UNIT 5

TRADE IN THE ETHIOPIAN ECONOMY

Unit Objectives

After completing this unit, you will be able to:

- state and explain the role of trade and its importance in the Ethiopian economy;
- distinguish the domestic and foreign policies and strategies applied by the Imperial, Derg and EPRDF regimes; and
- construct balances of payments.

Main Contents

INTRODUCTION

In this unit, we will study the Ethiopian trade sub-sector. According to the Ethiopian National Income Account classification, trade is a component of the service sector. It is a very important component of today's economy.

People buy hundreds of items, such as food, clothing, transport services, health services, etc. Other people sell these items. This process of buying and selling is called trade. Trade can be of two types. These are domestic and international trade. Domestic trade involves the exchange of goods and services among citizens in a country, whereas international trade is the exchange of goods and services among the citizens of independent or sovereign nations.

5.1 ROLE AND IMPORTANCE OF TRADE IN ECONOMIC DEVELOPMENT

At the end of this section, you will be able to:

- explain the importance of trade in economic development.

Key Terms and Concepts

- Balance of payments
- Trade
- Debt servicing
- Integration
- Globalization
- Growth
- Development
- Domestic trade
- International trade
- Absolute advantage
- Comparative advantage

Are you aware of the historical emergence of trade in Ethiopia? What role do you think trade can play in Ethiopia?

5.1.1 Historical Background of Trade in Ethiopia

Ethiopian trade was started during the time of the Axumite Kingdom. During this time, the state obtained considerable income from both domestic and international trade. Trade took its modern shape under the regime of Emperor Menilik II. Trading activities that took place once a week in traditional markets were supplemented with the opening of small shops in towns. A particular impetus in domestic trade was attained with the construction of railway lines from Djibouit to Addis Ababa, thereby increasing the number and types of commodities available for sale. Due to cultural influence, and lack of adequate capital and knowledge, almost all of the modern shops were owned and run by foreign nationals (Armenians, Arabs, etc.). International trade was facilitated through a network of trading routes from Adulis and other trading posts on the Red Sea coast. These trading routes were frequently used by both domestic and international traders and made the flow of goods and services to and from the country possible.

After the end of the Italian invasion, the modernization of domestic trade achieved a landmark. A responsible ministry, aware of its duties and responsibilities, backed by various rules and regulations for efficient operation, was set up. Institutions were also set up to provide training to Ethiopians who might enter the fields of trade and commerce. Above all, a commercial code was introduced in order to enforce laws governing business transactions. The business environment advanced greatly until the 1974 Revolution.

After the takeover of power by the Derg, the whole system of economic management, including domestic trade, changed greatly. Mass nationalization took place. Every activity of the national economy was guided under central planning: profit motives gave way to social objectives. Every measure to strengthen the socialization process was encouraged and, if necessary, subsidized.

The economy ultimately stagnated and demanded change. The reform measures that were started during the last years of the Military regime were not adequate enough to bring about the demanded change. And, as a necessity, a radical change in all spheres (economic, political and social) took place with the overthrow of the Derg in 1991. Since then, many important reform measures have been undertaken, based on the economic policies of the transitional period and on a number of most recent policy measures, rules, regulations and directives were issued to bring back a business environment governed by market law.

5.1.2 The Role and importance of Trade in Economic Development

Trade deals with business transactions that take place between households, firms, and governments. It can be divided into two: *domestic* and *international trade*.

Domestic trade refers to pure exchange activities within a national boundary. Domestic trade encourages the diffusion of knowledge, culture, and religion. As such, domestic trade fosters specialization in which each locality or region specializes in the production of specific commodities, thereby creating interdependence among regions. The whole basis of domestic trade rests on the fact that localities or regions differ in their resource endowments and in their economic and social features and capacities for growth and development.

International trade, on the other hand, can be defined as the exchange of goods and services among citizens of independent or sovereign countries. People are better off when they have trade than when they are without trade.

There are many factors accountable for the rise of international trade. Some of them are differences in resource endowment, demand, and economies of scale and specialization. For example, the differences in resource endowments lead to differences in relative costs in the production of goods and services among countries. Economies of scale provide additional cost incentives for specialization in production. That is, instead of manufacturing only a few units of each and every product that domestic consumers desire to purchase, a country specializes in the manufacture of large amounts of a limited number of goods and trades for the remaining goods. Specialization in a few products allows a manufacturing sub-sector to benefit from longer production runs, which leads to decreasing average costs.

While demand patterns seem to be similar throughout the world, especially among similar socio-economic income classes, differences in tastes and preferences certainly exist. For example, in country A, where demand is oriented toward steel, the price of steel that intensively uses the relatively abundant factor is relatively higher than its price in the trading country B. With the opening of trade, country A would find itself exporting cloth and importing steel from country B because B's steel is relatively cheaper at international prices. This occurs because demand in country A for the product using the abundant factor intensively leads to a high price for that product and the factor used intensively in its production that the physically abundant factor is the scarce factor from the standpoint of price definition. Because this is the result of a particular set of demand conditions, it is referred to as demand reversal.

International trade allows a country to specialize and export those goods and services that it can produce at relatively low cost and import those goods and services whose domestic production is relatively costly. As a consequence, international trade enables a country to consume and produce more than would be possible without trade. In other words, international trade enlarges the consumption choice of people by allowing them to consume those goods which they cannot produce. Unlike domestic trade, international trade provides foreign goods and services that cannot be produced within the domestic economy. International trade also encourages the diffusion of knowledge and culture because trade serves as a point of contact between people of different countries. International trade also encourages specialization, and creates interdependence among countries.

Activity 5.1

1 What are the causes and salient features of international trade?

2 What are the differences between domestic and international trade?

In general, there are two guiding principles that determine which commodities should be produced locally and which ones should be imported from abroad. These principles are

- *Absolute advantage and,*
- *Comparative advantage.*

A A nation is said to have an absolute advantage over another nation if either of the following two conditions exists:

i The country must be a sole producer of something due to factors such as climate, natural resources, and level of technology. For example, there is an abundant supply of diamonds in South Africa.

ii The country should produce the commodity more cheaply than others. For example, Brazil can produce coffee and forest products more cheaply than the USA can.

B Comparative advantage, on the other hand, says that a nation should produce and sell to other nations those products that it produces most effectively and efficiently, and should buy from other countries those products which it cannot produce as effectively and efficiently. In other words, a country will tend to produce and export those goods in which it has the greatest comparative advantage and to import those goods in which it has the least comparative advantage.

5.1.3 Restrictions and Modes of Payment in Foreign Trade

Because of its special features, foreign trade has been a serious area of debate. Since it involves trade among nations of different levels of economic development, capacity, currency, economic policy, etc., there are some issues which arise from international trade. Among these issues, trade restrictions and modes of payment are the two important ones.

A *Restrictions on International Trade*

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

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

Quotas

These are some of the oldest trade restrictions used. Quotas are a strong and very serious kind of restriction. Aquota places a limit on the amount of a product that can enter into a country. Quotas usually have a limit, so that the entrance of the goods into a country is stopped when the quota is met.

Tariffs

These are duties or taxes imposed by the government of a nation on goods entering that country. Tariffs may take different forms, but in general they raise the prices of the imported goods. Tariffs serve for two general purposes: they generate revenue for the government, and they protect local products from foreign competition. Unlike quotas, tariffs can be overcome by reducing prices. There are three forms of tariffs:

- ***Specific tariff:*** *specific tariffs are tariffs imposed on each unit imported or based on physical quantities.*

- ***Ad valorem tariff:*** *this is imposed on the basis of the monetary value of the product.*
- ***Compounded tariff:*** *this is a combination of the specific and ad valorem duties. That is, some products are taxed on both quantity and value.*

  Example: Birr 5 per quintal and 5% on the value of the good.

Exchange Controls

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

B *Modes of Payment in International Trade*

Payments in domestic trade are quite simple. In international trade, payment is an important area of concern. Payments in international trade can be made in one of the following ways:

- *Banker's transfer,*
- *Bill of exchange, or*
- *Letter of credit (LC).*

A ***Banker's transfer:*** This is a simple transfer of money from the bank account of the buyer (importer) in his/her own country to the bank account of the seller in the seller's country.

B ***Bill of exchange:*** This is an order in written form addressed by a creditor to a debtor and signed by the creditor, requiring the person to whom it is addressed (the debtor or buyer) to pay either on demand, or at a fixed date, or at a determinable future time, a certain sum of money to the person named on the bill or to his order. The bill is drawn by the creditor on the debtor and is sent to the debtor (or his agent) for the latter to pay or accept. The debtor accepts by signing his name on the face (front) of the bill together with the date, at which point the bill now becomes legally binding, and the accepter must meet it on or before the due date.

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

Activity 5.2

1 Discuss the rationale and benefits of foreign trade.

2 Discuss absolute and comparative advantages in relation to the Ethiopian economy and the rest of the world.

3 What different restrictions can a nation use to control the import of goods?

4 What are the major modes of payment in foreign trade?

Content Check 5.1

1 Trade involving the exchange of goods and services among citizens of independent /sovereign countries is ________.

2 Difference in production cost is the cause of resource endowment variation. True/False (*Give reasons*).

3 People are better off when their countries engage in trade than when they do not. True/False (*Give reasons*).

4 Identify the similarity between domestic and international trade:

A Both enlarge the consumption choice of people.

