

# **Economic Reforms and Structural Changes in Ethiopia since 1992; An Inquiry**

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Since the beginning of the nineties, Ethiopia has been experiencing significant political, economic and social changes. Despite the efforts of the Ethiopian government to strengthen market economy mechanisms and to decentralize and regionalize decision making structures, the country is still facing a number of problems such as poverty, soil degradation, regional conflicts etc. The elaboration of sound development strategies is essential to promote economic growth, and to alleviate poverty in the context of limited resources. In brief, the economy is undergoing the process of transformation in all most all the fields. In this context, the paper is an attempt to understand the process of transition and its implications in Ethiopian economy. The study focused the issues such as institutional development and socio economic changes that are taking place in Ethiopia since 1992 economic reforms. Furthermore, the study assessed the economic structural changes at national level as well as the strengths and weaknesses and elaborated regional and structural strategies for Ethiopia.

## **Objective and Methodology**

- a) The objective of the study was to assess the economic structural changes at national and regional level as well as the strengths and weaknesses of the regions and elaborate regional and structural strategies for Ethiopia. It also focused the issues such as the process of transition, institutional development and capacity building.
- b) Basically the study looked into the economic changes in Ethiopia since 1992 economic reforms. However, we considered the earlier period for understanding the historical aspects. However, the study period is from 1992 to 2000.
- c) The data and information for the study are going to be culled out from the secondary sources; however, we also concentrate on primary data wherever necessary to substantiate the argument. The data sources are Bureau of Planning and Economic Development, Central Statistical Authority and so on.

Preliminary observations showed that the Ethiopia is a transitional economy, which is undergoing many changes since 1992. The year 1992 is an important year in the history of Ethiopia because it culminated with the introduction of economic reforms. Further, we strongly believe that the reforms implemented in any developing economy will have a direct bearing on the economic growth and reduction of poverty. However, the speed with which the reform process should proceed is a debatable issue as it is concerned with the economic performance of a country prior to the introduction of economic reforms.

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The transition from a planned economy to a market economy involves a complex process of institutional, structural and behavioral changes experienced by former socialist countries while moving along with transition to varying degrees (1).

The intensity of reforms and the degree of liberalization vary from country to country and depends heavily on the structural, institutional and behavioral changes. Therefore, whether the rapid reform is preferable to slow reform is a question of policy matter and the concerned government should decide it.

Considerable literature exists on the concepts of transition to decide which are the countries really experiencing the transformation process. Different people defined the transition in different ways. However, there is unanimity about its meaning and application. Let us review them here briefly.

### **Transitional Economy**

A transitional economy is described by Walder, as the one in which the planned allocation of goods by government officials is replaced by allocation through direct bargaining between buyers and sellers or from a command to a market economy, this is being adopted in Central and Eastern European countries.

Another description by Mundle says that the transitional economy is the “one where material production is still dominated by agriculture”, but in which the relative weight is shifting in favor of “ a substantial manufacturing sector”. Others also opined in the same way as Mundle and defined it as the transformation from a low-income agrarian to a high-income industrial economy, or a developing to a developed society (2).

Further, the transitional economies represent many variations within each, and each may include a series of steps. These variations can reflect unique circumstances or they may embody situations for which there is a thorough historical record, such as the transition from subsistence to commercial agriculture. However, there is a different case wherein an economy may be moving simultaneously from agrarian to industrial, and from centrally planned to free market, as in the case of Ethiopia (3). Nevertheless, the general goals in all the transitional economies are to “increase their productive capacity, change the structure of their economies, increase real per capita incomes, reduce poverty, and increase the health and education of the population”.

Precisely, the transitional economy is the one, which is moving from socialist central planning to free market principles, which is being adopted in Africa and Asia. It is nothing but a sort of economic transformation wherein one is striving to achieve the most efficient and effective means of resource allocation through liberalization of the economy, privatization of public enterprises, and decentralization of the decision making process.

It is not only an issue of transition, but also underdevelopment, missing markets and the interface between useful intervention by the state and liberalization. Since Ethiopia is a developing economy and identified with lower per capita income and low levels of saving and investment the useful intervention by the state is essential in order to realize the benefits of liberalization in all sectors of the economy. However, the role of the state should be confined to facilitate various market economy mechanisms and to enable the reform process to continue.

Further, the priority for countries in the second stage reforms is financial system reforms. Banks are not yet playing much of a role in financing investment in most transition economies. It is likely that many transition economies will require another round of bank portfolio and capital restructuring programs. Indeed the role of government in supporting the financial sector in transition economies is crucial because the financial sector is responsible for deploying scarce capital resources in the most efficient way. It is concerned with gathering, processing and disseminating information precisely the areas in which market failures are often most marked.

