Développement des
Investigations sur
Ajustement à
Long terme

HOW TO PASS FROM A WAR TO A PEACE ECONOMY :
THE ETHIOPIAN CASE
RESEARCH PROGRAMME CONTRACTED BY THE EC TO DIAL
Nber R/821

ETHIOPIA'S ECONOMIC POLICY DURING THE TRANSITIONAL PERIOD

by

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JUNE 1992

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TABLE OF CONTENTS

PRESENTATION OF THE PAPER

1.a) This document is one of the contributions expected by the EC to cover the research programme contracted to DIAL : How to pass from a war to a peace economy : the Ethiopian case.

b) The programme has to focus on two subjects. One purely related to Ethiopia has to throw some light on what are the major EC's fields of action to help the country to recover. The second has to indicate what can be grasped from the Ethiopian case to ease analogous transition of other developing country.

c) As agreed between the members of the international working group assembled by DIAL this document presents and discusses the Ethiopia's Economic Policy during the Transitional Period (EPTP). It is organized as follows : first, an introduction to the political framework of the EPTP ; second, a description of the EPTP ; third, a scrutinity of it and fourth some conclusions related to the two subjects of the programme. It is worth indicating that the EPTP is scrutinized at both conceptual and past trends level. Further scrutinity will appear through the other documents of the working group dealing with the EC's questions. That will specially be the case with the document dealing with what would be the expected macroeconomic and general equilibrium and/or disequilibrium effects of the transition as those focusing on its sectoral potentials. **Readers who are time constrained may immediately jump to the conclusions. Indeed, they are introduced by a summary of the all document.**

d) The scrutinity of the EPTP and beyond it the interest for the Ethiopian transition has revealed the need to identify what could be some **market parameters** of the Ethiopian economy. This has led to estimate a set of relevant elasticities using econometrics. They will appear in another document probably available by end of July. These elasticities would illuminate Ethiopian transition departing from three periods i.e. 1960–74 : the market functioning before the marxist regime, 1974–90 i.e. the command economy period or the marxist one, 1960–90 i.e. Ethiopia at long run.

I - INTRODUCTION

2. The government which has overthrown the DERG–regime has recognized that Ethiopia was in **dire** conditions by issuing documents on its **intentions** related to **Ethiopia's Economic Policy during the Transitional Period (EPTP)**. This one is defined to be the period (after the DERG–regime) characterized by the coalition of various forces (represented in the Council of Representatives) around a **common Charter** which is the pillar of the transitional economic policy (but not only). It will cover the years 1991 to 1993 and end by free elections. With regard to economic rationality, the coalition resembles mainly marxist reformists and market ones. So, the EPTP is a compromise policy document.

3. The Charter has a major aim which is **the strengthening of peace**. Therefore, although the economic policy (intentions of) has been designed to provide satisfactory solutions to **urgent** problems so as to **get** i.e. **stabilize** (and maybe improve) **a basic peace economy**, the government intends to do so in the framework of the given reached **broad** political consensus*(1)*. Moreover, the related documents indicate that the EPTP has to serve **a longer period** than the transitional one **with minor changes**. The preceding reveals that the **EPTP is fundamentally a political macro framework to refer to during a transition deeply marked by the need to sustain peace i.e. to get it as the permanent state of the Ethiopian society**. Therefore the measures (i.e. the laws, regulation and detailed procedures of implementation) which have to be decided to shape the economy along the lines of the EPTP have not only to be relevant (given urgent needs) but also "featured" by a certain amount of political neutrality so as to permit the expected continuity. From an Ethiopian political viewpoint such a continuity will pave the way to **democracy** i.e. a political regime which would no more trample upon the human and democratic rights of the people.

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1 That means the political framework of Ethiopia is given till the announced free elections.

4. Wich regard to expected changes, the EPTP illuminates five overlapping processes the Ethiopian society has to go through :

– *two institutional ones i.e. a transition*

(i) from **civil war to peace** which would permit (it is expected so) ;

(ii) that to a **democratic order.**

– *three economic ones i.e. a transition*

(i) from **a military and command use** of resources to **a civilian productive basic** one ;

(ii) from **a basic peace** economy to a **market–based** one ; and

(iii) from market to sustained growth development.

These processes shape the global transition movement of the Ethiopian society. The government's documents indicate how **the global transition** is expected to **sequence : recovery (Economic transition) depends on political changes (political transition) for these ones are the prerequisites to improve the general climate of the Ethiopian society**. That is the reason why the documents list the anti–democratic nature of the regime to be one of the major non structural causes of Ethiopia's economic crisis (from 1974 up to 90 compared to pre–1974 years). So, contrarily to what has been a belief in mainstream political economics since the 1960s, **the Ethiopian views** (as reflected in the government's documents) **do not support the idea that growth carries with it democracy at long run**. Neither they support the opposite view for there could not be any sustained democracy without income sharing i.e. when the social aspects of growth and income distribution are neglected. That is the reason why the EPTP advocates some policy mix i.e. coping with economic objectives (macroeconomic stabilization) **and** social concern, and, policy supporting voluntary people participation schemes. By emphasizing the needs to conserve and develop natural resources, the EPTP illuminates also a rather long term economic process, that to **sustained economic development**.

5. The democratic nature of the EPTP (at least expected to be so) is revealed by its content and a wide bargaining process to amend its initial version. Indeed, since the overthrowing of the DERG–regime there have been two documents in English issued by the government : one an unofficial translation dating from August 1991 intitled : the Economic Policy of Ethiopia for the Transition Period (a draft submitted for discussion by Tamrat Layne, the prime Minister) and an amended translation officially published on January 13, 1992. The amended document was adopted by the Council of Representatives in its amharic version on November 22, 1991. The amended version includes the results of discussions of the EPTP organized all over the country*(2)* between August and November 1991. To **my** knowledge*(3)* modifications would have concerned controversial issues especially that of the property rights related to rural and urban land and houses nationalized in 1975. That is through that bargaining process that the decision to keep state land ownership was taken as that not to return houses to their original owners but to sell out with a priority to the tenants. The end of state monopoly on foreign trade is also a product of the bargaining process as the liberalization of retail trade price.

6. From several points (for instance, the accepted increased role of the private sector in development ; the emphasis put on profitability to manage the enterprises whatever their ownership is ; the acceptation of freedom as the only criteria to create producers' co–operatives ; the confirmation of previously recognized rights to peasants : right to hire labour, possibility to transfer land–use rights to heirs, right to freely dispose of their produce on the open market ; the advocacy for the development of large–scale commercial farming, etc...) the EPTP assures the continuity with the reforms decided by the DERG–regime (March 5, 1990) (annex 1). It differs from these reforms as follows :

(i) it clearly indicates the **nature (political and economical) of the transition movement as how it is globally expected to sequence.** As a result it explicity mentioned that people **have** human and democratic rights they can **enjoy**. Further, the government intends to give rise to increased voluntary popular participation through the EPTP ;

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2 As said to me but not checked by me.
3 That is on the basis of discussions held at AA.

(ii) it clearly indicates that the State will have **a limited role on the decision making process** at the opposite of its role to issue laws, regulation related to market or to define, shape and articulate market macroeconomic planning (such as fiscal and monetary policy, for instance) ;

(iii) it links expected changes **at the micro level to sound applied macro–economic policy** ;

(iv) it tends to **articulate the growth facets** ;

(v) it benefits from **peace and international donors community's concern** as chance for its implementation ;

(vi) it no more refers to **socialism** as the **basis** direction of the country's development although the State continues to support **collective** managing schemes (co–operatives, people's associations : they have to be voluntarily decided nevertheless) ; it intends to use **refurbished Agriculture Marketing Board** (AMC previously abolished as a result of the DERG–regime's reforms) to regulate the grain market **and to give 30 per cent of the voting rights** on enterprise management boards to the related workers. This later intention may again submit managers to collective pressures.

II - ETHIOPIA'S ECONOMIC POLICY DURING THE TRANSITION PERIOD (EPTP)

7. The EPTP is **first introduced by a short summary of what are the economic conditions in Ethiopia when the civil war ends***(4)*. Documents used are the government's ones already mentioned plus notes taken during the Conference on the State of the Ethiopian Economy organized by A.A. University. These notes appear to me a little more objective to the achievements of the DERG–regime than the government's documents. Indeed, the government's final document overlooks the liberalization measures taken since 1988 in the agriculture and investment sectors and exaggerates the importance of corruption. The introduction is accompanied by an annex resuming Ethiopia's key data. Through it the focus is on **major past trends relevant for present and future economic reforms, exclusively**. The reader is thus kindly invited to refer to the annex when reading the economic conditions at the end of the civil war as when analysing the EPTP. **Second, the EPTP is described along lines which have been selected to provide its better understanding both in terms of economic and political analysis**. The lines are a mixed product of those featuring the government's documents and thoses reflecting the author's perception and sensitiveness when being twice on mission to A.A. (from Nov. 19 to Dec. 1, 1991 and from March 22 to April 3, 1992). The lines have also been selected so as to make easier to answer to the EC's questions.

A - THE ECONOMIC CONDITIONS AT THE END OF THE CIVIL WAR

8. **When the civil war ends** the Ethiopian economy may be featured as follows : it has become a **supply–shortage economy** under the DERG–regime. Indeed, from 1974 to 1990 the agriculture output could not supply enough food and goods, the industry one could not supply enough goods and the services one could not supply enough services. Some selected data can throw some light on that shortage economy. They are related to the agriculture sector which dominates output, employment and export receipts in Ethiopia. The average food surplus is 18 gr per day and person under normal circumstances (OECD computation). This leads

4 For more detailed analysis the reader should refer to DIAL's related works :
S.REMY : Ethiopie – 1968/1988 : Note rétrospective sur l'évolution macro–économique des deux dernières décennies, Juin 1991, 28 p.
M–P.VERLAETEN : The Ethiopian verses, june 1991, 39 p.
and to the papers issued during the Conference on the State of the Ethiopian Economy organized by A.A. University. Further, he should also read the document issued by the DIAL's working group on the question.

to an amount of 1760 gr which is 4 per cent below the FAO emergency ration. At the end of the 80s food production per capita (1979–81 = 100) reaches the level of 88.7. It has to be compared to the values of 97.6, fifteen to twenty years ago and 109.6, twenty–five to thirthy years ago. With an amount of cereal imports of 609.0 thou–metric tonnes in 1987 (last available data) Ethiopia has become Africa's leading non–commercial food importer. **But even as such twenty per cent of the population is in need for food aid at the beginning of the 90s.** Even if shortage increased at the end of the 80s because of **civil war**, it is not only the result of that war. More fundamentally, it is due to a sample of facts. A combination of civil war, anti–democratic choices, policy distortions, environmental degradation, an unfavorable demographic dynamics, adverse external factors (drought, natural calamities, external shocks) and a host of structural problems (backward technology and methods of cultivation, weak linkages betwen sectors ...) has been responsible for the disappointing performance of the economy from 1974 to 1990. **As a result between 1974 and 1990 per capita real income declined by about 0.8% per annum revealing declining living standard of a population already wallowing in extreme poverty (60 per cent of the population is living below the absolute poverty level) and being denied human and democratic rights.**

9. The dismal record of the Ethiopian economy was essentially due to the disappointing performance of the commodity producing sectors (i.e. agriculture plus industry : 1.2% per annum on average) especially agriculture the dominating sector of the economy, which grew by merely 0.7% or more than 2% below the rate of growth of population. The performance of the industrial sector was more respectable (2.5%) but only within limits imposed by a stagnating agriculture. The services performed better (3.5%) but largely on account of rising military expenditures and a vastly expanded government bureaucracy (public administration and defense : 5.7%). As a global outcome saving deteriorated strongly from 1974 to 90 compared to pre–1974 years. In 1990, the share of gross national saving in GDP was 5.2 per cent while it was 12.9 per cent in 73. The situation yet aggravated in 1991 with a saving ratio going to zero per cent. On account of a steadily declining saving rate and generally rising tendency of investment (i.e. military and defense ones mainly due to war) at least up to 1987–88, the country's resource balance has been declining, reaching (–) 11% of GDP in 1988. On trend, the state of the country's resource balance has meant increasing reliance on external resources*(5)* to

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5 Cessation of aid from a number of major lending agencies followed the 1975 nationalization and subsequent compensation problems. This was even more true after november 1977 when Ethiopia received help from the USSR and Cuba to combat regional political activism and Somalia. Progress on this issue at the beginning of the 1980s led the World Bank to resume lending by February 1981.

finance the country's investment effort. As far as **productive** investment was concerned this was one of the lowest in the world. Consequently, Ethiopia's debt position has been deteriorating at an alarming rate. In 1990, for example, debt service payments to western donors*(6)* represented almost 60% of the value of exports. At the beginning of the 80s, this ratio amounted 8% only. So, Ethiopia entered gradually into a **solvability constraint**. A corollary of the widening resource gap has been a large and steadily widening budget deficit by 1988–89 (12% of GDP ; 16% in 1989–90), triggered to a large extent by mounting military expenditure and spending on the government bureaucracy. Despite the government matched its expenditure by vigorous revenue mobilization that peaked at 30 per cent of GDP in 1989, forced state enterprises to save and created exceptional sources of revenue (a war levy and the requirement of payment of arrears by state enterprises) this had led to a situation where almost two–thirds of this deficit was financed by external sources at the end of the 80s, the rest being covered by borrowing from the banking system. Domestic bank financing, so far rarely above 4 per cent of GDP, exceeded 10 per cent in 1989–90. This has also meant a dramatic expansion in money supply, with obvious inflationary consequences.

10. The state of the balance of payments was also unhealthy. The import cover of the country by the end of the 1980s was less than ten days. The decrease of the export to import ratio in real terms since 1973 was one of the results of a deep agriculture crisis. It gave rise to an increased structural resource imbalance whatever the terms of trade were. The situation improved a little in 1989 and 1990. In 1991, it deteriorated again because a greater part of coffee, the main export commodity, went to smuggling and drought affected the Hararghe production area. The fall in coffee export could not be compensated for by other commodities. Further, the rise in the oil price in the second half of 1990 worsened the terms of trade. So, Ethiopia became **featured by a liquidity constraint**. Resource imbalance taken into account with saving decrease compared to investment meant that Ethiopia became structurally a two gap country (trade plus saving gap). Pressures to devaluate the Birr, the local currency, increased giving rise to a parallel exchange rate and some capital outflows. In the light of all that preceeds, it is not surprising to have noticed that, there has been a worsening of unemployment and a general erosion in living standards. Not to mention people dying from starvation in some areas of the country because of recurrent droughts and misguided or frankly wrong agriculture policy. Although the military government attempted to introduce policy reforms in its last

6 External debt reached the level of US $ 3.3 billion at the beginning of the 1990s of which about 80 per cent due by the Central government. The preceding amount does not include Ethiopia's military debt to the late USSR. Since involment started in 1977, it was estimated to have reached US $ 5–6 billion by 1989.

days (annex 1) specially relevant for peasants agriculture (the dismantling of producers' co-operatives, the recognition of tenure rights and the abolition of the Grain Marketing Board, mainly) these came too late to make any appreciable **global macroeconomic and social difference**. But there were differences at the sectoral level, for instance, at that of agriculture(7). Moreover, reforms have given rise to a process of increased informal **market** activities due to the reduced government's legitimacy and operationality and people's increased poverty. This process with the parallel exchange rate has created a **dual economy** in Ethiopia. To the DERG-regime's credit it is worth mentioning the efforts in favour of education. Elementary and secondary education expanded at a rapid rate compared with the pre-revolutionary period **(school enrollment ratio 1985 : primary 36%, secondary 15% - 1975 24% and 6% respectively ; literacy rate 1986 : 90% of population age 15+ - 1970 4%)**. Nevertheless, in the light of the UNDP human development index (varying between zero and one) which summarizes both real GDP and educational attainment (and life expectancy), Ethiopia has remained a low human development country. Its index has a value of 0.282 i.e. below the Bangladesh's one (0.318). As such Ethiopia has been put by the N.U. in the sample of low social progress countries (lower value index : 0.116 for Niger, higher one 0.489 for Morocco). So, when the Derg-regime collapsed, it left behind it an economy in ruins and a society in extreme destitution.

11. The Ethiopian potentials (where agriculture dominates) were also deeply challenged during the 1974-1990 period by increased soil erosion in response to recurrent droughts (1972-3, 1981, 1984-5, 1989-90) but not only. Soil erosion has become a permanent feature of Ethiopia since the end of World War II. Population growth in the twentieth century enhanced by the partial control of epidemies and by the relative peaceful period of Haile Selassie's reign after World War II has given a new dimension to the pressure on land. Its impacts have been severe. Long fallow periods can no longer be maintained and arable land comes under continuous cultivation. Soil fertilization through organic manuring has become less frequent because the scarcity of firewood forces people to use cow-dung as household fuel. As a result erosion due to natural factors (wind, rainfall) has worsened or more precisely has been exacerbated by agricultural practices. It features mainly the Highlands which account for 90% of the population and economic activities, 95% of land cultivated and two thirds of lifestock. Of 53.6m ha in the Highlands, 6m are highly eroded, 8.5m are mediumly eroded, 13m are eroded

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7 Output increased after producers' co-operatives were dismantled and output prices rose after Marketing Board Corporation were abolished. Further, the response of agriculture supply to prices improved.

and 10.9 are susceptible to be eroded. This lets 15.2m ha only to be not eroded. FAO and the late government of Ethiopia with finance from the World Bank in 1983–85 carried out a study to present a rural development strategy for the severely eroded Ethiopian Highlands. The study (never officially accepted by the government of Ethiopia) estimated that over 1,900 million tons of soil were lost from the Highlands of Ethiopia annually. The losses are of productive top soil, and they are for all practical purposes irreversible. **The study characterized the Highlands of Ethiopia as "one of the largest areas of ecological degradation in Africa, if not in the world"**. One of the findings of the study has been that, if present trends continue, **by the year 2010** some 38,000 sq.km of the Highlands would be eroded down to bare rock, a further 60,000 sq.km would have a soil depth of 10cm or below which would be too shallow to support cropping. This would mean that in that year almost **10 million people would have to derive their food and income from sources other than cropping their own lands and that they would have to be absorbed elsewhere in the economy.**

12. The Ethiopian government took measures or programmes to combat degradation which reduced agriculture potential productivity (land yield) by 1 to 2 per cent per year on average. They included the building of terraces, the closure of hillsides, the planting of trees and the construction of irrigation schemes, as well as the relocation of people on a **local level (villagization)** and on a **regional or national one (resettlement)**. Several organizations co-operate in the implementation of these programmes (the World Food Programme and the European Economic Community, for instance). Although being aware of the gravity of the degradation for agriculture production and, so, their welfare, it seems that the peasants' responses to the government's mesures have been weak. Apart from the fact, that the peasants were poor and lack the necessary tools and seeds to do something substantial to arrest erosion, **the reason behind such a behaviour has likely to be found in the relations between the government i.e. its delegates and/or mandating bodies and the private farmers in the framework of the former's agriculture policy**. The focus was on ideology rather than efficiency. People were order what to do and opposition was considered to be a counter-revolutionary attitude. **The official approach was prescriptive and commandist rather than consultative and supportive of local initiatives.** In fact as several analysts of Ethiopia have said, the main feature of the structural changes in the Ethiopia countryside since the 1974–revolution was to substitute the State for feudal lords as the supreme appropriator of peasant produce, labour and think ! Consequently, peasants participated in environmental rehabilitation only when

food-for-work was arranged. In this framework, the government's measures lost a certain amount of efficiency and participation because several ones had not only something to do with environmental degradation or drought but civil war also. So, it was not always very clear for peasants wether **villagization or resettlement** were decided to reduce the pressure on land or to empty the rebellion regions. This was particularly obvious in the case of Eritrea and Tigray proned to recurrent drought and so featured by pronounced environmental degradation.

13. To conclude, at the end of the civil war, **the Ethiopian monetary economy was about to collapse ; Ethiopian identity, a product of efforts through history, was about to vanish and Ethiopia had remained one of the poorest country in the world. Its constant dollar GNP per capita was lower than in 1965.** So, the major challenges the government which overthrew the DERG-regime had to cope with were :

(i) peace to secure ;

(ii) relations between people to improve as much as these ones with the State ;

(iii) the country to rehabilitate ;

(iv) food reliance to modify so as to **reduce risks to famine for the present** ;

(v) demobilized soldiers to accomodate properly ;

(vi) a process of increased informal activities to manage ;

(vii) external resources to secure in the framework of a position of illiquidity and quasi insolvability ;

and
(viii) poverty to alleviate.

All this presumed :

ix) a state budget and moreover an evolution of it permitting to account for political, economical and social concern.

B - THE EPTP : SHAPING THE ECONOMY

14. **The EPTP lists intentions related to policies to re-shape the economy and grasp growth during the global transition movement.** It gets its short term operationality by clearly spelling out the objectives assigned **now** to the Ethiopian policy. The main intentions of the EPTP on the basis of which policies have to be implemented can be synthetized as follows :

To set up Ethiopia with an efficient mixed economy where market rules apply and market failure or lack of interest from the private sector are accounted for through State's interventions directly i.e. as an investor and indirectly through a "social" treatment of the issues related to the private decision making and modifications to the stance of applied macro policy. This leads to the following policies which should encompass the economy(8).

B1 - A mixed economy

15. **P.**(9) **to redefine the role of the State and the private sector in the economy so as to increase their relative efficiency.** As a result (of the expected mixed economy) the **role of the State as a sole owner** (i.e. as sole direct investor) **should reduce at the opposite of that of the private sector.** The state ownership sole or on joint venture arrangements with domestic or foreign capital should concentrate in sectors which **are crucial for the economy ; cannot easily attract private capital because of a rather long period to get activities profitable or need to much capital, or imply large-scale units ; may help to stabilize prices ; may be a source of revenue to the State (when they can be run profitably) ; may be strategic to employment opportunities...**

8 Sentence from the author.
9 P. is used for policy or policies.

16. On the basis of the preceding, the **state ownership** would be concentrated as follows :

1. Agriculture :

in

- Large–scale units ;
- Previous state farms strategic to employment opportunities ;
- Ownership of rural land.

2. Mining and energy :

in

- Strategic minerals and industrial input and minerals for which marketing opportunities would have to be explored ;
- Major electric power generation activities.

3. Industry :

in

- Large–scale engineering and metallurgical plants ;
- Large–scale fertilizers and pharmaceutical plants and industries which supply strategic raw materials to major chemical industries ;
- Some previous state industrial enterprises which can be run profitably and as such are a source of revenue to the State.

4. Trade :

Domestic Wholesale Trade

in

- Basic goods of mass consumption ;

Foreign Trade

in

– Management of foreign exchange earnings ;
– Marketing activities.

5. Tourism

in

– **Some** tour operators only.

6. Services (other than mentioned elsewhere)

in

– **Some** limited areas **when necessary**.

7. Financial Services (Banking, insurances, other financial institutions)

in

– **Ownership** in order to ensure that the related institutions will play their proper role in the process of economic development (while making profit).

8. Transport (Air, sea, rail)

in

– Ownership with the exception of medium–sized air and rail operations.

9. Communications (Posts, Telecommunications)

in

– Ownership.

10. Construction

in

- Low cost construction agencies ;
- Infrastructure, public buildings.

11. Housing

in

- Ownership of urban land.

Analogously, the **private ownership** would be concentrated in activities which do not fall under sole state ownership. That means as follows :

1. Agriculture :

in

- Peasant agriculture but the State will design strategies for the formation of **co-operatives** on a voluntary basis though. And further peasants are given rights (refer to section B2) except that of land sale and mortgage.

2. Mining and energy

- The private sector's role is limited to specific areas (refer to section C9)
- There is a public property of all mineral resources ;
- **Mining and energy projects previously confiscated will be turned over to private investors after careful investigations only.**

3. Industry

in

- Activities which do not fall under sole state ownership particularly the **domestic-resource based industries** (the cottage ones, for instance) ;
- **The health sector.**

4. Trade

4.1. Domestic trade

Both the retail and wholesale trade would **benefit from a specific regulation** by the State.

Wholesade trade

in

– All activities, at the exception of the trade of some basic goods related to mass consumption. In this respect, the State would take appropriate measures to create the conditions for co–operatives to freely engage themselves in such a trade.

Retail trade

Entirely to private ownership.

Illicit trade (i.e. unregistered transactions)

Entirely to private ownership (obviously).

4.2. Foreign trade

– End of the state monopoly with existing quantitative restrictions being remplaced with tariffs ;

– Exporters are allowed to keep a certain portion of their earnings to expand their business ; the portion has to be determined on a case–by–case basis.

– **Marketing services :** Most likely state agencies working on foreign trade would continue their operations **but in competition** with private exporters.

5. Tourism and the related services

Private ownership (i.e. end of the state monopoly) of tour operators and related services, but the State will handle the foreign exchange earned from tourism so as to ensure its proper utilization.

6. Services (other than mentioned elsewhere)

Private ownership

7. Financial services

Through local credit **associations mainly**.

8. Transport

8.1 – Road

Private ownership ; Transport **associations** and Cies are the preferred forms of organization in privately-operated road transport activities.

8.2 – Air, Rail, Sea

Limited role of the private sector because this one has not **now** the capacity to run the related transport services.

