

THE DISMAL ECONOMY: CURRENT ISSUES OF ECONOMIC REFORM AND DEVELOPMENT IN ETHIOPIA*

Eshetu Chole

Department of Economics, Addis Ababa University

ABSTRACT: *Written prior to the devaluation of the Birr and related adjustment measures, this paper is concerned with issues of economic reform in Ethiopia. The first section reviews the country's economic and social crisis. The second considers the prospects for economic reform and recovery by focusing on the political environment; the relative roles of the state and private sectors; the link between economic reform and growth (with special attention to structural adjustment in general and exchange rate adjustment in particular) and the social dimensions of economic reform. It concludes by arguing that the most significant determinant of the prospects for economic reform and growth is the political environment.*

I. THE CURRENT ECONOMIC AND SOCIAL CRISIS IN ETHIOPIA

Ethiopia is currently going through a critical period of transition. The end of the long-drawn-out and devastating wars, it had been hoped, would finally usher in an era of peace. Unfortunately, as the war drums begin to beat again - this time in other settings - such hopes seem to be dissipating in the quicksand of ethnic politics. Having suffered for seventeen years under a brutal dictatorship, the Ethiopian people had been hoping for more democratic governance. But, as the controversies surrounding the recent elections make only too clear, the country's halting efforts in this direction have yet to bear fruit. Its economy debilitated at least in part by a stifling policy environment, it had been expected to move towards greater market orientation. But any signs of this are invisible as of now. For long encumbered by over-centralized rule, Ethiopia is now experimenting with a decentralized pattern of regional administration, but this is a move that is full of unpredictable consequences. These multiple tasks make the transition a particularly complex and difficult process.

It is rendered even more complex by the fact that it is taking place in a context of mass poverty and serious social dislocation. The economy is in ruins, and must submit to extensive reform if it is to be galvanized at all. In order to appreciate the current economic and social situation in Ethiopia it is best to begin with a review of the legacy

* This is an Inaugural Lecture delivered at the Inaugural Ceremony of the Ethiopian Economic Association on the 15th of August 1992, Addis Ababa.

of the military government.¹ Between 1974 and 1990, GDP grew at an annual average rate of 1.9%, which in conjunction with a population growth rate of 2.7% led to a decline in per capita income of 0.8% per annum. The major cause of this disastrous performance was stagnation in the agricultural sector, which grew by only 0.7%, or a full 2% below the rate of growth of population. In other words, food production per capita fell by 2%.

The period witnessed a rapid and consistent decline in the saving rate, from 13% on the eve of the revolution to about 4% in the last years. This was largely due to a dramatic rise in government consumption, accounted for in large part by steep rises in military spending and government administration. In contrast, the rate of investment rose steadily, averaging about 14% towards the end. However, this figure compares unfavorably with the saving rate of similarly placed countries. Even then, because of the poor record of domestic saving mobilization, most of this investment effort had to be financed from external sources, with the consequence that the country's debt position deteriorated at an alarming rate. Towards the end, the country started defaulting on its debt obligations, and hence accumulating arrears.

The wide investment-saving gap was paralleled by a large and steadily widening budget deficit, in spite of considerable increases in government revenue. This substantial deficit was financed by external sources and borrowing from the banking system. This was a major factor in the growth of money supply, with inflationary consequences.

Likewise the trade deficit was steadily rising, a fact which was the major factor in triggering and expanding a negative balance in the current account. Consequently, the country had to borrow abroad and draw down on its foreign exchange reserves. This meant a drastic decline in import cover, so much so that by 1989-90 the country's foreign exchange reserves could cover only 10 days' imports.

These facts inevitably translated into declining living standards. In addition to falling per capita income, the economy was characterized by declining food availability, an erosion in the purchasing power of income, rising unemployment, poor housing conditions, limited access to water and sanitation, etc. Thus, according to World Bank estimates, 60% of the population lived in absolute poverty, meaning they could not afford the minimal requirements for decent human living.

And all the available evidence shows that these negative trends accelerated during the last year of the Derg.² In 1990/91 GDP further declined by 0.3%, implying a fall in per capita income of 3.2%. The sectoral rates of decline were 7.4%, 4.9% and 15.1% for agriculture, industry and services, respectively. The investment rate declined to 10.4% of GDP, while the saving rate was -0.2%, suggesting that the country consumed more than it produced. Export earnings declined by 24.4%, while - in contrast - the value of imports increased by 16%, giving rise to a trade deficit of Birr 1.6 billion. Arrears on external debt rose to Birr 450 million. The total budgetary deficit was in excess of Birr 2 billion, about 60% of which was financed by borrowing from the banking system, with clearly discernible inflationary consequences. The Addis Ababa retail price index rose by 20.9%, compared to 5.2% for the previous year. And open urban unemployment was very conservatively estimated at more than 600,000. One concludes, therefore, that the military regime left behind a bankrupt economy and an accumulation of social problems.

However, the fall of that regime has not led to an amelioration of the economic situation; on the contrary, the process of economic decline has continued unabated. It is estimated that over the last year or so GDP declined by 10%; that the investment rate declined to 9.1%; and that the saving rate reached an all-time low of -3.2%. Export earnings are also estimated to have reached a very low figure of Birr 388.6 million, with the value of coffee exports having hit a rock-bottom figure of Birr 164.9 million. In contrast, there has been a slight rise in the value of imports, raising the trade deficit to about Birr 1.8 billion. The debt service ratio on accrual basis is estimated to have exceeded 95%, but it was much lower on cash basis for the simple reason that arrears were being accumulated. The share of the budget deficit financed by bank borrowing was even higher, and the price index continued to escalate.

The country's social problems have also been compounded over the last year.³ The end of the war has meant the demobilization of over 300,000 former soldiers, for whom no alternative source of income has been found. They and their families, conservatively estimated at between half a million and 800,000 (in addition to the former soldiers) represent an immense social problem that cries out for an immediate solution. Second, it is estimated that about one million people have been displaced on account of ethnic conflict; these are for the most part sheltered in makeshift accommodations and

dependent on relief handouts. Third, thousands have been dislocated from former resettlement sites and are in need of urgent assistance. Fourth, there are additional thousands evicted from Eritrea and without means of sustenance. Fifth, there are thousands who have returned from Somalia, Sudan and Djibouti. Sixth, the urban situation, particularly in Addis Ababa, has been deteriorating rather fast, with a very rapid rise in the numbers of street children and beggars, in addition to the overcrowding that is quite easily observable. And finally, there are the ubiquitous drought victims. All in all, some eight million people are estimated to be in need of relief assistance. It must be borne in mind that this is on top of the massive poverty with which the country has to contend even in the absence of such additional crises. Indeed, life for millions of Ethiopians today comes very close to the Hobbesian characterization of "poor, nasty, brutish, and short".

The challenges facing Ethiopia are therefore truly daunting and cannot be met without making significant policy departures and undertaking resource mobilization on a large scale. In the policy area the major developments in the post-Derg era have been: (a) the issuance by the transitional government of an economic policy for the transition period; (b) the conclusion of an agreement on economic recovery and reconstruction; and (c) negotiations that the government has been conducting with the Bank and the Fund with a view to launching a structural adjustment program.

The new economic policy [23, p. 28] promises to relax the grip of the state on the economy, to encourage and support private enterprise and to give greater scope for popular participation in the economic development of the country. More specifically, it is envisaged to privatize some state enterprises; to remove barriers to private investment; to minimize state interventions in such areas as marketing and pricing; to give greater autonomy to state enterprises; and to withdraw the privileges enjoyed by them. In brief, the intention is to move the economy in the direction of greater market orientation. All this is at the level of intent. There are, however, serious problems of implementation, quite apart from the question of the extent to which the government is committed to economic reform [see 7].

