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**A SCRUTINITY OF THE ETHIOPIAN POLICY
FRAMEWORK PAPER AS A FOLLOW-UP OF WORKS
DONE BY DIAL ON ETHIOPIA FOR THE E.C.**

**M-P. VERLAETEN
DIAL PARIS (France)**

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In "Sleeper", a futuristic comedy, the fate of the world depends on Woody Allen destroying the last remaining piece (the nose, actually) of a despot known as "the leader", so that evil scientists can never recreate him. He succeeds. The world is saved.

...

In the real world not every ceteris can be paribus.

...

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ABSTRACT

The paper scrutinizes the Ethiopian Policy Framework Paper in the light of the previous Ethiopian policy document (Ethiopia's Economic Policy during the Transitional Period) and works done by DIAL's working team for the EC. It indicates that while the EPTP was more a way to accommodate socialism with market, the PFP is more an attempt to promote market delaying social aspects to the long run. In this respect, the DIAL's recommendations to the EC deliver a message for a more balance policy than the PFP, they question on the relevancy of some internationally recommended policy (the devaluation one, for instance). Beyond the Ethiopian analysis, DIAL's staff questions to know whether or not a transition from civil war and command economy is like a structural adjustment process especially when the related country is so poor. Should it not be the case would lead institutions other than the WB and IMF, concerned with transition, to try to participate to it since the beginning i.e. that of the process leading to the drafting of some PFP, so as to plead for a more cautious policy.

INTRODUCTION

1. **The Policy framework paper (PFP)** analysed here is the product of a wide bargaining process featured by two rounds :

1- one needed to submit a policy document to Ethiopian forces represented at various levels within the Ethiopian society. The aim was to give the transitional government increased legitimacy and to reflect some political compromise ensuring continuity and thus peace so as to pave the way to democracy. The result is the EPTP document dated from Nov. 21, 1991 ;

2- one needed to gain international credibility and financial support to the EPTP. The result is the PFP document prepared in collaboration with the staffs of the I.M.F. and the World Bank. **While the first document (the EPTP one) was an attempt to describe rather exhaustively the Ethiopian economy so as to illuminate the nature of the transition advocated (from civil war and command economy to peace and market), the PFP one reflects efforts made to provide the country with a guidelines document for transitional macro and sectoral policies consistent with international mainstream market economics in conjunction with encountering the domestic private operators' expectations.** In this sense, the PFP document is also a way which indicates how it has been arbitrated between conflicts of objectives appearing in the EPTP. This explains why macro policy advocated by the PFP document differs widely from that from the EPTP one.

2. An analysis of the EPTP document led DIAL's staff to conclude that although being politically pertinent for peace to secure was the highest priority⁽¹⁾ and economically pertinent for market functioning is much more efficient than command economy to tackle with the stabilization of a decentralized economy, the EPTP lacked from relevancy and credibility. Indeed, **major Ethiopian challenges** i.e. risks to famine to reduce, poverty (and people's destitution) to alleviate, employment opportunities to create and the process of informalisation to account for **were neglected as the influence of the credibility gap existing between the local business community and the government on the availability of production factors** (private saving, private initiative) **to get a privatised economy.** This later constrained variable reduced obviously the operability of the EPTP all the more because on a lot of sensible issues to the business community, not invited to participate to the bargaining process, the

1) Still present increased difficulties in the Oromo region reinforce this assertion.

EPTP needed clarification : price decontrol, tax and duty modifications, property rights, modifications to the Labour Law. The EPTP lacked also from credibility given unclear announced global arbitrage between state and private initiative or responsibility. Indeed, through the announced maintain of state ownership in banking, the non advocacy of an independent monetary authority to ease macro stabilization, the promotion of collective participation schemes at the enterprise level, the specific regulation advocated for sectors where private initiative was invited to take over (retail trade and the road transport activities), the non accepted deregulation of the fertilizers system, the overseeing of ministries on private investment, an open price policy somewhat constrained, the number of motives put forward to advocate state intervention (particularly when sectors reserved for the State are non-existent in Ethiopia today) **private initiative remained very directly state regulated or constrained**. All this created a climate which was not particularly conducive to private investment either from the local business community or the foreign one. Regarding the later one the need to clarify the position of the Ethiopian government toward foreign capital opportunities in the Ethiopian economy as uncertainty as to when the Birr would be devalued were detrimental to transitional expected growth.

I – ETHIOPIAN ECONOMIC REFORMS IN THE LIGHT OF THE PFP

3. Most of the weaknesses featuring the EPTP and noted by DIAL's staff (2) have been corrected in the PFP document and as a result **the content of economic reforms** pursued by the Ethiopian government appears **clarified**. Further, **objectives and targets to achieve** are now clearly indicated, **pursued strategies** now detailed and **accompanied with a time frame for implementation**. So, policy uncertainty as to what and when to "enjoy" the measures is reduced. Likely this will positively affect private operators' behaviours and so expected growth. Reforms can be grouped into two sets : (i) that leading to a **deregulated command Ethiopian economy gradually transformed into a market-driven** one and (ii) that focusing on a **decentralised Ethiopian society**. This later reform is much more emphasized than through the EPTP. Economic reforms over the period 1992/93 – 1994/95 have the following objectives : (i) to attain a real income growth higher than the population growth rate ; (ii) to bring down the rate of inflation to approach the rates in major trading partner countries and (iii) to make substantial progress toward balance of payment viability. Macro tools to use are : (i) a Birr parity adjustment with external trade deregulation; (ii) price decontrol ; (iii) a reduction to the budget deficit ; (iv) an austerity monetary policy yet providing adequate credit to the growing private sector and leading to a non discriminatory interest rate

2) See for more details work done by DIAL's staff on the EPTP from page 61 to 78.

structure that is positive in real terms.