9. Communications

Very limited role

10. Construction

Private ownership

11. Housing

State's encouragement to housing **co-operatives**

To conclude with regard to the roles of the state and the private sectors, the EPTP is a combination of public sector-based basic goods, services and financing and private sector-based food production, trade and distribution.

17. At the opposite of its role as a sole owner, the State's **protecting and managerial functions** should increase. For instance :

- it will have **to protect any people's democratic rights** ; **to regulate the economy i.e. issue** (democratically) laws and controls, regulations and directives, detailed procedures of implementation, specific sectoral regulation (one for the domestic trade is expected), new tariffs systems (expected for the transport activities and foreign trade), to **favour** enabling conditions to encourage private accumulation (both the domestic and foreign ones) and to **establish** regulatory authorities (one for the transport sector is expected) ;

- and also **to monitor the economy i.e. shape** it with consistent and co-ordinated macro policies, selected industrial and export oriented strategies ; **reduce** all sorts of disequilibria ; **mobilize** enough external resources ; **assist** peasants, **alleviate** the problems of specific regions (affected by war, recurrent drought, demobilized soldiers, environment degradation, ...). Analogously, the State's **rehabilitating** function should increase. Basic infrastructure needs to be restored and expanded as well as social services (health and education ones, etc).

B2 – A market(mixed)–based economy (or the promotion of private initiative)

18. People should be endowned with **rights** related to private decision making. The recognized ones (i.e. listed through the EPTP) are the :

- property rights and related to compensation ones ;
- right to move ;
- right to act as free trader ;
- right to act as domestic entrepreneurs ;
- rights recognized to foreign capital ;
- right to apply market rules.

a) P. to recognize property rights

Rural and urban ownership

19. The first one is a controversial issue between the North and South of the country. Therefore, it has been delayed till a referendum after the free elections. So, there is at the moment no expected change of public ownership of rural land. This means that peasants cannot sale the land or mortgage it. But they are receiving the rights to lease land, pass it on to kins and be fully compensated when expropriated. Further, the State will correct previous discriminatory allocation of land by reallocating land to landless without discrimination. Analogously to the case of rural land, the State remains the owner of urban land. But he will ensure its equitable distribution for housing construction. People receiving urban land will be guaranteed the rights of ownership including those to sell, rent, transfer, etc... In the eventuality of expropriation compensation would be given.

Houses and Mineral resources

20. The right of house ownership is fully recognized. Nevertheless, nationalized houses (1975) will be sold by the State and compensation paid **to those who deserve on the basis of appropriate studies***(10)*. Mineral resources remain public property.

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10 Some of the late house owners were in the streets at AA to express their feelings against that intention on January 6, 1992.

b) P. to recognize the rights to move (resettlement and villagization)

21. Previous **resettlement and villagization** must be discontinued. Nevertheless, the document indicates that they would have to be carried out in the future to relieve shortages of land, population density, etc...(refer also to paragraph 11). In this framework, they would have to be **voluntary**.

c) P. to act as private free trader

22. Peasants can act as (private) free traders i.e. they can sell their products where they wish and at freely determined prices. Moreover, they would receive help from the State to get **fair** prices. How is not said. Further, they would receive help to get a free access to the needed input and local agriculture services.

d) P. to act as domestic entrepreneur

23. The right to expand modern large-scale private farming should be recognized. Therefore, the State will provide fertile lands in uninhabited areas on concessionary bases and provide full guarantees to private entrepreneurs either individually or on a joint venture basis. The opening of fertile lands to private investors will be made after ascerting this would not result in eviction or affect the interests of peasants and nomads as well as those who practice shifting cultivation. People should receive the right to engage in the sectors of the economy with no limit on capital and guarantees of ownership. They can act as sole owner or on joint venture arrangements with the State and/or foreign capital. The preceding given **domestic investors** should receive a **preferential treatment** especially **when they engage in expanding large-scale modern farming, industrial activities, construction, cottage industries** (or local domestic resources ones) **and local credit institutions.** The preceding means that domestic capital would **always** be preferred to foreign one when referring to these activities. This is also true for banking.

e) P. to recognize rights to foreign capital

24. The document only indicates shortly that foreign investors should be given adequate guarantees and incentives. This shortness may indicate that the Ethiopian Authorities do not really **expect or wish** (for instance in banking) an upswing of foreign capital at least at the beginning of the transition movement.

f) P. to apply market rules

25. **All enterprises** (or farms) should be **submitted** to **market rules** i.e. the **profitability, management autonomy** (at plant level in the industry sector) and **fair competition** ones. State enterprises (or fleets) which cannot be rendered profitable through restructuration would be either closed down or sold to the private sector (obviously, if any) except under specific circumstances, for instance, to keep employment opportunities within specific areas, etc... Moreover, state monopoly would be abolished as the previous regulation prejudicing the private sector. The first assertion concerns specially foreign trade, tourism (and the related services) and the transport corporations.

B3 - An economy where economic and social targets are combined ; where democratic and economic requirements are simultaneously accounted for(11).

26. These expected fulfillments should be the achievements of **gradual** policies and policies **mixing the criteria of profitability and employment redundancy**. Indeed, the latter would occur because there is a lot of state's enterprises or farms which support financial losses. The concern of labour redundancy is particularly emphasized when industrial privatization, the new trade policy and the need of exchange rate adjustment are mentioned. This concern is very relevant since the risk of making workers redundant could be extremely high. Indeed, the number of state enterprises to be closed down is **high** for they generally suffer from losses, routinely covered by the State. The level of expected privatization is **low** for there is a credibility gap between the State and the private sector (para. 61). With regard to labour redundancy, the State would take parallel measures to **provide** employment opportunities. Analogously, it is intending to

11 Sentences due to the author.

favour **privatization and people's voluntary participation in development.** For instance, in agriculture, unprofitable state farms would be handed over to those around the farms or to the related employees provided this measure does not lead to conflicts with the nearby population. **In industry, the workers would receive a third of the voting rights through representation on enterprise management boards.** Further, **the State would favour the formation of co-operatives or associations on a voluntary basis.** This is indicated as regard almost all sectors where private initiative is invitated to take over and in banking.

Agriculture

"The State will design strategies for the formation of co-operatives on a voluntary basis" (!)

Wholesale trade

"... to create the necessary conditions for private capital and co-operatives to freely engage themselves in such activities"

Road transport sector

"... Transport associations and companies would be the preferred forms of organization in privately-operated road transport activities" ..."

Housing construction

"... The State will encourage and support housing co-operatives. Banks should design new regulations supportive of this measure".

Financial sector

"...local credit associations will be encouraged with appropriate government backing" ..."

27. In the light of the preceding, it appears clearly (to the author, at least) that **democracy in the Ethiopian sense** (i.e. through allocated voting rights to workers on enterprise management boards, co-operatives and people's associations) is a way to play some market game (privatization). More precisely, it is a condition (at least an implicit one) for markets to be accepted and to function efficiently (it is hoped) in a society where various challenges exist : heterogeneous coalition of rulers (para. 2), still political unstability (para. 37 to 39), extreme level of poverty and people's destitution (para.8), etc... Then, **democracy** is not only related to political order (the relations between a State and its citizens). **It is a mix of political and economic organization systems.** Which mix will obviously, depends on how various systems articulate particularly from the viewpoint of their implicit process of identification (i.e. these between people and the State, workers and their enterprises, these ones and the political regime) (refer to para. 35). Democracy is also a way to feature the dialogue between **people and the State at various levels of administrative responsabilities.** Here the document indicates that the State would issue detailed policies to define relationships between national and local administrative organs with the government regarding the ownership of resources and regional economic responsabilities.

C - THE EPTP : GRASPING EXPECTED GROWTH THROUGH SOME SELECTED STANCE OF MACRO POLICIES

28. Growth is expected to be grasped through a set of **consistent and co-ordinated macro, sectoral** and **environmental policies.**

MACRO POLICY

C1 - Monetary policy to be such as **to ward off inflationary trends** resulting from the circulation of money in volumes beyond the economy's capacity.

C2 - Exchange rate policy to permit a **gradual adjustment of the Birr parity to the US dollar** (to which it is linked since February 1973) in conjunction with the study of other alternatives.

C3 - Foreign trade policy to allocate foreign exchange to private entrepreneurs and replace the existing quantitative restrictions with tariffs. As a consequence of state allocation of foreign exchange, the exporters have to surrender all their earnings to the State in exchange for local currency. They are allowed to keep a certain portion of their earnings to expand their business but on a case–by–case agreement. In the case of tourism, the State will handle the foreign exchange earned from tourism so as to ensure its proper utilization.

C4 – Fiscal policy to achieve fiscal balance through :

(i) **a proper taxation system (announced for agriculture only** : a fair system of taxation will replace the cumbersome tax structure and improvements will be made in the system of collection) ;

(ii) substantial **reductions of public expenditure** especially in administrative and military outlays ;

(iii) **external resources to be secured** ;

(iv) an induced growth impact due to a **reallocation of resources** (domestic and external) to the productive sectors. It will create fiscal peace dividends.

In this framework, the document indicates that sizable budget deficits are likely to continue even after taking such measures. This is a very realistic view given needs to fulfill in the Ethiopian society for the present, past debts to shrink, the reduction of the fiscal basis (given increased informal activities and smuggling...) and what the government expects during the beginning of the transition, i.e. a macroeconomic **stabilization** and not an **upswing** of growth.

C5 – Foreign reserve policy to secure external resources and channel these ones effectively for economic reconstruction.

C6 – Price policy to be generally a free one except when it is necessary to implement the new tariffs structure (announced for the transport sector and foreign trade only) or to protect consumers and producers of agriculture goods against price fluctuation (by buying and selling grains on the open market), or to help peasants to obtain fair prices for their products...

SECTORAL AND ENVIRONMENTAL POLICIES

C7 – Agriculture (and Environment)

P. to boost peasant agriculture in conjunction with the conservation and development of natural resources through a greater share of the budgetary and manpower resources. The general measures to boost peasant agriculture would be to extend an all-round support to farmers for building feeder roads, help the peasants in obtaining fair prices for their products, promote an extensive distribution and use of fertilizers, improved seeds and the provision of agricultural extension services. Specific measures would also be taken related to different agro-ecological zones in the country and population density. The measures which have to be studied would (attempt to) alleviate the particular problems of these areas. As far as natural resources are concerned priority will be given to the conservation and development of forestry, livestock, soil and water.

C8 – Industry

P. to **develop** it (refer to section B1 – A mixed economy) with a **special concern to its links with agriculture, the utilization of domestic raw materials and the health sector** (intersectoral linkage of growth to be promoted).

C9 – Mining and energy

P. to expand private accumulation particularly in specific areas. These ones are **left** to private initiative (on the basis of concessions) because of resource constraints or because they are technology-intensive ; P. to explore and study geological and energy resources...

C10 – Transports

P. to issue a new tariffs system and establish a regulatory authority.

C11 - Services

P. to expand the role of private capital with a particular emphasis on investment in export-oriented undertakings, retail trade, tourism and related services, road transport, housing construction. The State would also act as to minimize **illicit trade**. It would also particularly regulate domestic trade.

C12 - Banking

P. to **guide** the financial institutions so that **they play their role in development while making profit.**

OTHER ANNOUNCED POLICIES

29. The document announces the formulation of **social, wage, population** and **technology** policies as well as a new **labour law**. This one would have to promote productivity and efficiency in conjunction with the protection of the workers' rights. So, this policy would strengthen the measures favouring a mix of profitability and employment criteria to lead the decision of closing down and generally to favour an "alliance" between democracy and privatization to grasp growth. Although the wage policy remains to be formulated, the document indicates that the existing economic conditions do not leave room for making meaningful changes in salaries*(12)*.

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12 By december 9, 1991, there was a strike of the workers from the banking system for wage increase. Civil servants and state owned enterprises' wages have been frozen since 1975 at the exception of a shift in 1979 for low wage people.

D - SHORT RUN PRIORITY AREAS

30. At short run i.e. till the free elections, the EPTP spells out the targeted objectives. They are :

D1 - Rehabilitation

To rehabilitate regions affected by drought and war particularly those affected by resettlement, villagization and the burden of demobilized soldiers.

To rehabilitate means to restore infrastructure destroyed by the war and due to a lack of maintenance and upkeep. This would also mean to undertake activities benefitted to people and expand infrastructure in some neglected areas (to be identified). **All this on a limited scale given the short duration of the transition (1991-93) to the free elections.**

D2 - Development

To create a conducive atmosphere to enhance the participation of private capital to development.

To complete on-going projects and launch studies in areas of mining, energy, irrigation, needed new organization and management schemes, etc... as well as a study for streamlining the administrative machinery, **appreciate the employment impacts of the implementation of the EPTP, existing manpower, availability of candidates to become entrepreneur, etc...**

III - SCRUTINITY OF THE EPTP

31. The EPTP is scrutinized on the basis ot its **pertinency** ; the **importance of the omitted or neglected factors (or fields of action), the need for clarification and in comparison with some adjustment programme that could have been issued by the World Bank under the same circumstances.** The criteria of pertinency covers two definitions i.e. these of internal and external pertinency. **Internal pertinency leads the analyst to ask wether a tool is the proper one given what it is expected to serve while external pertinency looks at the fitting between some announced policy and the measures already decided to implement it.** To be more precise internal pertinency asks wether the EPTP is relevant for the expected global transition (vision of it) while external pertinency looks how the measures decided to implement some parts of the EPTP reveal these parts (or the related facets) and how economic reforms are expected to sequence. **Through external pertinency it is the degree of fine tuning the economy permitted by the EPTP which is investigated.** Omitted or neglected factors (or fields of action) as the need for clarification are revealed through a comparison between the EPTP and the real situation at the beginning of the transitional period (i.e. at the end of the civil war). As such the analyst can appreciate how major **past** economic trends are or not accounted for through the EPTP i.e. how much it is **relevant** given the country's present economic and social conditions*(13)*. So, the reader is kindly requested to refer to point A of section II (The Economic conditions at the end of the civil war) and the accompanying annex 2 as to the related document issued from the working group. The reader should also keep in mind that further scrutinity will be given in the framework of other documents from the working group related to transitional macro disequilibrium and **growth potentials.** This would illuminate a little more the **operationality** of the EPTP. **Obviously, at the end of the process of scrutinity pertinency, relevancy, fine tuning and operationality have to say to same story otherwise the EPTP would be a society nonsense.** Then, they give the EPTP its **consistency.**

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13 As such it is assumed that the present is dominantly a product of some recent past.

A - PERTINENCY

A1 - Internal pertinency : is the EPTP the proper tool for the expected global transition ?

32. Here, there are two questions to raise which are **is it politically i.e. peace related to pertinent** and **is it economically pertinent** ? The focus is on the **conceptual** level. First let us try to answer to the first question. For a society like Ethiopia to pass from civil war to market-based economy implies to reconstruct all the relations **between** the citizens and these ones **with** the State (included all the local, regional authorities), in such a way to drastically modify the degree of identification between people and the political organs. Departing from this viewpoint, the transition covers first of all issues related to politics or more precisely to democracy. This presumes crucial steps in a proper sequence. The steps would ease people's access to information of any kinds (through a free press, for instance), attempt to increase people participation in the public process decision making on a voluntary basis and legalize party politics. They should occur in the framework of a **State behaving like an impartial body**. The question of the ranking of the steps is a debatable one for it depends on circumstances prevailing within each society at a given time. In the light of recent history, the legalization of party politics and the political neutrality of the State seem fundamental. Nevertheless, this must not lead to empty economic reforms from their announced content. Such a risk exists in Ethiopia for the present time. The very reduced number of measures already decided to implement the EPTP could be a relevant indicator of this risk (refer to section A2 which follows).

33. From the preceding viewpoints, the EPTP **seems** to be conceptually pertinent. Indeed, through it, first, the government **introduces the political requirement of democracy** (this one being the achievement of peace) as a pillar for economic stabilization and recovery (para. 3) ; second, it uses a **democratic wide bargaining process** (para. 5) **to amend the EPTP** ; third, **it indicates its intentions to organize the functioning of the market on the basis of a policy mix coping with social and economic targets** (para 26) ; fourth, **it opens to continuity after the free elections** (para. 3) and **fifth, the EPTP is the result of compromise between various forces grouped around a common charter***(14)*. As such what appears it that the EPTP is a macro framework to refer to lead Ethiopia to

14 They play the role of party politics. Obviously there could also be other forces appearing after the free elections.

a social democracy where privately-operated units of production are not only influenced through macro policies i.e. indirectly(15), but directly also through free organized (it is hoped so) people participation schemes. So featured, **this democratic system has much to share with the late Yougoslavian one.** One hopes it would not fail like this reference one, specially when the need to restructure firms (and farms) will make a lot of workers redundant ; when regional re-equilibrium will lead to conflicts with fiscal balance, etc... From these viewpoints what the government intends to promote as **institutions related to macro market functioning** (for instance, trade unions, employers unions, etc...) will be a key issue of the EPTP. To notice that this is not touched by the EPTP for the present time (but that will be covered by the expected new Labour law : para. 54 and 58).

34. The question of democracy as a pillar for growth is a very interesting one recently re-investigated by economists. They found that the most immediate connection was in the case of famine and famine prevention. Major famines have taken place in market economies and in nonmarket socialist economies, but not in any country with a democratic system, with opposition parties and with a relatively free press. Institutionalized public pressure and a free press have a creative role to play, not just in preventing major disasters such as famines but also in making social security programs less fragile. This obviously is particularly relevant in the case of Ethiopia where famine has been a quasi permanent fact since too long as people's poverty and misery. And more over when the government de facto has to apply a strong adjustment process. Political rights are important both in themselves and in their consequences. They give those in authority appropriate incentives to be concerned with the well-being and the misery of the people. Obviously, **how** to balance economic and social concern is not said. Recent history tells us that has never been easy in the context of developing countries, or those where there has been challenged government **and** State.

35. In the light of the preceding **democracy in the Ethiopian sense** is a way to play the market game efficiently and with an expected social (and political) stability. That would be in accordance with the society global aspirations **expected to reveal** through free elections and referendum. One can also expect that this would lead to much equity for Ethiopia is one of the poorest countries in the world. In this respect, as in that of the society aspirations, the EPTP could be challenged by three systems of identification interacting deeply as long as time is running. The first two ones are the **identification between workers and firms' goals (factory**

15 Because they influe more on the issues of the private decision making than on the latter as such.

identification) and that between the firms' and the State's ones (regulation identification). They interact through a third one which is the **identification between people's aspirations and fulfillments and the society's achievements (society identification).** Identification processes cannot be neglected for they give a society its internal cohesion which is a key for sustained peace an democracy (if ever). Let us give a few pertinent examples based on some countries historical **trends.** In **Japan,** there are high levels of factory and regulation identification. Further, the society identification is more or less viewed (even tought to citizens) like the permanent result of the first ones. So, **people identify micro goals with macro ones and social achievements.** Global cohesion is extremely high. People adhere deeply to japanese goals wherever they come from. They have got a strong identity. At the opposite is **France.** Here, there are low levels of factory and regulation identification and, moreover, the society identification is very unstable. It has or not something to do with the result of the other ones. **Macro goals reflect first of all the vision of some members of the élite.** Compared to Japan, France is a society in search of its identity and as such its internal cohesion. So, **micro, macro goals and social achievements have always to be reconciled not only through changes in policies or of politics but reforms of all sorts.** France seeks always for the best reform i.e. that which would permit to fine tune the interests of the participants to its society. **Germany** lies between Japan and France. Indeed, its levels of identification are lower than in Japan but higher than in France. Macro policies have always been defined in the framework of a wide bargaining process where at the opposite of the Japanese society identification is not permanently viewed as the result of factory and regulation identification. So, **macro goals are those on the basis of which the society hopes to manage all the participants' interests.** Macro goals, reflect the efforts made to reconcile goals not assumed to be untouched being the perfect "product" of some more intelligent people. They are not a vision of a high stylised society. **So, the German society is practically endowned with cohesion while France gets it theoretically.** Another interesting example is that of **Italy** where the society identification is challenged by the identification towards some private groups. The permanency of the mafia can be explained through **that** challenged society identification process. The Italian case illuminates the framework of many developing countries where the State i.e. the symbol of the society identity is variously challenged by private groups. In all these cases results of some announced Economic policy have always been challenged by the interaction of identification processes. This has been variously scrutinized by a lot of economists.

36. From that preceeds the EPTP seems also politically pertinent. Indeed, departing from civil war, it adresses the question of growth on the basis of the **country's internal cohesion**. In this respect, it carries with it processes of identification difficult to avoid and manage, particularly, in a society where ideology has been used to artificially fixing the frontiers of identification processes at the opposite of helping people to discover what they had in common. Further, it was also used to indicate how to share incomes (and, so, to prejudice some groups). Finally, all will depend on the nature of legality promoted by the Ethiopian Authorities as the belief by the population in the stability and enforcement of the new laws. That will also show wether the plea for democracy was not only a way to attract new international aid.

37. **The process of society identification has become particularly important in Ethiopia since several months. Indeed, to reinforce it, so as to use it as a tool to increase its legitimacy, the government has acted along lines of ethnicity, faith and language.** It has attempted to demonstrate that many bad things occured to Ethiopia because this one was ruled and dominated by the Amhara. As an outcome of this, the government last year acknowledged that Ethiopia is a mixture of peoples by giving tribal-based movements seats in parliament and the cabinet, and allowing them to form parties, sometimes with their own armed militias. This has created a cocktail of organisations based on race (or analogous) rather than ideology. The promised elections will probably be fought on ethnic grounds. **Results could be not only an independent Eritrea** (with this one formalizing its break with Ethiopia at a referendum in 1993) **but maybe also a Tigray one and the creation of an Oromo land in search for more autonomy, at least.**

38. The government's policy has led various political fractions to fight for their own scrap of land. **For the present time, this has already reduced the government's economic capabibility to face some of the country major constraints. For instance, by preventing him to collect revenue on coffee, the main export commodity, and carrying food for famine victims.** This has occured because of the troubles in the eastern province of Harerge*(16)*. In that area, at least eight armed groups claim the region as their own. Dire Dawa, the provincial capital, is a flag makers' heaven. Several groups are Somali clans. Others are Oromo (once known as Galla), from the largest national group in Ethiopia who repeats that his language and culture have been banned since the Amhara conquered the region in

16 Information from the Economist dated from April 11th-17th 1992, p. 56-58.

the 19th century. All are calling loudly for independence, in many voices. The offices of the Oromo Liberation Front are just down the road from the Islamic Front for the Liberation of Oromia ; the Oromo People's Democratic Organisation (a creation of the Ethiopian People's Revolutionary Democratic Front which is presently in power at A.A.) has its headquarters nearby.

39. The Oromo political activists opposed to the EPRDF have used two cards against the rulers of Ethiopia. The first one is coffee and the second the vital roads linking Dire Dawa to Djibouti and the seaport of Berbera in Somalia. With regard to coffee export increased smuggling and contraband of export have been organized. This has reduced Ethiopian export earnings and fiscal revenue to the State. Regarding the vital roads Oromo Muslim fundamentalists have recently laid mines along the Berbera one. The Oromo Liberation Front blew up a bridge near Harer stranding trucks carrying food for famine victims. To conclude let us just indicate that in the case of a break between the Harerge province and Ethiopia to form an Oromo land (or a Muslim one, Oromia), the government in power at A.A. would lose:

(i) the road and the railway from A.A. to Djibouti ;

(ii) the coffee production and export earnings from this province*(17)* ;

(iii) the production and export earnings of khat (a mild narcotic) which was the fifth source of foreign currency at the beginning of the 1990s before the related trade becoming fully unregistered in 1991 ;

(iv) the Bale province predominantly populated by Oromos : Cattle herding and dairy farming are its principal sources of livelihood, coupled with an expanding timber industry that draws on the huge expanses of forest that bedeck the Bale mountainsides.

The preceding indicates strongly that the society identification process is a key issue in the Ethiopian case. As far as the other processes of identification are concerned all will depend on rights recognized to trade unions and employers ones to decide on agreements between themselves without interference.