Although not strictly a policy move, the second important development is the signing of an agreement for an Emergency Recovery and Reconstruction Project (ERRP)

of \$672 million, of which \$600 million is expected to be put up by the World Bank, the African Development Bank, the EEC and a few other donors; and the remaining \$72 million is to be put up by the Ethiopian government. The significance of the ERRP is not only that it makes funds available for the recovery and reconstruction of a devastated economy, but also that it is perceived by the Bank as a prelude to the country embarking on an adjustment program.

The first phase thus involves "emergency assistance needed to overcome the devastating effects of the several decades of civil unrest, and to recommence essential economic activity" [18, p. 2], and was designed in close consultation with the government. Of the total money committed, 43% is a production component (for meeting import requirements for industrial spares and materials; transport equipment, spares and tires; and petroleum products); 35% is an infrastructure component; and 22% is a social sector component.

Perhaps more significant over the long haul is that the ERRP is seen as paving the way for structural adjustment. After cautioning that the ERRP "is not in itself a vehicle for policy reform", the President of the World Bank states that "the project has [nevertheless] been designed to ensure that all of the components will be compatible with and complement the coming reform program". Further,

at the same time, it must be emphasized that because of the weakened state of the economy, the ERRP on its own would bring only temporary relief without the rapid design and implementation of the program of adjustment. For this reason, special efforts were made to ensure that the program of reform is on track by organizing the first Policy Framework Paper (PFP) mission prior to the submission of the project to the Board. It is expected that the outcome of that mission does indeed confirm the TG's [Transitional Government's] commitment to a comprehensive program of policy reform, and the expectation that agreement will be reached on the PFP within a reasonable timetable.[18, p. 3]

The country has started negotiations with the Bank and the Fund on a possible structural adjustment program; in fact there have already been two rounds of such negotiations. Since public knowledge about the negotiations is limited, whatever we can say in this regard is gleaned from some government and Bank documents. Again

according to the President of the World Bank,

The second phase, which will begin in parallel with the start-up of the ERRP, consists of the design of a program of structural reform, whose implementation will start in 1992. ... Alongside the design of the reform and adjustment program, the Bank will carry out an intensive review of the current portfolio, and further restructure existing projects if necessary to increase their relevance to the new situation. Agreeing on the program of reform would also open up the prospect of Ethiopia's entry into the Special Program of Assistance for Africa (SPA), and a broadened program of IDA investment projects.[18]

It is against this background that I will now proceed to discuss the prospects for economic reform and recovery within the next few years. Since not all issues can be dealt with within the compass of this paper, I have chosen to concentrate on what I consider to be the most important determinants of the course of the economy at least for the balance of the transition period. These are the political environment, the relative roles of the public and private sectors; the link between economic reform and growth; and the social dimensions of economic reform.⁴

2. PROSPECTS FOR ECONOMIC REFORM AND RECOVERY

2.1 The Political Factor

It is obvious that economic reform cannot take place in a political vacuum. But beyond a recognition of this fact, the link between political and economic reform, in countries that are forced to implement both, is not very clear. That there cannot be much democracy in an environment of economic stagnation seems quite evident. It is also true that political developments define the perimeter within which economic reforms take place. But whether or not democracy is a prerequisite for economic development is far from clear, at least based on historical experience. Thus, although South Korea, Taiwan, Singapore, and Chile under Pinochet have registered impressive rates of economic growth, they cannot be considered democratic regimes in any regularly accepted meaning

of the term. And the World Bank has been unable to establish any clear link between economic reform implementation and democratic governance. "Democratic governments", it says, "are not necessarily more adept at managing reform" [26, p. 133].

Whatever the link between political and economic reform may be, there is no doubt that the politics of a country can exert a positive or negative influence on the performance of its economy. I would go even farther and submit that in Ethiopia the most significant determinant of how the economy will perform in the immediate future is undoubtedly the **political** factor.

First, the Transitional Government's attention is so totally taken up in attempts at constructing a new political order that economic issues - burning as they are - have not been able to get the attention they deserve. To forestall a possible misunderstanding, my contention here is not that economic reform can be undertaken in complete disregard of political realities. It is rather that since economic reform is as much a matter of confidence-building as it is of implementing change, any posture that may be construed as reflecting lack of commitment to it can have adverse consequences on the economy. This means that, even in the process of pursuing the political agenda, time must be taken out to take care of the most pressing economic problems, especially given the state of the Ethiopian economy and the destitution of the people.

This suggests the importance of not only the **type** of the economic reforms that will be instituted but also of the **speed** with which this will be done. Nine months have elapsed since the economic policy of the Transitional Government was made public, but there are few signs to date of moves in the direction of implementation.⁵ Efforts at reforming public sector enterprises and privatization have not gone beyond preliminary discussions, the new labor law has not been finalized, and negotiations with the international financial institutions have not been completed. The proclamation of the new investment law is the only measure that has been made public to date [19]. Whatever the reasons for slow reform implementation, the fact is that this has created a great deal of uncertainty with regard to the new economic course, especially so within the private sector. And uncertainty is the worst situation in a period of transition.

Nor is the issue one of politics first or economics first. Even if priority is to be given to putting the political house in order, the real question is whether the kind of

politics pursued is one that will facilitate or obstruct economic growth. It is on this aspect of the problem that I wish to dwell further.

First comes the question of security and political stability. It is important to note that the insecurity in many parts of the country, which has been exacerbated by the controversies surrounding the recent elections, is likely to grow worse - not better - in the immediate future. And this is bound to have an adverse impact on the economy. It will interfere with production, disrupt the movement of goods and people, and generally create an atmosphere of doubt and uncertainty, to the obvious detriment of economic growth. Especially noteworthy in this regard is that the regions affected are those that have traditionally been the backbone of the economy.

Another reason why economic development is a casualty of political instability is because it makes it impossible to acquire the "vision" without which any exercise in economic reform would be meaningless. As pointed out by one student of the problem, "weak governments that are trying to maintain legitimacy have a hard time thinking beyond the short-term".⁶

Also, the uncertain and highly charged political atmosphere will seriously erode whatever chances there may have been for reaping a peace dividend. For, as the old wounds of war begin to heal, it seems new ones are opening up on the Ethiopian body politic, making a pipedream out of the promise of peace. Military engagements will continue to require the commitment of resources and personnel, the government's revenue mobilization efforts will be frustrated, export earnings will be drastically reduced, and investment will be discouraged. Therefore, unless the political situation changes for the better, it will constitute the most serious deterrent to economic recovery. Unfortunately, the chances of peace and political stability being achieved in the immediate future look rather slim.

Finally, one has to consider the economic impact of the contemplated decentralization of regional administration [20]. Although there is nothing specific that the government has made public in this regard, there are a number of questions to raise. For instance, how much control will regional administrations have over resources (e.g., land, forests, minerals) that are found in their respective regions? With respect to exportable commodities (especially coffee), how much say will the regions have? What

kind of economic activities can the regions undertake without consulting or getting the permission of the central government? What legal powers will they have in raising revenue? What mechanisms will be put in place to ensure revenue-sharing between the central government and the regions?

All these are questions that need to be answered before anything definite can be said about their economic implications. However, even though the extent of the envisaged departure from the past practice of a highly centralized administration may not clearly be known, there is no doubt about the direction. If, for instance, regional administrations insist on getting a substantial share of export earnings generated by products originating from their regions, as seems likely, this will greatly weaken an already fragile central budget. It will also introduce a significant element of inequity between resource-rich and resource-poor regions. In other words, unless the relationship between the center and regions is handled carefully, it could end up by seriously weakening the national economy while exacerbating regional differences. While the move away from over-centralization is welcome even from an economic point of view, too radical a restructuring can be detrimental to the national economy. After all, development means building one national economy and ensuring that the benefits of such development are shared equitably. Any arrangement that departs from this will create a breeding ground for tensions. In this connection, it is instructive to note the similar experiences of Eastern and Central Europe.