1.1. A MARKET-DRIVEN ECONOMY

4. In that economy, private initiative is praised to allocate resources efficiently on the basis of a decentralised price mechanism. Private responsibility recognized through ad-hoc rights is valued through a free process of managerial autonomy and profitability. It is constrained by competition and credit. In accordance the PFP indicates :

1.1.1. Privatization

1- **The open-up of almost all activities to the private sector.** Undertakings reserved to the state are now **severely** limited to a few strategic industries such as large-scale engineering, mining and metallurgy. So, the privatization of banking strongly advocated by the business community and the WB is now on the agenda in Ethiopia. **This with the announced modification to the Central bank to transform it into an independent monetary authority will ensure that all operators will be submitted to the bottom-line discipline.** Also to notice that large-scale farming which could be a rentable opportunity for private investors are no more reserved to the state.

1.1.2. A market liberalization

5. Privatization will be accompanied with market liberalization i.e. **price decontrol** and the removing of other controls and the **substitution of market regulation** for the late one.

a) Price decontrol

Open price policy will now prevail on all goods markets except for goods produced by monopolistic enterprises and a few essential goods. Price deregulation of firms that are producing tradable goods and that have a monopoly position in the domestic market (e.g. sugar, cigarettes and metal sheets) will be coordinated with import liberalization reform.

b) Deregulation/regulation

All sectors or activities will be touched. It is no more mentioned that retail

trade and the transport sectors will benefit from a new specific regulatory authority. It is sensible to say that the expected growth impacts of market liberalization are likely to occur through activities which can easily attract private initiative or boost it. Here one has to mention the privatization of the **road transport, housing and construction, domestic and external trade** sectors, of **large-scale farms**, and the boosting of **peasant agriculture** through applied open price policy. One can also refer to the announced privatization of **small(3) public enterprises** such as hotels, some retail outlets and manufacturing industries (such as processed agricultural products, for instance). **Banking** and the **insurance** companies should also be mentioned although their privatization is less easy. Regarding regulation according to market requirements, the PFP indicates that the government will improve existing institutions as well as create new ones. New skills will also be provided. No doubt that these needs will require some international financial and technical support.

1.1.3. Public enterprise reform

6. Privatization and market liberalization will be accompanied with a clarified restructuration program for public enterprises on the basis of which **all enterprises in Ethiopia will then be submitted to market rules**. The program will cover : (i) the introduction of institutional, legal, and regulatory changes **to provide a framework for reform in the public enterprise sector** ; (ii) **a phased program of divestiture, liquidation and rationalization of public enterprises** ; and (iii) **the establishment of mechanisms to monitor the performance of these enterprises**. No doubt also that public enterprise reform will require international financial and technical support.

1.1.4. Incentives to private initiative

7. Apart from changes to the late regulation, to macro policy, privatization will be encouraged by the promotion of : (i) new investment and mining codes (4) ; (ii) a revision to the commercial one and (iii) a new Labour Law. Through these documents it is expected to **beter encounter the wishes of the business community** of Ethiopia and abroad (to remove restrictions on the size of private investment, to permit the repatriation of profit and remittances, to reduce the top marginal rate of personal and corporate taxes... to link wage to productivity... to increase labour flexibility) **without nevertheless neglecting to adress the long term employment issues of private**

3) Indeed, private initiative is not particularly interested by large-scale plants unefficient and unprofitable generally.

4) The investment one has already been published.

business. That is the reason why the government will develop a long term strategy of re-aligning the price of labour to capital with a view to encouraging labour intensive activities. The public investment program and other initiatives supported by the reforms program, will also be formulated with this goal in mind. These decisions were likely taken because the government abandoned the idea of keeping 30 per cent of the voting rights for workers on enterprise management boards. Foreign investment will also be encouraged by Ethiopia's recent subscription to international investment agreements on investment guarantees and the streamlining of joint venture approval to one window procedures.

1.1.5. Institutional changes related to market functioning

8. It would be incredible to advocate privatization without **changes to rights recognized to market operators.** Here apart from rights already implicitly introduced (right to invest, to market, to enjoy profitability), the PFP, compared to the EPTP, indicates that a legal reform will take place to provide peasants with **security of land tenure.** On the housing front, individuals will be guaranteed **the right of ownership of the houses** they build and the right to sell, rent and transfer them. The question of the property of urban land seems to have remained a debatable one for nothing appears on it in the PFP compared to the EPTP. So, one has to question to know whether housing and construction markets can be liberalized as advocated without private property of urban land. Regarding **property rights related to nationalised assets** the document indicates the government's will to pay compensation to **original owners** according to well-defined criteria. As such, the government encounters also one of the wishes of the business community. How to find money remains an open question. Further, difficulties could also appear if the debate turns to cover other assets than houses : factories, for instance.