## **Economic Reforms**

In 1992, the Transitional Government of Ethiopia has come out with a new economic policy in which the thrust of the reform consisted of transition from a command to a market economy, economic stabilization and structural adjustment. Therefore, the need for the reforms can be explained in terms of an imbalance between economic growth and population increase, deterioration of official exchange rate by about 70 per cent in the parallel market, substantial amount of arrears on bilateral debt. Further, the bank borrowing by the government was around 10 per cent of GDP, increase in money supply by about 18 per cent and the inflation stood above 20 per cent and so on (4).

The economic reform measures undertaken in the past ten years were mainly concerned with the correction of price distortions, removal of restrictions on the private sector, instituting markets for factors of production, trade liberalization, and reducing the imbalance.

To remove price distortions at macro and micro levels wide ranging policy measures were undertaken. The exchange rate was devalued and further allowed to adjust in a bi-weekly auction market. Parallel to the auction market imports from own sources of foreign exchange has been encouraged. Raising the rates of interest on bank deposits and virtually prices of all goods ended financial repression and services have been liberalized and markets deregulated. At present, the price control applies only to petroleum, fertilizer and rents of government owned houses. Along with this process of liberalization lies the reform of public enterprises, which provided financial and management autonomy to state owned enterprises. Similarly, the reforms included removal of subsidies and functioning of public enterprises on purely commercial basis.

The major restrictions on the private sector have been lifted and there is no ceiling on the size of domestic private capital. Nearly all business activities are open to domestic private enterprise either on its own or in partnership with government except few areas kept for government monopoly. The registration and licensing procedures are simplified and the legal restrictions are

almost removed. Recently, all government retail outlets, several hotels and factories have been privatized through sale. In brief, the ground is prepared for privatization to take off.

Various steps have been taken to institute the markets for factors of production. The rate of interest has been kept positive in real terms. The land has been allocated under a land lease system. With the legalization of a new labor code, which provides for independent labour unions and, right of management to hire and fire, a free market of labour has been institutionalized. A market has been created for foreign exchange (5) through the biweekly auctions.

In trade regime, the quantitative restrictions are replaced by the tariffs and subsequently tariffs are lowered. In order to stabilize the economy the Transitional Government of Ethiopia has followed stricter fiscal discipline by reducing the expenditure on defense.

All these measures point out that the country is fully determined to adopt the economic changes, as there is an improvement in the poverty situation.

### **Agricultural Sector**

Agriculture is the backbone of Ethiopian economy as it is the mainstay for majority of the population in rural areas. Nearly 85 per cent of the population depend on it for their employment and livelihood. In consonance with this, the government of Ethiopia has formulated the strategy called Agricultural Development Led Industrialization (ADLI) and placed emphasis on agriculture on account of its potentially superior growth linkages, surplus generation, market creation and provision for raw materials and foreign exchange.

However, the government has declared in 1994 that the right to ownership of rural and urban land as well as of all natural resources is exclusively vested in the state and in the peoples of Ethiopia. Land is a common property of the nations, nationalities and peoples of Ethiopia and shall not be subject to sale or to other means of transfer. As a matter of fact, the land redistribution that took place in seventies has resulted in an average land holding of 2 hectares productivity and increased agricultural output. As a result, the food production per capita has registered 6 per cent 1996. it is also noticed that the volume of food output has increased tremendously during 1993 and 1997. besides, the value of agricultural exports has increased from 193 millions of US \$ in 1993 to 426 millions of US \$ by 1996. all this evidence suggests that the thrust cast upon agriculture has resulted in positive effect.

### **Performance of the Economy**

The performance of the economy during 1992-1995 (the three years period) it showed that the economy has performed quite well. The GDP registered an annual average growth rate of 6.4 per cent, which is mainly due to the growth in agriculture. Also seen some progress in the balance of payments situation and the foreign exchange coverage of imports. After the introduction of the reform program the level of imports has remained with in the same range as before in absolute terms for the first three years (1992-93-1994-95). Though a sharp increase registered in 1995-96

from 1063 million USD in 1994-95 to 1412.9 in 1995-96 (32.9 per cent) the rise in imports was maintained in 1996-97 but with a slower pace.

Further, the imports of capital goods and consumer goods have accounted for the lion's share of total imports. On average, capital and consumer goods comprised 32.7 per cent and 30.1 per cent of total imports during the five years of reform respectively. Unlike the pre-reform years, imports of capital and consumer goods have declined during the early years and later maintained a stable share in total imports while imports of semi-finished goods and fuel have shown a steady increase.

There has also been a significant improvement in public finances particularly the deficit has fallen from 14.6 per cent in 1993-94 to 7.2 per cent in 1994-95. Another important indicator is inflation which is quite under control and registered below 10 per cent. During pre-reform period 1990-91-1991-92 it was as high as 21 per cent.

