group together, so communities provide the type.

- Fostering intergovernmental competition It is believed that government managers lack incentives to produce at minimum possible cost.
  - Private firm managers will be out of business of they fail to minimize cost. But public managers can continue.
  - But if citizens can change among communities/states, it creates incentive for governments' managers/administrators to produce efficiently and to be more responsive to citizens.
- Experimentation and innovation in locally provided public goods & services: For many policy questions no one is certain what the right answer is, or even whether there is a single solution that is the best in all situations.
  - One way to find out is to let each community choose its own way and then compare the results.
  - The case in Ethiopia is different. One policy used across all parts of the region in the country.
  - Therefore, purel decentralized or centralized system cannot be expected to maximize social welfare.
    - ✓ There is some optimal level of federalism.

Thank you…. !