Tension has emerged in most of the reforming countries between the strong central leadership needed to push through difficult reforms and the broad participation and compromise needed to ensure widespread support for the program. Central executive authority has been discredited by past experience, and a new model of strong government with a legitimate role in a market system has not yet emerged. In fact the pendulum in several countries is swinging in the opposite direction, towards greater decentralization and autonomy of provincial and local governments. This is likely to complicate reform efforts in the short run [10].

Further comment would be superfluous.

2.2 The Role of the State and the Private Sector

In the final analysis the central problem of economic reform is one of deciding the relative roles of the public and private sectors. After decades of concern with problems of market failure, the international ideological-intellectual pendulum has swung to the other end, so that what is good form now is to hammer on problems of government failure. In our obsession with the current orthodoxy, which is unequivocal in its condemnation of state intervention in the economy, we tend to forget that, curiously, the pronounced role of the state over the last generation or so traces its ancestry, at least in part, to conventional welfare economics. According to this branch of orthodox economic theory, there are certain cases of "market failure" which justify government intervention in the economy, some of which being market imperfections, public goods, and externalities.

Liberalistically interpreted, this has been taken as a recipe for extensive government intervention, especially on account of pronounced market imperfections and the large scope for external economies in Third World countries. Government intervention was also justified by the weakness of the private sector in these countries. Yet another factor was the emergence of "the socialist camp", giving respectability to planning and hence to an extended role for the state.

There were, however, less principled considerations as well:

The central motivation behind economic policy was regime survival. The emphasis was on buying political support and sustaining it, thereby avoiding the risk of being driven into the political wilderness. To the extent that the same policy could also be rationalized in terms of the prevailing development ideology, a convenient rhetoric was at hand. Priority was placed on avoiding political crises in the short run [11, p. 31].

Consequently, the main features of the economic policy that evolved in these countries was characterized by a) a substantial degree of government ownership of productive enterprises; b) extensive government regulation of economic activities, the corollary being undermining the private sector and a preference for administrative methods of resource allocation over market mechanisms; and c) considerable expansion in government expenditures. Thus, although in varying degrees, the heavy hand of the

state was all too obvious in most of these countries. Such an overextended state, in conjunction with a rapidly deteriorating natural environment, a hostile international economic setting, little technological advance and a rapidly growing population, was instrumental in producing a dismal economic record.

In view of this, a reconsideration of past policies has begun in most countries, although the sincerity and sense of commitment with which this is undertaken leaves considerable room for skepticism. Central to such a reconsideration is narrowing the scope of the government in the economy and allowing a greater role for the market. The compelling reasons for moving in such a direction have been intensified by what has been happening in the erstwhile socialist countries and the concerted pressures of donors, spearheaded by the World Bank and the International Monetary Fund.

Compelling as these reasons are, however, they should not lead us to lose sight of the indispensable contributions of the state or to exaggerate the virility of private enterprise in countries such as Ethiopia. This is neither to deny the adverse consequences of indiscriminate government interference in the economy nor to downplay the merits of the market. It is merely to point out that societies in transition will be ill-served by blanket condemnations of the state, as "the new orthodoxy" would seem to demand.

This is so because, in the first place, as the World Bank itself concedes, "intervention by the public sector is not undesirable in itself. On the contrary, many sorts of intervention are essential if economies are to achieve their full potential" [26, p. 131]. Especially noteworthy in this regard is the important role governments have to play in such areas as infrastructure and education, and - more generally - in creating an "enabling environment" for development.

In this connection, it is worth reviewing the experiences of the Asian countries which are always cited as success stories. Contrary to popularly held notions, these countries are not models of *laissez-faire*. In every case, the role of the state "was large, ... it was active, and it was interventionist" [24, p. 81].

Take Taiwan first:

The Milton Friedman view of Taiwan is quite wrong. To say that they went to free enterprise completely, that this is an example of markets in operation is wrong. It is not that. It is a question of the state using its power intelligently and

selectively... [24, p. 35]

Much the same applies to Korea;

Korea was far from a market-oriented economy. It certainly had market elements and they were important, but look at the ways in which government really ran the show. Every large corporation in Korea that got credit got it through government banks and at very subsidized interest rates, generally zero or negative real interest rates for most of the period.[24, p. 54]

It should also be noted that "Korea has a greater share of GDP from public enterprises than India does" [24, p. 64].

Third, of Singapore it has been written that it has "one of the most dirigiste governments on earth" [3]. In the words of another journalist, "Singapore's economic miracle owes something to the fact that what might look like free-market capitalism is actually a capitalism carefully controlled and orchestrated by the government".⁷

The upshot of all this is that the issue is not whether the state should intervene or not, but how it should intervene. Specifically, the issue is whether it intervenes to promote growth or to stifle it.

In the second place, we would do well to remember the constraints within which the private sector operates. As Kitgaard notes, "in the throes of our current disillusion with government in the third world, we may tend to forget past disappointments with the private sector" [17, p. 3]. With respect to the Ethiopian case, the constraints are of two types. The first refers to the fact that the private sector is of limited scope. Never particularly robust even in the best of times, it has been seriously incapacitated by seventeen years of a policy framework that viewed it as an adversary, not an agent, of development. On this account, whatever private capital survived was driven underground.

This does not mean that fortunes were not made by private entrepreneurs; they were. But the very success of the private sector embodied its limitations as well. Private capital, to the extent that it thrived at all, did so by exploiting the pervasive scarcities that were the hallmark of the Ethiopian economy. It was engaged in rent-seeking, not in productive activity. Having been accustomed to the easy way out, it will not now be easily persuaded to invest its resources in productive activities, unless it perceives the

new policy environment to be unusually promising. Even then, however, it would be misleading to operate on the assumption of a dynamic private sector. It should also be noted that the fortunes alluded to above are concentrated in relatively few hands. Therefore, it would be unrealistic to expect much from the private sector in the immediate future. This should not, however, be misconstrued as belittling the importance of creating an environment conducive to private capital. It is of the utmost importance, as has been demonstrated by experiences of a world-wide scale.

The second type of constraints within which the private sector operates is related to the current policy environment. First, the attitude of the Transitional Government to the private sector is at best ambivalent. Although the economic policy expresses intent to give a larger scope for private enterprise, it should be recognized that there are many activities that have been reserved for the state. But more important is the fact that the private sector does not perceive the current policy environment as encouraging.

Quite apart from the problem of perception, there are also serious problems, some inherited from the past order and some of a more structural nature. These include the foreign exchange constraint (which is more severe on the private sector); discrimination in terms of access to credit; unfavorable tax laws; a labor law which seriously disadvantages the private investor; excessively involved bureaucratic procedures for obtaining licenses, clearing goods from customs, access to services such as electricity and telephone; and difficulties of obtaining land, to name only a few of the major ones. It is for these reasons that the prospects for privatization, which is much talked about, are bound to be unpromising. In addition, there are many intractable problems associated with the privatization exercise, including deciding on which enterprises to privatize, valuation of enterprises, choosing the best modalities for privatization, and coping with its social impact (unemployment, price hikes, etc.).

It seems more likely that government efforts will concentrate on rationalizing public enterprises rather than on privatizing them. The economic policy of the transition period envisages giving broad autonomy to state enterprises; using profitability as the major criterion of performance; and requiring state enterprises to compete with private ones without being given any privileges. But the policy also includes a stipulation that is bound to lessen enterprise autonomy in practice, because it states that "labor should have

a third of the voting right through representation on enterprise management boards" [23, p. 28].