The performance of exports in the 1980's was dismal. The value of exports stood between 350-450 million USD, with a decade's average of 402.3 million USD. In 1990-91 exports drastically declined to 276.4 million USD, constituting 67 per cent of the exports in 1980-81. To reverse the declining trend in exports and instigate growth a package of policy measures have been introduced since 1992-93. Chief amongst these measures are; devaluation of the Birr followed by a fortnightly auction, rationalization of the tariff structure, internal market liberalization and elimination of export taxes except on coffee.

These measures are expected to improve exports in different ways;

1. They assure the maintenance of real exchange rate in the face of an increasing inflation. They render the export market more attractive than the domestic market. This in turn enabled switch resources from production of goods for home consumption to the export market.
2. By making the official channel more attractive helped lessen the practice of smuggling through shifting export from unofficial to official channel.
3. These measures have induced producers to utilize their capacity and increase of exportables production.
4. These policies have altered the relative prices of tradable and non-tradable goods in favor of the former. If there are no structural constraints, these policies would help switch resources from non-tradable to tradable sector. Additional resources will also be channeled to the tradable sector.

## **Privatization**

With the onset of transition, most of the countries in the world are moving toward capitalism from socialism. Most of the studies on privatization and liberalization have confirmed and emphasized the need for the growth of private sector as an important agent of economic growth. The privatization of previously state-owned enterprises that is leading the program for private

sector development in Africa. Indeed, of the 400 privatizations carried out in the 1980s in Less Developed Countries 160 occurred in Africa.

Reflecting on the new economic reality in Africa, Barcar N'Diaye, the President of the African Development Bank (ADB) stated;

“ It is now generally accepted that over time the majority of public sector enterprises have not performed efficiently. Instead of accumulating the surpluses or supplying services efficiently, a good number of these enterprises have become a drain on the national treasuries. Due to this poor performance coupled with the growing recognition of the cost of ineffective public enterprises in terms of foregone economic development and scarcity of domestic and external resources for public sector expenditure, reappraisal of the strategy of heavy reliance on the public sector has become imperative. From this reappraisal, a view has emerged – the need for enhancement of the role of the private sector in development.... We in Africa are facing a great challenge. We believe that the creation of conducive environment for the growth of the private sector, an important agent of economic growth, is essential”(6).

In fact, before restructuring and privatizing the state owned enterprises the conducive condition for competition should be created. Otherwise, the vested interest groups will create a situation wherein the real competition may not exist and impede the development of a competitive market economy. It's a question of maintaining the right balance between private property and competition. As rightly pointed out by Joseph Stiglitz it may be a mistake to put all the weight on private property and neglect competition. However, the priority to be given is country specific and it depends on the situation that is prevailing earlier to the reforms. For instance, China has given priority to competition and has put less weight on private property and it seems to have quite successful in the past decade and a half (7).

The government of Ethiopia has gone for privatization of state owned enterprises (SOEs) as part of their economic reforms program. The Prime Minister has announced this in the Parliament on several occasions and certain people are displaced for them the government has launched a program called ' safety net ' to rehabilitate the ousted workers.

Though the privatization program started in 1994, sixteen SOEs have been privatized in a year or so. Further, very large number of SOE sales are planned for 1996-97 in some of the largest economies in SSA. In fact, 179 SOEs have been advertised for the sale in Ethiopia (8). Nevertheless, in view of the rapidly growing importance of the privatization in the overall process of economic reforms it is important to assess the post-privatization performance of erstwhile SOEs.

Further, the post 1992 reform agenda can be categorized into three; first was liberalization, stabilization and reconstruction of the economy. Second was, structural reforms (early privatization) and sector investment planning. Third is, institutional development, capacity building and coping with second-generation issues such as corruption.

In fact, the country is undergoing second stage of reforms and making attempts to privatize the state owned enterprises. But the question is underdevelopment and the lack of competition in various sectors of the economy. Further, certain markets in this country are not yet developed and the development of markets is a prerequisite for the privatization process. According to Joseph E Stiglitz especially in developing and transition economies the markets are lacking, if the markets exist they may function less because of the rapid change in the economic environment. While market failures loom larger in developing and transition economies, the successful governments (like East Asian economies) have helped create markets such as stock markets and long-term credit institutions. They have established and enforced laws and regulations that have made financial markets more stable and increased competition in all sectors. Therefore, the government of Ethiopia has to develop the markets for capital, labour and foreign exchange. Along with this, the private sector participation is essential to take place. So that the competition would increase and result in efficiency.

Finally, one can reap the benefits of competitions and efficiency provided the markets are well developed. Otherwise, the early privatization process will lead to concentration of ownership rights by the rich people alone and result in income inequalities.