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17 Though Harerghe is largely a province of desert and low-lying savannah, its northerm reaches are mountainous and fertile and it is here, on the high edge of the eastern Ethiopian escarpment that Harar, the regional capital, is located. Harar stood, as for centuries past, in rich, well-watered agricultural land. The area produces coffee, for which Harar is famous, as well as "great" quantities of khat (catha edulis), wheat, millet and other grains and a variety of fruits and vegetables.

its factors and money markets. It is through the trade between production and consumption that production factors are priced and, so, are integrated to the goods market. This is also true with the money market. In the case of labour, capital and money particularly, this indirect valutation (i.e. through the goods market) or integration led developed economies to regulate the related flows, behaviours of economic operators and the market structures. This was an attempt to clarify the functioning of these factors markets given the need to ensure the reproduction of the factors as to fulfill economic, social and democratic objectives required by the society. Regulation prevailed in developed market-based economies since the end of the 1970s. Deregulation prevails up to now because the net costs of regulation increased continuously and the economic trends since the first oil shock strengthened risk-adverse operators, particularly those from the banking sector. Deregulation more or less favours the idea of keeping the same price determination for both goods and factors i.e. that of the market. As such markets are perfectly integrated since a price is a cost on another market and vice-versa. Obviously, the emphasis put again on market has varied according to economies or better societies. Nevertheless, deregulation with its emphasis on market **virtue** has gained credit everywhere. This has been strengthened since the vanishing (or nearly so) of the command economies in Eastern Europe. Deregulation has also touched developing countries through adjustment programmes recommended and financialy supported by the "western" donors. At the eve of the 1990s, the idea of market has gained credit for both goods, factors, money and even environment. **So, a market-oriented economy is an economy where market symptoms prevail everywhere.**

42. In the light of the preceding, the EPTP might be economically pertinent if it is recognized that market is a sequenced process leading to sequenced reforms. Or put it another way that to promote market-based economy one should first advocate it for the production of **goods** and second for the **production factors**. Indeed, the EPTP focusses quasi exclusively on the production front. Let us demonstrate this in the light of that preceeds (para. 40). The EPTP **recognizes people's rights** (included that of **enjoying** of these ones) at the exception of **land ownership** and **1975 nationalized house ownership** ; it **supports private initiative** and state's one in development ; it emphasizes **price reforms leading to market price determination** for goods and **market rules** for all units of production. Further, through expected political deep changes, it attempts to **modify the Ethiopian process of society identification**. And so, **it will influe on the degree of acceptation of private operators to be regulated**. Therefore through political and economical intentions expected to give rise to political commitments to

implement the EPTP, **the EPTP might very well be a tool to give the government its expected legitimacy and market operationality on the goods market front.** In this respect, nevertheless, two issues could be crucial, that of postponed land ownership and that of **state's share in the economy**. The first one fundamentally depends on the effective popular support of the government for the present time and the relevancy of government's arguments. These ones are that the State would remain the land owner at least during the transition period in order to avoid :

(i) the risks of tenancy in the South of the country, established monopolies all over the country and increased rural migrations because of speculation on lands ;

(ii) price distortions and speculation giving rise to impoverishing process in the case of low income people i.e. nearly everybody in Ethiopia.

43. The issue of land ownership has recently been investigated at the international level by well known economists. Let us illuminate that issue a little bit on the basis of the paper the related economists produced*(19)*. The major idea developed by these economists*(20)* is that there is some economic rationality to keep state land ownership. Indeed, as long as development runs demand for land increases. Therefore, the State can benefit from land price increase at given land supply. This is even more true if it invests in basic infrastructure... valuting the land. Then coping with increased demand means that the State gets a **land rent** rather analogously to what Ricardo indicated (Essays on the Influence of the low price of corn on the profit of stock - 1815). Such a political measure would not only be relevant with regard to the deficit of the State's budget but also in terms of equity. This one, obviously, when the State gets its mandatory functions through a real democratic process. The theory of the state land rent is not new. It was particularly advocated by L.Walras in its "Théorie mathématique du prix des terres et de leur rachat par l'Etat (1880)" and also by a US economist named George (1839-1896). State land rent in Ethiopia implies some cadastral survey. This one can in no way be achieved within the timespan of the transition. The land rent question which is that **of how to organize a market for a dominant factor of production** has been put on the agenda by the World Bank. It is worth to be investigated carefully

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19 The paper has been published in English in Etudes foncières nber 52, sept 1991.

20 These economists who are from the best ones of the world were : N.Tideman, W.Vickrey, M.Gaffney, L.Harris, J.Thisse, CH.Goetz, JM.Hartfield, G.Wunderlich, DR.Fusfeld, E.Clayton, R.Dorfman, C.Kaysen, T.Scitovsky, R.Goode, SR.Ackerman, J.Tobin, R.Musgrave, F.Modigliani, WJ.Samuels, G.Orcutt, E.Smolenski, T.Gwartney, O.Oldman, Z.Griliches, W.Baumol, G.Ranis, F.Altschul, J.Helliwell, G.Pontecorvo, R.Solow, A.Khan, H.Levin.

for its positive potential impacts on the budget(21). It is also a way to offer rentable **opportunity to invest to private capital** in a country where this is a key issue but also a very debatable one. Food ramping inflation would ensure a good real return to capital departing from a land selling price which could not be very high. Marketed lands could be the 3,000,000 ha which could become productive if irrigated. Out of this vast area only 100,000 ha have so far been exploited.

44. The question of the state share in the economy remains always a debatable one. It has been variously investigated by a lot of economists. What economic science has to say about the appropriate roles of the State and the private sector may be summarized by four theorems, **one** from **market socialism** and **three** from **welfare economics.**

1) **The Lange–Lerner–Taylor Theorem** says that market socialist economies and private capitalist ones are equivalent(22) ;

The last three theorems are from welfare economics.

2) **Old welfare economics** (1960) says that the markets are efficient, except for certain well-defined **market failures** such as **externalities,** or the **public provision of infrastructure**. Government, no matter how well organized, no matter how competent, could not do any better than the market. Old welfare theory was reinforced by the results of competitive equilibrium analysis. There were as follows:

(i) there is always an efficient equilibrium (under the well known assumptions of Arrow–Debreu) ;
(ii) market is an efficient equilibrium ;
(iii) the efficient equilibrium is Pareto–optimal.

Economists extended the concept of market failures to **missing markets, conditions leading to the violation of perfectly competitive behaviour** such as imperfect information, increasing returns and entry barriers. But they indicated that these reasons have to be set against the possibilities of government failure. More recently, economists have made further extensions pointing to government action. That would be the case for the **perceived responsability** to **alleviate poverty and deprivation** ; the **support of basic rights** and **equality of opportunity** ; the

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21 For more analysis on the constraints of the Ethiopian budget, the reader should refer to the related document issued by the DIAL's working group.
22 Nobody would have any doubt on that, obviously !

promotion of paternalism where individual preferences are overridden by the government ; **the acceptance of responsibility for future generations which current generations left by themselves might not take.** New welfare economics tries to explore hidden assumptions in the earlier fundamental theorems of welfare economics. They are incomplete risk or futures markets and imperfect information.

3) **The first new theorem** says that in the presence of imperfect information, incomplete risk markets, and incomplete futures markets, there is the potential for government intervention. This is due to the fact that there is simply no theory of the comparative properties of different economic system under conditions of **bound rationality**. This one means when economic agents are forced to form expectations about the behaviour of other agents, because of the absence of a complete set of futures and risks markets. The new theorem does not say what governement must do to realize the potential intervention.

4) **The second new theorem** has to do with **privatization.** This issue discussing wether government should intervene or not in the **production** was not addressed in the earlier literature. Indeed, only that of government intervention (Pigouvian interventions of a very limited kind, only) was touched. The new theorem says that private production can emulate public production, that is ideal public production, only under highly restrictive conditions. So that, in general, the two are not equivalent. This provides a weak intellectual foundation for understanding the precise roles of the government and the private sector. What the theorem says is that there is a potential scope for government intervention, but it is a fairly diffuse and ill–defined role untill details are fill out.

45. In the light of the preceding theorems, the EPTP theoretical way of sharing between the state and private sectors gets an economic rationality. Indeed, basic infrastructure extended to basic goods, services and financing, missing markets... imperfect information, incomplete risk markets and futures markets, emulation of public production, all this pleads for government intervention and production. How **precisely** remains a question. An answer has been given by J. Stiglitz at a roundable discussion on Development Strategies at the W.B. (1990). "This issue of the roles of the State and the private sector in development strategies should not be viewed as a contrast between the private sector and the government. It really is a question of the **whole complex** of relationships among market, nonmarket, government and State, and voluntary institutions and the particular forms that the government intervention takes. Further, the general implication from

reading history is that ownership is not as important as the environment in which a firm operates. **Competition is more important than the private-public division**". So, **in this respect the EPTP will be pertinent on the goods front if competition features really the all set of Ethiopian enterprises whatever their owner is.** To be fully economically pertinent, the EPTP should announce reforms on the **production factors market front too.** This is not really the case at the exception of **labour** for which a new Labour law has been announced (refer para. 29). Indeed, and as indicated previously (para. 43), **land** remains state ownership at least till the free elections. This is also true for **banking**.

46. The creation of a **land market** (para. 43) is not only a way to secure revenue to the State. It is also a way to economically rationalize the use of this factor of production and to reconcile the peasantry with the State. Through a land market policy the State could fulfill different targets amongst which :

1) the environment rehabilitation (para. 28 – C7) ;

2) the improvement between surplus and deficit food production areas (annex 2) ; between drought affected and more abundant rainfalls ones ;

3) the accomodation of ex-soldiers and militias properly.

The creation of a market for land should be a **flexible process**. Indeed, it should permit **to sell lands according to what people of some specific region are accustomed to**. For instance, in the North of the country to the village community and in the South to peasants individually. In such a framework, the State would have to issue a tax system favouring the purchase of land for productive purposes rather than speculative ones. The fact that private and public (local) operators should be allowed to participate to the market in conjunction with foreign capital would permit to organize some **land open market policy**.

47. The organization of a **market for financial funds** through the establishment of private commercial banks would permit*(23)* :

1) to create market opportunities to private investors ;

2) to get "rapatriated" capital flows from the informal sector (likely) ;

23 More detailed analysis appears at para. 57, 63, 84, 101 to 103.

3) to make the first steps to integrated markets (the real and financial ones ; the formal and the informal ones) ;

4) to soften the devaluation needs by reducing the real exchange rate overvaluation for capital inflows generally lead to real exchange rate appreciation.

But all this presumes real positive interest rate to remunerate saving. And also operators endowned with enough purchasing power so as to support some bottom line discipline applied by banks. What could be a market for financial funds in Ethiopia should lead to carefully investigate the financing power of its informal sector for it more or less appears that the dynamics and saving of this one could be important. Indeed, if all said to the DIAL's team at A.A. during the meeting at the Chamber of Commerce is true :

a) on 26 000 Chamber of Commerce members (at A.A. only) about 20 000 would be from the informal sector (at least) ;

b) an important amount of idle money could be easily rendered available at the condition of some specific policies (a reduction of the tax system plus the possibility to make workers redundant, mainly (refer para. 62)).

The creation of a private banking system could be a crucial issue for it could help (amongst other things) **to create jobs more easily than expected.** This point will receive further scrutinity at paragraphs 84 and 99.

A2 – External pertinency : how the measures already decided by the Ethiopian government reveal some parts (or facets) of the EPTP, and the sequencing of economic reforms ; the degree of fine tuning of Ethiopian economy

48. Before listing the measures, it is worth indicating that one of the major constraints to decide for political commitments is peace to strengthen **i.e. the broad political consensus not to modify (at least). As such measures have to be efficient given short run priority areas with a high degree of political neutrality** or compromise (para. 2). That is the main challenge to the Ethiopian society for the present time which encompasses the other ones (food self-reliance, demobilized ex-service men, informal market economy, the country's rehabilitation needs ...). The Oromo question adressed through paragraphs 37 to 39 indicates that peace is not well established in Ethiopia for the moment. The political situation which remains unstable might explain why there has not yet been many measures decided to implement the EPTP. Further, it could also explain the sequencing of the measures.

1) The Ethiopian Economic Recovery and Reconstruction Program (ERRP)

49. In the light of the preceding (para. 30), the measures should mainly concern the country rehabilitation assuming that the stabilization of peace is the best thing to promote a conducive atmosphere to enhance private initiatives. In this respect, the Ethiopian government has presented and discussed a rehabilitation programme with the international donors community under the W.B's supervision. **It would amount slightly more than US $ 600 m of which 47 per cent for the productive sectors i.e. agriculture, industry and construction materials, 18 per cent for social targets (education, health, social rehabilitation funds and structural food aid) and the rest (35 per cent) for infrastructure rehabilitation i.e. transport and roads mainly. This programme covers about 92.1 per cent of the Ethiopian Economic Recovery and Reconstruction Program (ERRP) (table at the following page). Major foreign financers are the IDA (38.1 per cent), the ADB (20.8 per cent), the EC (19.2 per cent), the USAID (14.4 per cent) and Sweden plus Japan (2.5 per cent). Ethiopia has also received help from the EC as such. Indeed, on the basis of the Lome Convention US $ 70 m have been made free.** Further, the EC has allocated to Ethiopia ECU 0.65 m for war prisoners and 0.35 m for Ethiopian refugees in Djibouti.

50. ERRP foreign financing is constrained by two main conditions which are **the transport deregulation and the liberalization of the fertilizers system**. When being fulfilled they would permit the ERRP to go before the WB's board i.e. to be internationally financed. The Ethiopian government has already accepted the first condition. Indeed, by december 1992, transports will be deregulated. As a consequence of such an agreement transport price increases are gradually decided. Disagreement between the Ethiopian Authorities and the WB remains regarding fertilizers. Reason clearly indicated by the former is the expected price increase in the case of deregulation and the eventuality of the Birr devaluation. This would negatively affect the peasants demand for such products, although only 14 per cent of the peasants are using fertilizers. But there could be another reason much more relevant. It could be that the government knows rather clearly that he cannot really boost the peasant agriculture as indicated in the EEPT (para. 28–C7). Indeed, to help peasants to obtain fair price for their produce (which is the key to boost peasants production) is a very debatable issue for a country where the peasant agriculture sector remains de facto quasi the lonely source of surplus for investment and reduced indebtness given :

SCHED

ETHIOPIA: ECONOMIC RECOVERY & RECONSTRUCTION PROGRAM
COST & FINANCING TABLE AS OF MARCH 3, 1992 (in US$ million)

	COST			FINANCING											
	Foreign Cost	Local Cost	TOTAL COST	IDA Proposed Credit	IDA Reallocations	USAID 1/	EEC	ADB	Sweden	Germany	Netherlands	Japan	EIB	UNDP	Total Foreign Financing
PRODUCTION															
Agriculture:															
Fertilizer	80.7	10.1	90.9		30.0	15.0	20.4	14.3				1.0			80.7
State Farms Spares	3.1		3.1				1.5	1.6							3.1
Transport															
Coffee/Tea Exporters	3.4		3.4					3.4							3.4
Ministries	11.6		11.6					11.6							11.6
PADEP VI Roads	4.6		4.6				4.6								4.6
Seeds	8.8	0.6	9.4					6.6			2.2				8.8
Pesticides	8.7	0.0	8.7					3.9			0.6	4.2			8.7
Veterinary Drugs	11.5	0.3	11.8		5.0		1.2	5.3							11.5
Agric'l Equipment	14.5		14.5					14.2				0.3			14.5
Industry: Public	87.0		87.0	40.0		12.3	20.2	9.0	5.5						87.0
Private	41.5		41.5			10.0	18.0	6.0		7.5					41.5
Construction Materials	7.0		7.0	7.0											7.0
Subtotal	282.4	11.0	293.4	47.0	35.0	37.3	65.9	75.9	5.5	7.5	2.8	5.5	0.0	0.0	282.4
SOCIAL															
Educ: Reconstruction	25.7	10.8	36.5		15.0	10.0	0.7								25.7
Health: Drugs/Supplies	37.8	0.9	38.7		7.5	10.0		17.5			2.8				37.8
Reconst/Equipt.	11.7		11.7				0.5	11.2							11.7
Social Rehabilitation Fund	5.0	10.1	15.1	5.0											5.0
Structural Food Aid	29.1		29.1			14.7	14.4								29.1
Subtotal	109.3	21.8	131.1	5.0	22.5	34.7	15.6	28.7	0.0	0.0	2.8	0.0	0.0	0.0	109.3
INFRASTRUCTURE															
Transport:															
Civil Aviation	5.0	2.0	7.0	5.0											5.0
Railways Spares	3.0		3.0		2.0		1.0								3.0
TA	1.5		1.5		1.0		0.5								1.5
Trucks New	26.3		26.3			7.5	2.3	11.2	5.3						26.3
Spares	36.2		36.2			7.5	22.3	6.4							36.2
Tires	7.0		7.0		7.0										7.0
Transport Contract	12.0	1.4	13.4	12.0											12.0
Petroleum Products	20.0		20.0	20.0											20.0
Buses:															
Tires	1.0		1.0	1.0											1.0
Spares	3.0		3.0	3.0											3.0
Port	0.7		0.7				0.7								0.7
Roads:															
Assistance to ERA	35.1	1.2	36.3	23.6			7.7	3.8							35.1
Civil Works	20.3	5.1	25.4	20.3											20.3
Rehab of MTC Equipt.	1.3	0.6	2.0	1.3											1.3
TA	4.2		4.2	4.2											4.2
Water Supply	13.7	4.8	18.5		5.2		0.4			8.1					13.7
Power Reconstruction	11.0	2.5	13.5	3.0	8.0										11.0
Telecoms Reconstruction	11.0	1.4	12.4	4.0									7.0		11.0
Refinancing of EEDPAC PPF	0.6		0.6	0.6											0.6
PMU Technical Support	1.0		1.0											1.0	1.0
Subtotal	213.9	19.1	233.0	98.0	23.2	15.0	35.0	21.4	5.3	8.1	0.0	0.0	7.0	1.0	213.9
TOTAL	605.6	51.9	657.4	150.0	80.7	87.0	116.4	126.0	10.8	15.6	5.6	5.5	7.0	1.0	605.6
of which:															
Physical Contingency	18.3	2.5	20.8												
Price Contingency	25.4	2.4	27.8												

1/ Including US$27 million Agricultural Commodity Aid (Wheat & Cotton) under PL480 (Title

(i) the collapse of the state sectors (industry and farms) ;

(ii) the increase of unregistered and contraband activities (coffee, chat) ;

(iii) the waiting position of the private operators ;

(iv) the remaining available registered saving (saving ratio to GDP of nearly 0 per cent in 1991).

With regard to the surplus extraction, Eshetu Chole [10] indicates that this occured mainly through agricultural taxation, grain marketing and pricing and foreign exchange generation. For instance (Eshetu Chole p. 97), "the price received by the producer for unwashed coffee is about 40 per cent of the international FOB price. Of the remaining 60 per cent, 44 per cent is taken by taxes and duties, which leaves 16 per cent for interior costs, finance and insurance, and cleaning and other costs". **In this framework, to keep low fertilizers (input) price could be a way to circumvent an agriculture policy that has to remain from the extractive type (compared to the protective one) even if it is mixed with market liberalization and incentives to peasants.** This is also relevant if one accounts for the government's announced intention to promote extensive use of fertilizers (para. 28–C7) as for the disruption of local service co-operatives in most areas since the dismantling of these ones after the reforms of the Derg-regime. **To conclude the fertilizers issue could well be regarded as a symbol of the government's will to improve its relations with the peasants at minimized credibility costs.** The government has nevertheless not closed the door to the fertilizers deregulation. Indeed, it has asked the FAO to conduct a study on this issue. And finally, let us also indicate that **the fertilizers problem hids a regional one.** Indeed, the consumption of fertilizers is concentrated on three regions which are **Gojam, Shoa,** and **Arssi. They are three surplus areas.** They would be prejudiced in case of fertilizers liberalization and as such risks to famine could increase. Further, regional disequilibrium and risks to famine could also increase by december 1992 i.e. when transports will be deregulated. In this case, the private sector would only supply fertilizers to those **endowned with enough purchasing power to pay for new fertilizers and transport costs. This might indicate that the government may have deliberatly chosen a mix policy (deregulated transport sector, still regulated fertilizers supply).**

2) Measures

51. The measures already decided to implement the EPTP are listed below. Their number is rather reduced, so that one can say **that the EPTP has not yet begun to be implemented.** This might be due to political problems (within the rulers' coalition, amongst the regions...) and, therefore, to the need to gain credit for the EPTP (i.e. its content) at the international level as financial support to it. Presentation of the EPTP at Washington (W.B.) has only started mid February 1992. The Ethiopian government has then announced he would be ready to decide for political commitments by June–July 1992. Measures already decided can be grouped into five sets respectively related to **institutional changes between Ethiopia and Eritrea, macroeconomic stabilization, privatized Ethiopian economy, market functioning and agriculture.**

Relations between Ethiopia and Eritrea

52. The Ethiopian government has signed 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 has also been signed with Eritrea.** These agreements reflect mutual benefit for both Ethiopia and Eritrea. Indeed, the first one gets acces to energy and the world markets while the second gets acces to agriculture raw materials (skins, cotton, grain, etc...) needed for its manufacturing activities. Available information does not permit to indicate how the external duties will be shared between Ethiopia and Eritrea. These signed agreements could explain, why, after a period of quasi floating exchange rate, the Eritrean Authorities decided to re–establish the Birr value at its old parity i.e. the Ethiopian one. Nevertheless, several political analysts at A.A. also indicated that Eritrean rulers were helping Oromo activists so as **to secure** their relations with Ethiopia by creating troubles along the roads to Djibouti !

Macroeconomic stabilization

53. **On the current account front the government has abolished (dec 7, 1991) the franco valuta system on merchandise imports.** This sytem permitted economic operators to import merchandise when they could pay for these ones in foreign currency **without** state intervention i.e. without requiring foreign currency from the banking system. In this case, they had to pay an extra fee varying from 40 to 100 per cent of the import value. From 1983/84 to 1989/90*(24)* about 40 per cent of merchandise imports fell under the franco valuta system. In 1990/91 this percentage has fallen to 24. On the **domestic price front**, the government has showed its will to promote price rationality by increasing prices for a lot of commodities such as oil, the transports tariffs (public and private) and a set of consumer goods. This with frozen wage since 1975 (at the exception of a shift in 1979 for low wage people) has revealed **increased poverty** and **corruption**. In this respect, it is worth indicating that for several economic operators met at A.A. to play the market game is nothing else but a way to legalize corrupted trade practices*(25)*. Depending on the role and influence of these operators such a behaviour may weaken the government's credibility and legitimacy.

Privatized economy

54. Economic operators are waiting for the new **Labour law** as for **the announced new investment and mining codes**. Information obtained when being on mission indicate that **the new Labour law would permit to make the labour force redundant under specific conditions.** This is one of the major requirement of the private operators members of the Chamber of Commerce. For these people labour shedding in Ethiopia is a way (not the only one, nevertheless) to close the credibility gap between the private sector and the government on the profitability and management autonomy front. In this respect, it is worth indicating that neither the department of labour nor the Chamber of Commerce have taken part to the discussions leading to the writing of the preliminary version of both the Labour law and the investment (or mining) code. In both cases, it is now too late. Indeed, the new investment code has been approved by the Council of Ministers and is now before the Council of Representatives ; the new Labour law is being discussed by the Council of Ministers.

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24 Ethiopian fiscal year. It begins July 6th and ends July 7th of the next year.
25 As it is now the case in some late Eastern countries.

55. On the basis of information given when being at A.A., the labour redundancy will be accounted for through :

(i) the administration of some **major** corporation by boards where workers will have rights (30 per cent of the global ones has been indicated in the EPTP),

and

(ii) the payment of government's compensation to workers depending on years of service in the case of minor factories. Almost all trade and industrial corporations would be touched by labour redundancy. Indeed, the government has made clearly understood by people participating to the Labour law discussions that 10 Ethiopian corporations (at least) belonging to the manufacturing sector should be sold to the private sector. This represents 110 factories and a labour shedding of about 100.000 people (according to ILO data on manufacturing employment). If one accounts for the government's intentions related to the dismantling of external trade monopolies, all the **industrial corporations would be touched** except maybe the Petroleum and Pharmaceutical ones.

56. With regard to the new investment code or better policy meetings got at A.A. permit to indicate the following features grouped into two headings :

(i) The Ethiopian managing unit

1- All the information on the regulation of investissement opportunity in Ethiopia would be now given to private operators at a **centralized level** i.e. by a specific unit called the Investment Committee (I.C.). It has already been established. This is to permit increased rationality and speed in a favourable way to private candidates ;

2- The I.C. would have to seek for the appropriate incentives and to send the fulfilled investment form to the related ministeries so as to get **comments** and **licencing**. He would also have to compute the fees to be paid to the government. Extra incentives would be given for depressed areas ;

3- The I.C. would have to do its work within the shortest period of time (a few weeks has been indicated ; previously the investment approval procedure could last several months) ;

(ii) Policy to foreign capital

4- The policy would follow strictly the EPTP. So, foreigners are allowed to invest in all sectors excepted in defence, posts and telecommunications, broadcasting, air, rail and banking. Nevertheless, foreign investment remains to be approved at **ministerial level** (as domestic ones) ;

5- Foreign capital would be particularly welcome in the following sectors : export, mining, energy and transport. This so as to help to strengthen the linkage between agriculture and industry, diversify the export basis and the industrial activities and ease the country's energy constraint ;

6- Special support will be given to domestic investors on the basis of comparative advantages **nevertheless.**

57. In the light of the preceding, it appears that the expected applied investment policy will follow the lines of investment policy applied in developing market-oriented economies. Obviously, this does not indicate wether the new investment code will be an efficient tool to attract private capital (both the domestic and foreign ones). All depends on what was expected by the private sector. In the case of Ethiopia, the sector seems much more in favour of getting **a private banking system with an appropriate credit policy** (see para 62). For the budget any investment code is first of all a bit on the future. The government is allocating funds (incentives) **waiting** for growth, income, employment and taxes. This is rather costful when the country has an heavy international public debt. In this framework, a good credit policy may be much more useful by putting the burden of the **private investment** on the **private sector** managing the banking system. Further, this is also a way to favour the integration of the goods and financial markets and, as such, to help the monetary authorities to correctly determine the exchange rate value (para. 104 to 114). **From the preceding viewpoints, the focus on an investment code at the expense of a good credit policy through the privatization of the banking system might likely be an important mistake.** This could also bias the relations between the government and the private sector by indicating that the former one through the ministerial approval of investment wishes to remain able of overseeing

private initiative. Depending on the relations between the government and the private sector (bad in Ethiopia for the present time) this could increase the credibility gap (or the regulation identification one) between the former and the latter. The cost would be to comfort private operators to remain on a waiting position a rather long time. To close the credibility gap between the private sector and itself the government has committed a working group to study the tax system and how to modify it so as to encourage the private sector. As such, it might fulfill one of the requirements put forward by the Chamber of Commerce to get a **free** market economy in Ethiopia (para. 62).