1.1.6. Macro Policy

9. In a market economy, private initiative is encompassed within economic policy which has to be flexible enough so as not prejudicing "animal spirits", while harmonizing global economic and social targets. In this respect, a transition to market departing from civil war increases the set of difficulties. Indeed, the government depends almost immediately on the private sector to get a better allocation of resources on the one side and, on the other, it depends on people to get increased legitimacy and ensure peace. From these viewpoints, **the PFP indicates a rupture of trend at short term,** at least, **toward market rationality** compared to the EPTP. Although being quite

legitimate given the considerable troubles of the Ethiopian economy, this could also reflect some longer-term overvaluation of market efficiency to cure Ethiopia. In this respect, to appreciate year by year how market would help to reduce poverty and people's extreme destitution, to render the country food-sufficient, how is the balance between profitable investment and increased employment opportunity will be particularly important. Apart from changes to the price policy already introduced differences of content between the EPTP and the PFP concern also **fiscal, monetary and external trade policies**. On the **monetary front**, it is now indicated that the objective is a reasonable credit growth permitting to **meet the needs of the productive sectors, particularly the private one** while reducing inflation and pressures on the balance of payments. This obviously presumes either the budget deficit to be under control which will not be the case at short term, and/or an independent monetary authority to resist the pressures to monetize deficits.

10. **On the fiscal front or beter the public budget one transition is a particularly complex process.** Indeed, the government intends to act on two fronts. **The first one**, which is also the most classical one for developing countries under World Bank's adjustment process, is **to attempt to reduce deficit till some acceptable level by public expenditures decreases** (austerity in the purchases of goods and services, a reduction in budgetary subsidies, a reduction of the administration size, civil service pay to be restructured to reward productivity and merit) and **modifications to the composition of public expenditures** (a shift from military to economic and social sectors, to neglected regions; from wage bill to productive investment expenditures) and by **public receipts increases** mainly through peace dividends and a restructuring of the tax and customs systems to accomodate a market-based economy. **The second one** is to **transfer some fiscal power to augment local responsibilities while safeguarding the government's capability to achieve economic and social targets**. This aspect is directly linked to the reform of administrative centralization. It is obvious to indicate that these two fronts can lead to conflicts of objectives.

11. **External trade** is a key issue of Ethiopian transition to market given its short and medium term impacts on **rural income and saving, public receipts** and on **the longer term country's capability to reduce indebttness**. Policy advocated will comprise the following measures : (i) an exchange rate devaluation (5) on the basis of which Birr price modifications will be fully passed on to export suppliers ; (ii) a legislation ensuring automatic granting of export and import licenses to eligible candidates ; (iii) a modification of the export eligibility criteria to include suppliers of

5) It has already been operated.

intermediate input ; (iv) the elimination of all export taxes, except on coffee ; (v) the liberalization of the coffee marketing regime ; (vi) a revision of the import tariff structure with a view to rationalize rates of effective protection ; (vii) the elimination of the discriminatory access to foreign exchange in the case of private sector.

1.1.7. Sectoral Policy

12. Compared to the EPTP major changes of **content** concern **agriculture, mining and energy** while let us recall it all sectors are now touched by market liberalization. The **agriculture** sector is said to be at the core of the government's efforts and pursued strategies to grasp growth. **This is fully relevant given the importance of agriculture output for income, employment, saving, export and fiscal receipts and the establishment of a real industrial basis. Further, it is also a way to reconcile Ethiopian peasants with Ethiopian government.** Compared to the EPTP, the agriculture policy advocated in the PFP gives much more importance to peasant agriculture, and less to large-scale farms which furthermore are no more reserved to the state; it establishes an analogous treatment between producers and traders through a global market liberalization ; it emphasizes the need to define an administrative framework for the delivery of agriculture services, credit, input distribution, and maintenance of rural infrastructure in the context of the relationships between the Central Government, regional governments and village level administrative institutions (a policy paper on Rural Institutional Framework is expected by December 1992). **Peasant agriculture (production and marketing) will be boost through :** (i) the liberalization of producer price ; (ii) the security of land tenure being ensured ; (iii) improved rural transport coordination and planning of rural roads ; (iv) the liberalization of marketing regime for output and input ; (v) support for agricultural research and extension services ; (vi) the expansion of small and medium-scale irrigation schemes, of farms to market roads. Measures (i) and (iii) are very important to better feed the Ethiopian population. Indeed, they will stimulate the peasants' access to markets and so connect surplus and deficit areas. Also they will reduce spatial dispersion of prices in a way favorable to competing markets (better allocation of profitable resources on the basis of price signals). Likely, this will positively affect the country food-supply shortage problem. To notice that peasant agriculture with retail trade remain the lonely sectors for which it has been indicated that the government will encourage the establishment of cooperatives on a voluntary basis though. In the EPTP, the formation of cooperatives or associations was advocated regarding almost all sectors where private initiative was invited to take over (agriculture, retail trade, road transport sector, housing construction) and in some limited banking

activities. Here, the scope for collective participation schemes has been reduced to the quite legitimate field of **service** cooperative (disruption of the DERG's ones with as a result a weakening in the rural institutional framework) and in that of retail trade. Regarding the capacity of the country to feed its population **now**, it is worth indicating that appreciations of what could be needed cereals imports and international food-aid are missing. By point (iv) concerning input market liberalization, the government encounters a wish from the business community and the World Bank. Concern on the availability of agricultural input while minimizing marketing costs (expected increase because of price liberalization, Birr devaluation and transport deregulation) leads nevertheless the government to indicate that the seeds and fertilizers liberalization will be operated in a phased manner. Behind that assertion one can indicate that the government likely wants to reduce risks to famine. Indeed, regions using fertilizers (Gojam, Shoa and Arssi) are three **surplus** areas.