That state enterprises should be judged on the basis of efficiency brooks no dispute. Here again, however, there are a number of problems that should not be glossed over. It should be especially noted that these enterprises, which had been operating in a highly protected manner, will not find it easy to operate on the basis of competition.

In the final analysis, however, what is most important will be not the pace of privatization or even success with respect to rationalizing state enterprises. What is decisive is the overall environment within which economic activity is to take place. It is one of dismantling the entire structure of rules and regulations that have blocked the energies of investors as well as those of the people at large. It is - in short - a matter of recasting the role of the state as a facilitator of development.

2.3 The Link Between Economic Reform and Growth

As indicated above, Ethiopia finds itself face to face with the real possibility of a structural adjustment program. As a latecomer to this type of policy exercise it has the opportunity to learn, if it so wishes, from the experiences of other countries. It is therefore worthwhile to begin with a brief review of the theory and practice of structural adjustment.

The most immediate cause for the emergence and proliferation of structural adjustment programs (SAPs) in Third World countries was the unprecedented economic crisis that hit them in the 1980s. A combination of internal and external factors combined to cause declines in per capita incomes, food production per capita, saving and investment rates, and export earnings; rising budget and balance of payments deficits; spiralling inflation; and mounting debt, all these culminating in severe declines in living standards.

Internally, the major causes of the crisis were rapid population growth, backward and inappropriate technology, poor physical and human infrastructure, environmental degradation, erroneous policies and, in certain cases, civil conflict. The external factors included deteriorating terms of trade, the oil shocks, stagnating or declining exports, stagnating or declining resource flows, and increasing protectionism in the advanced

countries. This combination of adverse factors plunged many countries into a crisis from which many of them have yet to extricate themselves.

Given such severe crises, continuing with business as usual was obviously out of the question. In fact, one could argue that the crisis could assume such dimensions partly because economic reform had been neglected for too long, making any anticipated adjustment measures more painful than they would have been if they had been implemented earlier. There was thus no debate on the need for adjustment, for to deny this need would have been to argue for these countries to continue along the path of immiserization.

The real debate was therefore not on whether or not to adjust, but on what kind of adjustment. One school argued that the major causes of the crisis are structural, i.e., factors inherent in the phenomenon of underdevelopment (such as poor infrastructure, backward technology, reliance on primary production, an unfavorable international environment, etc.) and that merely tinkering with policy reform without tackling these structural problems would not get the countries out of the crisis. Another school, especially the international financial institutions (IFIs), put the blame on the policy failures of governments, some of which included over-extending the role of the state, stifling private initiative, neglecting agriculture, spending beyond the economy's means, and maintaining an overvalued currency. They therefore called for the speedy introduction and implementation of measures for economic stabilization and structural adjustment.

In principle, there is a distinction between stabilization and structural adjustment. The objective of the former is to restore macroeconomic balance to an economy that has been characterized by persistent budget and balance of payments deficits as well as by inflation. The solutions proposed are in the nature of short-term corrective measures aimed at reducing public expenditure, reducing aggregate demand (including both domestic production and imports), tight money policy and restricting incomes; expenditure-switching policies aimed at increasing the supply of tradeables through, among others, exchange rate adjustment and export subsidies; and institutional reforms such as privatization and trade liberalization, among others. It is usually the IMF that is associated with stabilization measures.

Structural adjustment, on the other hand, focuses on what are considered to be longer-term structural problems that inhibit growth. It includes measures to promote the mobilization of domestic resources (including fiscal and monetary reform and enhancing the efficiency of public enterprises); measures for enhancing the overall efficiency of the economy (including privatization, reform of the civil service and public enterprises, encouragement of private investment); trade liberalization (including the removal of import quotas, tariff reduction and export promotion); strengthening the public sector through improvement in management; and institutional reform, including the rationalization of services, the introduction of user charges, etc. These are in the nature of medium- and long-term measures, and they are usually associated with the World Bank.

What should be obvious from the measures listed above is that there is a great deal of overlap between stabilization and adjustment measures. Moreover, the functions of the Bank and the IMF, which were clearly distinct when the two institutions were initially set up, have tended to converge over time, so that now it is common for both of them to be involved in the negotiation of SAPs with developing countries. We shall therefore use adjustment to refer to packages that include measures of both stabilization and structural adjustment proper.

The contents of standard SAPs generally include:

- a) measures for reducing the role of the state in the economy and enhancing that of the private sector, including privatization and providing incentives to private investors;
- b) retrenching government expenditures;
- c) reforming the civil service and enhancing the efficiency of public enterprises through providing them greater autonomy, rationalization, introducing criteria of profitability, etc.;
- d) allowing a greater role for the market in resource allocation, including removing restrictions on trade, lifting government controls on prices, liberalizing imports and generally minimizing administrative interferences in the economy;
- e) devaluation of currency;

- f) the introduction of user charges for services provided by the state, such as health, education, etc.;
- g) removal of subsidies for food, health, education, transportation, etc.;
- h) tightening money supply and putting a ceiling on credit; and
- i) restraint on increases of wages and other incomes.

SAPs which have included all or most of these measures have been introduced in a large number of countries. They have naturally been surrounded by a great deal of controversy regarding how effective they have been. The controversy revolves around two central questions: how successful have they been in **economic** terms; and what have been the **human costs** of gaining economic success where this has been achieved? Economic success means generating growth and, more specifically, raising per capita income, savings, investment and export earnings; reducing inflation; and reducing budget and balance of payments deficits. In human terms, one would be interested in knowing what the impact of SAPs has been on human welfare in general, and on nutrition, health, education, poverty alleviation, unemployment, etc., in particular.

While the questions are clear, there are unfortunately a number of thorny problems involved in attempting to answer them. Take the methodological issues first. One approach is to compare the records of adjusting and non-adjusting countries as groups. While there is a logical basis for comparing the performance of the two sets of countries, this approach is not without its difficulties. In the first place, the differences between the two sets of countries may not be simply that one group has adopted SAPs while the other has not. It is possible for other factors to come into play (for example, drought and civil conflict), thereby introducing variables that have nothing to do with adjusting or not adjusting. Because of the difficulty of controlling such variables, it is possible to end up with misleading conclusions. Secondly, because the comparison is between **groups** of countries, interesting variations between sub-groups and even between individual countries could be concealed. Thus, while a certain conclusion may hold for a sample of developing countries, it may not hold for the least developed countries within that sample, or for the countries of Sub-Saharan Africa, or for oil importers as a group. Therefore, while it may not be possible to dispense with this approach entirely, caution should be exercised in making categorical conclusions based on it.

The other alternative would be to compare the performance of the same country prior to and after adjustment. On the face of it, this would seem a perfectly acceptable procedure. However, it too has its limitations. If, for example, the country performs worse in the post-adjustment period, would one be justified in attributing the deterioration to the adjustment package? If one did so, how would one respond to the claim that maybe the situation would have been even worse without adjustment? This lands us in the realm of speculation, which would put any neat conclusions in disarray. Moreover, the problem of other variables is relevant here also. For instance, if drought coincides with the launching of SAP, how much of the resulting deterioration in the economic situation can be attributed to the policies and how much to the drought? The problem of methodology is thus not amenable to easy solution.

Quite apart from the question of methodology is the perennial data problem. In the first place, not all the data required to make an evaluation may be available, this being especially so in the case of social data. Second, even if some sort of data are available, they may be of doubtful validity. Third, the available data may not run for a sufficiently long period of time to enable making observations on trends over time. And finally, the data may not be disaggregated enough to enable making an analysis of the impact of SAPs on different segments of society.