Market functioning

58. In conjunction with the preceding expected conditions to make the employees redundant, the new Labour law would also include new dispositions :

(i) reducing the government's interference on the relations between workers and employers ;

(ii) recognizing collective agreements freely negociated ;

(iii) allowing employers' associations ;

(iv) allowing trade unions to become internationally affiliated.

These dispositions reveal (it is expected so) the **government's will to endown Ethiopia with labour market organizations as it is the case for market functioning economies** even if this could lead to conflicts with other objectives. For instance, that to restructure state firms.

59. The government has also instructed **ministeries to review their functioning with respect to market functioning**. The aim is not to reduce the number of civil servants even if that could lead to such a result. The aim is to get administrative structures or units in accordance with market requirements. This would encounter another proposition from the Chamber of Commerce.

Agriculture

60. Without government's financial support peasants cannot buy fertilizers. But the government's room for manoeuvre is financially very narrow given the state of the budget. So, the food production is more or less given depending on the availability of cultivated areas (and irrigated ones in some cases) and rainfalls (when peace is assumed). This is when neglecting the influence of environment degradation on yields (and then agriculture income). In this framework, the government has committed a working group to study what could be the impacts of using organic farming at large-scale. This could reduce the financial constraint of fertilizers in the eventuality of their price liberalization and improve the relations between the government and the peasants. Indeed, organic farming is less exogenous to the peasants' knowledge than agriculture using fertilizers (and pesticides) produced by the chemical industry. The costs for the balance of payments would also be reduced. Organic farming may further help to curb rural migrations, a real challenge not only to Ethiopia but to all developing countries which have generally denied organic farming (and farming) to feed their population.

3) The Ethiopian private sector's expected measures

61. Before turning to the sequencing and speed of economic reforms let us have a look at the measures expected by the Ethiopian private sector. The Chamber of Commerce has published its expectations in a document dated from September 27, 1991 which was sent to the government. A very interesting point appearing on page 2 of this document is the mention that comments and views of Ethiopian **abroad** residents had also enriched the analysis sent to the government. Another (introductory point) is the use of the word **free** market (page 7) for market-oriented economy. Both points indicate (at least to me) **the suspiciousness of the Chamber of Commerce to the present government of Ethiopia.**

62. The Chamber of Commerce expects the following decisions from the government :

(i) **A modification of the role of the State in the economy** i.e. :

– the **withdrawal** from the production, trade and services areas **except under very specific circumstances** : too high level of accumulation, low profitability, importation of basic consumer goods which involves subsidies, export under bilateral agreement, mass transport services, municipal and infrastructural construction. The preceding would be at the opposite of the government's role to regulate and monitor the (market–oriented) economy ;

– the focus to lay down infrastructural networks, research institutes, protection of the consumers, ..., **to supply input and services to the agriculture sector at competitive prices and easier terms of payments.**

(ii) As a consequence of (i) **almost all activities in Ethiopia should be opened up to the private sector. So, contrarily to the government's position, the banking sector would be opened up to private initiative. Then, a credit policy leading to positive real interest rates (on trend) could be managed.**

(iii) **A modification of land ownership** accounting for specific conditions featuring rural and urban land :

Rural land

– Private ownership of rural land worked on by peasants ;

– Contractual landholding concession in case of private large–scale farms (right to sell or exchange land being prohibited).

Urban land

– Under government control.

(iv) **A new Labour law** permitting :

– to get relations between employers and employees based on productivity and profitability i.e. **to get labour redundancy when necessary** ;

– **to protect both partners in accordance with internationally accepted principles** ;

- to recognize the right to employer to manage his enterprise as he sees it fit ;

- to itemize the labour benefits of the employee ;

- to define the methods of settling disputes.

(v) **A new income tax and duty system showing** :

- **a reduction of the tax burden** ;

- favorable orientations to investment and export.

(vi) – **The immediate issuance of a democratic constitution** ;
 – The establishment of legally constituted court completely independent.

(vii) **1975 nationalized assets being restituted to their original owners** ;

(viii) A reduction of the bureaucracy and the design of the rest of it in accordance with markets functioning. For instance, by the creation of sector specific institutions.

63. The measures already decided by the government encounter **some** expectations of the Chamber of Commerce (labour redundancy, managerial autonomy, protection of social partners, modification of the tax system). The land ownership issue could also be met after the announced referendum. Ascending difficulties concern mainly :

- the country rehabilitation (for which not many things have already been decided and done) ;

- to **complete the withdrawal** of the State from the production, etc... ;

- the opening up of all activities to the private sector i.e. particularly the **banking one** ;

- the deregulation of the **fertilizers** system, and

- the restitution of 1975 nationalized assets.

In this respect, the State will be led to accept a complete withdrawal from the production (etc...) since it cannot pay for future losses, needed spareparts and upkeep costs given the expected evolution of the budget. **Then, the question will be how to price the state firms and farms.** An international auditing expertise would be needed. The selling of state assets could be a first step to the opening up of banking to the private sector. **Through an international negociated agreement to ensure the credibility of the procedure, the state assets could be used as based capital for the private banks.** So, the state would be one of the share holders of the private banking system. **Unless the budget deficit would be under control, it would not be allowed to borrow from the commercial banks.** In case of privatized banking system revealing a profitable market opportunity, both the government and the private sector would benefit of it. This would also permit a gradual ajustment of the interest rates (in level and structure) leading to a trend of positive real interest rate in the future. A restitution of 1975 nationalized assets is not possible at short term given its expected costs. It would become possible at medium one through another banking arrangement.

4) The sequencing and speed of economic reforms

A SURVEY OF THE ECONOMIC LITERATURE

64. Reforming an economy is not only a question of economic policy content. It has also something to do with the problem of the appropriate sequencing and speed of reform. Basically, there are two interrelated questions : (1) in what order should markets be deregulated and liberalized, (2) what is the optimal speed of reform (i.e. overnight vs gradual). It is on the basis of the answers given to (1) and (2) that a sound macro policy has to be selected and sequenced. Before commenting the Ethiopian sequencing and speed of reform let us illuminate the issues a little bit through **a quick focus on what economic researchers found dealing with structural reforms in the LDCs.**

(i) The speed

65. **Most analysts** agree upon **gradual** reforms. The reason for this resides on the role of adjustment costs (or welfare costs) and on the opposition to the reform policy than these costs can generate. **Therefore, they plead for accompanying policies** to minimize the short run unemployment effects and other adjustment costs associated with reform policies. In this respect, some authors assert that one way of reducing the adjustment costs is by relying on foreign capital during the transition. As a result, **restrictions on the importation of capital should be reduced as first step of the economic reform.** The preceding assumes that capital controls are precluding capital inflows. This, of course, needs not be the case. That will not be the case in those countries where the domestic financial sector is repressed. Then, the implicit proposed sequencing is **the domestic financial sector to be liberalized before either the trade or capital account.** The interaction of credibility problems and adjustment costs has also led several economists to support the idea of government **acting rapidly** by providing a subsidy for investors moving into some "new sector". In this way, the apprehension stemming from the lack of credibility will be compensated.

(ii) The sequencing

66. Economists dealing with the question of sequencing first focussed **on trade versus capital accounts liberalization.** In this framework, they raised the question of competition of instruments*(26)*. The basic point is that the attainment of a particular target may require some variables (either exogenous or endogenous) to move in a particular direction while the attainment of other objectives will require those variables to move in the opposite direction. For instance, Mc Kinnon argued that the capital account restrictions should be relaxed only after trade and other industrial sector distorsions had been dismantled. This avoids real exchange appreciation at a time when due to the tariff reduction reform, a real exchange rate depreciation is needed. This problem is compounded by the fact that foreign capital inflows are unsustainable in the long run. Consequently, a structural reform of the trade account should deliberately avoid an unusual or extraordinary injection of foreign capital. Further, he also asserted that trade liberalization should only take place after the fiscal deficit is eliminated. In this way, the government will face no need to borrow from abroad to finance its expenditure and, thus the need for capital

26 This is not a new one. It was discussed by Tinbergen and Mundell in the 1960s. In the 1970s and 1980s it gained increased interest on the basis of Mc Kinnon and J. Sach's analysis.

inflows during the transition will be reduced. To summarize, **Mc Kinnon (1973, 1982, 1984) (and others)***(27)* **proposed the following sequencing.**

1. Fiscal balance ;
2. Trade account to liberalize ;
3. Capital account to liberalize.

To Mc Kinnon (and others) defenders of floating exchange rate replied that nobody knows wether trade reform would resul in real depreciation or appreciation of the exchange rate. For this reason, they argued that the appropriate order would imply opening up the capital account with floating exchange rate before reforming micro-decisions via the reduction of import tariffs.

67. **Economists also based their conclusions as how to sequence on macroeconomic welfare considerations.** In this later case, the criterion used to choose a given course of action is simple : "Sequencing A is preferred to sequencing B if social welfare under A exceeds that obtained under B". Here it is worth mentioning that the criterion does not address the important question of wether the government can equally precommit itself to carrying out both sequences. According to the modern theory of economic policy if the government runs into precommitment limitations time consistency problems may occur with as a result modified welfare based-sequencing. On the basis of welfare grounds **J. Frenkel (1982, 1983) (and others) proposed** :

1. Goods markets to be liberalized before ;
2. Capital ones.

This he argued because assets markets clear almost instantenously while the attainment of equilibrium in the goods markets usually takes some time. In all that preceeds it is worth indicating that credible reform programme is assumed. From this viewpoint many economists have indicated that it is in the **credibility sphere where the most important lesson on the sequencing of liberalization lies.** In a sense the implementation of a consistent and credible policy package turns to be more important than attempting to determine the correct order of liberalization. Indeed credibility is the key issue for the survivability of a structural reform attempt as for its related evaluation.

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27 See for instance, World Bank Conference on the dynamics of structural reform (1985), and various IMF studies.

68. Impressed by East Asian macro performances, economists, for instance, Bhattacharya and Linn (1988) proposed to refer to the East Asian sequencing in the framework of other developing countries. Then, the sequencing should be as such :

1. Real sectors should be liberalized before financial ones ;

2. Domestic financial markets should be liberalized prior to opening the capital account ;

3. Barriers to international trade should be removed before lifting capital controls.

69. The question of the appropriate sequence of economic reforms has also been raised **in terms of stabilization versus trade reform liberalization**. Here economists indicated that the sequence will depend greatly on the extent of the initial macroeconomic disequilibrium particularly from the inflation viewpoint. In fact, the problems faced by policy makers will be vastly different in countries with **low** or **medium** inflation that in those that are experiencing **high** to **very high** rates of inflation. Edwards (1987–1989) (as others) proposed the following scenario :

i) Mildly inflationary countries

Trade reform policies can be implemented quite independently of the macroeconomic achievements.

ii) High inflation countries

The strategy should be to proceed more slowly. Initially, while the process of controlling the fiscal deficit is underway and inflation has not been fully subdued, it is recommended eliminating **some** of the controls and external distortions. In particular, at this stage, it is usually desirable to tackle those restrictions that had been imposed solely for "balance of payments" motives. More drastic trade reform measures (i.e. those dealing with restrictions originally imposed for resource allocation motives) should generally be postponed until macroeconomic equilibrium is achieved.

70. **The main rationale behind the above recommendation has to do with the "competition of instruments" problem already introduced. In a highly inflationary context some policy measures conducive to attaining macroeconomic stability will tend to hinder the liberalization goals.** In fact, one of the most important sources of tension between stabilization and liberalization programs resides in the fact that a successful liberalization requires a real exchange rate depreciation, while disinflations have often resulted in an appreciation of the real exchange rate. **A second source of "competition of instruments" refers to the role that trade taxes play as a revenue source in the developing countries.** In many cases the elimination of tariffs will result in a decline in tax revenue and, thus, in an increase in the fiscal deficit, putting positive pressure on inflation. In countries with a large **public debt** there is a third potential source of conflict. If liberalization is accompanied by a real devaluation which is the recommended policy from the external sector perspective the real cost of servicing the debt will increase, putting more pressure on the deficit and jeopardizing the inflationary goals.

ii) Very high inflation countries

As the prevailing level of inflation becomes higher and higher the possibility of major trade-offs between the goals of stabilization and trade reform increases. In addition to the real exchange rate trade-off discussed above, **in the case of very rapid inflations (above 100 per cent per year), three other sources of conflict between the goals of the two policies, related to relative price variability, interest rate behavior and wage rate indexation, can play a very important role.** As Fischer (1986, 1987) emphasized, an important consequence of rapid inflation is that relative prices become highly variable. This enhances the degree of uncertainty in the economy and has a negative impact on investment decisions. The process of sectoral allocation of capital can, indeed, be seriously disrupted with some investment going into the "wrong" sectors. **All of this, of course, suggests that the liberalization objectives may be hindered if the reform is attempted before the macroeconomy has been stabilized.** As a consequence of this a number of authors, most notably Stanley Fischer, argued that under conditions of **very high** inflation liberalization reforms should be postponed until the macroeconomic environment has regained its stability.

THE ETHIOPIAN REFORMS

71. The EPTP is not explicitly accompanied by a document indicating the sequencing and the speed of Ethiopian economic reforms. Such a work is nevertheless being done by a team of economists grouped into the Economic unit of the President. Information obtained at A.A. indicate that they would advocate **macroeconomic stabilization as being the first step of reforms in conjunction with the country rehabilitation.** The main rationale behind this would be the need to **sustain** and **re-enforce** peace and **to get a basic peace economy.** Applied macro stabilization would first of all mean :

(i) to account for cessed Eritrea ;

(ii) to get the budget deficit under control ;

(iii) to reduce inflation through austerity monetary policy ;

(iv) to improve the food production.

Here it is worth indicating that although the EPTP does not refer explicitly to cessed Eritrea its related macrostabilization process would account for this rupture. The second step would be **to promote private initiative** when macroeconomic stabilization would have created a favourable policy environment. A rational speculation then leads to conclude that **current and capital account liberalization** would be the third step to submit the private sector to international competition (i.e. to stabilize really the economy from the inflation viewpoint) and to strengthen private accumulation. The measures already decided are consistent with the proposed order of sequencing. This one follows the international recommendations in the case of high or very high inflation countries. In this respect, the opening of the banking sector to private initiative should be done before the capital account liberalization in order to favour integrated market which is a key issue of stabilization and capital account liberalization. The budget evolution will be the key issue of this set of processes since there cannot be any macro stabilization with increased deficit. From this viewpoint if an ERRP is necessary to reconstruct the country's basic infrastructure, a BRP (Budget reconstruction programme) to be financed by the international donors community would also be needed.

5) The degree of fine tuning of the Ethiopian economy

72. It is not yet possible to appreciate this one since it can only be done through **an interactive framework of active behaviours**. For instance, through the reaction of private investment to the government policy followed by the government's reaction to the reaction of the private sector, etc...

B - IMPORTANCE OF THE OMITTED FACTORS (OR FIELDS OF ACTION)

73. **On the basis of Ethiopian past trends**, the omitted factors which would also be fields of future action are :

i) how **to manage the expected cession of Eritrea**

and in this respect

ii) how **to reorganize the links between Ethiopia and the world markets** ;

iii) how **to tackle with the household energy consumption** ; the **permanent state of poverty** ; **the urgent need to reduce the most immediate risks to famine** ;

v) how to tackle with the **factors of production availability** (quantity and quality) to privatize the Ethiopian economy ?

vi) how **to promote and improve markets functioning at the macro level** ;

and

vii) how **to establish an independent monetary authority and promote private commercial banks.**

Further, they are factors which have been mentioned but in such a way compared to the reality that they appear to nearly have been forgotten. This is the case of the **informal sector** for which the word illicit has been unproperly used (para. 16) in the Ethiopian context. In this framework, the issues of **fiscal balance** (para. 28 –C4) could be very detrimentaly hindered because informal activities challenge fiscal receipts, the expected reform of the tax system and the expected peace dividends coming from the reallocation of resources. They also challenge growth expected to be grasped because they compete with the formal activities through favorable relative output prices i.e. a price determination in terms of very low production costs, **only**. From a theoretical viewpoint, the informal sector is a pure trade economy (a reduced one nevertheless) i.e. a market–based one without State and collective social concern. The issue of **demobilized soldiers** is not properly introduced. It is emphasized in the framework of the rehabilitation of **some regions, only**, although, it is a national employment problem. **The reinsertion of ex–soldiers could also be a constraint on fiscal balance** except if the government succeeds in **boosting** labour intensive activities.

B1 – Eritrea

74. Cessed Eritrea might challenge the EPTP in terms of supply of future factors of production, demand opportunities, efficiency of the managed regulation and increased pressures on the Birr parity.

Supply of future factors of production :

(i) approximately 40 per cent of Ethiopian potential manufacturing output remains to be lost with as main result a definitive reduction of fiscal receipts ;

(ii) all Ethiopian seaports remain to be lost which also means external duties and basic infrastructures, for instance, the crude oil refineries. Then one understands why Ethiopia has negociated an agreement with Eritrea (para. 52).

Demand opportunities

Eritrea has to account for a shortage of agriculture output because of its high eroded lands. That will create opportunities for Ethiopia to trade with Eritrea in the framework of Ethiopian agriculture goods being substituted for Eritrean manufacturing ones. Further, Eritrea needs Ethiopian supply of agriculture raw materials (cotton, grains, skins ...) to get manufacturing output.

Efficiency of the managed regulation

Eritrean Economic Policy is not known (at least to me). Therefore, one can guess it might challenge the EPTP through a set of differentials related to selling prices, rates of taxation, retained earnings to exporters, incentives to foreign capital, market structure, etc... The preceding indicates that the issues of cessed Eritrea cannot be forgotten for they could be very detrimental to Ethiopia's expected stabilization and future acceleration of growth. The potentiality of the Eritrean challenge can be illuminated a little bit through a focus on the recently appearing Eritrean Investment Code (January–February 1992). This document published in the Gazette of Eritrean Laws indicates the **following macroeconomic policies (MP) to be implemented** :

1. MP favouring import–substitution activities and the use of local resources ;

2. MP favouring foreign capital on joint venture arrangement in the transport and telecommunication sectors.

i) air transport : joint venture arrangement with the Eritrean State, only ;

ii) telecommunication, sea and road transport : joint venture arrangement with the domestic private sector, only. This one should always get a minimum of 51 per cent of the enterprise shares.

3. MP favouring mining : incentives would only be given to enterprises where the State participates.

4. MP attracting foreign capital. It is welcome provided that 50 per cent of the expected output either comes from exports or import–substitution activities. In this later case, the rate could be reduced to a level which has to remain at least acceptable.

5. MP favouring the purchasing of imported input. Exemption from taxes and customs duties would feature purchased input of investment goods and materials which cannot be supplied by Eritrea. Exemption from income taxes would feature investment at the sectoral level :

i) **Agriculture** : during two years for investment from US$ 0.1 m to 0.3 m, five years if it exceeds US $ 1 m ;

ii) **Other sectors** : during two years for investment from US $ 0.25 m to 0.75 m, five years if it exceeds US $ 2.5 m.

In the light of these listed intentions, the main Eritrean challenge to Ethiopian regulation would come from **attracted foreign capital and favoured domestic accumulation through taxes exemptions.** But trade opportunity between Ethiopia and Eritrea appears also to be more likely. Indeed, the Eritrean investment policy is more manufacturing looking than the Ethiopian one. And to get manufacturing output, Eritrea has to import from Ethiopia agricultural raw materials. This economic interdependency should normally lead to further agreements with Ethiopia which is also the easiest market for Eritrean products. Obviously, this presumes a set of not defavourable customs and exchange rate policies from both areas. All this should normally lead to the creation of some Customs Union between Eritrea and Ethiopia at the mutual benefit of both areas.

Increased pressures on the Birr parity

Challenge to Ethiopian macro policy may also come from the Eritrean Birr parity. Indeed, in 1991, the Eritrean Authorities devaluated the Ethiopian Birr (compared to the US dollar always) at the opposite of the Ethiopian ones. This has led the **Ethiopian** private operators to expect the same and to proceed on the parallel market at a rate different from the official one during a waiting period not yet ended. This has continued although the Eritrean Authorities re-established the late parity after signing an economic agreement with the Ethiopian ones (para. 52). For the present, the result is that on Ethiopia's parallel market the rate of exchange of the Birr is approximately the previously devaluated Eritrean one*(28)*. This leads to increased smuggling and contraband*(29)* and a process of pure profit speculation difficult to get rid of or at least to manage. Further, this expands dangerously the stock of money in circulation so that the risk of having more inflation than recently increases.

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28 And this one is in fact inherited from the end of the DERG-regime (para. 10).
29 Political reasons also explain increased smuggling (para. 38-39).

B2 - Ethiopia and Djibouti

75. Despite its agreement with Eritrea, Ethiopia has turned to Djibouti **to secure some links with the international markets.** For instance, it has negociated new store facilities. In the case of unresolved difficulties with Eritrea with as result increased dependency on Djibouti new Ethiopian transport facilities (not emphasized in the EPTP) would have to be provided. Ethiopian Authorities are aware of what could be the Djibouti challenge. They have designed a committee at the ONCCP (Ministry of Planning) to tackle with the Djibouti issues. Djibouti could not only be a challenge to Ethiopia. It could help the country to recover. Let us illuminate the Djibouti issues on the basis of a document from the related ONCPP committee*(30)*.

76. **Officially, the amount of trade between Ethiopia and Djibouti in recent years averages around forty million US Dollar. The unregistered trade turnover is estimated to be about five times as much.** It is mainly explained by a well developed inter-border in spite of unproper Ethiopian socio-economic policy and unfavourable price policies on the Ethiopian side. A well known example is that of chat (or khat). Chat is a chewable plant and is one of the major Ethiopian exports to Djibouti (fifteen million US Dollar yearly). Practically all the legal "chat" has gone underground in 1991 because of unfavourable relative prices. The Djibouti area has been an outlet of most of Southern Ethiopia's exports to the rest of the world for centuries as the traditional trade route was served by seaports in that region (Tadjura in today's Djibouti, Zeila and Berbera in Northern Somalia). Reciprocally, the dominance of informally imported manufactured goods from East Asia in Ethiopian markets was proof of the extensive trade relations with Djibouti. It is also worth indicating that Djibouti apart from consuming Ethiopian produce re-exported most of these goods to the vast Middle East Market.

77. In the light of the preceding, it appears that the Djibouti issues (the old and new expected ones) could be very important for Ethiopia's growth :

(i) they could permit Ethiopia in partnership with Djibouti to exploit its hitherto untapped trade potentials with the Arab world ;

(ii) they could make Ethiopia's imports cheaper for Djiboutians could facilitate and even process some ones for the mutual benefit of both peoples ;

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30 The two following paragraphs are quoted from this document written by Tesfaye Asfaw (from the ONCCP).

(iii) they could create a conducive environment encouraging unregistered business to become legal ;

(iv) they could help to revitalize Ethiopian self-administrative regions bordering Djibouti (the Afar and Somali regions) ;

(v) they could help both countries in securing international assistance to modernize their fragile infrastructural facilities in general and the ancient railway line in particular.

B3 – The household energy consumption

78. Paradoxically, the EPTP raises the point of natural resources conservation and development but without giving attention **to household energy consumption** which is a major cause for deforestation in all rural areas (and for misfedings in urban centers : recurrent shortages of kerosene and gaz). **Further an energy concern is completely missing from the EPTP** but it will be touched through the new investment code. Indeed, the energy sector is an investment opportunity where foreign capital would be particularly welcome (5– para. 56).

B4 – Poverty

79. The fourth omitted issue is poverty. Very surprisingly (at least to me), poverty to alleviate is not adressed as **an issue** in the EPTP although it is the dominant feature of the Ethiopian society since many years (so long, too long). When neglecting politics, most likely, this is the result of a belief that growth **sustained** by a market-based economy will be **the** solution to poverty at long-run. Indeed, when there is not very much to share better is to try to increase what would be shared. In this respect, it is worth indicating that market functioning implies some economic operators endowned with purchasing power otherwise there would be no buyers **and** some other ones with a surplus of production otherwise there would be no sellers. When these conditions lack, there is no market or more precisely no monetary market economy. Then, the economy is a barter one where people only survive and the domestic currency is no more a way to trade. Here let us just recall **that 60 per cent of the Ethiopian population live in a subsistence economy where monetary market does not matter**. Further, let us also indicate

that the surplus which comes from agriculture which dominates GDP, employment and exports receipts is very low. It reaches the amount of **18 gr per day and person.** This has led the WB to indicate that agriculture supply should increase by 33 per cent on average during ten years in conjunction with an import increase of 30 per cent by year to secure food consumption in Ethiopia. With regard to gross purchasing power, the situation is as follows (in 1989) : in the agriculture sector where 80 per cent of the labour force works, the average income per person and year is approximately US $ 141, while the average values for people from the industry, the manufacturing and the services sectors (20 per cent of the labour force) are respectively US $ 445,1184 and 1135. Within the agriculture sector the revenue is US $ 35 for people from the subsistence sub-sector*(31)*.