13. Related to **mining** and **energy**, differences between EPTP and PFP are the following : **mining**, the government intends to encourage private sector **production of building materials**, of which there are **now widespread shortages**. **Energy**, the government intends : (i) to develop the country's hydroelectric resources for domestic and export purposes (to Djibouti and Sudan) ; (ii) expand the national grid into rural areas ; (iii) encourage participation of the private sector in the expansion of small-scale electricity generation ; (iv) **find alternative to the use of fuelwood as sources of energy** (natural gas and coal to be substituted for scarce fuelwood and charcoal) ; (v) **to revise electricity tariffs (by Dec 93) to bring them into line with production costs**. Point (iv) is certainly well taken in the light of natural resources conservation policy. Indeed, fuelwood used by **poor households** (the majority of the population) is a major cause for deforestation in rural areas. Also to notice that some conflicts of objectives are likely to occur on the energy front. Indeed, consumer prices are likely to increase through tariffs restructuration while the government intends to promote access to energy particularly into rural areas.

1.1.8. Social Policy

14. Compared to the EPTP, the PFP **elaborates** much more on social aspects, demographic, and human resources developments. Although a timing is now given for social policy, it is worth indicating that the **achievement** of the targets depends now on announced long term strategies compared to the EPTP. Subjects touched are : (i) the improvement to the access to **safe water** and **effective sanitation** particularly to low income groups and in rural areas ; (ii) **employment** : this point has

been touched at paragraph 7 related to incentives to private initiative. Here the nature of the arbitrage operated between economic and social targets appears clearly, for, it is indicated that the employment issues of market have to be addressed through long term strategies ; (iii) **health and education** : basic infrastructure to reconstruct, provision of basic drugs and medicines to make are the advocated policies; (iv) **demography** : a National Population Policy will be formulated so as to **harmonize population and income growth and natural resource conservation** (it is a needed step to promote long term sustainability); (v) **Human resource development** : the focus would be on the role of **women in development so as to alleviate poverty**. To notice that the PFP mentions a poverty alleviation program which is not detailed in the document.

1.1.9. Environment

15. The environment policy is **now** detailed. The government's policy will be to couple efforts to promote a more efficient use of energy with the adoption of improved practices to conserve land, water and other natural resources. The conservation policy will be addressed from the perspectives of **all sectors that impact land use** (i.e. mainly agriculture, livestock and the energy sectors). The point is well taken because through agriculture it is an implicit recognition of the link existing between poverty and environment degradation. This link is more and more on the agenda of international institutions concerned with environment protection in the framework of sustainability.

1.1.10. National disasters and food security

16. The government intends to further enhance its capabilities to cope with natural disasters. This issue was not addressed in the EPTP. To this end, the government will formulate and implement a National Disaster Prevention and Preparedness strategy by 1992/93. The strategy would include : (i) the issuance of a national emergency code defining the conditions that constitute an emergency ; (ii) the responsibilities of officials in central, regional and local governments in the event of emergencies ; and (iii) the establishment of a food security reserve, strategically located in regional depots to facilitate speedy distribution in case of need, to cover four month's emergency requirements pending the mobilization of external assistance. In order to expedite emergency operations, the government is considering the constitution of a budgetary contingency fund from which payments could be made once an emergency is declared. Contingency plans will be laid out for public works projects to provide temporary employment for the unemployed and the victims of natural disaster. Here too, the

government's strategy is relevant given the permanent food supply shortage of Ethiopia and recurrent droughts since the beginning of the 1970s. No doubt that the government's strategy will permit to better combine the agriculture output supply policy, the food import one and the international food-aid requirement.

1.2. A DECENTRALISED ETHIOPIAN SOCIETY

17. Ethiopia is embarked upon a process of **achieved decentralization**. A proclamation establishing 14 administrative regions and describing their functions and responsibilities has already been issued. To meet their resource requirements, regional administrations will be entrusted with the legislative power to levy and collect taxes. Such fiscal powers will have a direct bearing on the existing fiscal system of the Central Government which has to support strong and likely long term pressures from the international donors to reduce its deficit. In that field too, the Ethiopian government will need further international financial and technical support. **The fiscal decentralization nexus could be a vicious one in Ethiopia, at least at short term.** Indeed, the Ethiopian rulers in power at A.A. continue to be challenged by groups of political activists of which one of the most active is the Oromo group. This has led to increased smuggling and contraband particularly of coffee, the main export commodity, although that could also be a result of expectation to Birr devaluation (before it was decided). **So, the situation is not clear enough to permit to say whether or not political activists in Ethiopia are trying to conquest their sovereignty through a de facto regional money channelling.**