B Both bring goods that can't be produced locally.

C Both encourage the diffusion of knowledge and culture.

D None of the above

5 ________ is a kind of restriction that places a limit on the amount of product that can enter into a country

A Quota

B Tariff

C Exchange control

D All are possible answers

5.2 TRADE POLICIES AND STRATEGIES IN ETHIOPIA

At the end of this section, you will be able to:

- examine Ethiopian domestic trade policies and strategies, based on ownership policy;
- understand distribution policy, pricing policy, and licensing policy; and
- examine the Ethiopian foreign trade policy

Key Terms and Concepts

- Duty drawbacks scheme
- Duty-free importation scheme

The development of trade in a nation is affected by the policies and strategies adopted. In Ethiopia, different policies and strategies have been adopted by different governments. We will see both the domestic and foreign trade policies and strategies that have had an influence on the development of commerce internally and externally.

5.2.1 Domestic Trade Policies and Strategies

The domestic trade policy of Ethiopia has different components which determine the trade environment and its development. Some of the components of the domestic trade policies are given below.

Ownership Policy

During the Imperial Period, most of the trading activities were controlled by the private sector. But, motivated by socialistic ideology, the Dreg nationalized both the wholesale and retail trading enterprises, which were mainly owned and run by foreign nationals, and restructured those which were not nationalized in order to meet the socialist-oriented objectives of the government. In other words, the dominance of the government in manufacturing, distribution, transportation and finance was the order of the day. This measure of nationalization stifled the rising participation of national entrepreneurs in all sectors. After nationalizing and restructuring trade organizations, the government reorganized them into wholesale and retail trading corporations and enterprises under the supervision of the then Ministry of Domestic Trade.

The participation of private organizations in domestic wholesale trading activities was very limited. For instance, in food grain marketing, merchants in Arssi, Bale and Gojam were banned altogether. In Gondar and Wollega, grain merchants had to surrender all their purchases to the government-owned Agricultural Marketing Corporation (AMC), while in other surplus-producing areas, such as Shoa, they surrendered 50 percent of their annual purchases to the corporation. In the domestic wholesale trade of manufactured products, the Ethiopian Domestic Distribution Corporation (EDDC) had a monopoly, and private traders were forced to take part in the trading of items with slow rates of turnover allocated to them by the corporation.

Activity 5.3

1 Explain the ownership structure of domestic trade during the Derg.
2 Discuss how private traders participated in trade during the Derg.

Distribution Policy

The distribution policy followed during the Derg was mainly a direct reflection of its ownership policy. As the ownership policy was based on socialist ideology, the distribution policy was in favor of socialized sectors. Those sectors under public ownership and cooperatives were given priority in the distribution of goods and services. The private sector, on the other hand, was only entitled to the residual. For instance, from 1985/86 to 1991/92, EDDC sold, on the average, 31 percent of its sales to private traders, while the rest went to socialized sectors. Moreover, all of AMC sales were directed to government institutions and urban-dweller associations.

The most important strategies employed in the distribution of basic or essential goods for which shortage was common were quota allocation and rationing. Basic commodities such as sugar, wheat flour, salt, etc. were under strict quota allocation. The then existing administrative regions received their quotas by EDDC, depending on supply. After the quota allocation, rationing was implemented, mainly through urban-dweller associations and service cooperatives, to final consumers, depending again on supply and on family size. But urban dwellers who were not registered in kebele associations were not entitled even to rationing and, as a result, they were forced to buy those basic commodities at very high prices from private shops. Likewise, the movement of food grains from region to region by private traders was strictly forbidden. Only AMC had the mandate to move grains between regions, although other public organizations got permission to do so when a need arose.

Restriction on the movement of food grains by private traders had the following impacts:

- *It adversely affected the consumers in deficit areas by pushing up grain prices.*
- *It eroded incentives for producers in surplus areas by depressing prices.*
- *It hindered both the expansion of marketed supplies and the development of an integrated national market, which were very important for the country's economic development.*

In January 1988, the government announced that private traders would be issued permits to move grain as long as they agreed to sell half of their purchases to AMC at AMC buying prices. As of late 1988, there were reports of some private traders moving grain in some areas. However, there was a disincentive to trade in cases where the official prices at which traders had to sell to AMC were lower than the local prices at which they purchased the grains.

Activity 5.4

1. Discuss the distribution policy during the Derg period.
2. Explain what mechanisms were used to distribute goods and services during the Derg period.

Pricing Policy

During the Derg Regime, price determination through the free functioning of market forces of demand and supply was disturbed by the government's intervention. There were, by and large, administratively managed pricing practices. However, there were no uniform pricing policies or procedures across sectors or commodities. In this section, the pricing policies followed with regard to manufacturing and agricultural commodities will be reviewed.

The prices of manufactured products, which were considered very basic and in short supply were determined by the Ministry of Domestic Trade and announced to consumers through public notices. These commodities could be imported and/ or domestically produced. After price determination, price control was the next step. The prices of other manufactured products were determined on a cost-plus basis. However, this mechanism of price determination had its own limitation as it allowed inefficiencies of manufacturing and trading enterprises to be transmitted to consumers in the form of additional costs.

More problems were observed in the pricing mechanism of agricultural commodities or food grains. Based on the cost-of-production study undertaken by the Ministry of Agriculture, national farm-gate and wholesale prices of food grains were introduced in 1980/81. These fixed prices continued to be operational in the purchasing activity of AMC until 1987/88, when a minor increase in price modification was introduced. The upward price revision ranged from 6 to 10 percent, depending on the type of crop. Official marketing of food grains with fixed prices ended with the introduction of the mixed economic policy in March 1989/90.

Activity 5.5

1. Discuss the pricing policy of the Derg.
2. Explain how the prices of agricultural and manufactured goods were determined during the Derg.

Licensing Policy

Domestic trade licensing involves the issuance of licenses to wholesale, retail and service trading activities. The licensing policy during the Derg regime aimed at limiting the participation of private traders as depicted in Proclamation No. 76/1976. According to the proclamation:

- *Trading activity was allowed only to proprietorships;*
- *There was no licensing to government employees;*

- *Wholesaling was limited to the capital ceiling of Birr 300,000 and retailing to Birr 200,000;*
- *An individual could get licensed only in the region in which he/she resided;*
- *Only one business license and one business undertaking were permitted to an individual. Branch establishment was prohibited; and*
- *License provision was tied to supply conditions.*

These restrictive licensing conditions for private traders were relaxed with the introduction of mixed economy policies during the dying hours of the Derg Regime. Following the relaxation of restrictive licensing conditions, a great many new wholesale, retail, and service licenses were issued to individuals and business associations. For instance, new licenses issued in 1988/89 before the relaxation of licensing restrictions were 3,163, and this number went up to 30,729 in 1990/91— that is, after the relaxation of those restrictive licensing conditions.

With the overthrow of the Derg by the EPRDF and the establishment of the Transitional Government of Ethiopia (TGE) in mid-1991, changes took place in the political, economic, and social conditions of the country. Rules that encouraged the functioning of the market were institutionalized, with some government intervention when necessary. The importance and constructive role of the private sector in the national economy was better appreciated and an enabling environment for its operation was created. The foundation for the changes observed was laid down with the adoption of the country's new economic policies during the transitional period. Subsequently, various proclamations, regulations, and directives, as well as reform measures, were introduced so as to create a favorable legal framework for the implementation of the adopted policies.

Liberalization Measures: Trade liberalization, particularly that for food grain marketing, was started during the Derg regime as part of the reform measures envisaged in the polices of mixed economy. However, there was public doubt regarding the continuity of the system because there was still a heavy government hand in all sectors of the economy.

The first most important step taken after the Derg was the removal of restrictions on traders. Private traders were allowed to operate side-by-side with government parastatals. Controls on inter-regional grain movement were also removed and, as a result, price differentials between surplus and deficit areas narrowed. The quota system for grain purchases was abolished.

The adoption of the new economic policy and the subsequent measures taken under the New Economic Reform Program further consolidated the reform measures started in 1990 and introduced additional ones. This time, the reform measures were well rounded, ranging from macroeconomic to sectoral policies, and they were radical enough to bring structural change to the whole economy.

As a result of the liberalization measures undertaken so far in domestic trade:

- *New entrants as well as established traders can move food grains freely from market to market;*
- *Obtaining licenses and legal recognition are relatively easy;*
- *The activities of parastatals a shrinkage in their purchase and distribution network;*
- *the traditional private marketing system has revived;*
- *types of markets and market channels in both rural and urban areas are diversified;*
- *private trade appears to be deficient in making goods available in time and place, compared with public sector trade;*
- *better quality grains are shipped to the central markets as prices are permitted to reflect widely accepted perceptions of quality differences;*
- *the producer-consumer price margin has narrowed, due to a sharp increase in producer prices, without change in the already inflated consumer prices;*
- *markets have started to experience price fluctuations related to supply and demand; and*
- *as can be observed from the trend in the number of new domestic trade licenses issued, (for both wholesale and retail trade) the volume of commodities handled and the number of participants in private trade have increased since the launching of the reform.*

Privatization Measures: Nationalization and socialization were the basic economic principles of the Derg government. In the new economic policies adopted by the then TGE and the now FDRE government agencies have had only limited participation in wholesale trade and their complete withdrawal from retail trade activities has been well expressed. The role of the private sector in running wholesale and retail trading more efficiently is well-appreciated.