80. From that preceeds it appears that to look at poverty when focusing on the transition to a more market-oriented economy is fundamental. It means to carefully investigate the question of **poverty in agriculture** and, in this respect, to raise the following point : why is the Ethiopian agriculture poor. The answer matters because it will influe on the efficiency of the expected agriculture policy and, so, on future growth impulses. Therefore a specific policy accounting for poverty would be welcome not only for growth but also in terms of the society identification process, a key issue for peace and democracy (para. 35 to 37). This policy could be much more helpful to secure peace (leading to democracy) than the expected decentralization process (which is on the agenda). Indeed, this process will cost money to Ethiopia before becoming fruitful (if ever). Further, it could also re-create bureaucracy at different levels. When poverty is high and generalized, it does not matter to modify its administrative shaping. Poverty as such not to look at is also a pure political question, that of a State accepting responsibility for misery. The poverty question should normally lead to a focus on **demographic trends.** Indeed, at given income growth (which could very well likely be the most favourable result during the period of macroeconomic stabilization), increased fertility rate and decreased infant mortality one (see annex 2), **increased poverty is what has normally to be expected.** At long run the (real) per capita consumption elasticity to per capita real income is 0.91*(32)*. This accounted for with a real income growth of 0% (at best) and a 3% increase of the population means that basic welfare would reduce by 2.79% per year. Is this still an acceptable figure even for a transitional economy. And further, one of the poorest in the world ?

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31 These data have been computed using value added at factor cost except for manufacturing for which it is earnings. The subsistence data comes from an OECD publication [19 : -Books- p.46].

32 Results from the estimation of some econometric relationships on Ethiopia. Work done in co-operation with an OECD econometrician (N. Troubat).

B5 – Immediate food self-reliance improvement

81. **That is the first key issue of the short run priority areas for the transitional period, because it is the most tangible to people.** It has nothing to do with peasants agriculture revitalization or boosting but with how to get an **immediate** increase of agriculture output supply. Indeed, there are 9 m people at risk of famine in Ethiopia (6.5 m in districts where drought has killed the crops, the rest mostly victims of the late civil war). To tackle with the related issue would have meant to deliver seeds and water-tanks if people were to plant for the next harvest and more over medical care. This has not been done up to now.

B6 – Factors of production to privatize the Ethiopian economy

The related issues are illuminated below (sections B9–B10 and C para. 94).

B7 – The promotion of markets functioning at the macro level(33)

82. The question has to be adressed in the framework of factors of production markets **which are not touched through the EPTP**. Indeed, labour and capital have to be "represented" at the macro level to permit social agreements on productivity and wage, mainly, to be reached between workers and employers. This presumes trade and employers **unions** being recognized rights related to markets functioning of the economy. This is not only a question of social stability but also of intersectoral costs linkage and competitiveness. The rights to be given to factors of production unions is required by the Chamber of Commerce. An answer will be given through the new Labour law. Workers and employers unions to favour is also a way to focus on factory and regulation identification processes (para. 35). This may help to close the credibility gap between economic partners.

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33 For more on the analysis of market functioning in Ethiopia, the reader has to refer to the related document issued by the working group.

B8 - The establishment of an independent monetary authority and the promotion of commercial banks

83. The importance of firm monetary control in stabilization efforts is well documented. Strong monetary control in a market-oriented economy requires a **central banking system** able to stabilize the economy indirectly by adjusting interest rates or other policy instruments. Establishing such an institution is especially critical in late command economies where controls over production and resource allocation and the absence of commercial banking activities may have obscured the importance of a strong monetary authority i.e. first of all **an independent from the State's one**. The cruciality of such an issue has been illuminated in the case of Asian success stories like Hong Kong, Korea, Singapore and Taiwan Province of China*(34)*. Two common characteristic stood out : the absence of pressure for monetary expansion to finance large and continuous fiscal deficits and the fact that none of the four countries allowed its currency to appreciate in real terms solely as a result of inflationary monetary expansion. In the light of the EPTP, it is not clear at all how the Ethiopian Authorities emphasize such an issue. Indeed, it has been indicated that the major financial institutions would stay under state ownership in order to ensure that they would play their proper role in the process of economic development (while making profit). So given, the quality of the monetary control would first of all reflect the government's priorities. In this respect, the EPTP indicates that the monetary policy should be such as to ward off inflationary trends and fiscal policy should achieve fiscal balance. Then, the question is : is it not easier to fulfill the preceding targets with the help of an independent monetary authority as it is the case in most market economies. This is obviously a debatable question. And, finally, let us also mention that **monetary control is particularly crucial at the beginning of the transition process, just before to remove various restrictions**. Indeed, monetary control to be established permits any "monetary overhang" to eliminate. That prevents the possibility of large increases in consumer spending (and imports) from the liquidation of outstanding monetary balances. Only then can monetary policy maintain a reasonable degree of stability in both the price level and the macroeconomic environment. If restrictions on trade and (maybe currency convertibility) are removed before the monetary

34 Investigation was due to Maxwell J. Fry : "Financial Structure, Monetary Policy and Economic Growth in Hong Kong, Singapore, Taiwan and South Korea, 1960-1983" in Export-Oriented Development Strategies, ed. by Vittorio Corbo and others (London Westview Press, 1985). Sargent (1982) in his study of ending hyperinflation, also stressed the critical role of strong fiscal discipline in re-establishing macroeconomic stability. Thomas J. Sargent : "The Ends of Four Big Inflation" in Inflation : Causes and Effects ed. by Rober E. Hall (Chicago : University of Chicago Press, 1982).

overhang is eliminated the opportunity to use domestic money balances to purchase imported goods will drain foreign exchange reserves and put strong pressure on exchange and interest rates. From these viewpoints monetary control should have been applied once the DERG announced its reforms. This would have permitted to reduce recent private consumption price increase and the pressures on the Birr parity.

84. The **need** to promote a commercial banking system is not emphasized. This also is a crucial issue. Indeed, market price mechanisms do not function appropriately when producers are not subject to "the discipline of the bottom line" i.e. could no more expect the State would routinely cover their losses or disguise these ones. Therefore, the hardening of budget contraint with as a result the promotion of a commercial banking system is a particularly important step that should accompany the rest of the reforms. In this respect, the EPTP is weak because it is just said that domestic private capital will be encouraged to participate in banking (and insurance activities). It is worth recalling (see para. 47, 57 and 63) that the promotion of private commercial banks in a way to :

(i) favour markets integration (the real and financial ones ; the formal and informal ones) ;

(ii) get capital inflows ;

(iii) create investment opportunities ;

(iv) reconcile the State and the private sector (para. 62–63).

It has to be added that it is also a way to eliminate the monetary overhang either from the formal or informal sector or both. A very serious risk in Ethiopia for the present. Further, **it could also be a way to soften labour redundacy and expected real wage decrease in Ethiopia.** Indeed, when firms are either unable to borrow from either the central bank or the private sector or very much credit constrained, their liquidity is entirely given by the stock of money they hold. This stock cannot be changed unless the firms sell inventories. In this situation, a liquidity crunch and an input loss can develop, for instance, if there is a one–step rise in the price of input respective of what happens with output prices. Then, firms will try to offset the liquidity crunch by drastically lowering real wages until a level of liquidity consistent with full–capacity utilization being restored.

Such a scenario has already occured in the late Eastern countries, particularly in Poland. In such a situation there is increased labour shedding in conjunction with real wage decrease. In Ethiopia, this could lead to increased labour shedding and a decrease of the real wage from the formal sectors till the level reached on the informal market or even below. So, this would reinforce the position of the informal sectors compared to the formal ones from the profitability viewpoint (no taxes to be paid to the State, no social concern).

B9 - The informal sector

85. This issue is a very important one. Indeed, Ethiopia is embarked upon a transition to be fully informal-marketed*(35)*. Through the **announced reforms** (the DERG-regime's ones and the EPTP) this is a result of the **government's drastically reduced legitimacy and operationality. As the degree of society identification reduces (being challenged by that of private groups identification) so does that of acceptation to pay for the State's mandatory functions. This informalization process is also a reflection of people seeking for solutions to increased poverty. But, whatever it is the fact remains that a market-based economy has already begun functioning in Ethiopia.** The importance of the unregistered trade may be as follows : the daily turn-over of mercato (which is the big market at Addis Ababa and likely also the biggest one in Africa) could be of Birr 5m*(36)* compared to a yearly GDP figure of Birr 10 billion.

86. An informal economy is a set of interrelated channels through which trade but also employment, prices, saving, fiscal receipts, foreign currency and exchange rate, etc... escape de facto from established government's market regulation. Further, applied policy is challenged. At the moment, this is obvious in terms of the parallel exchange rate which increases the pressure to devaluate the Ethiopian Birr, but not only. Indeed, there is also challenge to the expected privatization of the economy for **informal entrepreneurs are "the animal spirits"**

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35 The reader has to be aware that the definition of the informal sector is a matter of opinion. In this respect the Director General of the ILO wrote : "After two decades of investigation by scholars and international civil servants, there is still no generally accepted definition of the term informal sector (The Dilemma of the Informal Sector, Report of the Director General, p. 1). So, given the ILO groups in the informal sector all activities where employment is below ten workers".

36 Information obtained when being on mission at A.A. The reader has to remain aware that it was not possible to check that figure by using rigorous procedures.

of the country for the present. Moreover, **they also represent some potential domestic accumulation** in a country featured by shortage of saving on investment and foreign aid on domestic financial resources. "Endowned" with a very meaningful informal sector Ethiopia could be a test-case for developing countries embarked upon analogous transition. Then, the question to be adressed would be how **to combine informal private initiative and macro planning when there has been strong challenged process of society identification** and so government regulation and policy. The solution is not simply to modify relative prices, generally through price liberalization leading to price increase. But maybe, more fundamentally, **to improve political** order and information so as to get increased transparency (of any sort) and legitimacy and **to promote specific policy looking to the informal sector in conjunction with the privatization of the all economy.** The first one may permit people to understand better who is responsible for the past, where they are going, what are the costs of the transition at their level and how to voluntarily participate or protest. As such a process of reconciliation may operate. Further, the government will gain credibility in front of the population. The second will favour competition **within** the all set of activities.

87. The preceding requirements are fundamental for an **efficient market-based economy** to function. Indeed, when one speaks about demand and supply one refers to traders, the people which buy and sell. At the exception of wealth, there is no other difference between private operators. Therefore, the price determination does not result from traders but from **trade.** Prices move to balance supply and demand. They are the signals that direct resources to their most efficient uses. When prices are freed, scarce goods become more expensive, but that is the incentive for more production. In the case of an **informal economy,** supply is managed by a limited number of people or better families at the opposite of demand. Therefore **the market structure is that of monopoly.** Further, it is also that of a coalition of monopolies. Then, in the eventuality of price liberalization leading to price increase in the formal sector, expected additional supply will be meaningfully captured by monopolists because their purchasing power is higher than that of the private operators from the formal sector. **This creates a process of price determination in terms of monopoly, only.** So, supply increases as the informal activities or monopolies because these ones remain always more profitable than the formal ones (no taxation, no social concern). **In this framework, the price reform leads to strengthen informal activities and a monopoly price determination. Further, price increase as long as the demand gap does not**

vanish through monetary devaluation (of the internal value of the currency). In this respect, the expected upswing of privately-managed formal activities will be strongly constrained for the monopoly purchasing power, trade relations, act as **barriers to entry** on the supply market*(37)*. To reduce the preceding risks, the government has to issue specific policies favouring competition at long run and to gain increased credibility.

88. Economists and policy makers know what are policies favouring competition at long run in the framework of formal activities. In the case of dominant informal activities and related monopolies the things are much more obscure. Here, the attempt is **not** to prejudice monopolies (of the informal sector) as such. Indeed, they create job opportunities, meet various needs of the population very well, bring advance in production, etc... at a time where the transition challenges the government's policy in terms of growth, income, needs, etc... **So, the government cannot prejudice the informal sector without prejudicing the economic targets of its policy. Then, it has to use the informal sector and its related monopolies to fulfill the targets of its macro policy. Therefore, it should favour the informal activities through specific policy including those reinforcing competition amongst the monopoly activities.** This taken into account with policy favouring private domestic accumulation in the formal sectors would **promote competition everywhere in the economy at minimized social costs.** Further, this would permit the government to tax the informal activities. Such a policy has been pursued in P.R. China particularly in the 1980s*(38)*. The policy has been to encourage and support the informal sector on the one side and on the other to persude the related entrepreneurs to observe regulations and abide by the law. Two measures have been relevant in this respect. The first one has been **to issue licence for business on the basis of which to benefit from the government'support** ; the second, **to reform the business tax so as to get informal businessmen paying a certain amount in conjunction with encouraging them to do more business.** That policy which has not led to register unregistered trade has been a success up to now. The total levyed taxes from the related sector has gone from Yuan 6 billion in 1986 to 14.5 in 1990. Such measures would be very helpful to Ethiopia because they would be based on what can be thought of as **a factor of production of the country, the informal sector, which cannot be prejudiced without prejudicing the all transition.**

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37 The preceding scenario occured in many developing countries embarked upon market reforms. It also featured the late Eastern countries.
38 I discussed the later point attending a short meeting at the UNESCO (Monday, Feb.10, 1991).

B10 - The demobilized soldiers

89. It is an issue which has not to be introduced in the framework of **regional rehabilitation**, but in that of the country **employment challenge.** Something like 1 m soldiers (militias included) have to be demobilized*(39)*. This precisely means 300,000 to 500,000 **jobs to offer** (at least)*(40)*. Up to now the Ethiopian Authorities have raised the question in terms of further foreign aid requirement needed to send the soldiers back home. They ask for US $ 154 m to cover the living expenditure for one year as far as the urban population is concerned, 15 months in the case of rural people. To demobilize soldiers i.e. being given job or money to wait for (or create) a job, to go back to farming reveal not only an employment opportunity problem but also that of **skills**. Indeed, the army (militias not included) was the best trained power the country had. So, the army is quasi the lonely resource of skills immediately available for restructured state farms and factories and expected increased privatization of the economy (when neglecting the informal entrepreneurs). The US government has an agreement with the Ethiopian one under which :

(i) a reduced army would be reconstructed ;

(ii) the rest would have to be accomodated **properly**.

In this respect, it is worth indicating that no much progress have been made up to now. Contrarily to the Eritrean Authorities, the Ethiopian ones seem not aware that the restoration of the country's basic infrastructure and power generation station could offer opportunities to accomodate properly with demobilized soldiers. As an outcome, the army is in the way to be accomodating by political groups (para. 37) with few gains for peace and growth and likely increased informal or really **illicit** activities. Apart from the army there was another source of skills, that of the late "communist party". It represented the country capabilities to **organize**, manage, etc... From this viewpoint, the decision to made the party illegal, contrarily to open expressed US views, might be an economic nonsense. **If one accounts for no much**

39 Not accounted for the Eritrean soldiers : This information has been given to me when being on mission to AA. If one accounts for the soldiers' families between 1 to 2 m people have to be helped to go back home.
40 Militias non included but can we really think to get the related people demobilized without offering them a job ?

progress made to accomodate demobilized soldiers properly and trend to increased informal activities one can say that for the present Ethiopia cannot really expect increased privatization of the formal economy. Therefore, the risk of getting a market-based economy only through the informal activities is high. This again pleads for specific policies encouraging and strengthening the informal sector otherwise growth stabilization (which is expected till the free elections) would not occur. What would occur in this case, nobody knows.

90. In the light of the preceding, it appears that the EPTP is not very economically relevant. For instance, it neglects when spelling out the short run priority areas three challenges which are particularly tangible to people. There are food self-reliance to modify so as to reduce risks to famine for the present time, demobilized soldiers to be properly accomodated and poverty to focus. With regard to macro stabilization, it neglects the lonely factor of production the country has at short term to create growth and employment : the informal sector. Further, it does not explicitly emphasize the need to modify the banking system so as to ease (at least) macroeconomic stabilization. Being first of all a document reflecting a broad political consensus, one can understand why Eritrean issues have been omitted. Indeed, Eritreans who have the power now (in Eritrea) are allied to the coalition which is ruling Ethiopia. So, the EPTP is a document securing peace between all Ethiopian forces i.e. the Eritrean ones included.

C - A NEED FOR EPTP CLARIFICATION

91. In the preceding framework, it is worth indicating that the EPTP needs some clarification in many cases. Beyond the fact that it is first of all a macro framework of listed intentions on the basis of which to decide for neutral political commitments, the insufficient degree of clarification could be due to a certain one of ignorance related to market dynamics*(41)*. Let us just indicate a few relevant examples. What does that mean a fair system of taxation in agriculture ; -to help peasants to obtain fair prices for their produce ; -to prevent consumers and producers from grain price fluctuations ; -to advocate the development of large-scale commercial farms in conjunction with putting restrictions on land

41 For the moment, there are only two economists working within the Economic Unit of the President. Funds for more have been asked to the WB. The economists staff working at the Council of Representatives level is also reduced.

allocation to investors ; –to give **adequate** guarantees and incentives to the foreign investors ; –to **secure** external resources ; –to **favour voluntary** resettlements and villagization, **voluntary** formation of co–operatives and associations ; –to undertake **gradual** adjustment of the Birr parity to the US dollar. Indeed, all these assertions get naturally their definitions in a command economy but this is no more the case with a market one. For instance, in such an economy **prices result** normally from demand and supply adjustment. So, scarced goods (or services) get higher prices. Since Ethiopia is a shortage economy, prices paid to the producers should normally increase for many goods and services in the case of the expected reform so as to close the gap. This would be true except when some investment surplus would have to remain extracted from a given sector, the agriculture one in Ethiopia (para. 50)). **Prices fluctuate normally**, then what is the level of abnormal fluctuation on the basis of which the State should intervene. Taxation may be a burden but **not purely in terms of the related rates, also given market dynamics.** Large–scale commercial farms are first of all market investment **opportunities** and not government's decision. Incentives to foreign investors have to be such as equalizing domestic and international return to capital of assets bearing the same risks. **So, they are very exogenous to a government's decision.** Rights to move or to co–operate are **privately–managed ones**. But there are a lot of pervasive ways to influe on these rights (specially when people are poor or in extreme destitution) so as to get voluntary and collective decisions. The Birr issue is illuminated further.

92. The need for further clarification could also be due **to some recognized (even if it is not written) unability to do something in the short–run** (1991–93). For instance, what does that mean **to boost local agriculture supporting services given the disruption of local service co–operatives in most areas.** Further, what is the **real meaning of fiscal balance when decentralization of economic management is on the agenda** with as expected results economic prerogatives to the new local governments particularly in the fields of tax collection, transfer of responsability for public expenditure or when it is indicated that sizeable budget deficits will continue. Short–run constraints might also be relevant in the case of the **remaining state land ownership given the time needed to get a cadastral survey** ; or in that how **to mix profitability and social concern when restructuring state farms or enterprises**, or that how to **detail monetary policy** (credit ceilings, interest rates, ...) given there is not even a budget for the current fiscal year.

93. The need for clarification could also be a reflection of political compromise between marxists and market reformists (para. 2) given a belief that market adjustment could not be perfect (if ever it can) i.e. could lead to conflicts with the given announced targets. This might explain why : **price liberalization could be somewhat constrained** (agriculture, retail trade, road transport) ; **-the government strongly has indicated its intention to regulate domestic trade when simultaneously inviting the private sector to take over this trade particularly the retail one***(42)*, the same being true for the road transport sector ; -the state foreign trade marketing agencies would **remain although competing with private exporters and retain their regulating functions** (ETIMEX) ; -the government has advocated to decide on exporters' retention earnings on a **case-by-case** agreement ; -the government has emphasized market rules for all traders (management autonomy for instance) except in the case of financial institutions. With regard to these ones it has the intention **to guide** them so as to permit these ones to play their role in the country's development **while making profit**, and to **reduce the private sector's competition** in that sector.

94. Amongst all the issues which need some clarification, two are very relevant to the international community including the Ethiopian diaspora leaving in the US (Washington DC, mainly)*(43)*. **There are adequate guarantees and incentives given to foreign investors and the gradual adjustment of the Birr parity**. This later issue is illuminated at section D2 which follows. So let us focus only and very briefly on the "foreign investors" issue. The EPTP emphasizes the need to support and encourage increased privatization of the economy. But as such, it is presumed (for the related issue is not touched through the EPTP) there would **be enough adequate factors of privatization within the Ethiopian economy***(44)*. More precisely, it means there are candidates to become private operators, a certain level of saving they can invest and available auditing services to price the state farms and enterprises to be sold (but not only). The reality might be much more obscure than that. Indeed, one has to account for the increased weight of the informal activities where the "animal spirits" of Ethiopia vanish for the present time and, moreover, for a very low level of registered private saving (or monetary

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42 The litmus test of the government's intentions in this area will be the dismantling or otherwise of EDDC (Ethiopian Domestic Distribution Centre) and its retail branches, and the willingness to let private sector compete with other marketing agencies : AMC (Agriculture Marketing Corporation), AISCO (Agriculture Input Supply Corporation), OPEC (Oilseeds and Pulses Export Corporation), ECMC (Ethiopian Coffee Marketing Corporation)).

43 It is influent on the World Bank for the latter requires advices and comments when preparing drafts on Ethiopia (comment given to me by some W.B's staff member when being on mission to AA).

44 The EPTP nevertheless emphasizes the need to get a study related to a broad scope of manpower issues (para.30).

overhang) (saving ratio of 0.12 per cent in 1990/91 ; in absolute terms, saving declined from Birr 703 million in 1989/90 to a negative Birr 14.8 million in 1990/91). Therefore, when neglecting the informal sector, the question of privatized economy could very much be how to attract urgently private foreign capital so as to create income and employment (and fiscal receipts) at first glance and opportunities for domestic accumulation (privatization) at second. Then, apart from state firms, industries and farms which cannot be run profitably and then should be either closed down or privatized(45) and banking which remains close to private initiative what could be the main fields of investment to foreign capital. **Nobody knows if there are any at given international costs and return to capital. In this respect, the EPTP could lack from relevancy because it may lead to conclude (through the priority given to the domestic investors in many activities ; the unclear treatment given to foreign capital) that foreign investors are not particularly needed or welcome. This although economic rationality would lead to urgently open the economy to foreign capital.** Unless the investment code permits practically to clarify the government's real position to foreign capital this might affect the process of macroeconomic stabilization through increased pressure to devaluate the Birr. The main rationale behind that would be economic operators being sure the government has no other choice but to accept this measure to get rapatried funds, external resources and foreign direct investment favouring privatized Ethiopian economy. This would reduce the government's operationality and as such the efficiency and sustainability of the EPTP. To conclude, **the EPTP lacks from relevancy. It is a political document to sustain peace. As a guidelines document to apply macro policy it needs (i) to spell out relevant priorities (ii), to include a set of omitted subjects and (iii) to be clarified on a lot of relevant issues. Rather unfortunality amongst the omitted subjects are the main challenges to the Ethiopian society for the present and the future i.e. famine, employment and poverty.**

D - THE EPTP COMPARED TO A WB'S ADJUSTMENT PROGRAMME (W B'S A.P.) THAT COULD HAVE BEEN ISSUED UNDER THE SAME CIRCUMSTANCES

95. The comparison is made in general and specific terms. In the later case this means in those of foreign trade tariffs, the banking and the Birr parity adjustment issue. As such the appreciation of the room for action of the Ethiopian Authorities in front of the international donors community (including the Ethiopian diaspora) is better balanced.

45 More likely by foreign capital given the lack of interest for large-scale plants of the domestic private sector.

D1 – A global comparison

96. The EPTP could easily be a WB's A.P. issued under the same circumstances. Indeed and quite analogously, it put the emphasis **on the same determinants of growth** and pleads for **the same stance of macro policy to restore macroeconomic stability** :

Determinants of growth

(i) dominant privately-operated activities ;

(ii) a reduce role of the State in the investment process decision making ;

(iii) market rules for all traders.

As an outcome of points (i) to (iii) people have to be recognized rights to act as free traders and state firms, industries and farms have to be restructured ; privatization has to be expanded.

Macro policy

(i) a monetary policy to regulate ramping inflation ;
(but the content of this policy has not yet been determined)

(ii) a balance fiscal policy with the creation of new tax and budgetary systems ;
(but budget deficit is said to remain sizeable despite the government's intentions)

(iii) a major price liberalization ;
(but some regulated commodities would remain, the fertilizers, for instance)

(iv) a wage policy that has to stay under control as long as labour productivity has not been strengthened ;
(but labour shedding would be possible)

(v) a foreign trade policy where quantitative restrictions are removed ;
(but they are replaced with tariffs)

So, the EPTP indicates that the Ethiopian government could accept the logic of a W.B's A.P. even if it would be the case with some reserves or differences (as how the WB would apply macro policy in the Ethiopian case) and although the sequencing and the speed of Ethiopian economic reforms have not yet been officially indicated. Also from the viewpoint of some omitted factors there is convergency. For instance, the WB's AP does not generally focus on poverty (and people's destitution) as such*(46)*. This is also true for famine. Major differences are likely due to the departing framework of war and the political features of people grouped around the common Charter*(47)*. And maybe also to other facts (degree of ignorance, unability to do something in the short-run, recognized imperfect market adjustment process, para. 91 to 93). **Differences are as follows** :

(i) the EPTP is a **political document to secure and strengthen peace** ;

(ii) through it the government intends to **favour domestic private capital** compared to the **foreign one** (not deliberately it seems but on the basis of comparative advantages) ;

(iii) it intends to **mix economic and social concern at the beginning of the transition***(46)* ;

(iv) it intends to favour voluntary people participation in conjunction with privately-operated activities ;

(v) the EPTP does not indicate the need to establish a central banking system able to stabilize the economy independently from the state's support or pressures ;

(vi) it does not support the view of establishing commercial banking activities while private operators are supposed to be ruled by the bottom line discipline ;

(vii) it does not remove all foreign trade restrictions (tariffs are substituted for the quantitative ones). Further international payments remain constrained*(48)* ;

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46 The World Bank recognizes that there is social costs in case of structural adjustment. But it says that is the price an economy has to pay as long as it is not a market-oriented one and further an international competitive one.