Besides, the third stage of reforms involves institutional development, capacity building and coping with second-generation issues such as corruption. Since it is a developing country it lacks institutions for providing housing, health and education facilities, which are basic to human beings. Therefore, the sectoral investment planning should focus on these issues, while making allocation to various sectors of the economy. Besides agriculture is another area, which requires attention particularly in view of the strategy i.e.. Agricultural Development Led Industrialization (ADLI) adopted by the government of Ethiopia. It needs investment from both private and public sectors in order to develop infrastructure such as irrigation facilities, modern technology (tractorization) HYV seeds, and fertilizers and pesticides. Furthermore, human resource development is vital for achieving the capacity building. Therefore, the country has sought the assistance from UNDP for developing the education.

Another issue, which is of paramount importance, is corruption by power and influence. Those seeking to encourage economic growth, democracy, and a fair distribution of income and wealth need to be concerned with the corruption of state officials in transition economies. Corruption has the potential to become so widespread that it could undermine and even destroy the transition process. Corruption can be reduced, if not eliminated, if the government is firm and determined in introducing the civil service reforms. It should also enforce anti-corruption laws, reduce the incentives for payoffs, and increase the accountability of government to citizens.

## **Government Policies and Poverty**

A study by Lionel Demery and Lyn Squire (9) came out with an interesting finding that there is a systematic link between policy implementation and outcomes for the poor-effective reform programs are associated with reduced overall poverty, inadequate ones with worsening poverty. The study was an attempt to examine how policy reforms in Africa affected poverty. It has

covered six countries from Sub-Saharan Africa. Ethiopia is one among them. Further, the study concluded that changes in poverty have been quite diverse-one country shows a dramatic increase in the share of population in poverty, one shows a roughly constant share, and four countries showed significant declines.

The survey covered the period from 1989 to 1994 and seven different areas of Ethiopia. The survey initially carried out by the IFPRI and repeated by the Institute of Development Research in Addis Ababa. It was designed to cover regional, ethnic and agro-ecological diversity.

As far as the absolute poverty is concerned, the percentage of population in poverty in 1989 was 59 and declined to 41 in 1994. The decline in poverty is 18 per cent. The poverty line as a percentage of mean expenditure is 54. It is calculated by following the head-count index-the share of the population below some predetermined poverty line. The study suggested that there is a close link between poverty on the one hand and macroeconomic balances and the rate of economic growth on the other. The conclusion is that the policy affects the poor positively helps in improving the well being of the people.

### **Conclusions and Emerging Issues**

Ethiopia has successfully launched the economic reforms in the early nineties and proceeding with second-generation reforms like privatization and so on. Remarkable progress has been achieved in the first four years of reform period though the process of reforms is continued. Agricultural sector has registered an increase in the volume of food grains output and per capita food production. There is also an increase in the value of agricultural exports during 1993-1996.

The rate of growth of GDP has registered an increase after the introduction of the reform program in 1992-93. There is also an improvement in saving and investment since 1992. Higher rate of inflation (21 per cent) occurred during 1990-91 to 1991-92. However, following a tight fiscal and monetary policy, good performance of the economy, except some years, market integration and transport deregulation, the accelerated inflation has been contained. The external sector performance was poor as reflected by persistent current account and trade deficits.

The performance of the public sector was characterized by an excess of government expenditure over revenue during eighties has been reversed after 1992-93. The government revenue has, on average, been growing faster than government expenditure fully covering the recurrent expenditure and a significant part of the capital outlay. Though deficit level is still high because of growing size of capital budget the financing of the deficit has been non-inflationary. Money supply that grew at higher rates until the end of 1994-95 has slowed down since then conforming to the objective of stabilizing the economy.

However, the pace and process of reforms has been disturbed by the border dispute with the Eritrea in the recent past. In fact, the process of development has been slowed down during 1999-2000 for the lack of funds for the programs of development. It was reported in the newspapers that there was a shortage of food to millions of people in Ethiopia. Nevertheless, it

has the potential to come back to the right track and move in the direction of improving the economic growth for which the reforms process will provide an impetus and result in far reaching changes.

### Foot Notes

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4. Newai Gebre-ab: “ Highlights of Economic Reform in Ethiopia, 1992-96”, *The World Bank*, processed pp 1-2
5. Considering it as a factor of production in a least-developed country such as Ethiopia.
6. Kofi Apraku, “Manpower and Entrepreneurial Skill Shortages: Constraints to Private Sector Development in Africa?”, in *Privatization and Investment in Sub-Saharan Africa*, ed. By Rexford A.Ahene and Bernard S.Katz, Praeger, New York, 1992, p.119
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8. Paul Bennell (1997); “Privatization in Sub-Saharan Africa; Progress and Prospects during the 1990s”, in *World Development*, Vol.25, No.11 pp 1785-1789
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