The Ethiopian Privatization Agency started privatizing public enterprises in February 1995 by selling retail trade shops and stores as well as small and medium-size hotels through tenders. So far, a total of 126 retail trade shops and stores have been offered for privatization, out of which 108 have been sold. Of these, 69 sold. On tender basis, while 39 sold directly to employees organized under safety-net programs.

In addition, the private sector has been investing in wholesale and retail trade activities. This indicates significant changes in the attitudes of the business communities that had been accustomed to “air to air” trading practices for almost two decades. In general, the participation of the private sector in domestic trade, in particular, and in the national economy at large has been encouraging. The following table depicts the profile of private sector participation in wholesale trade for the period July 1992 - April 1997.

Table 5.1 **Operational and Under-Implementation Projects (July 1992 - January 1997)**

Project status	Total	Wholesale and Retail trade	Share of wholesale an Retail Trade from total (in %)
1 **Certified**			
Number of projects	3,306	117	3.5
Capital (in ‘000)	25,653,317	387,454	1.5
Employment creation	202,266	5,408	2.7
2 **Operational**			
Number of projects	663	12	1.8
Capital (in ‘000)	470,9258	33,178	2.7
Employment creation	27,416	343	1.3
3 **Under implementation**			
Number of projects	475	12	2.5
Capital (in ‘000)	3,501,304	54,007	1.5
Employment creation	35,013	352	1.0

Source: *Ethiopian Investment Authority*

Activity 5.6

1 Explain the different trade liberalization measures undertaken post-1991.
2 Discuss the likely effects of liberalization measures.
3 Explain what is meant by privatization.
4 Describe privatization measures taken so far by the government since 1991.
5 What do you infer from the information given in Table 5.1?
6 Discuss how domestic trade licenses were issued during the Derg period.
7 What restrictions were imposed on private traders?

5.2.2 Foreign Trade Policy

The foreign trade policy of the Derg had four major objectives.

- *Mobilizing government revenue by imposing taxes on imports and exports,*
- *Protecting domestic economy participants from foreign competition,*
- *Maintaining a favorable balance of payments at a sustainable level, and*
- *The gradual prevention of the private sector from foreign trade participation.*

Consistent with the last objective, the government discouraged private importers and exporters from exporting traditional export items, such as coffee, pulses, oil seeds, and the like. Public enterprises were established to run such activities. During this regime:

- *Exporters were not allowed to export commodities at prices less than the reference prices provided by the government.*
- *Exporters were also forced to surrender 100 percent of the foreign exchange they obtained to the government.*
- *There was a restrictive foreign exchange licensing system for private use.*
- *The exchange rate was fixed at Birr 2.07 for a dollar for quite a long period of time.*
- *The government provided marketing channels for all imports and major exports of the country.*

However, after the overthrow of the Derg, the TGE started taking a number of foreign trade policy measures in 1992. The government

- *changed the fixed exchange rate regime to that of a managed floating exchange rate regime (that is, a rate determined by the market).*
- *introduced a bi-weekly foreign exchange auction market in May 1993.*

Currently, this auction system is changed on a daily basis. The marginal rate (the market clearing rate) established at the auction used to be used as a secondary rate applicable to all current and capital account transactions until the next auction, with the exception of a limited number of payments for which the foregoing exchange rate was made available at the official rate. However, the two rates were unified on July 25, 1995, and a weekly foreign exchange auction was introduced a year later.

In August 1998, the government replaced the retail auction market with wholesale auctioning in which commercial banks, the foreign exchange bureau, and investors in need of large amounts of foreign exchange (above USD 500,000 per auction) could participate. An inter-bank market for foreign exchange has also been introduced and is still practiced.

The other main external trade reform measure was the suspension of taxes and duties levied on exports, except on coffee. It was introduced in January 1993. But the tax on coffee was also removed after the recent historic coffee price decline in order to reduce the adverse effects of this price decline on coffee growers and other citizens participating in the coffee market. This tax removal on export of all commodities together with the devaluation, provides a strong incentive to exporters because it allows them to receive the equivalent of world prices for exports. Government subsidies to exporters were also terminated when export taxes were lifted.

Complementary to this measure, the government introduced an export duty-drawback scheme in August 1993 to further encourage investment in the production of exportable item. There were two versions in this incentive scheme.

i The first was the duty draw-back scheme. It provided persons or enterprises that were wholly, partially, or occasionally engaged in exporting their products, refunds of the duty paid on raw materials (whether imported or locally produced) used in the production of the exportable item. The duty draw-back scheme has had two terms of condition.

- *The first term states that when the raw material or commodity on which duty is to be drawn-back is re-exported in the same condition, 95% of the duty will be refunded.*
- *The second term stipulates that if the raw material or commodity on which duty is to be drawn-back is exported after being processed or used for packing or containing, 100% of the duty will be refunded. However, this scheme is applicable only if the commodity produced using the raw material is exported within one year from the date on which such raw material has been imported or purchased locally.*

ii The second version of the scheme is known as the duty-free importation scheme. This scheme authorizes organizations and persons wholly engaged in supplying their products to foreign markets to import or locally purchase raw materials they use in production of such commodities free of duty. Similar to the earlier scheme, this scheme requires exporters to export their commodities within one year from the date on which the raw materials used have been imported or locally purchased.

Furthermore, within the framework of promoting exports, the following measures were undertaken:

- *Reducing license fees for coffee exporters and simplifying the procedure for getting licenses.*
- *An action program for the liberalization of the coffee sector has also been developed.*
- *Since 1996/97, the government has reduced the 100 percent foreign exchange surrender requirement on exporters to the National Bank of Ethiopia to 50 percent and allowed the exporters to open foreign exchange saving accounts at commercial banks and save 10 percent of their proceeds for a given transaction. The remaining 40 percent of their earnings is to be exchanged for Birr within three weeks at a rate they find favorable. This saving is to be used for investment and other expenditures related to the development of the export sector.*

With respect to import trade liberalization, the government has been introducing policies step-by-step or gradually. For example,

- *Maximum import duties were lowered from 280 percent to 80 percent during the first move of import liberalization and currently stands at 50 percent.*
- *In addition, efforts are being made to correct legal and administrative impediments to import liberalization through a simplification of the system of granting import licenses and permits.*

In line with the government's policy to build a market-based economy, the external sector has also benefited from the abolition of monopolistic operations of public enterprises, which used to dominate the export and import sector alike. Since then, the private sector has been encouraged (including by the simplification of entry to market) to participate in the external sector.

Activity 5.7

1 Discuss the various reform measures taken in the external sector.
2 Explain what is meant by duty-free importation scheme.
3 What were the limitations of the trade policy during the Derg period?
4 What are the major differences between the trade policies of the Derg regime and of the current government?

Content Check 5.2

1 The distribution policy that was followed during the Derg Regime was mainly a direct reflection of its ________ policy.

2 Restrictions on the movement of food grains by private traders

A Raised grain prices in deficit areas

B Depressed prices in surplus areas

C Hindered expansion of market supplies and the development of an integrated national market

D All of the above

3 "Mobilizing government revenue by imposing taxes on imports and exports was one of the foreign trade policies of the Derg regime". True/False (Explain).

4 Commodities under strict quota allocation during the Derg Regime included

A Sugar

B Wheat flour

C Salt

D All of the above

5 Suspension of taxes and duties levied on exports, except on coffee, was one of the reform measures taken by the Transitional Government of Ethiopia. True/False (Explain).

5.3 THE STRUCTURE AND PERFORMANCE OF TRADE

At the end of this section, you will be able to:

- evaluate the structure and performance of trade;
- analyze the structure of domestic trade;
- evaluate the structure and performance of foreign trade, as compared to export and import performance; and
- identify the major trading partners of Ethiopia.

Key Terms and Concepts

- Wholesale trade
- Retail trade
- Export earning

What can you say about the structure of trade in Ethiopia? Has the recent financial crisis affected its performance?

5.3.1 The Structure of Domestic Trade

The concept of 'structure' here refers to the relative magnitude of wholesale trade activities under public and private enterprises, including retail trade in domestic trade activities.

Wholesale Trade under Public Enterprises

Wholesale trade in manufactured and agricultural products was more or less under government monopoly during the Derg Regime. Both imported and domestically produced manufactured products could be distributed only under the sole monopoly of EDDC, and agricultural products mainly through AMC. Even though there were licensed private wholesale traders, they were forced to take commodities that were less in demanded from EDDC.