47 Several analysts at A.A. indicated that they could be more political reformists than economic ones.

48 From this viewpoint the abolition of the franco valuta system could very well be a step backward. It would also affect fiscal receipts (para. 53).

(viii) it does not put forward the links between monetary policy, interest and exchange rates ;

(ix) it adresses the question of the modification of the Birr parity on a gradual perspective and carefully i.e. without neglecting other alternatives.

97. The preceding given, one has to indicate that, through a set of maintained prerogatives though always easy to legitimize on basis of some economic rationality, the State remains able to **oversee** or prejudice private initiative. As such, the EPTP does not send the same message to the private sector as would be the case with a WB'AP. This could have something to do with some political compromise at the government's level as with some natural suspiciousness between both economic partners. Suspiciousness means that the credibility gap is much more difficult to close in case of the EPTP than in that of a WB'AP which would be exactly the same. This is even more true when they are some differences although quite legitimate ones. The prerogatives are :

(i) a dominant **state ownership** of basic goods sectors and of financing ;

(ii) the **overseeing** of the private investment through ministerial approval ;

(iii) a banking sector i.e. a **credit policy** which remains **closed to the private initiative** ;

(iv) **a state allocation of export (and tourims) earnings** ;

(v) an expected specific **regulation** to be issued for the domestic **trade** ;

(vi) an **open** price policy **somewhat constrained** ;

(vii) a **state** decided scheme of the voting rights at the **enterprise** boards level.

D2 – A comparison through the foreign trade tariffs, the banking and the Birr parity questions

98. Now, let us comment a little bit on the three issues which could be very costful to Ethiopia given economic operators' (domestic and foreigners) rational (may be) expectations and behaviours and World Bank's views on these questions. These issues are :

(i) the substitution of tariffs for quantitative restrictions in foreign trade ;

(ii) the privatization of banking ;

and

(iii) the Birr adjustment parity.

1. Foreign trade tariffs

99. **Through the EPTP the Ethiopian government intends to promote import substitution activities in conjunction with exports ones. This in the framework of imports tariffs being substituted for quantitative restrictions. Depending on what could be the accompanying policy related to exports such an announced policy could very well be inconsistent from the exporters viewpoints.** Indeed, the induced relative price changes (of the importables relative to exportables and non–tradeables) on the import side may mean that the protection of importables is achieved by the (implicit) taxing of other domestic activities besides import. Examination of the ways in which the burdens of taxes (and subsidies) are shifted on to other groups of producers and consumers is a critical element in the evaluation of trade policy. Such an examination indicates the true protection of importables and the extent of the shifting of the burden of protection on to exportables and non–tradeables. The share or incidence of this burden depends essentially on the degree of substituability (in demand and production) between the products of the importable sector and the other unprotected sectors. Economists developed a method of the **true protection rate.** It consists to estimate the shifting parameter through regression analysis where the explained variable is

the price for non-tradeable goods on the export ones and the major*(49)* explaining one the import price relative to the export one. The parameter has to range between zero and one. When it tends towards unity, this indicates that the increase in non-tradeables goods will tend towards that of the importables. A value going to zero indicates that the prices of non-tradeable goods follow the export ones. In the first case non-tradeables and importables are close substitutes, whereas in the second there is substitution between exportables and non-tradeables. The parameter reveals the extent of the shifting of the incidence of protection on to exportables. The higher is the parameter the greater the shifting effect.

100. **The preceding method has been applied to Ethiopia. The shifting parameter amounts 0.82.** Although being biased for one used the domestic consumption deflator*(50)* for the non-tradeable price, **it indicates that intervention to protect imports operate as an export tax.** This result is fully consistent with other ones on the same subject. Indeed, in Africa, on average 77 per cent of all intervention operates as an export tax*(51)*. The knowledge of the shifting parameter permits to compute **the true protection** rate of imports*(51)*. For instance, in 1987 (last available data) **the nominal import protection rate** (computed roughly as the ratio of import duties to import values) **was 19 per cent while the true one reached the value of only 3 per cent.** At the opposite, **the rate of export taxation** (computed roughly as the ratio of export duties to export values) increased **from 19 to 30 per cent.** In the light of the preceding, one understands why the WB advocates the need to **reduce import tariffs.** Indeed, through induced relative import price shifts, import tariffs bias the allocations of resources against exports. Further, they favour the activities of import substitution which is generally the focus of the informal sector. **So, import tariffs prejudice exports and favour informal activities. But they favour the budget at least at short run.** From the later viewpoint, an investigation of what could be the budget elasticity to growth and to the tariffs would be welcome.

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49 Other variables such as the GDP and the Balance of Payments (both in real terms) are introduced in the equation to account for disequilibrium. Indeed, the true protection rate has been developed under the critical theoretical assumption of equilibrium.

50 The only available to us being in Paris.

51 For more detailed analysis and computation, see for instance

D. Greenaway and Ch. Milner : "True Protection : concepts and their role in evaluating trade policies in LDCs", The Journal of Dvlpt Studies, vol. 23, nber 2.

I. Dem, A. Sogodogo, M-P. Verlaeten : "La protection dans les échanges commerciaux : arguments, formes, mesures et applications aux pays de l'Afrique subsaharienne", DIAL, oct.91.

2. Banking

101. To create a private banking system (refer also to para. 47, 57, 62, 63 and 84) presumes to be able to appreciate what is **the domestic capital market flexibility**. Indeed, this permits to **appreciate** what could be **the departing market nominal interest rate** to be determined and, so the real one, once **one can forecast the inflation rate.** A real positive interest rate is indeed the preliminary condition to get a market banking system. A team from the IMF recently worked on the subject. It published a macroeconometric model for developing countries allowing the hypothetis of capital mobility to be explicitly tested. One estimated some parts of the model in the framework of Ethiopia. To appreciate what could be the Ethiopian capital market mobility one needs to estimate a demand for real balances equation and an interest rate one. Once this has been done, one solves the (real) money demand equation for the nominal interest rate when a shadow money supply has been substituted for the demand one. The shadow amount is obtained by removing from the supply of money the effects of current private capital flows on the central bank's stock of foreign exchange reserves. The obtained interest rate is then introduced in the interest rate equation as an explaining variable with the international interest rate and the expected change in the value of the domestic currency. So, one gets an estimated parameter of the domestic capital market flexibility. It ranges between zero and unity. When it is equal to 1, it implies that the domestic interest rate is determined by the uncovered interest parity condition (i.e. the roles of the international interest rate and the expectations, only), and thus corresponds to perfect capital mobility, at the opposite when it has the value of zero. In this later case the interest rate is determined by a completely closed capital account. As the parameter increases from zero to unity, the degree of capital mobility increases, since the interest rate approaches its uncovered parity value.

102. The preceding method has been applied to Ethiopian data from 1960 to 1990. The method gives a value of the domestic capital market flexibility of **0.85** being strongly influenced by the period 1974–90 for which the test was also made. The results indicates an equivalent degree of capital flexibility for Ethiopia at long run compared to African standards. Indeed, for instance, one gets values ranging between 0.7 to 0.8 in the case of African countries belonging to the Franc Zone(52). In the light of results obtained by the IMF's team (1.04) the African values may appear low. But this is likely due to the belonging to the Franc Zone and the

52 Work done by N. Troubat being a DIAL's trainee in 1991.

policy applied by the DERG–regime in the case of Ethiopia (negative real interest rate on trend).. In the case of a liberalization of the banking system in Ethiopia, the preceding result on Ethiopian capital market flexibility would lead to an increase in the nominal interest rates. Indeed, Ethiopia through the link between Birr and US $ belongs implicitly to a dollar zone. So, this would lead the monetary authorities to follow some US leading rate. Then, the knowledge of a set of elasticities linking real balances to real income, inflation, interest rate and the money transaction costs would permit to compute the growth rate of real money supply to keep the Ethiopian leading interest rate constant as long as the US reference one is kept unchanged. But, depending on what would be the expected inflation rate such an interest one could not be enough to get a real positive interest rate. In this framework, the solution would be to stick the Ethiopian leading interest rate to the yearly expected inflation one. In this case the real interest rate would be zero at best. Then, money supply would be computed departing from expected inflation, only.

103. In Ethiopia, the IS curve is flat and the LM one steep. This is because investment is very sensitive to the interest rate (elasticity of about –1.5) and real balances to real income (elasticity of about 2.0)*(53)*. **Then, in the eventuality of an austerity monetary policy**, nominal interest rate would increase at given real income because a decrease of real money supply shifts the LM curve out to the left. The LM curve would thus cut the IS one at a lower real income level. Given the high elasticity of IS to the interest rate, **the real income decrease would be very high.** This indicates that **the only way to soften this depressing effect would be to get increased employment opportunities through capital inflows. Or put it in another way to get capital inflows in response to the nominal interest rate increase.** The preceding should lead the government to carefully investigate :

i) the available saving of the informal sector ;

ii) how to reach an agreement with this sector (which dominates the Chamber of Commerce) to create private banks.

A steep LM curve also implies some comparative effectiveness of monetary policy over fiscal policy even if a change to the later one is strongly advocated by the private sector (para. 62).

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53 Estimation made at DIAL's in co–operation with an OECD econometrician (N. Troubat).

3. Birr adjustment parity

104. The debate on some currency parity is a very complex one for it combines reasonings related to **the seek of an appropriate exchange rate** and that **how to get currency convertibility**. The first one is a condition of the second one while this latter is a challenge to macroeconomics.

i – An appropriate exchange rate

105. The question of how much a currency is overvalued (undervalued) as it is said for the Birr (the Birr exchange rate to the US dollar is fixed since February 1973 : 1 $ = 2.07 Birr) is a very difficult one. Indeed, first of all it presumes the analyst is able **to identify the real and speculative factors influencing the external value of the currency** ; second, it raises the question **to know which theory of exchange rate determination is the proper** one **to apply.** And third, it leads to conclude that **the selected theory would easily permit to measure the gap** of overvaluation (undervaluation) **with a high level of confidence.** All the preceding questions (or requirements) are difficult ones i.e. remain to be debatable because of the reality and/or in the light of mainstream economics. Let us illuminate the issues a little bit.

106. When there is an informal sector in a developing economy **there is always and, by definition, a certain amount of pertinent speculation on the local currency.** Likely because the informal sector can be thought of as the one where economic adjustments are more easy to make (no regulation, high level of labour market flexibility, etc...) than on the formal market. In this sense, it plays a role rather analogous to the financial sector in a developed economy compared to the real one. It sends signals of needed adjustments to the economic operators of the related country wherever they perform. Therefore, the quicker adjustments of this market may lead to exchange rate overshooting (or undershooting) as it is the case with the financial sector of some developed country. But at the difference of this country the links of integration between both markets (or sectors) are weaker and, as a result, the informal sector does not really send signals which are undoubtfully relevant for the economic operators performing in the formal sector. Very obviously, because the informal activities are related to **domestic** consumption while the formal ones i.e. the export sector, mainly, fullfil needs of **foreign**

consumption. So, the related goods... equilibrium are not the same. And furthermore, even if signals could be relevant there is a major constraint which is how the monetary authorities regulate money and exchange rate policies. In a developed economy, they account for both markets (the financial and real ones) signals (differently obviously according to the countries' regulation, stance of macro policy, etc...) and are generally independent from the political authorities. In a developing one, they account for formal market signals only. Further, very often the external value of the currency is given being determined through specific exogenous process (the Franc zone, for instance) or on the basis of high political decision (the currency as the country real flag) or to attempt to curb structural inflation given low productivity level and/or saving rate, to modify demand–supply imbalance. To conclude, on the first point, in a **developing country there is always an amount of pertinent speculation on the currency** (varying through time, obviously) **because the markets of the economy are not integrated and it exists permanent disequilibria**. So, one way to tackle with the related speculation is to modify drastically the economy so as to integrate its markets, and reduce the various disequilibria. **Therefore, when the analyst questions on the need to modify the exchange rate of some developing country (coping with informal market and speculation) it raises the point to know wether such a modified rate is the proper tool for adequate structural changes and what are the accompanying conditions to get the expected results.** In this respect, mainstream economics teaches us that the analyst seeks for a **supply** (or profit) multiplier greater than one to get growth acceleration and which would be revealed through a process of supply **diversification**(54) at given world markets (prices and structure). Indeed, what is needed at given world price is a modification of the real exchange rate leading to increased ploughing back of profits of the export sector (compared to the domestic one) and as such of financially sustained investment. This one would determine the capacity of production in nature and volume. This should normally lead to integrated markets on the basis of the expected general improvement of the economy efficiency and return to capital. Unfortunately, experiments made by developing countries since the 1970s indicate that the degree of succes to modify supply on the basis of devaluated exchange rate has not been very high at the opposite of the demand and labour depressing effects. Maybe was it due to unadequate accompanying conditions. Who knows ? At the opposite, **industrial strategies pursued by the NICs reveal that induced supply structural changes have been a quite powerful determinant of exchange rate parity.**

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54 For more, see M–P. Verlaeten : "Appréciation des conditions théoriques présupposées pour espérer réussir une dévaluation", DIAL, january 1991, 156 p.

107. Nobody knows what is the **proper** exchange rate determination model for a given economy. Facts indicate that the most sensible view on that question it to ansver that this determination is a mix of factors emphasized by various theories but as such (a mix) not always (even rarely) shaped very consistently. Briefly, one can say that there are two big families to explain how exchange rate is determined*(55)*. One puts forward the relationships between a country's macro performances (growth, inflation, interest rate, monetary policy) and its real balance of payments. Through their implicit effects on that balance, it explains how nominal exchange rate **varies**. Therefore, the goal of the exchange rate policy is how to modify the external value of the currency so as to account for internal **and** external disequilibria. Exchange rate equilibrium value is that for which there is no more gap. Or, on the basis of IMF's status, no more balance of payments gap. The other one emphasizes that real and financial sectors of an economy are linked to the related international ones after free-trade has been assumed. Then, it concludes that there **is unicity of prices** for goods (and/or services) with the same features and **returns of financial assets** bearing the same risks. Therefore, the exchange rate gets an equilibrium value which is that of a pure conversion factor only. In this respect, endowned with purchasing power an economic operator can perform on any market in the world he wishes. Because it is also assumed that the markets of a given economy are integrated there is only **one** exchange rate determination or equilibrium value (purchasing power parity = purchasing interest rate parity). Overvaluation (or undervaluation) occurs when nominal exchange rate changes do not account for inflation rate differentials between a country and its partners. In this case, an appreciation or a depreciation of the real exchange rate occurs. The theory also explains that unicity could be either a short run equilibrium or a long run one. For instance, the **monetary school** asserts that such an equilibrium could prevail at short run when monetary policy is properly used to tackle with inflation differentials. Assuming full employment and fully integrated markets so that the real demand for money is given (no expected influence from either real income or the nominal interest rate), it determines the inflation differentials on the basis of money supply ones, only. Money supply is endogenously determined by the monetary authority of the countries. When these authorities conduct their policy so as to reduce the monetary differentials to zero so is the inflation one. In this case, price unicity prevails amongst free traders and real exchange rate level remains unchanged. This can be put in another way. **Starting with an all-out equilibrium, the exchange rate of country A's currency should**

55 We deliberately focus on the two families which have influenced the most macro policy recommended by the international donors community to LDCs. That means we neglect the absorption and structural approaches.

change to maintain equilibrium in the same direction and same proportion as the change in A's prices (money) over the change in World prices (money).

108. Since the 1970s, the monetarist determination of exchange rate has prevailed. First of all because developed economies structurally had to account for increased inflation rate with decreased productivity one (structural inflation process), second, because ramping inflation gained from oil shocks (1974, 79 and 80) and, third, because monetary school dominated international financial institutions so that **mainstream economics became monetarism**. Developing countries have been differently influenced by monetarism than developed one. Although one can argue that in both cases demand depressing effect have prevailed at least when fiscal policy tended to be a balance one in **conjunction** with austerity monetary policy. Monetarism prejudiced developing countries because :

(i) the full employment assumption is not relevant for these countries ;

(ii) the full integration assumption is a nonsense for these countries ;

(iii) domestic and foreign prices have not very much in common given the level of development of the related countries compared to western standards.

Points (i) and (ii) lead to conclude that disequilibrium prevailing in developing economies have to be accepted for monetary policy has not to account for structural **real** imbalance. Therefore as in the case of developed countries, it tackles with issues related to inflation, only. Exchange rate is a monetary phenomenon. It has not any structural real effects. Point (iii) is a crucial one. It emphasizes the need to look at the global input-output system of developing countries rather than at a strong idealized export one when questioning on what is the proper exchange rate determination. To illuminate this, it is necessary to put forward the following assertion. The price levels which are compared to determine the exchange rate level at the equilibrium and out of this one must price some **common items** otherwise that would be a nonsense to compare these price levels under purchasing power parity and the monetary approach*(56)*. In this framework, the analyst uses generally aggregate price index such as the GDP deflator and similar index for the world to get a measure of the exchange rate level or of its changes at a certain moment of time. Doing so, it implicitly assumes that :

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56 There would be none pertinency of unicity otherwise.

(i) all goods are traded*(56)*

or

(ii) competition levels factor costs everywhere in the economy at diffused technique of production

or

(iii) non traded goods use traded ones as main input.

Under these assumptions price unicity can prevail even when some goods are not traded. So, fundamentally, the analyst uses a model where there is one single good, the tradable or competitive one. Within this model countries can produce or trade a same basket of goods at the same unit price. This basket will permit producers to maximize their profit without distorted price as consumers to do the same with their utility. Therefore countries get quite analogous input–output system as tastes in the case of consumers. This reflects the fundamental condition to sustain currency convertibility (markets being integrated) at long run or equilibrium value of the exchange rate. **For countries performing under such circumstances, the real exchange rate does not affect the sectoral resource allocation as long as the changes of the nominal exchange rate account for relative price differentials or money supply ones** (departing from an equilibrium position). This means as long as the real exchange level remains unchanged. In this framework, the exchange rate change is a monetary (inflation) phenomenon leaving unchanged the rest of the economy (sectoral resource allocation).

109. The preceding "scenario" is not valid in the case of developing countries. Indeed, their domestic sectors can only produce and trade a limited number of goods, so the rest has to be imported ; export and import goods cannot be aggregated into a single traded good because they differ too much in nature, price determination and dynamics. And further, the related countries' price determination are not homogenous between their export, import and domestic sectors. Therefore, the analyst has at least to account for two goods when stylising the developing

country's economy and discussing what is the related equilibrium exchange rate value. The two goods or sectors are the tradable and non-tradable ones. Then, the equilibrium condition as to be read as follows (Michaely 1978). **Starting whith an all-out equilibrium, a change in the exchange rate which would retain the original level of the relative price of tradable vs non-tradable goods in the economy would establish an equilibrium rate of exchange.** In the light of the preceding condition, monetarism is valid when disturbances occuring in the economy either originate in the monetary sector or are neutral between the traded and non-traded sectors and when no change in the terms of trade takes place when foreign prices change. That is the reason why the monetary approach explains the equilibrating mechanism of the real balances without any resort to production effects in the economy.

110. The preceding leads to conclude that mainstream monetarism could not very much help to define what is the exchange rate equilibrium level (or condition of convertibility at long run) in countries coping with structural changes or external shocks leading to terms of trade modifications. But it explains why modified parity is unstable when the influence of the informal sector is great or increases. Indeed, this one helps to reveal (all things being given) what could be the value of the exchange rate in a three goods model i.e. given tradable and non-tradable ones with their related price and factor costs determination. Or put it in another way when accounting for the country real input-output system. So, the informal sector of a developing country creates pressures on the legal exchange rate, to devaluate generally, in the absence of any price speculation motive. **Indeed, it illuminates not only the need to distinguish between traded and non-traded goods when focusing on price induced structural changes but also to do that between traded goods. Export and import price changes differ, and so is again modified the sectoral resource allocation of the country.** Indeed, in a developing country external shocks such as changes in foreign capital inflows or movements in world prices, internal shocks such as modified foreign trade tariffs, etc... modify the resource allocation departing from changes between domestic and import price and domestic and export ones. This occurs accounting for some related elasticity of substitution between the three goods in both the production and consumption activities. Such an analysis which has been recently re-investigated (S. Devarajan, 1991) generally leads to other value for the equilibrium exchange rate than the preceding ones (the monetarist and the purchasing power parity ones). This is due to the fact that the analyst attempts to focus on the general equilibrium of a given

country instead of a partial or idealized one. It is only under very specific circumstances that convergency occurs. This recent analysis demonstrates again that monetarism is not the proper theory to apply in the case of country coping with structural changes as why the domestic sector generates pressures (generally to devaluate) on the legal currency of a developing country. This is because the country does not account for **the global interdependence between production and exchange rate or the complete set of relations between the sectors both in production and consumption.**

111. It is difficult to measure the exchange rate gap. Indeed, the equilibrium value accounting either for internal and external targets (balance of payments approach) or all that occurs at the sectoral allocation level is difficult to formalize. Improvements to the subject have recently been proposed by S. Devarajan (1991) in the framework of a General equilibrium model. The approach used is that of extended purchasing power parity. The author shows that the measure used at the international level was not adequate in case of terms of trade shocks and when it is not assumed that the balance of trade was in equilibrium. But improvement does not mean revealed certitude of what could be the equilibrium value of the exchange rate of some developing country. Practically, in almost all these countries doubt on what is the equilibrium value put the economic operators on a waiting position attempting to grasp information on it. They never fully accept the official parity. So, there is always a pertinent speculation. **To conclude, the Ethiopian Authorities are right to carefully investigate the question of the Birr** adjustment. Unfortunately, they will have a price to pay for that. Indeed, for the Ethiopian community leaving in the US the condition to get rapatried funds is a Birr devaluation. The expected amount could be as big as 2.0 times the Ethiopian GDP (i.e. US $ 10 billion), on which period has not been said. Birr devaluation is also strongly supported by the World Bank **which seems to assess there is no other possibility to boost the dominant sector of the economy but to create a positive real exchange rate effect.** It would increase the prices of the agriculture export sector in domestic currency compared to the rest of the sectors. But this presumes :

(i) producers benefitting really from the relative price change i.e. the latter not being kept by the State ;

(ii) inflation not being such that it would reduce the producer's real income increase;

(iii) producers able to consume more or invest more (no market rationing) ;

(iv) producers not being risk-adverse ;

and

(v) world market not being constrained or depressed for the main export commodity of the country (coffee).

In this respect, and although the Ethiopian price supply elasticity appears somewhat high (0.6) compared to the world market ones (from 0.12 to 0.72) one has to account for the evolution of the coffee world market. This market is rather depressed apart for high quality arabica coffees, mainly produced by Colombia. At the London meeting (April, 6 to 10, 1992) the International Coffee Organization has led producers to understand that further quota reductions would have to be decided otherwise price would continue to go down. Even in the eventuality of further price decreases demand (at given world income) would not expand very much for it has a low elasticity to price (−0.13 at long run for Ethiopian coffees). Further, the income elasticity (at given world price) is also low (0.22 for Ethiopian coffees). Hides and skins benefitt from better perspectives. The world market expands. Their price supply elasticity could be as high as 1.66 at long run (0.83 at short one). **The WB also thinks that import being more expansive would be better allocated.** This would lead enterprises to more efficient production and investment decisions. This can be true although the Ethiopian import elasticity to the real exchange rate is rather low : −0.27. Apart from growth and resources allocation to improve the WB could also be seeking for a longer-term objective that how to get currency **convertibility for current account transactions in the Ethiopian case** (CCAT) while the government could have **thought to a very very** reduced form of **internal convertibiliy** (IC) and **partial convertibility for capital account transactions.** Let us throw some light on these definitions.

ii – Convertibility

112. There exists mainly three definitions of convertibility*(57)* :

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57 I quoted the following from an I.M.F.'s occasional paper to write the next paragraphs : "Currency Convertibility and the Transformation of Centrally Planned Economies", by Joshua E. Greene and Peter Isard, june 1991, p. 1–9.