Bearing these methodological and data problems in mind, we now turn to the available evidence. What is particularly striking in this regard is that the literature is replete with contradictory conclusions. In general, the Bank, the Fund and a number of other analysts argue that adjusting countries have on the whole performed better than non-adjusting ones in economic terms, and that there is no evidence to demonstrate that SAPs have caused a deterioration in the social situation. On the other hand, there are those who reject SAPs outright as total failures in restoring growth and as even greater failures in social terms, because they have led to serious social deterioration wherever they have been implemented. These may be taken as extreme positions.

The reality is more complex and probably falls somewhere in between. A nuanced - and consistent - position is that of UNICEF, which has been the leading champion of "adjustment with a human face". At the risk of over-simplification, UNICEF's evaluation of SAPs may be summarized as follows [See, e.g., 22]. In economic terms, the real

question is the extent to which SAPs have managed to accelerate economic growth; specifically, what has been their impact on real per capita income, saving, investment, the balance of payments deficit, the budget deficit, and the rate of inflation? The available evidence reveals considerable variation between countries. Taking developing countries as a whole, there are some that have registered an improvement, while there are many that have experienced a deterioration in the wake of SAPs. However, in Latin America and Sub-Saharan Africa, the regions with the largest numbers of adjusting countries, experience has been negative on balance (although there has been variation between countries within these groups). The broad conclusion for these regions is that, on the whole (with the exception of a few cases), adjustment policies have not delivered better economic performance, although it is conceded that countries in Asia, for example, have done better.

What, then, is the likely impact of adjustment on the Ethiopian economy? Since not all issues can be addressed here, I would like to concentrate on the measure that is considered central to economic reform by most students of the problem as well as by the international financial institutions, i.e., the **devaluation of the Birr**.

Let me begin by disposing of the issues that are not subject to dispute. First, there is no doubt that the Birr is over-valued. Second, and following from the first point, there is no question about the need to make an adjustment in the exchange rate. The controversy centers around the **timing** and **magnitude** of adjustment.

The basic problem of an overvalued exchange rate is that, like any price distortion, it exerts an adverse impact on economic efficiency and growth. Specifically, it discourages legal exports; encourages illegal ones; and discourages import substitution. Therefore, devaluation would be expected to encourage exports, not only the traditional ones but also new ones; and to divert illegal exports to legal channels, thereby putting more foreign exchange in the hands of the government. Also, by effecting a shift from an administrative allocation of imports to one based on the market, it would bring about an improvement with respect to the allocation of imports. In addition, by making imports relatively more expensive, it would provide a spur to greater import substitution. All in all, the argument goes, devaluation would lead not only to an improvement in the balance of payments, but also to more efficient resource allocation across the board.

While all these points are well-taken in principle, there are a number of arguments presented against an **immediate** devaluation in Ethiopia. First, the export supply response to devaluation may be exaggerated, at least in the short run. While it is readily conceded that devaluation would divert some exports from contraband to official channels, its impact in boosting traditional exports and encouraging new ones is debatable. With respect to traditional exports, most notably coffee in the Ethiopian case, there are at least two reasons for skepticism in this regard. In the first place, the time lag involved between planting new coffee trees and harvesting coffee beans for export is long, involving anywhere from three to five years, thus casting doubt on the immediate efficacy of devaluation. Secondly, there are a number of structural constraints that hamper a substantive supply reaction, including poor infrastructure - and therefore fragmented markets (exacerbated by the current political insecurity), limited access to land and other inputs, technological constraints, etc. With respect to non-traditional exports, while devaluation may encourage them over the long haul, it is highly unlikely that the country's export structure will be significantly altered in the immediate future. Thus, the supply argument for devaluation is at best of a medium-term nature.

Second, there are the inflationary consequences of reform to contend with. In response to devaluation, the prices of imported consumer goods and the costs of imported inputs such as machinery, spare parts, fuel and fertilizer are bound to rise, with a considerable impact on living standards, especially those of the poor and fixed-income receivers.

Third, for devaluation to be effective, it will have to be accompanied by complementary measures, including tight monetary and budgetary policies; restraint on wages; and civil service and public enterprise reforms. And this raises two problems. The first is how realistically budgetary expenditures can be cut, credit limited and wages restrained unless one assumes a massive inflow of resources from abroad, an assumption that is questionable at best. Second, here too there are social consequences to worry about, including the laying-off of workers, reduction of subsidies of essential goods and services, etc., issues to which I will return later.

The counter-argument in favor of devaluation starts by conceding that it will not be a costless exercise. However, it is contended, delay in correcting a seriously distorted price will merely compound these costs if the corrective measure is to be taken at a future point in time rather than now. In addition, some of the costs are blown out of proportion. For instance, it is argued that the inflationary impact with respect to consumer goods is highly exaggerated, for the simple reason that the prices fetched by these goods on the free market already reflect the real, not the official foreign exchange rate, which means that there will be no significant new inflation on account of devaluation. With respect to such items as fertilizer and fuel, it is argued that a possible subsidy scheme can be designed or that it may even be possible to use an administered exchange rate (as opposed to the market one) for a limited period of time. With respect to the social consequences of devaluation, the contention is that it is possible to work out arrangements for a social safety net so that the adverse impact on certain groups can be minimized. The funds for such a scheme could be obtained from abroad, because the implementation of adjustment measures holds the promise of external funds to help the country tide over what will necessarily be difficult times.

I hope the foregoing represents a fair, even if condensed, summary of the major issues of the debate. The debate, as pointed out earlier, is not on whether or not the Birr is overvalued, or on whether or not there is need for exchange rate adjustment. It is rather on the wisdom of immediate devaluation. While many of the arguments on both sides are well-taken, I find the insistence on an unconditional devaluation now less than persuasive, because it tends to overlook or consider unimportant certain basic Ethiopian realities. Perhaps it needs emphasizing that the debate is not about devaluation in general but about devaluation in Ethiopia today.

I believe there are very strong reasons for remaining skeptical about the impact of devaluation in boosting exports, for the reasons mentioned above. Such skepticism is strengthened by recent developments. Coffee exports, which used to fetch upwards of Birr 600 million annually in most years in the past, now account for less than one-third of that. Although the overvalued Birr is largely responsible for this, one must also recognize that the new political realities, especially problems of the free movement of goods and the existence of rival claimants to power in different parts of the country, have

contributed to the problem. Nor has there been any persuasive argument that Ethiopia can diversify her export structure in the immediate future.

In this connection, a familiar counter-argument is that the major immediate gain from devaluation is not boosting exports but improving the allocation of imports by moving away from a system of rationing to one based on market allocation. This is certainly a valid point, but fails to address the issues raised with respect to the inflationary impact of devaluation. Granted, this may not make much of a difference for imported consumer goods such as television sets or video recorders. But it says nothing about locally manufactured goods such as textiles, soap, footwear, etc., all of which have a significant import content.

The whole issue of the social consequences of reform is a point to which I return in the next section of the paper. But a word is in order here on the prospects for obtaining external finance to help cushion the adverse impact of reforms, including devaluation. Judging by the experiences of other countries, the prospects of getting such funds do not look bright, or not as bright as they are usually made to be. To the best of my knowledge, only Ghana has had such good fortune, but it is paying for this in a very high degree of indebtedness.

I am not, however, arguing for continuing with the status quo indefinitely. Some devaluation, with the new rate fixed somewhere between the current official and parallel market rates, is necessary. Like any corrective action, devaluation cannot be expected to be cost-free; the task is therefore one of minimizing the costs as much as possible. Specifically, the timing of devaluation should take the following factors into consideration:

- a) One important consideration relates to the prospects for tightening monetary and fiscal policies without introducing intolerable consequences for the economy. If restraint is not exercised in these areas, the inevitable consequence will be an endless spiral of devaluation and inflation, with serious adverse consequences for macro-economic stability. This requirement, indispensable as it is, is not easy to fulfill for an economy which finances a substantial portion of its budget deficit through domestic bank borrowing.