A **_Wholesale trade in manufactured products:_** EDDC was established by merging together nationalized trading organizations under Regulation Number 13/1975 with authorized and paid-up capital of Birr 10 and 5 million, respectively. The main objective of the corporation was to strengthen the arm of government in the socialization of wholesale trade in manufactured products. At the time of its establishment, it had a storage capacity of 28,000 square meters, 8 cargo vehicles, 18 branches, 338 workers and an annual sales turnover of Birr 40 million. The position of the corporation was further strengthened by Regulation Number 104/1987, which reflected the intention of the government to fully socialize wholesale trade in industrial products. This time, its authorized capital was raised to Birr 90 million and its paid-up capital to Birr 20 million.

After the downfall of the Derg, the corporation was restructured as Merchandise Wholesale and Import Trade Enterprise, and its paid-up capital has risen to Birr 50 Million through Regulation Number 103/1992. The enterprise has had no monopoly power and has been left to operate under a competitive environment. Stabilizing consumer markets and becoming profitable have been the two main objectives of the enterprise.

B **_Wholesale Trade in Agricultural Products:_** AMC was established with Proclamation No. 105/1976 with the principal objective of executing government policy in the field of wholesale food grain marketing, procurement, and distribution of inputs and maintaining national grain reserves. At the time of its establishment, its authorized and paid up capital stood at Birr 100 million and 21.1 million, respectively. With Regulation No. 103/1987, its authorized capital was raised to Birr 130 million and its paid-up capital to Birr 90 million. The intention behind this regulation was to fully socialize the wholesale trade in food grains and coordinate wholesale trade in manufactured products with wholesale trade in food grains.

After the downfall of the Derg Regime, AMC was restructured as the Ethiopian Grain Trade Enterprise (EGTE) in 1992. At this time its authorized and paid-up capitals remained the same as in 1987. However, major changes in its form of management and objectives were effected. The management was made autonomous and its objectives mainly became stabilizing grain markets.

Activity 5.8

1. Do you think EGTE (previously AMC) was operating up to its expectations this time around?
2. Do you think EDDC currently operates up to its expectation?

Wholesale Trade Under Private Enterprises

Private traders have the flexibility and efficiency to move goods more easily than government parastatals where and when they are needed. Besides, they can efficiently supply consumers at lower costs. However, the extent to which they are able to compete effectively in the market is dictated by the capacity they have in terms of access to capital, storage, and transportation as well as in terms of the various laws governing the economy.

Before the 1974 revolution, trade was predominantly in the hands of the private sector, and the role of the government was limited to the regulation and promotion of the private sector. After the revolution, however, the nature of trade completely changed and the economic environment as a whole became hostile to private-sector participation. Private businesses were made owner-operated, and were limited to only one type of business with no branches, and the government set a capital ceiling to limit their expansion.

After the downfall of the Derg, the Transitional Government of Ethiopia adopted a new economic policy during the second quarter of the 1991/92 fiscal year. The new economic policy brought about fundamental changes in economic outlook, management, and structure. In May 1992, the TGE undertook another big step: It legalized and broadened the scope of private-sector participation by issuing Proclamation No. 15/1992 — a proclamation issued to provide encouragement, expansion, and coordination of investment. These measures are believed to have caused attitudinal changes in business people who thought trade was the only area of participation. They therefore decided to take part in other economic sectors.

Retail Trade

In addition to controlling whole sale trade, the Derg Regime wanted to control retail trading. To this end, it organized publicly-owned retail trade enterprises like the Ethiopian Retail Trade Corporation (ERTC) and the Ethiopian Households and Office Furniture Enterprise (ETHOF) and by giving priority to commodity distribution to organized consumers such as urban-dweller associations in urban areas and service cooperatives in rural areas.

With the regime change in the 1990s, the government withdrew from retail trade activities. Accordingly, measures have been taken since 1994/95 to privatize government-owned retail trade organizations. Due to this and other conditions created by the TGE, the number of new retail trade licenses issued reached as high as 43,911 in 1991/92, an average growth rate of 264.5 percent compared to the preceding year. The new economic policy recognized the participation of voluntarily organized cooperatives in retail trading, but they are not being given any special privileges now.

5.3.2 Structure and Performance of Foreign Trade

In this section we will examine the performance and the relative share of commodities in Ethiopia's foreign trade activities. We will also discuss the trade partners of Ethiopia.

Activity 5.9

What measures do you think should be taken to change the current structure of export activities from being dependent on a single commodity?

Exports

Because Ethiopia's economy is underdeveloped heavily depends on agriculture, the structure of Ethiopia's exports is dominated by agricultural products, which alone accounted for more than 90% of the export proceeds of the country. As shown in Table 5.2, among the agricultural products, coffee accounted for the lion's share — about 70% — of agricultural exports and for 60% of total export earnings. Hides and skins and chat distantly follow second and third, and they account, on average, for 12% and 7% of total exports, respectively.

Coffee was the dominant export item as far back as the 1960's, constituting, on average, 55-60% of total exports. From 1994/95 – 1996/97, coffee alone accounted for 66% of total exports on average. Hides and skins were the second-most important export items, and they showed a general trend of improvement until their share peaked at 21% of total exports in 1991/92. From this year onwards, the available evidence indicates that hides and skins (as a proportion of total exports) exhibited consistently declining trends. Pulses and oil seed were important export items of Ethiopia.

When we look at the 2008/09 figures, we find that the same commodities dominated in the export activities of Ethiopia, as in the 1990's but with different shares. For instance, in 2008/09, coffee contributed only 26% of the total value of exports. This was due to a very large decline both in the price of coffee and in the volume of export, which resulted from the huge increase in the supply of coffee in the international coffee market offered by some new and old suppliers. However, coffee was the single most important contributor to the foreign exchange earnings of Ethiopia in 2008/09. The second and the third places were occupied by oil seeds and chat, with 24.6% and 9.6% shares, respectively (see Table 5.2).

Table 5.2 **Value of Exports, by Major Commodity Group (in millions of USD)**

Major Commodity	2006/07	% share	2007/08	% share	2008/09	% share
Coffee	424.2	35.8	524.5	35.8	375.9	26.0
Oil seeds	187.4	15.8	218.8	14.9	356.1	24.6
Leather and leather products *	89.6	7.6	99.2	6.8	75.3	5.2
Pulses	70.3	5.9	143.6	9.8	90.7	6.3
Meat and meat products	15.5	1.3	20.9	1.4	26.6	1.8
Fruits and vegetables	16.2	1.4	12.8	0.9	12.1	0.8
Live animals	36.8	3.1	40.9	2.8	52.7	3.6
Chat	92.8	7.8	108.3	7.4	138.7	9.6
Gold	97.0	8.2	78.8	5.4	97.8	6.8
Flower	63.6	5.4	111.8	7.6	130.7	9.0
Others	91.8	7.7	106.3	7.2	91.3	6.3
Total Export	1185.1	100.0	1465.7	100.0	1447.9	100.0

* *Previously known as hides and skin*

Source: *NBE, 2008/09*

The dominance of agricultural commodities makes the country's external sector susceptible to adverse shocks that affect both the agricultural and the industrial sectors. The shock experienced in the beginning of the 21st century by coffee-exporting countries is good evidence for this. Also the shock that hit the oil market is recent evidence of the problem of dependence on the export of primary products.

Export Earnings

The performance of the export sub-sector during the 1980's was characterized by stagnation with some sporadic erratic fluctuations. During the late 1980's and early 1980's, however, a clear trend of decline in export earnings was observed. Export earnings during this period declined so drastically that they financed only 17 % of imports in 1991/92. In absolute terms, export earnings declined from USD 443.6 million in 1988/89 to USD 154.2 million in 1991/92.

The introduction of the reform measures in 1992 seemed to have a positive impact on export performance. Export earnings showed continuous revival in the years following the reform, reaching a level of USD 453.6 million in 1994/95, restoring export earning and the capacity of financing imports back to the 1988/89 level, 43 %. The relative importance that a considerable growth in export earnings was particularly registered in 1994/95. It was documented that a considerable growth in export earnings was occurred in 1994/95, mainly due to windfall gains from an increase in the world price for coffee. A marginal decline in export earnings was observed in 1995/96, which was mainly attributed to the decline of world coffee prices in that year. Export earnings, on average, showed an increasing trend during the post-reform period. For instance, total export earnings increased from Birr 923.8 million in 1985/86 to Birr 3,511.6 million in 1998/99. Moreover, non-coffee earnings accounted for 34.5 % of the total export earnings, while coffee accounted for the remaining earning's during the post-reform period.

In the year 2003, export earnings were Birr 4,470.9 million indicating a close to 27% increase from its level in 1998/99. But they could finance only around 19.4% of the import bills in 2003. Total merchandise exports reached USD 1.45 billion in 2008/09, about 1.2 % lower than the previous years exports. Earnings from coffee, pulses, leather products, and fruits and vegetables tended to falter. Export receipts from coffee declined by 28.3% as a result of lower volume and international price. The volume of coffee exports went down to 21.5% due to problems associated with the domestic trading system, to lower demand in the international market following the global economic recession, and to the import ban by Japan, the second largest buyer of Ethiopian coffee. Consequently, the share of coffee in total exports fell to 26% from 35.8% a year earlier.