II - STRENGTH, OPERATIONALITY, WEAKNESSES AND SEQUENCING OF THE PFP

2.1. STRENGTH

18. It already has been emphasized (at paragraph 1 point 2). Let us recall it briefly. Apart from some relevant intentions which have been clarified, some omitted questions which are now addressed, the strength of the PFP is to provide the country with a guidelines document for transitional policy **consistent with international mainstream market economics**. This opens room for manoeuvre in front of the international donors community and the Ethiopian diaspora. Further, an arbitrage has

been operated to encounter most of the expectations from the business community (local and international). Objectives and targets to achieve are now concreted, pursued strategies detailed and uncertainty as to when the measures would be implemented has been reduced by an accompanying time frame. This renders the PFP much more credible to private operators than the EPTP. Likely this will positively affect expected privatization and growth. The future will indicate what were the business community's intentions i.e. to participate frankly to the government's market strategy or to create pressures so as to obtain a government change through the announced free elections (1993). The strenght of the PFP resides also in the decisions **it has led the government to accompany its implementation at the beginning**. In this respect, that to devaluate the currency is the best example. For the WB and Ethiopian diaspora leaving in the US, it was a symbol of government's will **to act differently**. The future will also indicate wether such a measure was really the most appropriate, at the beginning of the reforms, at least, and without a clear sequencing of these ones.

2.2. OPERATIONALITY

19. Increased credibility will likely render the government's policy and reforms **more operational**. But in this respect, it is worth indicating that to grasp the full benefit of what remains always a potential of operationality, the government has to get conducted studies on different subjects. The most relevant indicated by the PFP are :

(i) **fiscal reform** : (how to restructure receipts and expenditures combining market requirements, social targets and promoted decentralization, ...) ;

(ii) **public enterprises** (or farms) : (how to modify the legal framework to restructure public enterprises along the lines of market rules; which enterprises (farms) to keep public, to liquidate, to privatize; what would be the market price of enterprises (farms) to get privatized..., how to define market criteria to monitor public enterprises according to market rules... ;

(iii) **decentralization** : (a plan of arrangements between the Central government and the regions to define so as to augment local responsibilities while safeguarding national fiscal integrity);

(iv) **banking** : (how to create private banks, how to restructure public banks) ;

(v) **external trade** : (how to modify the import tariff structure to get a more uniform

effective protection of domestic industry);

(vi) **external funding** : (how to secure external assistance and on which basis concessional, non concessional; how to improve debt management, ...) ;

(vii) **employment** : (how to define the content of a policy addressing medium and longer term unemployment issues of private business and public enterprises restructuration...) ;

(viii) **agriculture** : (how to define the content of the announced policy paper on Rural Institutional Framework, how to use agriculture so as to alleviate **seriously** poverty) ;

(ix) **social aspects** : they all need appropriate studies focusing on **how** to achieve the objectives ;

(x) **environment** : the study needed is how to define a policy of sustainability i.e. for a development that meets the need of the present without compromising the ability of future generations to meet their needs.

2.3 WEAKNESSES

20. Although efforts were made, **some relevant questions remain to be omitted and there is a need for further clarification**. No doubt that will influe also on the policy operationality. **Omitted questions** concern :

- 1- how to manage the expected cession of Eritrea and, in this respect, how to reorganise the links between Ethiopia and the world markets, if necessary, i.e depending on some reached agreement between Ethiopia and Eritrea ;
- 2- how to account for informal activities ;
- 3- how to accomodate properly and urgently with ex-service men to get demobilized and, likely also private militias, or more widely how to account for the Ethiopian employment challenge ;
- 4- how to evaluate and encounter present Ethiopian food needs. To mention that all these points were indicated in the DIAL's works on the EPTP.

21. **The lack of concern with Eritrean cession's costs or gains** is very strange. Indeed, although there are not many measures which have already been decided to implement Ethiopian economic reforms, the new government's first reaction was to sign an agreement with the Eritrean Authorities to get a free access to the seaport of Assab from where the imported Ethiopian crude oil came. It was also at Assab that 70

per cent of Ethiopian consumed crude oil was refined. A mutual defense agreement was also signed. Ethiopia and Eritrea have a lot of reasons to harmonize their policies. Let us just briefly indicate that if Ethiopia gets access to energy and world markets, Eritrea gets access to Ethiopian agriculture raw materials (skins, cotton, grain, etc...) needed for its manufacturing activities. On the exchange rate front too, harmonized policy has to be advocated for each currency can create pressure on the legal rate of the other.

22. The issue of **informal activities** is a crucial one. Indeed, Ethiopia is embarked upon a transition to be fully black-marketed. This is likely a result of the late government's drastically reduced legitimacy and operationality and of people's efforts to reduce poverty. A focus on informal activities would not only be relevant given the need to reduce the budget deficit, all the more when it appears that it could likely not be the case at short term, but, also given availability of factors of production the country could easily mobilize i.e **informal entrepreneurs** and **unregistered saving**. This would also appear relevant given the government's intention to curb inflation and create private banks. Indeed, that would permit to correctly appreciate the monetary overhang and so, further expected inflation pressures (other than through price decontrol and competing markets). That would also permit to estimate some "rapatried" capital flows (from the registered to the unregistered activities) before committing to private banks and banking restructuration. It is obvious to indicate that a focus on informal activities is also a way to beter integrate the country's markets. And finally, it is also a way to promote transparency with market in corrupted framework.