(i) **Convertibility for current account transactions** (C.C.U.) along with measures to liberalize trade and payments, generally, is advocated as a source of competitive discipline and appropriate price signals that can play a vital role in guiding domestic enterprises toward efficient production and investment decisions. Economists have traditionally identified certain preconditions that must prevail if C.C.U. is to be implemented successfully. These preconditions have changed somewhat as the concept of convertibility and prevailing views on macroeconomics have evolved, and the basic requirements are **now** :

1) **an appropriate exchange rate** i.e. **which is conformed with balance of payment equilibrium** (see para. 107). It varies through time as the transformation process of the economy deepens ;

2) **an adequate level of international liquidity** so as to maintain a stable macroeconomic environment in the face of adverse short–term disturbances to the volumes or prices of exports or imports, to render credible the country's overall adjustment effort and discourage speculative action against its currency ;

3) a **sound macroeconomic policy including the elimination of any monetary overhang** (so as to avoid unsustainable speculative pressures) ; **the establishing of a central banking system able to stabilize the economy indirectly by adjusting interest rates or other policy instruments is crucial for that issue** ;

4) **an environment in which economic agents have both the incentives and the ability to respond to market prices**, from which all major distortions should have been eliminated*(58)*. The same preconditions apply to the elimination of trade restrictions generally*(59)*.

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58 The reform of enterprise incentives is thus a critical step along the road to establishing C.C.U.. So is the introduction of laws or other measures to clarify property rights, to legimitize the kinds of activities with which economic agents can respond to market prices and to designate which individuals have decision–making responsabilities within state owned enterprises. Further to encourage and promote privatization.

59 Restrictions on trade and currency convertibility have to be applied after the monetary overhang is eliminated otherwise it will drain foreign exchange ,reserves and put strong pressure on exchange and interest rates. Monetary overhang can be eliminated through currency reform, price liberalization and the sale of state owned assets. And also by setting interest rates at positive real levels although the latter may raise government expenditure if most interest bearing instruments are claims against the government.

(ii) Convertibility for capital account transactions (C.C.A.) or, at least, for certain types of capital flows is seen as helping to attract foreign investments inflows*(60)* and associated managerial resources and transfers of technology, which can significantly affect the transformation process. It also permits residents to cushion the real value of their savings against various shocks to the domestic economy. Discussions of C.C.A. centers on three issues :

1) **Wether capital account convertibility should be delayed until late in the transformation process or introduced simultaneously with C.C.A.**. In this respect, effective controls on capital outflows may be essential for the reform program to succeed. Without such controls risk-averse residents could have strong incentives to send capital abroad, even in the presence of sound macroeconomic policies and the resulting capital outflows could undermine the reform program. In this framework, it is worth remembering that private investment requires an appropriate and credible economic environment... and does not respond well when investors, foreign and domestic, doubt that the government will sustain its reforms. Thus the legal system and the nature of the **investment code** matter much. Further, there is the possibility of greater macroeconomic instability raising from the volatility of short-term capital movements. They can intensify any macroeconomic difficulties (pressure on the exchange rate) that develop during the implementation of a reform program. At the same time, the threat of volatile capital flows can be a source of policy discipline, heightening the Authorities concern to keep their macroeconomic policies sound. It is obvious to recall that given some trade-off betwen C.C.U. and C.C.A. authorities should recognize that **C.C.U. without C.C.A. is essentially equivalent to a dual exchange rate system***(61)* ;

2) **Wether restrictions on C.C.A. are likely to be effective once current account restrictions have been removed is unclear.** Indeed, they can be circumvented through leads and lags in the timing or distortions in the invoicing of current account payments. Therefore, the related effectiveness is likely to depend on the strength of the incentives for circumvention. Experience has shown that controls are generally ineffective when a country's macroeconomic policies and prospects are poor. Further the effectiveness reduces when information and transactions technologies increase **the integration of international capital markets** ;

60 Especially when various tax concessions and subsidies are used as inducement for private capital inflows.
61 This could explain why the Ethiopian Authorities abolished the franco valuta system.

3) **If C.C.A. is delayed, what types of capital account restrictions should be still removed in the short run.** The answer is those which could encourage long-term capital inflows. These changes could be part of a **general investment code reform.**

(iii) Internal convertibility (I.C.) means that residents are free to maintain domestic holdings of certain assets denominated in foreign currencies and thus to convert domestic currency internally into foreign currency assets. Such freedom is not tantamount to permission to make payments abroad or to hold assets located in foreign countries. Nor does it necessarily permit residents to hold any financial assets, other than foreign currencies that represent claims against nonresidents. Internal convertibility is a way to make foreign currencies available to banks or other intermediaries, thereby easing a country's foreign exchange constraint. **And also a way to integrate black markets into the formal economy thereby lowering transaction costs and encouraging greater uniformity in exchange rates.** It is obvious to indicate that internal convertibility renders difficult for a country to prevent currency conversions associated with payments for international transactions. Moreover, it renders difficult the maintain of effective restrictions on capital outflows. The preconditions to introduce I.C. are the same as the first three preconditions for CCU namely :

1) an approprate exchange rate ;

2) an adequate international liquidity ;

and

3) a sound macroeconomic policy, including the elimination of any monetary overhang.

In the absence of sound macroeconomic policy and attractive prospects, I.C. can level to large-scale substitution out of domestic currency into foreign currency (at given interest rates), which in turn can deplete official foreign exchange holdings. To summarize, it can very much complicate monetary policy making.

113. Should convertibility be established quickly ? That depends upon how fast a country can establish the related preconditions. This, in turn may depend not only on the speed with which resources can be reallocated across sectors to reflect the new environment but also on wether there is ample popular support for rapid and comprehensive reform. The later condition may hinge on the extent of the country's initial macroeconomic instability and distortions. **In deciding wether to introduce convertibility countries should also consider how rapidly they can implement supporting institutional changes and other structural reforms.**

114. In the light of the preceding definitions, it appears that Ethiopia neither fulfills conditions of current account convertibility nor that of internal one. Further, it would be very relevant to delay capital account convertibility till the macroeconomic transformation gets a certain level of operationality and therefore credibility. In this respect, questions which remain debatable are :

1) what is the appropriate exchange rate for Ethiopia at the beginning of the transition period ?

2) how to get an adequate level of international liquidity ?

3) is the expected macro policy sound enough given private operators' (domestic and foreign ones) rational (if any) expectations ?

Then one also understands why the Ethiopian policy makers have to look at the informal sector. Indeed, it has an exchange rate which is accepted by the economic operators (included the Ethiopian diaspora leaving in the US) ; it seems to be more liquid that the formal one for it is in the process of integrating both its real and financial sub-sectors ; it is a pure free-trade economy where market adjustments are at least effective if not perfect. All this indicates why the parallel exchange rate would more and more compete with the official one. It is a way to integer Ethiopia to the world markets whatever they are and so to the market economy. **Therefore, one can strongly advocate for the EPTP being modified so as to support the informal activities with the highest priority. One can also strongly recommend the EC emphasizes the importance of the informal sector and therefore allocates funds for applied researchs on that sector in Ethiopia.** One understands also why a private banking system matters. It will :

– help to reduce the monetary overhang and as such to strengthen macro policy ;

– soften the international liquidity constraint via rapatried funds from the informal sector, the Ethiopian diaspora ;

– decrease the pressure to modify the Birr via capital inflows ;

– help to integrate Ethiopian markets and to modify the interest rates levels (and structure) ;

– ease the measures leading to convertibility (C.C.A. + C.C.U. + I.C.).

V - CONCLUSIONS

A) SUMMARY

1 - The economic conditions at the end of the civil war

115. **At the end of the civil war,** the Ethiopian economy may be featured as follows. It has become a supply-shortage economy under the DERG-regime. The agriculture sector cannot supply enough food and goods, the industry one cannot supply enough goods and the services cannot supply enough services. For instance, at the level of agriculture which accounts for 40 per cent of GDP at factor cost*(62)* in 1990 and 80 per cent of employment and exports receipts, the average food surplus is 18 gr per day and person under normal circumstances. This leads to an amount of 1760 gr which is 4 per cent below the FAO emergency ration. Even if shortage increased at the end of the 80s because of the civil war, it is not only the result of that war. More fundamentally it is due to a sample of facts. A combination of civil war, anti-democratic choices, policy distortions, environmental degradation, an unfavourable demographic dynamics, adverse external factors (drought, natural calamities, external shocks) and a host of structural problems (backward technology and methods of cultivation, weak linkages between sectors, ...) has been responsible for the disappointing performance of the economy from 1974 to 1990.

116. Although the military government attempted to introduce policy reforms in its last days, specially relevant for peasants agriculture (the dismantling of producers' co-operatives, the recognition of tenure rights, the abolition of the Grain Marketing Board, mainly) these came too late to make any appreciable global macroeconomic and social differences. Per capita real income declined by about 0.8 % per cent per year (compared to +1.5% from 1960 to 1974) revealing declining living standard of a population already wallowing in extreme poverty. More then 60 per cent of the population was living below the absolue poverty level (US $ 90 per year). Constant dollar GNP per capita was lower than in 1965. Further, the population had been denied human and democratic rights. Ethiopia became also a two gap country. Saving decreased compared to investment as export to import

62 In reality this is more that 40 per cent of GDP at factor costs. Indeed, agriculture output is underpriced compared to the rest of the economy. The difference (in %) between paid price and market ones is the nominal protection rate. It averages 40 per cent on trend in the 1980s.

ratio. The import cover of the country by the end of the 1980s was less than ten days. On account of a steadily declining saving rate, an unhealthy state of the balance of payments and generally rising tendency of (military) investment, the budget deficit increased as the country's debt position deteriorated deeply. Pressures to devaluate the Birr, the local currency increased giving rise to a parallel exchange rate and some capital outflows.

117. Despite measures or programmes to combat environmental degradation potential land yields reduced by 1 to 2 per cent per year in the Highlands which account for 90% of the population and economic activities, 95% of land cultivated and two thirds of livestock. The Highlands of Ethiopia have been characterized as one of the largest areas of ecological degradation in Africa, if not in the world. If present trends continue, by the year 2010 10 million people would have to derive their food and income from sources other than cropping their own lands. So, they would have to be absorbed elsewhere in the economy.

118. The DERG–regime's reforms gave rise to a process of increased informal market activities due to the reduced government's legitimacy and operationality. This was also a population's solution to increased poverty. This with the parallel exchange rate created a dual economy in Ethiopia, one where market functioned and another where rents of various sorts operated. **To conclude at the end of the civil war Ethiopia was about to collapse.**

2 – The political context of the EPTP

119. The government which has overthrown the DERG–regime has recognized that Ethiopia was in **dire** conditions by issuing documents on its intentions related to Ethiopia's Economic Policy during the Transitional Period. This one is defined to be the period (after the DERG–regime) characterized by the coalition of various forces (represented in the Council of Representatives) around a common Charter which is the pillar of the transitional economic policy. It will cover the years 1991 to 1993 and end by announced free elections. The Charter has a major aim which is the strengthening of peace. Therefore, the EPTP final document has as main objective to **stabilize the economy** but departing from neutral political commitments. Moreover the document indicates that although being also designed to provide satisfactory solutions to **urgent** problems (the country rehabilitation, for instance, or the soldiers to demobilize and accomodate properly), the EPTP has to

serve a longer period than the transitional one with minor changes. With regard to economic rationality, the coalition resembles mainly marxist reformists and market ones. Further, at different top levels either the government or the State ones, there is a lack of market culture. To conclude, **the EPTP is first of all a compromise policy document. It carries with it major constraints these of relevancy versus political neutrality, market advocacy versus market understanding.**

3 - The EPTP

120. The final EPTP document pleads for **market functioning in Ethiopia as the efficient solution to the country's challenges.** As a consequence, it indicates that :

(i) the role of the state in the investment decision process should be reduced at the opposite of that of the private sector and that of the state issuing market regulation and monitoring the economy as it is the case with market-based ones ;

(ii) people should be recognized rights to act as free traders. This in addition to democratic rights ;

(iii) enterprises whatever their owner is should be submitted to market rules i.e. the **profitability, management autonomy and fair competition** ones.

121. Practically, and, as it has been the case for many developing countries, and rationalized through mainstream economics, the state ownership sole or on joint venture arrangements with domestic and/or foreign capital should concentrate in sectors or activities which are crucial for the economy in terms of growth potential, employment opportunity, price stabilization, or are featured by a lack of interest from the private sector, reveal market failure or externality, or may be a source of revenue to the State. So given, **the State keeps the opportunity to intervene in any sector of the economy.** Likely this is a result of some compromise between the two groups of reformists already mentioned. For the present time, **the EPTP would lead to measures of implementation shaping the economy as a combination of public-based basic goods, services and financing and private sector-based food production, trade and distribution.** Although the private sector would be encouraged to participate in banking state ownership would remain in that key sector. The trade and transport (road) sectors where private initiative is **strongly** invited to take over would nevertheless "benefit" from a

specific treatment, i.e. a **regulation** for the former, a new **regulatory Authority** for the latter. In any sector of the economy, private investment remains to be approved at ministerial level. Also, to mention that in the case of all sectors where private initiative would prevail the State would favour the formation of co-operatives or associations on a voluntary basis, though. So, **the State remains able to prejudice private initiative through various ways (regulation, financing and people participation schemes).**

122. **The document also pleads for enterprises restructuration given the need to render these ones profitable.** But, in this framework, there could be two big exceptions which are banking and the industrial sector. Again, this could be a result of political compromise. Banking would remain state ownership to ensure banks would play their proper role in development while making profit. This assertion could lead to conflicts of objectives. At the industry (plant) board level, workers would be given 30 per cent of the voting rights. This also could lead to conflicts of objectives. For instance, when labour shedding would have to be decided for profitability motive. The government has clarified its position in the second case. Indeed, it has issued a new Labour law on the basis of which labour redundancy is now permitted and liberty to negociate recognized to trade and employers unions.

123. Although, the document pleads for market rights, it does not advocate the change of the property rights in case of land (rural and urban) and 1975 nationalized houses. The first is a controversial issue between the North and the South of the country. It is delayed till the free elections. In the case of the second, compensation will be paid to those who deserve on the basis of appropriate studies. So, the late owners are not privileged compared to the actual tenants. No mention is made of what would occured to other 1975 nationalized assets.

124. **Through the state ownership in banking, the promotion of collective participation schemes, the regulation announced for the private trade and transport activities, the overseeing of ministeries on private investment, the number of motives put forward to advocate state intervention in production, private initiative although being praised remains very directly state regulated.** Further, the profitability and the management autonomies appear to be somewhat constrained. All this reflects also likely political compromise. But it could also be due to some intentions to guide Ethiopian macro policy along the lines of some Yougoslavian model. One can hope, the system would not fail like this reference one.

125. With regard to **macro policy**, the document advocates **policies recommended by the World Bank**. For instance, **a monetary policy to ward off inflation**, a **fiscal** one to achieve **the control of the budget deficit**, an **open price policy**. Regarding sectoral potentials, the government indicates mainly intentions of **boosting peasants agriculture** by helping producers to receive fair prices for their produce and an easiest access to the needed input. It also advocates an agricultural open market policy. **Privatization will be encouraged. How will depend on the new expected investment code.**

4 – A scrutinity of the EPTP

126. Although being politically pertinent for peace to be secured is the highest priority*(63)*, and economically pertinent for market functioning is much more efficient than non-market one to tackle with the stabilization of a decentralized economy, **the EPTP lacks from relevancy given Ethiopian present situation. Indeed, it advocates the functioning of a market system while neglecting basic challenges to the Ethiopian society and the market fundamental requirement i.e. the availability in quantity and quality of production factors.** It does not either advocate an independent monetary authority to ease macro stabilization or the promotion of a private banking system to create a credit market policy, a feature of market-based economy.

127. The basic challenges to the Ethiopian society are **the risks to famine to reduce, poverty (and people's destitution) to alleviate, employment opportunities to create and the process of informalization to account** for. With regard to two first challenges a market-based economy may help but not at short run for it is by itself a longer term challenge to Ethiopia. Further, it presumes a focus on profitability when conducting investment decision in a framework where firms are and will remain heavily liquidity constrained. So, at short run this will mean labour shedding and some decrease of the real wage maybe below that of the informal sector. The disequilibrium in the income distribution will increase rather quickly. Moreover, the State has not the money for the EPTP it advocates. Taxes are no more collected, smuggling of all sorts of commodities increases as informal activities. Debt to the international donors community including the late USSR has to be paid... Peasants are no more receiving seeds (and medical care). So, **food self-reliance and poverty need to be tackled with as such and not through the expected functioning of some economic process.** Poverty and famine are needed

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63 Present increased difficulties in the Oromo region reinforce this assertion.

focus in Ethiopia for there could not be any peace and expected democracy where 60 per cent of the population earns only US $ 35 a year and 20 per cent (at least) are permanently at risk of dying from starvation. And moreover when demographic pressures remain permanent contrarily to growth impulses. The international community has to be (or to remain) aware that peace in Ethiopia does not only get a meaning within the Ethiopian context but also beyond it. It also gets relevancy within the Horn of Africa. If Ethiopia does not succeed to secure peace, the all Horn of Africa will explode given the present situation in Sudan and Somalia. **To secure peace means first of all to feed the population and satisfy its most urgent needs.** An institutionalized market functioning can in no way be a short term solution when people are poor (and extremely destituted) and need food to survive. There could not be other priority but **how to reduce these constraints immediately**.

128. **The informal sector as to be thought of as a factor of production the country can immediately use to reduce supply shortage and create employment opportunities.** There are between 300,000 to 500,000 soldiers to be accomodated properly i.e. jobs or help to be given. To that amount redundant labour from needed restructured state firms has to be accounted for (± 100 000 people). An urgent focus on what is needed to improve the functioning of the informal activities as how to strengthen those ones would thus be relevant. Informal entrepreneurs are the "animal spirits" of the country for the present. Moreover, they also represent the lonely source of potential domestic accumulation in a country challenged by shortage of saving on investment and foreign aid on domestic financial resources. **The informal sector is an Ethiopian production factor.** On 26 000 members of the Chamber of Commerce, 20 000 or about 80 per cent manage informal activities mainly at Addis Ababa. The daily turn-over of their business could be Birr 5 m compared to a yearly GDP figure of Birr 10 billion. The big change at A.A. since several months with regard to jobs opportunity is the upswing of construction (private houses, shops and restaurants). **It is mainly due to informal entrepreneurs in agreement with local authorities. So, the EPTP instead of praising some mythic market functioning should have focussed on what to do to improve the functioning of the already functioning market activities.** This would have been particularly relevant given the fundamental requirement of any market-based economy and expected stabilization i.e. to account for factor of production availability when designing policies.

129. And finally, **the EPTP does not advocate the need to get an independent monetary autority and a private banking system to help to stabilize the economy.** A monetary control is particularly crucial at the beginning of the transition process, just before to remove various restrictions. Indeed, it permits any monetary overhang to eliminate. Otherwise the opportunity to use domestic money balances to purchase imported goods will drain foreign exchange reserves and put strong pressure on exchange and interest rates. That has occured in Ethiopia since March 1988. As a result the stock of money in circulation has expanded. It has led private operators to speculate on increased future inflation rate. So, the risks to have now more inflation than in the recent past are high. A monetary authority is also a key issue for government's credibility in front of private operators. It indicates that all operators will be submitted to some discipline of the bottom line. This more obviously when the creation of a private banking system is on the agenda. In this respect, the EPTP is weak because it just indicates that the domestic private sector will be encouraged to participate in banking where state ownership will remain. Here again, the government neglects an opportunity which could help to soften some constraints. **Indeed, a private banking system may** help:

1) **to close the credibility gap between the government and the private sector in Ethiopia.** That is a key issue for no macro stabilization can be expected when private operators remain on a waiting position. Further, this generally leads them to speculate against the currency annihilated the government's efforts to stabilize it ;

2) **to eliminate the monetary overhang,** wherever it comes from, challenging the expected macro stabilization by leading private operators to use it instead of endowning banks with the required reserves ;

3) **the country to get capital inflows** from the informal enterpreneurs, Ethiopians leaving abroad and foreigners. This would increase the capital market flexibility (index of about 0.85 at long run) and favour an adequate level of international liquidity ;

4) **the country to create investment opportunities** (through the fulfillment of one of the major requirements of the Chamber of Commerce) ;

5) **to favour markets integration** (i.e. the real and financial ones ; the formal and informal ones) which is a longer–term issue of macro stabilization and recovery ;

6) **to soften the expected labour redundancy and real wage decrease** by reducing the liquidity constraints of firms which often leads these ones to offset the liquidity crunch (when it occurs) by drastically lowering real wages and making labour redundant ;

7) **to favour private saving** for it gradually permits to modifiy the interest rates in level and structure so as to get positive real interest rates on trend.

130. The impact of the increase of the interest rates on the economy is the price to pay to get a private banking system. In Ethiopia, the IS curve is flat and the LM one steep. This is because investment is very sensitive to the interest rate and real balances to real income. Then, in the eventuality of an austerity monetary policy, nominal interest rate would increase at given real income because a decrease of real money supply shifts the LM curve out to the left. The LM curve would thus cut the IS one at a lower real income level. Given the high elasticity of IS to the interest rate, the real income decrease would be very high. **This indicates that the only way to soften this depressing effect would be to get increased employment opportunities through capital inflows. Or put it in another way to get capital inflows in response to the nominal interest rate increase.** The preceding should lead the government to carefully investigate :

i) a change of its fiscal policy. Indeed a steep LM curve also implies some comparative effectiveness of monetary policy over fiscal policy even if a change to the latter is strongly advocated by the private sector ;

ii) the available saving of the informal sector ;

iii) how to reach an agreement with this sector (which dominates the Chamber of Commerce) to create private banks.

Indeed, some arrangement could be organized between the State and the "banks" at the mutual benefit of both partners. According to it, state enterprises which cannot be run profitably would be "traded" against expected private banks equities the government would receive. So, if banking reveals to be a rentable opportunity, the government will also benefit from it and so, there would be more financial resources... to fulfill people's needs. As long as the deficit is not under control, the government would not receive the right to loan from the private banking system.

131. Apart from neglecting key factors, the EPTP lacks also from relevancy to give the country a guidelines document for a real operational macro policy. Indeed, its needs clarification for a lot of relevant issues. For instance, what does that mean : to advocate a price and an agricultural **open market policy** in conjunction with an announced intention to **help** peasants to obtain **fair** prices for their produce. This could indicate that the agriculture policy will remain from the extractive type even if it is mixed with market liberalization and incentives to peasants. Indeed, the government has no other source of revenue given :

i) the collapse of state firms ;

ii) the increase of smuggling and contraband as that of the informal sector.

The need for clarification which could be quite legitimate given (i) some ignorance of market functioning or dynamics or (ii) the impossibility to do something at short run or (iii) the need to get political compromise has a cost. It is to comfort private operators to remain on a waiting position. In this framework, a real income change of zero per cent a year would be the highest macro performance. It would be accompanied by labour shedding and real wage decrease i.e. by increased poverty. With a 3% increase of the population per year, this would lead to a decrease of real per capita consumption of 2.79% per year. Is this still an acceptable picture for an economy which is one of the poorest in the world even if it is a transitional one ?

5 - Measures

132. There are not many measures decided to implement the EPTP so that one can say the EPTP has not yet begun to be implemented. This might be due to political problems (within the rulers' coalition, amongst the regions...) and, therefore, to the need to gain credit for the EPTP at the international level as financial support for it. Measures already decided are related to (i) institutional changes between Ethiopia and Eritrea ; (ii) macroeconomic stabilization ; (iii) privatized Ethiopian economy ; (iv) market functioning and (v) agriculture.

6 - World Bank

133. The EPTP can easily be compared to a WB's Adjustment Programme that could have been issued under the same circumstances. Nevertheless, there are some major differences. **Two of these are the promotion of a private banking system and the adjustment of the Birr** parity. In the later case, the government has indicated intentions to carefully investigate the question in conjunction with the study of other alternatives. The WB is very much interested by that assertion although it does not believe there are other alternatives. In this respect, it does not really put pressures on the Ethiopian government **to devaluate** but **to provide** the other alternatives. Obviously, all depends on why to devaluate. In Ethiopia, export supply, for instance, that of coffee the main export commodity, has an elasticity of 0.6 to the price **received** by the producers. So, the producers would react positively to the Birr devaluation if they really get a real exchange effect. In this case there could be some additional growth. But, this would take some time (3 to 4 years for coffee) and above all, it would depend on the evolution of the Coffee world market. That market is depressed apart for high quality arabica coffees produced mainly in America (Colombia). Further, quota decreases have already been proposed by the International Coffee Organization at its London meeting (April 92) otherwise price would continue to go down. But even in that later eventuality, world market would not expand very much for it has low price and income elasticities (−0.13 and +0.22 for Ethiopian coffees). A devaluation can also be advocated to rationalize investment decisions through induced import price increase. Here, it is worth indicating that this could not be very relevant in a country where that would cost some time to **render** imports more price elastic (actual elasticity value of −0.27 to the real exchange rate) and where the price stabilization is the key issue just to discover what could be the domestic new reallocation of resources.

134. A devaluation can also have a longer-term target, that of convertibility. Here, the WB could have sought for some forms of **current account convertibility** (C.C.U.) while the government could have referred to a very reduced form of **internal convertibility** (I.C.) and **partial convertibility** for capital account transactions (C.C.A.). There are preconditions to introduce C.C.U. or I.C. There are:

1) an appropriate exchange rate ;

2) an adequate level of international liquidity ;

3) a sound macroeconomic policy ;
4) an environment in which economic agents have both the incentives and the ability to respond to market prices.