Similarly, export revenue from pulses dropped to 36.8% because of the 40.8% fall in the volume of exports, despite a 6.7% increase in international prices. Thus, the share of pulses in total exports shrank from 9.8% to 6.3% during the period under consideration.

The global economic downturn worsened. Export earnings from leather and leather products fell to 24.1% as the volume of exports went down by 51% in spite of a significant rise in international prices. On the other hand, export earnings from oil seeds, the second largest export item, increased by 62.8% due to 88.7% surge in volume, offsetting the 13.7% decline in international price.

Consequently, the share of oil seeds in the total exports rose to 24.6% from 14.9% in the preceding fiscal year.

Similarly, due to increased export to the Middle East and better international prices, revenues from meat and meat products and from live animals went up by 27.3% and 28.9%, respectively. Despite fears of the global economic crisis, export revenue from flowers improved by 16.9% in 2008/09 as a result of higher volumes of exports to different destinations, despite a marginal decline in international prices. Exports of chat and gold also fared well. Revenue from these items rose by 28.1% and 24.2%, reaching USD 138.7 million and 97.8 million, respectively in 2008/09.

Activity 5.10

1 What problems could a country encounter because it relies on the export of a single or very few primary products?

2 Whom do you think benefits the most from the international market: the primary product exporters or the industrialized ones? And why?

Public Versus Private Exports

The private sector development initiative that began to thrive during the Imperial Regime was thwarted with the advent of the totalitarian moves of the Derg. Private-sector participation in the export sector was marginalized, and government enterprises took the dominant role. For instance, the share of the private sector in total export earnings never exceeded 16 percent.

Following the introduction of the economic reform program, which encouraged a market-oriented system through reducing the role of the state in the economy and encouraging private-sector participation, the share of the private sector in export marketing grew continuously, increasing from 16% in 1990/91 to 48.2% in 1994/95, and then to 63% in 1996/97. This trend continued in 1997/98 when private exporters produced about 80 percent of the country's exports.

The general improvement in private-sector participation in the export sector was not accompanied by either a significant increase in the volume or in the diversification of export products. Just as in the case of overall export, the composition of private-sector exports is dominated by coffee, oil seeds, pulses, and chat, which altogether accounted for 85% of the private sector's annual export earnings. Coffee dominates the private sector's export earnings, accounting for 55% of the total revenue from exports.

Table 5.3 **Annual Foreign Exchange Earnings from Merchandise Export**

Operators	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98 (5 months)
Private sector	125.8	93.4	74.2	158.9	264.4	1317.8	1344.4	2084.0	923.6
Government	649.2	504	318.6	393.3	367.2	1418.4	1150.5	1223.8	252.6

Source: *MEDaC, 1999*

Activity 5.11

1 Discuss the structure of exports in Ethiopia.

2 Compare the share of the private sector during the 1980's and the 1990's.

II *Coffee Exports and Earnings*

Volume of Arrival and Export

As shown in Table 5.4, the export volume of coffee decelerated after it reached its peak in 1988/89, when 109.3 thousand tons of coffee arrived at the central auction market. It declined by 17% and 15% in the subsequent two years, falling to 60.2 thousand tons in 1991/92. From 1992/93 onwards, however, a strong resurgence in the export of coffee (volume of arrival) was observed, showing rises of 46% and 30% in 1992/93 and 1993/94, respectively. Indeed, the supply of coffee surpassed the 1988/89 peak and stood at 113.7 thousand tons in 1993/94, although this peak was followed by a slight decline to 102.3 thousand tons in 1994/95. The supply increased significantly to 141.4 thousand and 1165.5 thousand tons in 1995/96 and 1996/97, respectively. The growth momentum was slightly halted in 1997/98 as volume of arrival reduced to 155.4 thousand tons.

Table 5.4 **Volume of Domestic Supply and Actual Export of Coffee (in tons)**

Year	Domestic Supply		Actual Export		Actual exports as % of domestic supply
	Level	% Growth	Level	% Growth	
1987/88	83,411	-5.5	72,262	-0.8	86.6
1988/89	10,9299	31.04	77,707	7.5	71.1
1989/90	90,650	-17.06	83,251	7.1	91.8
1990/91	77,316	-14.7	534,57	-35.8	69.1
1991/92	60,155	-22.2	36,078	-32.5	60.0
1992/93	87,699	45..7	69,362	92.2	79.1
1993/94	113,680	29.7	73,004	5.2	64.2
1994/95	102,302	-10	78,420	7.4	76.6
1995/96	141,361	38.2	101,823	29.8	72.0
1996/97	165,536	17.1	117,979	13.7	71.3
1997/98	155,377	-6.1	121,365	2.9	78.1

Source: *MEDac, 1999.*

Not all of the coffee that is supplied to the central auction market is exported. The actual volume of export depends on the quality of the domestic supply, which must meet the demand specifications of the importers. In 1988/89, for example, only 78 thousand tons 71% of the domestic supply — was actually exported. Although the quantity supplied to the ceutal auction market was lower in 1989/90, the actual export was higher than the previous year — level, making up 92% of the domestic supply. A significant slowdown in coffee export was registered in the years 1990/91 and 1991/92, when it constituted 60% of the domestic supply.

Since 1992/93, coffee exports recovered consistently over the years. In 1992/93, the volume of coffee exports almost doubled from the previous year's level (showing a 92% increase). In 1993/94 and 1994/95, the volume of coffee exports increased further, though at a slower pace. It increased significantly in 1995/96, to 102 thousand tons, showing a growth rate of 30% over the previous year. It further increased to 118 thousand tons in 1996/97. Actual coffee exports in recent years ranged between 70-75% of supply, which was below the level that was reached during the late 1980's — in the range of 80-85% of domestic supply. This might be due to reform measures undertaken during the 1990's such as the devaluation of the Birr, market liberalization, regulation of prices, and the like.

Earnings from Coffee Exports

Coffee is the major export item, contributing, on average, around 35% to the overall foreign exchange earnings of the country. Data on coffee exports indicates that foreign exchange earnings from coffee drastically declined during the period 1988/89 to 1991/92. This was the period in which an overall decline across all export commodities was registered. The earnings from coffee was USD 90 million in 1991/92, a mere 36.5% of the 1988/89 level. A quick recovery was recorded in 1992/93, when earnings from coffee jumped to USD 217 million, which was comparable to those of the late 1980's. Earnings dropped to USD 153 million in 1993/94, but reached USD 300 million in 1994/95. The leap in 1994/95 was partly explained by the coffee price boom of the period. Although the volume of coffee increased by 30% in 1995/96, earnings from coffee declined slightly to 279.5 million, due to the immediate reversal of the price boom of the preceding fiscal year. In 1996/97, earnings from coffee increased to USD 359 million because of the moderate increase in the price as well as in the exported volume of coffee.

World Prices of Ethiopian Coffee

Ethiopia is a price taker in almost all of its export commodities. The world price for Ethiopian coffee usually depends on the price performance of the major coffee suppliers (like Brazil and Colombia) in the world market. In most cases, Ethiopian coffee-price booms have been associated with some form of supply shortfalls from major coffee suppliers. The price of Ethiopian coffee has been characterized by erratic fluctuations over the years. For instance, in 1988/89, the price of Ethiopian coffee was 151 U.S. cents per pound. It dropped to 99 U.S. cents per pound in 1989/90 and further to 93 U.S. cents per pound in 1990/91. A modest recovery was recorded in 1991/92 but immediately reversed in the following year. Then, the price of Ethiopian coffee registered a significant leap in 1994/95, when a pound of coffee fetched 182 U.S. cents. This resulted in a windfall gain in foreign exchange earnings to Ethiopia.

Activity 5.12

1 How can we increase our competence in the international market and maximize our benefits?

2 What measures could Ethiopia take to add value on every item it exports to the international market?

However, the windfall gain was short-lived as the price immediately declined to 125 U.S. cents per pound in the following year (1995/96). Beginning from the year 2000 or thereabouts the coffee price was at its lowest level since the Second World War. This reduced both the foreign currency that coffee exporters collected and the income that farmers received.

Imports

I *Trend in the Value of Imports*

In the second half of the 1980's, Ethiopian imports had stabilized at around USD 1 billion, except for slight declines to USD 874.8 million and USD 915 million in 1991/92 and 1993/94, respectively. The level of imports remained more or less stable within the same order of magnitude until 1994/95. A growth in imports, however, was registered in 1995/96, when imports increased to USD 1.4 billion, showing a nominal growth of 32.9% over the previous year. The preliminary estimates for 1996/97 and 1997/98 indicated that imports stabilized within the ranges of the 1995/96 level. Imports were estimated at USD 1.4 billion for 1996/97 and at USD 1.45 billion for 1997/98. As a share of GDP, imports consistently increased from 8.7% in 1991/92 to 23% in 1995/96 but slightly declined to 20% in 1996/97.