23. Ethiopia has to create jobs. **Transition to market can help but will it be quick and strong enough to improve people's current day living remains a debatable question.** In such a framework of uncertainty, the PFP should have adressed the question immediately (6) i.e urgently, even if it was just to require from the international donors community more aid (for contingency plans as proposed by DIAL's, for instance) as advocated for other issues, the public finances one, for example. It is worth indicating that in the Ethiopian context jobless people, ex-service men to demobilize, can easily be mobilized to create troubles, i.e to render the process leading to democracy and improved welfare much more difficult. **Ethiopia could easily become like Somalia today. In this respect, not to have evaluated present food needs is also fully detrimental.**

24. The need for clarification concerns **objectives, constraints on**

6) There is just a sentence at the end of the document (PFP on p.28) saying : contingency plans will be laid out for public works projects to provide temporary employment for the unemployed and victims of natural disaster.

announced tools to use, and the way to encounter some challenges.

1- the price objective to achieve

Major trading partner countries of Ethiopia are the E.C, the U.S and Japan. Then, the question is : does the Ethiopian government intend to catch up with these countries as advocated (point(ii) at paragraph 3). Is it sensible at short term (at least) given the inflation pressures the country has to face with and uncertainty as to what could be the inflation rate in the near future (given the size of the real monetary overhang, for instance) ? Does that not presume specific Birr adjustment policy accounting for changes to the parity of hard currencies ?

2- the balance of payment objective to achieve, that of external financing

What does that mean to make **substantial** progress toward balance of payment viability (point(iii) at paragraph 3). Is that word linked to some level of external reimbursement the country would have accepted to pay. In case of yes, which is it ? Regarding the **external financing requirement**, the PFP does not send any message permitting to appreciate the financial pressure on the country. Indeed, data are just but missing. This is rather unfortunate for it is one of the country's major challenges and it is also a way to get help from international donors (the EC, for instance) not only concerned with Ethiopian transition to market-driven economy but also with a government's capability to achieve economic **and** social targets, all the more when poverty seems to have become a fatality to the related country.

3- the constraint of the budget deficit to manage

Ethiopia has to reduce its budget deficit : what is the **acceptable** level for international donors community and on which period to achieve it, is not said ? What would the **structural** budget deficit of transitional Ethiopia would have been a requirement to appreciate the acceptable level ?

4- the constraint of the monetary policy to manage

How to pursue an austerity but flexible monetary policy when it already seems likely that the price objective is irrelevant and the acceptable deficit level unknown, further when an independent monetary authority not yet exists.

5- the constraint of the property rights to account for

Why is the urban land property rights issue not clarified ? Why are rural water, grazing and community forests rights not mentioned in the framework of natural resources conservation and agriculture policies.

6- the employment challenge to face with

What is the meaning of the strategy of re-aligning the price of labour to capital with a view to encouraging labour intensive activities ? Indeed, the price of capital which is the real interest rate according to mainstream market economics is still unknown depending on targeted money supply and the expected inflation rate. At long run, moreover, it depends on some achieved capital market flexibility i.e how private capitals (through private banks) react to domestic and international interest rates and expectations to the exchange rate. All this is fully unknown. **As a result the employment challenge is just but delayed to an undefined future. Again, the government misses an opportunity to claim for international help to fund contingency plans or more safety net policies (as advocated by DIAL's works).**

2.4. SEQUENCING

25. Although detailed strategies to pursue are accompanied with a time frame, no real sequencing process appears. Indeed, sequencing presumes : (i) to select objectives and tools according to the speed with which one wants to achieve the selected objectives and (ii) to allocate funds and skills consistently through time. Further, a clear distinction has to be made between objectives and tools. This presumes obviously that tools have to permit to achieve the objectives otherwise tools to modify belong to the selected priorities. **In Ethiopia, one difficulty is that tools normally used in market economies have either to be implemented or modified. In this sense, there are also objectives to achieve.** In the light of the PFP, it appears that the Ethiopian government intends to act on all fronts during the period 1992/93-1994/95. This is not only uncredible but also impossible. Further, up to now there has not been many measures of implementation already decided. But, nevertheless, a look at these measures reveal practically what could be the Ethiopian sequencing. Through the EPTP the question of sequencing was raised in terms of stabilization versus trade reform liberalization. As a result the government acted on the price (deregulation somewhat constrained) and the privatization fronts delaying actions on the external trade one. Now, that has changed, the focus is on the trade reform liberalization and financial deregulation fronts. This way to sequence the Ethiopian reforms is not easy carrying with it "competition of instruments" between : (i) inflation pressures to reduce and Birr to devalue (potential inflation pressure) ; (ii) deficit to reduce and external trade tariffs to eliminate or reduce (eventuality of public receipts decrease) ; (iii) public debt to reduce and Birr to devalue (eventuality of debt service payment increase). In this framework, what will

be the expected inflation rate is crucial for it could lead to three other sources of conflict related to **relative price variability, interest rate behaviour and wage rate indexation**, affecting private investment process and the level of poverty in Ethiopia. To conclude on the PFP : the feeling is that while the EPTP was more a way to accomodate socialism with market, the PFP is more an attempt to promote market delaying social aspects to the long run.