C.C.U. without C.C.A. is essentially equivalent to a dual exchange rate system. I.C. means that residents are free to maintain domestic holdings of certain assets denominated in foreign currencies and thus to convert domestic currency internally into foreign currency assets. Such freedom is not tantamount to permission to make payments abroad or to hold assets located in foreign countries. I.C. is a way to make foreign currencies available to bank or other intermediaries, thereby easing a country's foreign exchange constraint. In the light of that preceeds, the Ethiopian Authorities are right to take the time to investigate the Birr parity question. Indeed, neither the market behaviours nor the economic conditions plead for immediate adjustment. Unfortunately, the Ethiopian Authorities could have a price to pay for their investigation time. Indeed, for the Ethiopian community leaving in the US the condition to get rapatried funds is a Birr devaluation. The expected amount could be as big as 2.0 times the Ethiopian GDP (i.e. US $ 10 billion), on which period has not been said. Further, the WB could also block the negociations leading to an international financing of the Ethiopian Recovery and Reconstruction Programme.

135. With regard to the negociations between Ethiopia and the WB related to the Ethiopian Recovery and Reconstruction Programme disagreement is on the **fertilizers** issues. The WB would like to get the sector liberalized while for the government it is the symbol of its relations with the peasants given that there is no money to boost peasants agriculture as advocated by the EPTP. Further, the government has to account for the regions where fertilizers are used (Gojam, Shoa and Arsi). They are also some of these ones where there is a surplus of production. Therefore, it cannot deny the risk of increased famine in the eventualities of fertilizers price liberalization and/or Birr adjustment. Further, it has also to account for the impacts on fertilizers price of the transport deregulation by december 1992.

B) EC'S MAIN FIELDS OF ACTION TO HELP ETHIOPIA TO RECOVER

136. In the light of this document, **only**, the EC's main fields of action could be to help Ethiopia :

(i) to focus on poverty and agriculture ;
(ii) to focus on its informal sector to get growth and employment opportunities at short run ;

(iii) to appreciate which industrial activities have to be restructured ;

(iv) to promote a private banking system.

1 - Poverty (Famine)

137. Poverty is now (again) on the agenda of international institutions. Indeed, the UNDP for the 1992 edition of its "Human Development Report" understates the increased gap between rich and poor. Poor countries contribute only 1% of formal world trade and receive 0.2% of world private investment. They became poorer. Since 1960, their share of gross world product declined from 20.8% to 17.3% at the opposite ot their share in world population. So, the living standard of their population deteriorated. **Ethiopia fits "perfectly" that reality.** Up to 1965 its population has become poorer. It has been affected by recurrent drought so that westerners became accustomed to contemplate Ethiopian people dying from starvation on their domestic television screens. Further, as it has been (and remain) the case of many developing countries, the population has been denied human rights. In this framework, **the EC should develop and finance (alone or in co-operation) a specific program of actions focusing on the major aspects of poverty**. It could do so in co-operation with the WB for the new director of that one has recently said that to alleviate poverty was (again) the highest priority of the Bank.

2 - Agriculture

138. The focus on poverty shoud lead to a search of urgent measures to help **agriculture production to feed people**. That would be the highest priority. **Ethiopia has to be helped to become food sufficient.** At the end of the 80s food production per capita (1979-81 = 100) reaches the level of 88.7 compared to 97.6 fifteen to twenty years ago or 109.6 twenty-five to thirty years ago. 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 10 years and import at a rate of 30 per cent. Further, it has to account for soil erosion. Indeed, potential land yields decrease by 1 to 2 per cent per year as

a result of wind and rainfall erosion. Productive top soils are definitively lost in the Highlands which accounts for 90% of the population and economic activities, 95% of land cultivated and two thirds of the lifestock. So, 10 million people have **again** to be displaced. **The EC should thus concentrate its help on agriculture production.** EC' help should be articulated with the EC's programme on soil restoration already implemented in Ethiopia. To strengthen the later programme should be a priority for medium term EC's actions given the costs of soil degradation (reduced land yields and people to be again displaced). One easiest measure to get short term output increase would be to ensure peasants with seeds during the next following years. The second and third ones would be to ensure them with some basic medical care and with draft power (animal one) and water*(64)*. **The costs of such measures could not be very high at the opposite of their gains : food and employment.**

3 – Informal sectors (the employment challenge)

139. The **focus on employment** should lead the EC to link its counterpart to the ERRP to the decision by the Ethiopian Authorities to use the ex-soldiers to rehabilitate the country (as it is the case in Eritrea). This basic requirement is much more relevant that the liberalization of fertilizers. It should also lead the EC to plead for specific policy supporting and strengthening the informal sector. Policy of this sort are difficult to formulate. Indeed, evidence suggests that the processes and profile of the informal economy are historically specific, depending upon the relationship between the State, capital and labour in each country. Nevertheless, it is likely to say that such a policy would encompass measures :

(i) permitting **small** enterprises to develop ;

(ii) helping the enterprises 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 enterprises to export.

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64 From this viewpoint the amount of money devoted to irrigation in the ERRP (US $ 18.5) is just but insufficient.

4 – Restructuration of industry

140. Up to now, nobody knows with some economic rationality which industrial enterprises have to be restructured. The EC should finance an auditing programme of action related to industrial activities. It should determine which enterprises have to be closed down and what are their market price in case of private candidate willing to buy the related enterprises. It should also illuminate what would be the social costs of such an adjustment.

5 – Banking

141. EC should contract some study group to carefully investigate the question of : how to create it and at what costs and gains. That is a key issue for credibility, operationality and sustainability of Ethiopian economic reforms.

C) 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

142. There is not a lot to say. Indeed, relevant facts only occur when a certain policy package has been implemented which is not yet the case with the EPTP. Then, it is possible to better understand the behaviour of operators ; how they have reacted ; where were the bottlenecks ; which were the real constraints, etc... For the moment, in Ethiopia, the private sector is on a waiting position. **There is a credibility gap which has to be closed.** Maybe the lonely teaching of the Ethiopian experiment (up to now) is the following. **When the question is to reconcile people or groups or both better is not to announce a big reform but to decide urgently for political commitments on very limited but relevant issues.** From this viewpoint, the government should have helped peasants to get immediate access to seeds and some needed input using ex-soldiers and military trucks. It should have invited the Chamber of Commerce to participate to the elaboration of the EPTP, to the study group working on the tax system. These actions, very concretely, help to re-create the society identification process which has been destroyed by the late regime and the civil war. Without that process a peace market economy could not function in Ethiopia. Indeed, there would be increased inconsistency between private interests and social individual achievement within a society where that has been a rule.

ANNEX 1:

THE DERG-REGIME'S REFORMS

143. Under pressure from western governments unwilling to contemplate another famine on their domestic television screens and hoping to benefit from increased western financial support the Derg-government opened up to economic, social and political reforms at the beginning of 1990. At the 11th Regular Plenum of the Central Committee of the Workers Party of Ethiopia on March 5th President Mengitsu Haile-Mariam announced a completely new Ethiopian economic system based on a **mixed economy**. In addition, the President's speech included political innovations through which to embody an Ethiopian perestroïkha (or so called it).

144. The mixed economy was defined by several points amongst which the most relevant were :

1) **The co-existence of state and private enterprises or farms** to construct a **socialist** Ethiopia. In both cases private enterprises should be encouraged and strengthened ;

2) **A state managing system putting the emphasis on competition, profitability and productivity otherwise state enterprises or farms should be sold or closed down** ;

3) **The abolition of the Agricultural Marketing Corporation and the quota system** ;

4) **The abolition of the producers co-operatives if this would be the democratic will of the members** ;

5) **The admittance of peasants' rights to use specific areas of land and to transfer these rights to their legal heirs when they derive their livelihood from farming** ;

6) **The peasants' rights to hire workers to work on their farms ; the private investors' rights to establish modern large farms ; the private traders' rights to compete without any restrictions with the state-run trade enterprises in all sectors of the economy.**

145. The government indicated also that the six points should lead to a change in the national plans. Instead of issuing state's directives they should be transformed into indicative plans reflecting both planning and marketing laws. One of the government's objectives was to stimulate the agricultural sector. **As such the reform was more or less a response to a recognized agriculture crisis.** The Ethiopian perestroïkha was prepared since the beginning of 1988 i.e. in the context of the IDA supported Peasant Agricultural Development Project, the Ninth Plenum of the Central Committee of the Worker's Party of Ethiopia and the July 1989 three decrees. These ones were promulgated to liberalize the economy, improve the climate for private investment and encourage external assistance*(65)*.

146. The Ethiopian perestroïkha was just one cornerpiece of a wider Government's Economic Reform Programme (ERP) covering the period through the year 2000. Its major aims were :

a) to raise the real GDP growth rate on a sustained basis in order to progressively increase per capita income and consumption ;

b) to increase food production and food security ;

c) to diversify the production base ;

d) to increase exports through broadly based external sector policies ;

e) to promote balanced regional development in order to expand employment opportunities in both urban and rural areas ;

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65 The notes of the next paragraphs are from The Policy Framework Paper (1990/91 - 1992/93) prepared by the Ethiopian Authorities in collaboration with the Staffs of the Fund and the World Bank (August 30, 1990).

f) to provide adequate levels of health, education, and other social welfare facilities ;

g) to introduce and diffuse appropriate technologies in order to raise labor productivity ;

h) to work toward removing long-term structural impediments to economic stability with a sustained high rate of growth ;

i) to remove or minimize constraints to the quality of life, including the adverse effects of recurrent drought, high population growth, and environmental degradation. Vulnerable groups would be protected during this transformation.

147. To ensure the success of the reforms already announced as well as that of the institutional reforms envisaged in the ERP, the Ethiopian government announced the implementation of comprehensive macroeconomic policies and structural adjustement measures during the next three years (1990–93). They would permit :

a) to adopt an appropriate exchange rate level in conjunction with decreased trade and exchange restrictions ;

b) to phase out the remaining price distortions by eliminating most official price controls while allowing a flexible administration of the remaining controlled prices ;

c) to reduce the budget deficit through **revenue measures** that seek to broaden the tax base by removing price distortions and improving the elasticity of the tax system, and through **expenditure restraint** by containing the wage bill, curtailing subsidies, gradually reducing security-related outlays, and **setting priorities for capital expenditure** ;

d) to pursue a monetary policy consistent with the reduction in the rate of inflation by curtailing the Government's recourse to the banking system, while providing adequate credit to the expanding private sector, and adoption of a nondiscriminatory interest rate structure that is positive in real terms.

These measures and policies were expected to result in an average real GDP growth of about 4.5 per cent per annum during 1990/91–1992/93. This rate was mainly determined by the agricultural sector which would continue to be the leading sector in the economy.

148. The successful implementation of reforms was crucially dependent on containing the civil war and receiving increased financial support from the international community through increased levels of external resources on concessional terms and substantial debt relief. This was not the case with regard to civil war. So, even the period was too short to appreciate the outcome of the announced reforms on people, it can be said that **Ethiopia had begun a transition from a command economy to a market–based one under the DERG–regime.**

ANNEX 2
ETHIOPIA : KEY DATA

1. CURRENCY : Birr rate per US$
   (fixed since February 1973)

2. POPULATION

A. Level (million)		mid-1989
		15-20 years ago
B. Rate of change per annum (%)		1980-1990
C. Fertility rate (births per woman)		1989
		1975
D. Infant mortality rate (per thou live births)		1989
		1975
E. Life expectancy at birth (years)		1989
		1975

3. AREA AND NATURAL RESOURCES

A. Area (thou.sq.km)		end of the 80s
B. Density (pop. per sq.km)		1988
		1975
C. Agricultural land (% of land area)		1988
		1975
D. Forests and woodland	-thou.sq.km	end of the 80s
		15-20 years ago
	-% of land area	end of the 80s
		1970

(66) 40% at the beginning of the 20th century

4. WEALTH

A. G N P per capita (US $)	1989	120.0		(1)
	15–20 years ago	90.0		(2)
B. Rate of change per annum (%) (from constant price data)	1974–90	– 0.8	Own computation	
	1965–73	+ 1.5		
C. Absolute poverty income : –US $ per urban person	1981	190.0		(2)
–US $ per rural person		± 90.0		(2)
D. Population (urban+rural) below the absolute poverty level (%)	1981	60.0		(2)
E. Energy consumption per capital (kg of oil equivalent)	1987	21.2		(2)
	1975	14.2		(2)
F. Access to safe water (% of pop)	1985	14.0		(2)
Urban	1985	69.0		(2)
Rural	1985	9.0		(2)

5. FOOD

A. Production per capital (1979–81 = 100)	1989	88.7	Mission	
	15–20 years ago	97.6		(2)
	25–30 years ago	109.6		(2)
B. Cereal imports (thou metric tonnes)	1987	609.0		(2)
	15–20 years ago	67.0		(2)
	25–30 years ago	28.0		(2)
C. Food aid in cereals (thou metric tonnes)	1987	825.0		(2)
	15–20 years ago	87.0		(2)
D. Daily calorie supply (calories per person)	end of the 80 s	1,658		(2)
	15–20 years ago	1,533		(2)
	25–30 years ago	1,802		(2)
E. Daily protein supply (grams per person)	end of the 80s	50		(2)
	15–20 years ago	48		(2)
	25–30 years ago	59		(2)
F. Population in need of food aid (% of pop)	1991–92	20	Mission	

6. **EXPENDITURES SHARES (% of G D P)**

Food	1985	24.9		(2)
Housing		13.1		(2)
Fuel and power		3.7		(2)
Transport and communication		9.3		(2)

7. **INVESTMENT IN HUMAN CAPITAL**

A. **Medical care** (% of G D P)	1985	1.3		(2)
Population per physician (persons)	1984	77,356		(2)
	1975	86,100		(2)
	1965	70,191		(2)
Access to health care (% of pop)	1984	44.0		(2)
B. **Education** (% of G D P)	1985	0.4		(2)
<u>School enrollment ratio</u> (% of school-age group) :				
- primary	1985	36.0		(2)
	1974	24.0		(2)
	1965	11.0		(2)
- secondary	end of the 80s	15.0		(2)
	1975	6.0		(2)
	1965	2.0		(2)
- tertiary (science/engineering)	1986	19.0		(2)
	1973	17.3		(2)
	1965	19.0		(2)
<u>Pupils reaching grade 4</u> (% of cohort)	1986	48.0		(2)
	1975	58.8		(2)
<u>Literacy rate</u> (% of pop age 15+)	1986	90.0	Mission	
	1970	4.0	Mission	
<u>Newspaper circulation</u> (per thou pop)	1985	1.0		(2)
	1975	2.1		(2)
C. **Human development index** (0<H<1)		0.282	U N D P	

8. LEVEL OF URBANIZATION

= Population living in the cities as % of total population	10.6	1984 (census)
Growth of urban population (% per annum 1966-84)	4.8	

9. SHARE OF G D P (from current price data)

	1965	1973	1990	
A. Market prices	**1965**	**1973**	**1990**	(1)
Net ind. taxes	6.4	7.5	9.3	
Agriculture	53.8	46.6	36.9	
Industry	13.1	14.9	14.2	
of which Manufacturing	7.0	9.3	9.6	
Services	26.7	31.0	39.6	
B. Factor cost	**1965**	**1973**	**1990**	Own computation
Agriculture	57.5	50.4	40.7	
Industry	14.0	16.1	15.7	
of which Manufacturing	7.5	10.0	10.6	
Services	28.5	33.5	43.6	

10. AGRICULTURE GROSS VALUE ADDED (40.7 per cent of G D P at factor cost in 1990)

A. **Share** (%) (trend under normal circumstances) (1)

Field crops	40
Livestock	40
Cash crops	20

B. **Major cash crops** : coffee, tea, oilseeds, pulses, cotton, tobacco, fruits, pepper, sugar cane, vegetables — Mission

C. –**Grain production** : mostly for subsistence, only 25% of the production being marketed — ETHIOPIA : A GUIDE TO INVEST (February 1991 - p.9)
1970 : 18 % ; 1986/87 : 30.7/34.6 — O E C D - p.200

–Surplus areas : Arssi, Gojam, Wellega, Shoa, Gondar, Illubator, Bale, Wollo — O E C D - p.199
–Deficit areas : Harerghe, Kaffa, Gamu Goffa, Tigray, Eritrea, Sidamo — O E C D - p.199

D. **Land under cultivation** : 15 to 20% of the agricultural land — ETHIOPIA : A GUIDE TO INVEST (February 1991 - p.9)

E. **Land cultivated under irrigation** : 3% of the potentially irrigable land (=3% of 3.5 million ha)

F. **Economic operators** :

- 94% of land under cultivation is operated by farmers with less than 2 ha (per capita arable land 1965 : 0.5 ha – 1987 : 0.3 ha)
- 14% only of the total farm households use chemical fertilizers
- 30 % of the farm households are without draft power

G. **Employment** : Agriculture accounts for 80 to 85 per cent of the labour force

H. **Exports** : Agriculture accounts for 90 per cent of export earnings. Coffee is the principal export crop. It generates over 60 per cent of export earnings at normal rainfall. The production areas are **Hareghe, Kaffa** and **Sidamo.** Under normal rainfall the average production is between 160 to 200,000 tonnes ; 98% of the production is operated by small farmers.

I. **Livestock population** :

Total population exceeds more than 130 million including cattle (27), sheep (24), goats (18), equine (7), camels (7) and poultry (52).

1. INDUSTRY VALUE ADDED (15.7 per cent of G D P at factor cost in 1990)

A. **Principal manufactured goods** : food and beverage items, textiles, cement, leather and footwear, metal products, paper, plastic products, tyres and certain chemicals. The volume of production in most of these fields is fairly limited and covers only a small proportion of domestic demand. The manufacturing industry account for 10 to 11 per cent of G D P at factor cost in 1990.

B. **Geographical localization** : most industrial concerns are concentrated round <u>Asmara</u> (Eritrea) and <u>Addis Ababa</u>

C. Mining

Although the exploitation of gold and copper ores dates from prehistoric times on the Eritrean plateau, the mineral resources of Ethiopia are largely unknown. There are alluvial gold workings in the Adola area of Sidamo Administrative Region, and platinum workings which have been reopened near Yubdo in Wollega Administrative Region. There is a small output of iron ore from Eritrea. It is likely that the Eritrean plateau region will yield more extensive copper and iron deposits, but probably the area with the highest mineral potential lies in the west and south-west in Wollega, Illubabor and Kaffa Administrative Regions. However, this area is at the moment the least accessible and much of it is covered by rain forest. Valuable potash deposits have been proven in the Dallol Depression. These await the development of other infrastructure in this desolate region, but represent a potential source of mineral exports. Exploration for petroleum was carried out for some years in the Ogaden region without success. Emphasis was then transferred to the Red Sea coastal areas in the latitude of Massawa where some oil seepages were recorded and strikes of natural gas offshore from Massawa were obtained. More recently, however, attention has been diverted to the southern borders of Ethiopia. In Bale Administrative Region between the rivers Web and Webi-Shebelli, it has been reported that promising strikes of oil have been obtained. These, however, await official confirmation and suggestions on how effective exploitation can be achieved. Finally, estimates are now being made of the geothermal power potential of extensive sources in the Afar plain region. With its high rainfall and precipitous relief, Ethiopia is well-endowned with hydroelectric power potential. A number of plants are already in operation along the course of the Awash river, south of Addis Ababa. The Blue Nile river basin has been extensively studied and a large number of sites identified at which power production could be coupled with irrigation schemes.

Europa Publication Limited (1990): Africa South of the Sahara - 1991 p. 454-455

D. Employment-Exports

Industry accounts for less than 10% of employment (i.e. about 100 000 persons in 1987)*(67)* and export earnings. The textile industry provides the largest sector of employment, occupying about one-half of the industrial workforce. Most output is for the home market but a growing proportion, notably of semi-processed hides and skins and oil-seed products is being exported. Sales of hides, skins and finished leather goods account for 80% of the industrial exports.

Mission

(67) According to ILO Statistics registering employment in establishments with ten or more persons employed.

12. ACCUMULATION

A. Capital output ratio (average 1968–88)	2.5				Own computation
B. Rate (%) of capital depreciation (average 1968–88)	2.0				Own computation
C. Import content (%) of gross domestic formation (average 1961–80)	33.0				D.M. Etherington and A. Yainshet – p.50
D. Share in G D P (from current price data) of :					
	1965	**1973**	**1988**	**1990**	(1)
Gross domestic saving*(68)*	12.3	13.4	4.4	3.0	
Gross national saving*(68)*	11.7	12.9	7.2	5.2	
Gross domestic investment	13.3	11.4	15.3	11.3	

13. RESOURCE BALANCE (% of G D P)

RESOURCE BALANCE (% of G D P)	-1.0	2.0	-11.0	-8.3	(1)

14. REGISTERED EXPORTS (in '000 birr 1990/91)*(69)*

551 701 — Customs and Excise Tax Authority

A. **Main commodities** (Ascending order)

1. Coffee (washed and sundried) (±66%)
2. Livestock & livestock products (±15%)
3. Oilseeds & Pulses

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4. Fruits, vegetables & spices
5. Flowers
6. Olioresin
7. Sugar & Molasses
8. Tchat
9. Gum (olibanum, oppoponax, arabic and myrrh) (5–>12:15%)
10. Cotton textiles
11. Mining and quarrying
12. Miscellaneous

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(68) Gross domestic saving (GDS) = GDP – total consumption
(68) Gross national saving = GDS + net factor income and private transfers from abroad
(69) Ethiopian fiscal year

B. **Destination of Exports**			Chamber of Commerce

1. EEC member countries : Germany, the Netherlands and Italy mainly
2. US and Japan
3. Developing countries : Yemen, People's Dem Rep., Saoudi Arabia, Djibouti and Sudan, mainly
4. USSR

C. **World share for coffee** (the main export commodity) (%)		T.Akiyama & RC.Duncan p.48
All grades of coffee	4.0	
Unwashed arabica	14.0	
D. **Nominal protection rate** (producer to world price ratio) (%)		
Coffee (average 1978–86)	40.0	Own computation

E. **Export duties** : Exports are a source of revenue to the State. In the case of coffee, the main export commodity, taxes are particularly heavy. (Source: Custons and Excise Tax Authority)

Coffee : The following taxes are levied on coffee exports

1. Export duty

A flat-rate specific duty of 150 Birr per ton levied on all coffee exports

2. Cess tax (coffee board fees)

Another flat-rate specific tax levied on coffee at the rate of 50 Birr per ton.

3. Transaction tax

An ad valorem tax on the turnover of exporters levied at the rate of 2 % of sales.

4. Surtax

A variable rate specific tax on all coffee exports. Recently, with the drop in the international coffee price due to the abolition of the ICO quota system, the coffee surtax threshold was raised while direct subsidies were introduced so that the producer is paid a minimum of Br 2.26 / kg. for clean coffee (sundried coffee) and Br 0.45 / kg. for red cherry (washed coffee). The base of the determination of the surtax is the daily ICO Composite Indicator Price according to the following :

0 - 50	0
51 - 75	0.50 birr/quintal
76 - 100	1 " "
101 - 125	2 " "
126 - 150	3 " "
151 +	4 " "

5. Local authorities in the interior levy municipal charges at various points of the marketing chain.

6. No taxes are levied on domestic sale and consumption of coffee including the 2% transaction tax.

Hides and skins : Apart from a transaction tax of 2% they support an extra tax of US$ 0.06 to 0.15 per hide or skin which has to be paid to the Meat Board.
Pulses and oilseeds : A transaction tax of 2% plus an extra tax to be paid to the Grain Board. The rate of the surtax is as follows.

Fob price per 100 kg	*rate (%)*
a) up to 20	nil
b) over 20 up to 80	40%
c) over 80 up to 120	50%
d) over 120	60%

5. REGISTERED IMPORTS (in '000 birr 1990/91)*(70)* **1 955 007**

A. **Main commodities** (Ascending order)

1. Machinery
2. Transport equipment
3. Manufactured goods
4. Chemicals
5. Mineral fuels

70) Ethiopian fiscal year

B. **Origin of imports**

1. USSR
2. EEC member countries : Germany, Italy, the UK, France, Sweden
the Netherlands, Switserland
3. US
4. Japan
5. Developing countries : Korea, S.Arabia, India, Kenya, China, People's Rep

C. **Franco Valuta Purchases** (average ratio to total imports) (%)

1983/84-1989/90	about 40.0	Customs and
1990/91	24.0	Excise Tax Authorities

D. **Import duties** : All imports are taxed except capital goods.
Intermediate goods are subject to tax rates of mostly 50 per cent. Most consumer goods are taxed 100 per cent and luxury goods 209 per cent.

16. **G D P growth** (% per year)

1965/73	1973/80	1980/90	1989	1990	
4.1	2.2	2.0	2.3	-2.5	(1)

17. **Price indexes** (% per year)

	1965/73	1973/80	1980/90	1989	1990	
A. Consumer prices (Addis Ababa retail price index)	1.8	14.9	4.0	7.8	5.2	(1)
B. Implicit GDP deflator	1.9	5.7	2.0	3.7	2.8	

18. **Fiscal deficit** (% of GDP)

1986/88	1988/89	1989/90	
9	12	16	(1)

19. Debt outstanding and disbursed (US $ million)

	1980	1990	
Total (i.e. IMF+net short term capital+long term capital)	804	3,330	(1)

20. Debt service/exports (%)

Total (i.e. IMF+net short term capital+long term capital)	7.5	58.5	(1)

21. Reserves incl Gold (US $ million)

	262	55	(1)

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