As indicated in Table 5.5, in 2009, the value of imports was about Birr 9 billion, which was 5.1 times more than exports for the year. The annual average growth rate for the Reform Period far exceeded the performance during the 1980's. The construction and rehabilitation efforts following the initiation of the reform and the balance-of-payment support from external financiers enhanced the growth of imports.

Activity 5.13

What factors are responsible for the widening of our balance of payments from time to time?

II Imports for End Use

Ethiopian imports are usually classified into five major categories, based on their final use: raw materials, semi-finished goods, fuel, and capital and consumer goods. The data for the period 1991/92 to 1996/97 shows that imports of capital goods were dominant throughout the period except for the years 1993/94 and 1994/95, when imports of consumer goods accounted for a slightly larger share. The third import category was the import of fuel until 1993/94, when it overtaken by expanding imports of semi-finished goods. The share of imports of raw materials was quite insignificant and stood at 2% of total imports during the whole period.

As indicated in Table 5.5, total imports went up to USD 7.7 billion in 2008/09 from USD 6.8 billion in 2007/08. The ratio of imports to GDP, however, declined to 24.5% in 2008/09 from 26.4% in 2007/08.

Some of the categories of imports by end use are so broad that a detailed analysis is required for a better understanding of the subject under consideration. Beginning with imports of raw materials, they were 37.4% in 2008/09, presumably indicating the increased level of industrial economic activities as reflected in the growing share of raw materials in total imports from 3.8% in 2007/08 to 4.6% in 2008/09. Imports of capital goods also went up — by 29.7% over 2007/08, reaching USD 2.5 billion due to booming investment activities in the country. Hence, the share of capital goods in total exports rose from 28% to 32% in 2008/09.

Similarly, imports of consumer goods increased by 54.7% as a result of higher imports of both durable and non-durable consumer goods. The rise in non-durable consumer goods was due to increased imports of cereals, and of medical and pharmaceutical products. Consequently, the share of consumer goods in total imports in the same year (2008/09) grew to 30.3% percent, compared to 22.3% in 2007/08. Meanwhile, Ethiopia's fuel-import bill declined by 22.5% to USD 1.26 billion, mainly becuase of the drop in international oil prices, offsetting a 3.5%

increase in the volume of oil imports. Accordingly, the share of fuel in Ethiopia's total import bill fell from 23.8% 2007/08 to 16.3% in 2008/09.

Table 5.5 **Imports, by Use (In Millions of USD)**

	2006/07	% share	2007/08	% share	2008/09	% share
Raw Materials	148.6	2.9	257.8	3.8	354.2	4.6
Semi-Finished Goods	800.3	15.6	1,259.7	18.5	1,140.1	14.8
Fertilizers	140.0	2.7	302.1	4.4	270.7	3.5
Fuel	875.1	17.1	1,621.4	23.8	1,256.7	16.3
Petroleum Products	872.3	17.0	1,614.4	23.7	1,247.0	16.1
Others	2.7	0.1	7.0	0.1	9.7	0.1
Capital Goods	1,868.5	36.5	1,907.7	28.0	2,474.4	32.0
Transport	633.8	12.4	380.9	5.6	384.2	5.0
Agricultural	33.0	0.6	40.9	0.6	31.3	0.4
Industrial	1,201.7	23.4	1,485.85	21.8	2,058.9	26.6
Consumer Goods	1,317.0	25.7	1,515.7	22.3	2,344.1	30.3
Durables	520.7	10.2	459.4	6.7	635.5	8.2
Non-Durables	796.3	15.5	1,056.3	15.5	1,708.7	22.1
Miscellaneous	116.6	2.3	231.7	3.6	157.0	2.0
Total Imports	5,126.2	100.0	6,810.7	100.0	7,726.6	100.0

Source: *NBE, 2008/09.*

5.3.3 Major Trading Partners of Ethiopia

The major route of Ethiopia's external trade is towards Europe, followed by Asia. As indicated in Table 5.6, during 2008/09, Europe remained the largest market for Ethiopia's exports, accounting for 41.7% of the country's total exports. Among the European countries, Germany, which mainly imported coffee and flowers, was the largest buyer of Ethiopian goods. The Netherlands, the main destination for Ethiopian flower exports during the review period, was the second biggest market in Europe, followed by Switzerland, the sole importer of gold from Ethiopia. Italy, whose main imports included leather and leather products, coffee, and textiles and garments, held the fourth place. Exports to the Asian market accounted for 35.6%, of which 35.3% went to China, 21.6% to Saudi Arabia, 11.2% to the United Arab Emirates (UAE), and 7.8% to Israel. The major export items to China included oilseeds, leather, and leather products. Meat and meat products, coffee, live animals, and oilseeds constituted the bulk of exports to Saudi Arabia, while meat and meat products, pulses, and live animals were the major items exported to the UAE. Israel mainly imported oilseeds from Ethiopia.

When we consider export destinations by country over the years, some fluctuations have been witnessed. For instance, 16.6% of Ethiopia's exports went to African countries, of which about 88.6% went to three neighboring countries: Somalia, the Sudan, and Djibouti. Chat was the principal export item to Somalia, followed by live animals. The major exports to Djibouti include chat, pulses, fruits, and vegetables. The Sudan mainly imported coffee, pulses, live animals, and spices. The share of the Americas in total exports was 5.7%, of which 73% was to the United States of America, 9.8% to Canada and 1.6% to Mexico. The main export items to the US were coffee and oilseeds.

Table 5.6 **Export by Destination and Imports by country of Origin**

Continent	Export by Destination	Import by Origin
Europe	41.7%	24.8%
America	5.7%	6.5%
Africa	16.6%	3.9%
Oceania	0.4%	0.1%
Asia	35.6%	64.7%
Total	100.0	100.0

Source: *NBE, 2008/09*

As to the origin of imports, Asia remained the largest supplier to Ethiopia, with a share of 64.7%, followed by Europe (24.8%), America (6.5%), and Africa (3.9%). Out of the total imports from Asia, about 71% originated from countries, namely China (26.2%), Saudi Arabia (25.0%), India (10.8%), and the UAE (9.0%). The major import items from China included clothing and textiles, metals, telecommunication apparatus, vehicles, electric materials, and machinery. More than 70% of the imports from Saudi Arabia and 60% from the UAE were petroleum products. Metal and metal manufacturing goods constituted the bulk of imports from India. Regarding imports from Europe, Italy accounted for 24.5%, Russia 9.3%, and Turkey 8.9%. Machinery, metal, and grain were the main import items from Europe. About 76.8% of imports from African countries originated from three countries: Egypt (29.2%), the Sudan (28.1%), and South Africa (19.5%). The Sudan's major export to Ethiopia was petroleum products.

Imports from the Americas accounted for 6.5% of the total imports, of which 97.5% was from three countries – the USA, Brazil, and Canada.

Activity 5.14

1 Describe the nature of the exports and imports of Ethiopia.

2 Identify the major trading partners of Ethiopia.

3 What are the implications of a deficit in our current account balance?

Content Check 5.3

1 Ethiopia is a price maker in some of its export commodities. True/False (Give reasons).

2 Ethiopia's trade with COMESA is very strong. True/False (Give reasons).

3 Identify the major supplier of Ethiopia's imports.

A Netherland C Japan

B Germany D Brazil

4 World price for Ethiopian coffee depends on

A The demand for Ethiopian coffee

B Performance of major coffee suppliers to the world market

C Supply of Ethiopian coffee

D None of the above

5 _________ determines the export structure of a country except for

A Past economic policies pursued

B Level of development of an economy

C Its openness

D Resource endowment

E None of the above

5.4 DEVELOPMENTS IN THE BALANCE OF PAYMENTS IN ETHIOPIA

At the end of this section, you will be able to:

- define the concept of balance of payments;
- evaluate the development of balance of payments;
- examine Ethiopia's national debt service and its performance; and
- describe the relationship between trade and globalization and integration with economic growth.

Key Terms and Concepts

- Trade balance
- Deficit
- Balance of payments
- Debt servicing
- Globalization/integration

What do you think is the main reason for the widening of the trade deficit in the Ethiopian balance of payments?

5.4.1 Trade Balance

Trade balance refers to the difference between the export and import of goods and services. If the difference is positive, it is called a trade surplus, and if it is negative it is called a trade deficit. A chronic trade deficit has remained the dominant feature of Ethiopia's in external trade in merchandise in the past two decades or so. With relatively small but significantly expanding exports and sizable imports, the trade deficit generally widened between 1991/92 and 1997/98. A clear trend of decline in the trade deficit existed in the period 1991/92-1994/95. However, the trade deficit has been in a general state of expansion since 1995/96, owing to the increase in imports which was much faster than exports. In 2008/09, for instance, the trade deficit was estimated at USD 6.27 billion.

5.4.2 Current Account Balance

The current account records all exports and imports of goods and services and unilateral transfers. It is the combination of the trade account, the service account, and the transfer account.

As indicated in Table 5.7, between 1992/93 and 2008/09, the services account was the only component of foreign trade in Ethiopia that usually registered a positive balance of payments. Net services stood at USD 23.1 million in 1992/93. They subsequently declined and stood at USD 10.9 million in 1993/94. In later years they showed a an overall substantial increase. The increase came particularly from the improvement of earnings from other services (particularly transport-service earnings), on the one hand, and from the decline in the net interest payment, on the other hand.