III - DIAL'S RECOMMENDATIONS TO THE EC COMPARED TO THE PFP

3.1. COMPARISON

26. In the light of all that preceeds the major interests for the works done by DIAL's working team are :

- 1- to have **indicated and discussed** all the questions which were omitted in the EPTP and the PFP ;
- 2- to have **correctly identify where clarification was needed** (EPTP and PFP) and **how to clarify** ;
- 3- to have indicated **how sensibly arbitrate between economic and social objectives, targets and tools, short and long term issues** ;
- 4- to have **defined strategies to get less constrained tools to use** (the fiscal or the indebttness ones, for instance) by balancing objectives and financing constraints through specific strategies (for the budget deficit, for instance) ;
- 5- to have encountered all major Ethiopian challenges and the credibility gap through policy recommendations and **safety net policies**, the most obvious example being how to get ex-service men demobilized while restoring rural and urban infrastructure ;
- 6- to have **illuminated the informal activities challenge** not yet advocated in the PFP and to have **indicated some policies** to grasp growth through these activities ;
- 7- to have **illuminated the banking and financial issues** of the Ethiopian transition and selected some required policies linking informal activities, private banks and state enterprises restructuration ;
- 8- to have **recommended policies in the light** of a presentation of **mainstream market economics showing where problems could appear not only pratically but because of uncertainty featuring economic thought**. The best examples are those of a modification to the Birr parity and to the property rights ;
- 9- to have indicated where were needs for further studies (for instance, the fiscal decentralization nexus) and to have already provided a study indicating what could be the market parameters of the Ethiopian economy in the light of past macro performances ;
- 10- and finally to have indicated what to grasp from the Ethiopian analysis to ease

analogous transitions of other developing countries.

To conclude : The DIAL's works deliver a message for a more balance Ethiopian economic policy than the PFP, they question on the relevancy of some internationally recommended policy because of some theoretical scepticism. Beyond the works done on Ethiopia DIAL's staff questions also to know wether a transition from war and command economy to peace and market is or is not like an structural adjustment process through which to modify the allocation of resources.

3.2. RECOMMENDATIONS (text quoted from DIAL's executive summary)

27. In the light of the set of DIAL's provided documents, the EC's main fields of **urgent** actions should be to help Ethiopia to **focus on famine and employment**. This presumes recommendations for policy to be implemented or modified concerning (i) **Agriculture and Poverty** ; and (ii) **Labour intensive sectors (such as construction, but not only, accounting also for informal activities.)** At **medium and long term**, recommendations should focus on : (i) the need to **modify the legal framework** in accordance with market functioning but also accounting for market and government's failures within the economy ; (ii) **how to restructure state industry** ; (iii) **how to boost the private sector** ; and (iv) **how to get sustainable growth**. Before trying to detail relevant policies, it is worth indicating that the EC should also **recommend to the Ethiopian government to invite the Ethiopian business community to participate to discussion on policies to be implemented (or modified)**. This would be an important step to reduce the credibility gap between the political and economical spheres, a key issue for growth. Growth being variously constrained, **policies specifically accounting for major constraints should also be recommended and financed both at short and medium run**. Here it has to be referred to a **plan helping to finance the expected budget deficit without creating further inflation**. Such a plan could not be postponed without important growth losses. **How to help Ethiopia to re-imbursh its external debt** has also to be referred to as to **which amount of food-aid is needed to help the country to become food-sufficient and to reduce risks to famine**. To finance a **study on a change to the Birr parity** could also be relevant for growth, but not only, for it could be also positive for the budget (7) . To finance a **study on the inflation process**

7) DIAL's staff has already deliver a study focusing on some aspects of the Birr adjustment question. A focus of what could be the budget impacts of the question would be welcome.

in Ethiopia would also be desirable.

28. It is not now likely to define the contents of the recommended policies. Nevertheless, some measures have appeared to be relevant.

A - SHORT TERM

Objectives

Famine (Agriculture, International food-aid, Poverty)

This is not an Ethiopian fatality. Indeed, it can be modified through a policy encompassing **measures to increase output supply**. At short run, measures could be :

- to **increase prices really paid to the farmers** ;
- to **ensure peasants with the needed seeds during the following years** ;
- to **ensure peasants with some basic medical care** ;
- to **improve acces to water and draft power (animal one)** ;
- to **promote market spatial integration and more generally market liberalization** ;
- to **reduce taxation on peasants**.

Even if the agriculture output supply policy succeeds, Ethiopia would not be food sufficient before many years. Indeed, the WB has indicated that to produce enough food for its population (3 per cent increase annually) Ethiopia should increase its agriculture production by 3.3 per cent on average during ten years without ceasing to import. This indicates that it is likely to assume **international food-aid at short and medium term** even in the case of drought disappearing and agriculture output supply policy succeeding. Famine is also a reflection of **poverty**. This would lead to **studies trying to identify why the Ethiopian peasant is so poor**. The studies should then lead to longer-term recommendations and actions to be internationally financed.

Employment (Labour intensive sectors, informal activities)

At short run, **measures should encounter the needs to restructure agriculture infrastructure and to restore or reconstruct urban dwellings using two factors of production the country can easily mobilize i.e the ex-service men and the informal entrepreneurs**. Measures should also encounter the wishes of the business community to **increase labour market flexibility, to reduce the tax burden**. Measures could be :

- to launch a rural construction programme using soldiers who previously undertook infrastructure activities ;
- to give the informal entrepreneurs the burden to restore and reconstruct dwellings in urban areas ;
- to revise labour provisions to achieve firm-level flexibility in employment ;
- to reduce business taxation.