- b) Partly for this reason and partly due to the absolute necessity of designing an effective safety net, the efficacy of devaluation will depend on the prospects for obtaining generous funds from abroad. Again, this is something one cannot take for granted; in fact - given the experiences of other countries - there is justification for considerable skepticism. If such funds are not forthcoming at the required level and speed, the reform program may easily be derailed.
- c) A third important consideration relates to the prospects for implementing the other components of the reform program, including price decontrol, relaxing trade restrictions, public enterprise reform, privatization, etc. What makes action in these areas complicated is that they are inter-related measures which have to be considered as a package. Devaluation in and of itself cannot be a panacea if it is not supported by these complementary measures. Focussing on exchange rate adjustment alone is a partial remedy, and - like all partial remedies - of doubtful utility.

Thus, while the need for moving in the direction of a market-determined exchange rate is not questionable, a possible transitional arrangement might be retaining a moderately adjusted rate for imports such as fuel, fertilizer and other items deemed of particular sensitivity, and a market-determined rate for most other transactions. But the details of such an arrangement (including its timing and duration) need to be worked out carefully.

2.4 The Social Dimensions of Economic Reform

The central issue here is, even if SAP performs the economic tasks it sets for itself (restoring macroeconomic balance and ensuring growth), what, if any, are the social costs involved?

The **social** impact of SAPs is reflected through their effect on incomes, prices and the availability and cost of essential services. Incomes are affected through changes in levels of employment, wages and incomes from self-employment. In general, performance

has been poor. Private consumption expenditure has fallen in many countries although not by as much as investment and government expenditure. SAPs tend to depress real wages, essentially because of the restraint imposed on money wages; because of the lifting of controls on prices; and because of the inflationary impact of devaluation. True, SAPs have a tendency to change the rural/urban terms of trade in favor of the former, but their impact on the rural population is not uniform; for example, they tend to benefit producers of export crops more than producers of locally consumed products.

SAPs also have a general tendency to lead to reduced employment, although it is hoped that over the long haul, through improvements in overall efficiency, they may lead to greater job opportunities. The reason that they may lead to reduced employment in the short run is that a number of the measures (e.g., retrenchment of public expenditures, civil service reforms, rationalization measures introduced in public enterprises, etc.) necessarily involve worker lay-offs which cannot be compensated for by job creation in the short run. Therefore, they inevitably lead to declines in formal sector employment. It should be noted, however, that this leads to increases in informal sector employment, as those pushed out of the formal sector are compelled to seek sources of livelihood in the informal sector. However, it is well-known that wages in the latter are lower than in the former.

The social impact of SAPs is also reflected through their effect on government expenditures on social services. The evidence suggests that, on balance, SAPs have led to declines in real per capita expenditure on health and education. With respect to health, this has translated into deteriorating services, which - in conjunction with the introduction of user charges as well as higher charges - have led to declining attendance at public health facilities. To a certain extent, however, this negative trend has been compensated for by the expansion of effective low-cost interventions such as oral rehydration therapy and immunization (which - it must be added - is not because of, but in spite of, SAPs). With respect to education, the evidence shows declining enrolment and increasing drop-out rates.

In general, while some adjusting countries have registered improvements in social terms, e.g., higher real incomes, reduced poverty, rising social expenditures, etc., the majority have had to face declining incomes and per capita consumption levels; rising

unemployment and declining performance in the health and education sectors.

Of course, this still leaves the methodological issues raised above unanswered. Regardless of the methodological problems, however, there is ample justification for taking at least a skeptical stand on the social impact of SAPs. There is no better proof of this than recent attempts by the IFIs, especially the World Bank, to accommodate such criticism. There are several examples of such attempts. In 1987 the Bank, together with UNDP and the African Development Bank, launched the Social Dimensions of Adjustment (SDA) program, which "started as an initiative to collect better data on how the poor were being affected by adjustment policies, but ... was rapidly broadened to provide policy advice and some support for taking action to protect vulnerable groups affected by adjustment" [, pp. 1807-21]. The fact that the Bank devoted its **World Development Report 1990** to the problem of poverty is also further evidence of concern with the human aspects of policies. It is also known that Bank guidelines to staff involved in the preparation of policy framework papers require

"a brief description and assessment ... of the social impact of the government's intended adjustment program", and structural adjustment lending operations required that the president's report analyze the "short-term impact of the adjustment programs on the urban and rural poor, and measures proposed to alleviate negative effects" [27, p. 2].

Even the IMF has not been immune to these developments. "Now, before IMF missions depart from headquarters they are to discuss explicitly the poverty issues raised by proposed stabilization measures with country economists in the Fund and the World Bank" [27].

Essentially, however, what the Bank and the Fund attempt is to minimize the adverse social impact of SAPs rather than addressing the problem while designing them. In other words, the essentials of SAP are formulated without explicit consideration of social concerns, which are incorporated as a kind of after-thought at the end.

The alternative position, again consistently articulated by UNICEF, is that rather than adding social concerns at the end, there is need to incorporate them at the very beginning when the basic components of SAPs are being worked out [See 2]. The task, therefore, should be not merely one of minimizing the adverse impact of SAPs, but of

making sure that social concerns are built into them from the beginning. If this is done, social concerns will not be marginal to the essential design of SAP but will form an inherent component of it. In other words, better adjustment programs can be designed at the outset, rather than trying to embellish them once their essential structure has been determined.

In brief, UNICEF's conclusions [2, pp. 289-97], on the basis of lessons gained from country experiences, can be summarized as follows:

- a) In countries that are experiencing a severe economic and social crisis, adjustment is clearly indispensable. As pointed out by Jolly and van der Hoeven, "muddling through' in times of both internal and external imbalances is one of the worst policy options available" [16, p. 1802].
- b) Although economic growth is necessary, it is not - in and of itself - sufficient to protect vulnerable groups. The assumption that the benefits of growth will trickle down to such groups has proved untenable. In fact, it is possible to protect them for a short period even in the absence of growth, but obviously this cannot be sustained over a longer period.
- c) The experiences of a number of countries demonstrate that it is possible to combine growth with an improvement in human welfare (adjustment with a human face) if serious planning goes into the design of adjustment programs.
- d) Protecting the vulnerable is justifiable not only in human terms but also in terms of economic efficiency, because investments in nutrition, health, education, etc. make important contributions to raising productivity and accelerating growth.
- e) Success in promoting human welfare during adjustment is conditional upon a strong political commitment on the part of the leadership of a country towards this objective, generous resource flows from abroad and effective community participation.

In the Ethiopian situation, it is possible to identify the major potential social consequences of adjustment, although exact quantification of their magnitudes would be difficult. First, adjustment will definitely have a considerable inflationary impact, largely

due to devaluation and price liberalization. Devaluation, because it inevitably raises the Birr prices of imports, will cause increases in the prices of manufactured goods (textiles, soap, sugar, processed food, etc.) which are highly import-intensive; in the price of fuel (and hence the cost of transportation - both passenger and freight); in the prices of imported agricultural inputs, most notably fertilizer; in the cost of medicine and medical supplies; in the cost of imported foods (including wheat, for example); in the prices of locally consumed exportables (coffee, oil seeds, pulses, etc.); and in the prices of imported building materials. Such price increases will be reinforced by the lifting of price controls, especially those on manufactured goods, which are still subject to considerable price control.