The successive decline in Ethiopia's net interest payment to the rest of the world is a result of two factors: the decline in the interest payments on external debt, which is attributed to the effects of debt cancellation and rescheduling and the interest received on our foreign reserves in foreign banks and to the rise in interest earned on foreign securities since 1994/95.

Despite substantial private transfer inflow and a small but increasing net receipt from services, the current account balance continued to experience deficit during the years spanning 1992/93 to 2008/09. The balance of payments for the begining of the post- reform period is summarized by Table 5.7.

Table 5.7 **Balance of Payment (in millions of USD)**

Description/Year	1992/93	1994/95	1997/98	2006/07	2007/08	2008/09
Exports	222.4	453.6	600	1185.1	1465.7	1447.9
Imports	1051.8	1063	1450.5	5126.0	6810.5	7726.6
Trade Balance	-829.4	-609.4	-850.5	-3940.9	-5344.8	-6278.7
Net services	-23.1	60.8	88.7	230.0	142.3	385.9
Private Transfers	247.9	311.2	334.1	1728.6	2388.3	2706.8
Current Account Balance	-604.6	-237.4	-427.8	-1982.3	-2814.2	-3185.9
Capital Account	-128	8.6	174.8	676.1	1055.8	1664.9
Errors and Omissions	233.5	-37.1	-145.9	192.3	173.8	346.5
Overall Balance	-98.8	161.6	-107.5	85.2	-263.5	376.8

Source: *National Bank of Ethiopia, several reports*

Activity 5.15

1 Describe the concept of terms of trade.

2 Explain the components of balance of payments.

5.4.3 The Capital Account Balance

Unlike the current account, the capital account covers transactions in financial assets and liabilities. It is different from the current account transactions in that it necessarily involves domestic residents either acquiring or surrendering claims on foreign residents. Hence, it deals with changes in the level of claims on foreign residents.

Ethiopia's surplus in the capital account significantly rose by 57.7%, to reach USD 1.66 billion, by the year 2008/09, reflecting higher official long-term capital inflows and a modest increase in estimated inflow of foreign direct investment. Net official long-term capital increased 123.7 % to USD 739.3 million as disbursement of loans was 107.1% up and amortization payments 10% down during the same period.

Table 5.8 **Balance of Payments**

Particulars	2006/07	2007/09	2008/09
	A	B	C
Trade Balance	-3940.9	-5344.8	-6278.7
Exports	1185.1	1465.7	1447.9
Imports	5126.0	6810.5	7726.6
Net Services	230.0	142.3	385.9
Travel	69.6	149.8	207.9
Transportation	80.6	129.2	223.1
Government (n.i.e.)	258.8	134.6	160.4
Investment income	30.4	16.6	-33.4
Interest	47.5	30.0	-9.1
Cash (net)	47.0	30.0	-9.1
Arrears	0.0	0.0	0.0
Dividend	-17.1	-13.4	-24.3
Other Services	-209.4	-287.9	-172.1
Private Transfers	1728.6	2388.3	2706.8
Current Account Balance (excl. pulblic transfers)	-1982.3	-2814.2	-3185.9
Public Transfers	1199.1	1312.5	1551.4
Current Account Balance (incl.public tranfers)	-783.1	-15017	-1634.5

Particulars	2006/07	2007/09	2008/09
	A	B	C
Non-monetary Capital	676.1	1055.8	1664.9
Long-term (net)	224.6	330.5	739.3
Disbursements	238.8	377.3	781.3
Repayments	14.2	46.8	42.1
Cash	14.2	46.8	42.1
Arrears	0.0	0.0	0.0
Direct Investment (net)	482.0	814.6	893.6
Short-term (net)	-30.5	-89.4	32.0
Net Errors & Omissions	192.3	173.8	346.5
Overall Balance	85.2	-263.5	376.8
Financing	-85.2	263.5	-376.8
Reserves (-: increase)	-85.2	263.5	-376.7
NBE net foreign asset	-39.6	244.4	-429.0
CBs net foreign asset	-45.3	19.1	52.2

5.4.4 National Debt Service and Performance

National debt is an accumulation of annual loans entered between the Ethiopian government and creditor nations and lending institutions. National debt can be domestic or external or both.

Domestic debt is the accumulation of annual loans that the government borrows from domestic financial institutions, whereas external debt refers to the accumulation of annual loans that the government borrows from international financial markets. Domestic debt is the amount of public sector borrowing from different banks and other financial institutions in the country. This might have a crowding out effect (a reduction in private sector borrowing and spending caused by increased government borrowing) when looking into the predomination of the public sector within the financial market and reducing the real credit to the private sector. When deficit persists and is financed by domestic borrowing, the servicing capacity of the public sector will eventually be questionable. The origin of external debt could be traced to the willingness of the debtor countries to borrow and the lenders to lend. National debt service is simply the amount of foreign exchange required to repay the debt and the interest on the debt.

It has been indicated that foreign borrowing allows a country to invest and consume beyond the limit of current domestic production. However, inappropriate and excessive foreign borrowing will generate debt service obligation that will constrain future economic policy and growth. The debt servicing burden is simply the amount of foreign exchange required to pay the external debt and the interest on the debt, which shows an upward trend over time.

The external debt profile of Ethiopia showed remarkable changes in its magnitude in the period between 1991/02 and 2008/09 as shown in Table 5.8.

Table 5.8 **Stock of External Debt (in million USD)**

Years	Total External Debt
1991/02	8,790.19
1994/05	9,973.03
1997/08	9,691.11
1998/99	10,153.50
1999/00	5,452.0
2006/07	2,300.3
2007/08	2,753.6
2008/09	3,304.6

Source: *Compiled from NBE report, several issues.*

As indicated in Table 5.8, the size of external debt grew until 1998/99, thus imposing a higher debt service ratio (the ratio of principal and interest payment on external debt that it had to export goods and non-factor services) that was beyond the service capacity of the country. The available documents indicate that the size of external debt was USD 371 million in 1974/75 and that it had increased to USD 10.2 billion by the end of 1998. However, following the huge discount made by the Russian Federation, the total debt stock of the country was reduced by half and stood at USD 5.45 billion at the end of 1999. By the end of 2008/09, Ethiopia's stock of external debt reached USD 3.3 billion, 20% higher than the previous year.

Table 5.9 **Indicators of Debt Burden**

Debt Stock/Year	1987/88	1989/90	1993/94	1995/96	1996/97	2006/07	2007/08	2008/09
As % of GDP	41.3	43.1	90.8	71.4	63.9	11.8	12.3	10.5
As % of Exports	512.5	560.4	798.1	545.9	411.6	0.9	0.9	0.1
Debt Service	-	-	-	-	-	1.2	2.5	1.4
As % of GDP (Actual)	3.8	2.8	2.9	2.7	4.9	-	-	-
As % of Exports (Actual)	47.6	33.5	25.3	20.4	31.5	-	-	-

Source: *EEA, 1999; NBE, 2008/09.*

As shown in Table 5.9, between 2005 and 2008/09, external debt as a proportion of GDP declined from 12.3% to 10.5%. The ratio of the stock of debt to export of goods and non-factor services, however, showed no significant change over the last year. Debt owed to multilateral creditors constituted 61.4% of the total debt, and increase by 32.5%. Similarly, debt owed to bilateral creditors rose 7.8% and accounted for 30.9% of the total debt. On the other hand, commercial debt, which accounted for just 7.7% of the total debt, showed a 7.6% decline. The debt service ratio fell from 2.5% in 2007/08 to 1.4% in 2008/09 as a result of lower debt service payments.

However, the debt burden did not exhibit a decline. This was mainly because export earnings were less than what the country paid for imports, which created debt accumulation. As indicated earlier, export earnings were much lower than import bills, producing a huge deficit in the current account balance and creating a balance-of-payments problem for the country.

Thus, debt accumulation and repayment retards economic growth. In other words, our economic growth would have been higher had it not been for the draining of foreign exchange to service the debt.

Activity 5.16

1 Distinguish between domestic and external debt.
2 Explain why the external debt of Ethiopia has been growing.
3 What measures do you think should be taken by the government to reduce the debt burden of Ethiopia?
4 What are the implications of borrowing from local financial institutions?

5.4.5 Trade, Globalization, and Economic Integration

In the 1990's "globalization" as a vehicle for development became the strategy used most often in major international initiatives in the world. Ethiopia and its least developed allies went through a broad agenda of reform and voiced optimism in global forums about the potential for reversing decades of socio-economic stagnation.

In a very rudimentary sense, the economic dimension of globalization entails the process of integrating an economy with world markets. The economic interdependence that results from such process encompasses both product market (a market where goods and services are bought and sold) and factor market (a market where resources such as labor, capital, land etc., are bought and sold) and involves transactions in goods and services, investment and finance. The overriding principle underlying globalization is beneficial to all parties in an environment of voluntary exchange on the bases of comparative advantage, which in turn is enhanced through specialization. The source of comparative advantages for a country might be one or a combination of natural endowments and acquired endowments such as superior knowledge and specialization. Least developed countries (LDCs), including Ethiopia, generally possess comparative advantage natural-resource-based and labour-intensive industries.