Tools

Indebtness, fiscal deficit and inflation

Urgent measures could be :

- to soften the external debt service payment through a negotiated international agreement ;
- to ensure that the Russian claims do not receive Paris Club endorsement ;
- to sell some government-owned residential housing and smaller enterprises in the nontradable sector, the amount guided by the need to stabilise the price level and/or to get funds ;
- to sell some rural lands without neglecting the impacts on rural income and migrations ;
- to study the impacts of a Birr adjustment parity.
- to study the impacts (the economic ones but not only) of a rural land market. The government has to avoid rural impoverishing processes and dramatic migrations before deciding to market rural lands. So, a careful investigation of this option is needed ;
- to study the roots of the inflation process (the budget, monetary overhang, etc...) in Ethiopia.

B - MEDIUM TERM

Objectives

Legal framework, decentralisation

It is obvious to say that the legal framework has to be modified to fit democracy and market (for instance what sort of property rights to recommend) but that has to be carefully decided given all sorts of impacts on the whole society. Here too, studies are needed. This is also true regarding changes to decentralisation given their potential impacts on fiscal power.

Industrial restructuration

Up to now, nobody knows with some economic rationality which industrial enterprises have to be restructured. The EC should therefore finance **an auditing** programme of action related to industrial activities. It should first determine **which enterprises have to be closed down**, privatized and what are their market price in that eventuality. It should also illuminate **what would be the social costs of such an adjustment**. Second, it should define how restructure the rest of industrial enterprises.

The boosting of the peasantry ; the private sector.

Here measures should focus on :

- how to establish the **peasant cooperative societies as competing marketing channels** ;
- how to **facilitate livestock exports** by investment in marketing infrastructure ;
- how to establish **marketable water rights** in agriculture ;
- how to establish **communal rights** to regulate forests and similar agricultural common property ;
- how to **develop enterprises in formal activities** ;
- how to **integrate informal entrepreneurs without prejudicing growth** by deciding constraining rules, etc..., related to informal activities.

In the case of the private sector a focus on small-scale enterprises is required. This pleads for measures :

- (i) permitting these enterprises to develop ;
- (ii) helping them not to remain limited to the production of labour intensive, low technology goods but to capture a niche in upscale segments of the market ;
- (iii) helping them to export ;
- (iv) removing price controls on industrial production ;
- (v) permitting publicly owned banks to lend to private firms ;
- (vi) promoting a private banking sector.

This later recommendation is a wish of the business community and the WB. Contrarily to what can be thought many positive effects can appear both on the

economic, social and financial fronts what appears always desirable during difficult transition such as the Ethiopian one

Tools

Inflation

Measures should be to increase labour productivity, mainly, while addressing the employment issues of that recommendation simultaneously.

Financing

Measures could be :

- to establish a market in government debt ;
- to promote a private banking sector ;
- to establish attractive savings instruments marketed in rural areas ;
- to study what could be the structural budget deficit in Ethiopia.

C - LONG TERM

Sustainable growth

Here, it is pleaded for a development that meets the need of the present without compromising the ability of future generations to meet their needs. Policy focusing on **(i) Natural resources restoration and preservation (NR)** and **(ii) Poverty are at the core of the analysis en Ethiopia**. Regarding (i) this would lead the EC in agreement with Ethiopian Authorities to re-enforce its programme on soil restoration already implemented (Ethiopia (Highlands) being one of the most degraded area in the world.) and to define programme for reforestation, as advocated in the PFP. Such an extended policy would really appear as a test-case of what can be done in other developing countries with analogous features. Indeed, very often, the plead for NR policy is accompanied with ponctual measures, only. Here the question would be what **policy (i.e set of consistent interacting measures) for sustainability**. At long term policy for sustainability has to receive the highest priority in Ethiopia. So any EC's recommendations and/or actions at long run should focus on its core. Regarding (ii) this would lead the EC to help the government to define a demographic policy consistent with people's aspirations, expected achievements and sustainability (as advocated in the PFP).

IV – BEYOND THE ETHIOPIAN TRANSITION : WHAT CAN BE GRASPED TO HELP OTHER DEVELOPING COUNTRIES TO PASS FROM CIVIL WAR AND COMMAND ECONOMY TO PEACE AND MARKET-BASED ONE

Up to now, the Ethiopian experiment has taught DIAL's staff that :

- (i) credibility gap to reduce could matter more than rational policy (if any) to define. This is particularly true when there is a strong focus on past ideology and its results from one partner to the growth process ;
- (ii) to plead for market economy is ambiguous. Indeed, partners have their own definitions which sometimes can conflict. So, to avoid some partners to participate to discussions on market is risky. That increases also the credibility gap ;
- (iii) It is too early to indicate if there exists an Ethiopian transitional model. Indeed, further analysis and studies are needed. What can be said with a good level of probability is that in each country, there is a lot of conditions to be put in an hierarchical order to discover. More is not possible to say now ;
- (iv) It is a debatable question to know whether or not a transition from civil war and command economy is like a structural adjustment process especially when the related country is so poor ;
- (v) It is rather unfortunate for the EC not to be in the position to fully participate to the Ethiopian transition i.e not being questioned during the process leading to the drafting of some PFP. Indeed, then the EC has to include its fields of action in the framework of the PFP. This could be costful for the country and EC if transition is more than a structural adjustment process. Analogously to Shakespeare's Hamlet (Act one) said : "There are more things in heaven and earth, Horatio, than are dreamt of in your philosophy...", to DIAL's staff it is much more complex.

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