Second, adjustment is likely to have an adverse impact on the incomes of large segments of society, partly because it will depress real wages and partly because it will reduce employment. Real wages are bound to be depressed when restraints are imposed on money wages while prices continue to rise under the combined influence of price liberalization and devaluation. Reduced employment (at least in the immediate future) will result as a consequence of the retrenchment of public expenditures, the rationalizing of state enterprises and privatization. Given the present importance of the civil service and public enterprises in providing employment, any significant moves in the three areas mentioned above are certain to have an adverse impact on employment, and hence on incomes.

Third, adjustment is likely to reduce the availability of social services while raising their cost. As government expenditures are retrenched, per capita expenditure on the social services, particularly on health and education, is likely to decrease. Especially affected will be operating expenditures and repair and maintenance activities. If this happens, the availability of services is bound to decrease and their quality will deteriorate. The cost of social services is also likely to increase under the combined effect of devaluation, price liberalization, the introduction and/or raising of user charges, privatization and the withdrawal of subsidies.

Obviously, it is the poor - i.e., the majority of the Ethiopian population - who will be most adversely affected by inflation, income decline and the reduced availability and higher cost of social services. Both the Bank and the government have attempted to

address some of these issues. Following a request by the government that "the Fund and the Bank assess the actions which could be taken to address the problems of chronic poverty, the problems of the poor during the current transition, and the potential impact of a future reform program on the poor" [25, p. 9], a Bank mission has already visited the country, with one of its objectives being "to define short term actions which might be taken to alleviate poverty, social deprivation and the adverse effects on vulnerable groups of the ongoing economic adjustment" [25].

In addition to poverty alleviation, the mission addressed issues of health, nutrition, rural domestic water supply and urban sanitation, "because problems in these areas are most pressing from a welfare point of view" [25, p. 10]. Starting from the recognition that "as a group the poor often get a lower share of the benefits from growth if left entirely to market forces, especially in the short to medium run" [25, p. 3] and that "food prices could increase by about 25 percent following a purely hypothetical exchange rate adjustment to Br 5 per \$1" [25, p. 5], the mission proposed the following initiatives for urban areas:

a system of vouchers to be distributed to the poorest in the population entitling their holders to basic foods and other essential commodities [and] "cost of food" price adjustment to public employees to protect them from further price increases in acquiring a basic food basket.[25, pp. 4-5]

For rural areas, it proposed "a system of vouchers for farming households, entitling them to purchase farm inputs (such as fertilizer, improved seeds, tools)" [25, p. 25].

Another component of poverty alleviation the mission envisaged was increasing employment opportunities through labor-intensive construction activities such as building and maintaining rural roads, soil conservation and afforestation.

The mission also identified what it considered to be the major issues in the areas of health, nutrition, rural domestic water supply and urban sanitation, and proposed measures to be taken, including, among others, bringing existing health facilities to a high standard; rehabilitating existing health infrastructure; strengthening health management; a targeted nutrition program; improving community domestic water supplies; and low-cost sanitation works at the domestic/community level [25, pp. 6-7].

This represents the Bank's line of action. It shows a recognition of the possible adverse impact of reform on certain segments of society, although such concerns are far from comprehensive; for instance, education has been left out deliberately. It is, however, noteworthy that the Bank's concerns transcend the reform program and address more general issues of poverty alleviation.

What is government thinking in this regard? The government seems to be well-aware of the likely negative impact of adjustment in the social sectors, even though it significantly failed to address this question in its economic policy document. The only reference to social policy in that document is a statement at the very end, which reads "A macro-economic policy as well as a social policy that are consistent with this economic policy will be formulated and issued in the near future" [16, p. 44].

On the basis of the limited information that is available to me, I think there is clear recognition on the part of the government of the potential adverse effects of adjustment, including the inflationary impact of price liberalization and devaluation; the negative impact of tight budgetary and monetary policies on the supply of economic and social services; and exacerbation of the unemployment problem on account of retrenchment of workers in state enterprises and the civil service as well as on account of privatization. There is also a recognition that those most affected will be the poor in both rural and urban areas as well as fixed-income earners in the public service, essentially meaning the majority of the Ethiopian population.

Based on these and other considerations, the government has made a preliminary attempt to work out strategies through which it would be able to mitigate the adverse impact of adjustment on vulnerable groups and promote their greater participation in economic development. The most significant measures identified include providing the poor greater access to productive assets; helping raise the returns to such assets; creating opportunities for generating employment; facilitating access to health and education services; and transfers to identified target groups.

These broad measures translate into a variety of projects and programs, including projects for integrated agricultural development; afforestation, soil and water conservation; rural road construction; irrigation; small-scale cottage industries; income-generating activities; food and non-food subsidies; the rehabilitation of demobilized

soldiers, the displaced and returnees; and the building of social infrastructure. The government has also undertaken a preliminary costing exercise to determine the resources that would be needed to make these projects operational.

Thus, both the Bank and the government are aware of the adverse social consequences of adjustment, even if there may be no agreement on the specifics of these consequences. It is clear, however, that the government's proposals are much broader. However, both share a fundamental weakness. Without addressing issues related to the design and content of the anticipated adjustment program, they seem to concern themselves exclusively with how to minimize its fallout effect. Instead of attempting to incorporate social issues in the program, they prefer to take the program as given and concentrate on damage control. But, as the experiences of other countries demonstrate, such "compensatory" measures are simply not enough. The approach should therefore be more comprehensive.

In talking about a possible adjustment program for Ethiopia, we recognize that the country, being new to this kind of policy undertaking, has the advantages of the latecomer and it would be tragic if it failed to capitalize on the experiences of other countries. This is why, although its circumstances are not identical to those in other countries, a review of such experiences must be the starting point for action.

The magnitude of the challenge in Ethiopia is truly daunting. On the economic front the situation is perhaps not much different from that in most Sub-Saharan countries. On the social front, however, there is much that is unique in the Ethiopian situation. Just emerging from long and catastrophic wars, it still has to suffer their aftermath; demobilized soldiers with no source of livelihood; their dependents, left without any source of support; people displaced on account of ethnic conflict and leading a most precarious existence; returning refugees; those evicted from Eritrea; others forced to flee areas of resettlement; large numbers of disabled persons, street children, beggars; far larger numbers of drought victims; all on top of accumulated poverty add up to a social situation that is certainly out of the ordinary.

This is why "muddling through" is out of the question. The issue even goes beyond protecting vulnerable groups during adjustment, because it makes little sense to talk about vulnerable groups when the vast majority of the population can be so described.

It is in this context that the following lessons from the experiences of other countries should be considered.⁸

First, the general experience is that adjustment programs are expected to deliver too much too soon and with too few resources. Although the need for a longer-term approach seems to be accepted, including by the World Bank, resources have not been forthcoming at the level required to do the job. Adjustment programs are essentially deflationary in the sense that they aim at a speedy elimination of macroeconomic imbalances. While this may be a desirable goal, it may not be a realistic one within a brief period of time. Therefore, there is need to insist on less deflationary policies, a longer time period within which to implement them, and more generous funding from external sources.

In the Ethiopian case, there is no question that the economy requires shock treatment, and requires it now. But given the magnitude of the problem, there should be no illusion that dramatic improvements are possible in a short period or without a massive infusion of resources, especially in view of the many structural rigidities to which the economy is subject, including poor infrastructure, fragmented markets, foreign exchange constraints, and - on the political plane - insecurity in a number of regions. In such a context, deflationary macroeconomic policies that are associated with structural adjustment are not enough. The challenge is how to combine sound economic management with measures to protect the poor.

Second, attention should be paid not only to macroeconomic parameters but also to sectoral issues, with a focus on such questions as the distribution of income and assets, income-generating activities for the poor, and the provision of basic goods, with special emphasis on small farmers and those in the informal sector.