What challenges does globalization present and the what opportunities does it offer for countries like Ethiopia?

Let us begin with the potential opportunities.

Opportunities

In principle, globalization could offer the following opportunities:

- *Appropriately acquired and correctly channelled, it could*
- *Provide badly needed investment capital that could enhance productive capacity*
- *Enhance facilitate the easy flow of technology transfer*
- *Open markets for domestic products*
- *Make a domestic economy more competitive by imposing work ethics, discipline, and overall productive efficiency; and*
- *Strengthen international division of labour based on comparable advantages.*

Challenges

If proper policies are not in place, especially in the transition period, globalization may be hazardous to less developed countries' economic health. Some of these economic-health risks include:

- *Weakening or destroying whatever little productive capacity there is, particularly in the manufacturing sector, due to world competition.*
- *Complete vulnerability of the domestic economy to external shocks.*
- *Loss of the sovereignty of governments to address distributional and other social issues as they see it fit. This is because World Trade Organization (WTO) rules and the significant role of transnational would directly or indirectly put a constraint on what policies governments could pursue, and*
- *Trigger competitive devaluation and unproductive competition among the least developed countries, since most of them have similar endowments and comparative advantages. For instance, both Kenya and Ethiopia mainly rely on the export of coffee and tea.*

Economic integration is making international trade increasingly free by reducing (in some cases, eliminating) traditional trade barriers. Trade integration is one part of the large range of economic integration activities, which include integration of macroeconomic policies and freedom of factor movements as well as free trade between member nations.

The motives underlying the drive towards economic co-operation among countries are varied. Apart from those shaped by historical and cultural circumstances, the search for economic development and the expression of political solidarity have been prominent among them.

Economic co-operation's attractions are largely due to the advantages it offers through the enlargement of economic size and improvements in efficiency, and through the extension of the range and complementarity of resources available among countries.

Expected economic gains from regional economic integration are:

- *increased production arising from specialization according to comparative advantages,*
- *increased output arising from improved exploitation of scale economies.*
- *improvement in terms of trade with the rest of the world. For example, trade between the EU and the USA, Japan, etc.*

In Africa there are different regional forms of economic integration, which include these collaborations:

- *PTA (the Preferential Trade Area). The PTA was established in 1982. It has 19 member countries, and Ethiopia is one of them.*
- *Another regional integration is the ECOWAS (the Economic Community of West African States). It was founded in 1975 and has 16 member countries.*
- *The SADCC (the Southern Africa Development Coordination Conference), and*
- *The COMESA (the Common Market for East and Southern Africa).*

Activity 5.17

1 What optimal policy options does the country have to challenge the threat of globalization?

2 What is regional integration?

3 What benefits are expected from regional integration?

Content Check 5.4

1 The trade deficit of Ethiopia's merchandise external trade has been declining recently, owing to the increase in exports. True/False (Explain).

2 Debt cancellation and rescheduling tend to reduce the interest payments on external debt. True/False (Explain).

3 The current increase in private transfer inflows has improved the current account balance in Ethiopia. True/False (Explain).

4 One of the components of foreign trade that most often registers a positive balance of payments in Ethiopia is

A Capital account

B Current account

C Service account

D None of the above

5 The motives underlying the drive toward economic cooperation among countries are uniform. True/False (Explain).

5.4 DEVELOPMENTS IN THE BALANCE OF PAYMENTS IN ETHIOPIA

UNIT REVIEW

UNIT SUMMARY

- According to the Ethiopian National Income Account classification, trade and tourism are components of the service sector. In this connection, trade is classified under distributive services. The main objectives of this chapter have been to examine the role of trade in the Ethiopian economy and to identify the major constraints of these sectors.
- Trade can be domestic or international (external). In both cases people are better off when their governments engage in trade than when they don't. Domestic trade refers to the exchange of goods and services among citizens in a country. It can be local or inter-regional exchange in a country. It refers to pure exchange activities within a national boundary.
- International trade, is the exchange of goods and services among citizens of independent or sovereign countries. Many factors account for the rise of international trade. Some of them are differences in resource endowment, demand, and economies of scale and specialization. For example, the differences in resource endowments lead to differences in relative costs of production of goods and services among countries. Economies of scale provide additional cost incentives for specialization in production. That is, instead of manufacturing only a few units of each and every product that domestic consumers desire to purchase, a country specializes in the manufacture of large amounts of a limited number of goods and trades for the remaining goods. Specialization in a few products allows manufacturing firms to benefit from longer production runs, which lead to decreasing average costs.
- While demand patterns seem to be similar throughout the world, especially among similar socio-economic income classes, differences in tastes and preferences certainly exist. For example, in country A, where demand is very strong for steel, the price of steel that intensively uses the relatively abundant factor is relatively higher than its price in trading, country B. With the opening of trade between the two countries, country A would find itself exporting say, cloth, and importing steel, from country B because B's steel is relatively cheap at international prices. This occurs because the demand in country A for the product using the abundant factor intensively leads to such a high price for that product and the factor used intensively in its production that the physically abundant factor is the scarce factor from the standpoint of the price definition. Because this is the result of a particular set of demand conditions, it is referred to as demand reversal.

- International trade allows a country to specialize and export those goods and services that it can produce at relatively low cost and to import those goods and services whose domestic production is relatively costly. As a consequence, international trade enables a country to consume and produce more than it could without trade. Moreover, international trade encourages the diffusion of knowledge and culture.
- During the Derg Period, both domestic and foreign trade activities were under the control of the government. However, after the downfall of the Derg and the seizure of power by EPRDF, a number of reform measures were undertaken, particularly in the areas of trade and tourism. As a result of the liberalization measures taken by the government, participation of the private sector increased significantly in the trade and tourism sectors. Because of this, the magnitude of export earnings has increased from that of the post-Derg period.
- Balance of payments is a summary statement that summarizes all transactions conducted between Ethiopia and the rest of the world (i.e with its trade partners). As recent datas clearly indicate, the current account deficit is declining due to the significant increase in net capital flows.

REVIEW EXERCISE FOR UNIT 5

I *Choose the best answer from the given alternatives.*

1 Which statement is wrong?

A It would be advantageous, it is but impossible to locally produce all the commodities a country needs.
B International trade increases both consumption and production levels.
C The capital account in a balance of payments records loans received from abroad, among other things.
D All of the above.
E None of the above.

2 Why do nations participate in foreign trade?

A It stimulates economic growth.
B It brings about technological development.
C It raises the welfare of citizens.
D All of the above.
E None of the above.

3 An Ethiopian woman sends money from Europe to her family through a formal financial institution. This receipt of foreign currency will be recorded in Ethiopia under

A Capital Account
B Trade Account
C Current Account
D Service Account
E C and D

4 Which of the following shows the correct order of importance (in decreasing order) of agricultural commodities for Ethiopia's foreign exchange generation?

A Coffee, leather products, chat, oil seeds, and pulses
B Coffee, oil seeds, chat, and flowers
C Coffee, leather products, chat, pulses, and oil seeds
D Coffee, chat, leather products, pulses, and oil seeds
E None of the above

5 Currently the exchange rate of the US dollar against the Birr is determined by:

A The National Bank
B Auction involving all potential importers
C Whole sale involving commercial banks and some big importers only
D Bank-Inter buying and selling
E None of the above

6 ____________ considers physical quantities.

A Specific tariff
B Ad valorem tariff
C Compounded tariff
D None of the above

7 Identify the common mode of payment for imports in Ethiopia today.

A Bill of exchange
B Banker's transfer
C Letter of credit
D All of the above

8 During the Derg regime ownership policy was,

A based on socialist ideology
B in favor of socialized sectors
C favored quota allocation and rationing
D all of the above

9 The objective of the export duty draw-back scheme was

A to boost domestic production

B to encourage import substitution

C to encourage investment in the production of exportable

D none of the above

10 The objective of one of the following was to strengthen the arm of the Derg government in the socialization of wholesale trade. Which is it?

A Ethiopian Grain Trade Enterprise

B Agricultural Marketing Corporation

C Ethiopian Domestic Distribution Corporation

D None of the above

II *Say True or False and give reasons.*

11 We should import those goods in whose production we are relatively efficient.

12 Domestic trade enables a country to consume and produce more than it could without trade.

13 A rise in the price of Ethiopian coffee is associated with some form of supply shortfall from the major coffee suppliers.

14 Economic integration makes international trade freer by reducing traditional barriers.

15 Ethiopia's import structure is characterized by the dominance of semi-finished products.

16 The underlying principle of globalization is that all parties benefit from it, as long as exchange is based on comparative advantages.

17 Weakening or destroying work ethics, discipline, and efficiency are some of the challenge globalization poses.

III *Answer the following briefly.*

18 Discuss the differences between foreign trade and domestic trade.

19 Distinguish between domestic and external debt.

20 What are the indicators of debt burden?

21 Explain the difference between current accounts and capital accounts.

22 What is balance of payments?