Third, in addition to macro and sectoral policies, there is need to pay attention to "meso" policies, i.e., "policies that deal with the consequences of macro policies on special target groups, the poor, in particular" [12, p. 1839]. The basic idea is to use policy instruments such as taxation, credit, interest rate, etc. to protect vulnerable groups in addition to using them to promote growth.

Fourth, with respect to social sector spending, attention should be paid not only to the level of expenditure but also to how to make a given level of such spending more

equitable and more specifically targeted so that it can benefit low-income families and other vulnerable groups. In this connection spending on items such as nutrition, primary health care, primary education, etc. and focusing on small farmers, those in the informal sector, etc. is of special importance.

Fifth, as indicated above, compensatory measures also make an important ingredient of adjustment with a human face. In addition to subsidies, public works programs and income-generating activities, which were mentioned above, other lines of action are tailoring credit facilities for small businessmen and redundant workers; support for primary health care; provision of educational material, etc. Where compensatory programs are designed, they should be incorporated within existing structures, not seen as separate programs requiring separate administrative arrangements.

Finally, no intervention would be complete without an effective mechanism for monitoring the impact of adjustment policies and other interventions on the human situation. This helps not only to assess the effectiveness of interventions but also to identify needs as the adjustment program continues to be implemented. Even the Bank has recognized the importance of this point, as testified by its introduction of the Social Dimensions of Adjustment (SDA) program.

Admittedly, all these are easier said than done. Problems of implementation, partly on account of inadequate knowledge (especially with respect to targeting the most vulnerable) and partly on account of resource constraints, are bound to be formidable. However, a proper perception of the problem is an indispensable starting point.

3. CONCLUSION

The foregoing analysis does not make cheerful reading and lends credibility to Thomas Carlyle's description of economics as a dismal science. But one wonders if it is the science that is dismal or the reality it attempts to study. The more substantive question, however, is whether there is any light at the end of the tunnel for the Ethiopian economy as the present century draws to a close and the next one stands ready to knock at the gates.

In attempting to answer this question, I will eschew both a prophecy of doom - although it is very difficult to resist - and extravagant wishful thinking. In dealing with Ethiopia's economic prospects, we must be careful to distinguish the underlying problems from those of only current significance. Only by doing so can we acquire a proper perspective.

There should be no doubt at all about the seriousness of the country's deep-seated problems. Since these are fairly well-known, they can be passed with a cursory review. First, in view of the agrarian nature of the economy, must be the environmental factor. While the resource base for agricultural development is not as bountiful as it is often made to be, it compares favorably with that of many an African country. However, it would be foolhardy to underestimate the environmental constraints to which Ethiopian agriculture is subject. The alarming soil degradation that has devastated the traditional grain growing areas, the massive deforestation, and the frequently recurring droughts have seriously undermined the country's food production capacity. The tasks of rehabilitating the soil are enormous, requiring massive investment and a fairly long period of time. In the short term, therefore, the environmental constraint must be taken as a given.

Related to this is the country's demographic dynamics. A very fast rate of population growth, an age structure highly skewed in favor of the young, and no population policy in place combine to produce a demographic nightmare which - on top of massive poverty - makes for a bleak future. Even if a sound population policy were to be formulated today, its effective implementation would require, on top of resources, a fairly long period of popular education, and therefore time. This means that Ethiopia has to live with a rapid growth of population for a long time to come. Evidently, the ghost of Malthus is still around to haunt us.

Third, there is a whole cluster of familiar problems that can be called structural because they are inherent in the structure of underdevelopment. They include the dominance of low-productivity subsistence agriculture; a narrow export base; backward technology; low resource mobilization; poor infrastructure; and limited human resources. These too are problems that can be alleviated only over the long haul, but at least they can be ameliorated even in the short run provided the "development environment" is conducive.

It is this environment that demands immediate attention. As pointed out earlier, the major variable in the Ethiopian development equation is the political factor. For reasons already pointed out, to think of economic reform and development without a significant improvement in the political situation would be illusory. Speculation on the prospects for such an improvement would be hazardous, but skepticism would not be out of place.

This, however, should not be taken as an excuse for postponing economic reform. The government has to demonstrate in no uncertain terms that it takes such reform seriously. A failure to do so and to do so immediately is a sure recipe for perpetuating the morass in which the economy finds itself. For seventeen years the military regime was busy condemning the imperial order; and yet, when it fell, it left the economy in much worse shape than it had found it. To repeat that mistake, which would mean engaging in condemning the past without a vision for the future, would be a colossal tragedy for the Ethiopian people, whose calvary has already lasted too long and who deserve a better future.

What, then, does the future hold? The foregoing analysis may suggest a counsel of despair. But, when the temptation to write off Ethiopia as a basket case becomes overwhelming - as it so often does - one would do well to recall that even our not-so-distant past - which was certainly no golden age - gives a glimmer of hope for the country's future possibilities. It is thus worth recalling that there were times when this country used to produce surplus grain for export; when its budget was characterized by fiscal responsibility; when its balance of payments problems were manageable; when it had a solid reputation as a debtor; and when a parallel foreign exchange market was an unheard of aberration.

It is the realization of these possibilities that represents the major challenge for Ethiopian society today. In view of the enormity of the task, it cannot be done without generous resource flows from abroad, on the prospects for which, unfortunately, one cannot speak with any degree of certainty. But the major responsibility is that of Ethiopian society and of those who have assumed its stewardship. As I said on an earlier occasion, "to be sure, Ethiopia will not be catapulted into "the consumer society" in the immediate future. Yet the achievement of a society free from starvation and with access to the most basic necessities of life is not beyond its reach" [9].

NOTES

- ¹ This review is based on [8].
- ² The information in this and the following paragraph was obtained from the Ministry of Planning and Economic Development.
- ³ The information in this paragraph was gleaned from the following sources: [1, 13, 14].
- ⁴ The next section of the paper is based on the following papers: [4, 5, 6, 7].
- ⁵ I am aware that a Task Force and a Steering Committee on economic reform have been established, chaired by the President and the Prime Minister of the Transitional Government, respectively. But it is telling that these bodies, which could have been formed on the morrow of the policy declaration, did not materialize until several months later.
- ⁶ [24, p. 106]. And as someone else pointed out in the same volume, "The top agenda item for most of Africa today is not growth rate of 6 percent or higher, but how to prevent complete national disintegration. The future of Africa is not necessarily Malaysia. It's more like Liberia or Somalia. Until we get that straight, I think we are missing the picture" (p.143).
- ⁷ [21, p. 49]. This article provides a fascinating account of how Singapore is ruled.
- ⁸ This section draws on [2, pp.290-91].

REFERENCES

- [1] Christian Relief and Development Association, *Fact Sheet*, No.41, 21/04/92.
- [2] Cornia, G. Andrea, Richard Jolly and Frances Stewart, *Adjustment with a Human Face*, Vol. 1, Oxford: Oxford University Press, 1987.
- [3] *The Economist*, 16 November 1991.
- [4] Eshetu Chole, "Privatization and Deregulation in Ethiopian Industry: Problems, Prospects and Impact on the Economy", Paper Presented at the Second Annual Conference on the Ethiopian Economy, Organized by the Department of Economics of Addis Ababa University, October 29-November 1, 1992.
- [5] _____, "The Social Dimensions of Economic Reform in Ethiopia and the Role of UNICEF", Report Prepared for UNICEF Addis Ababa Office, July 1992.
- [6] _____, "On Problems of Economic Transition, with Special Reference to Ethiopia", Paper Presented at the Conference on Economy-Ecology Interaction in the Sahel, Organized by the Centre for Development and Environment, University of Oslo, 10-13 March 1992.
- [7] _____, "Ethiopia at the Crossroads: Reflections on the Economics of the Transition Period", Paper Presented at the Symposium on Rehabilitating the Ethiopian Economy, Organized by the Inter-Africa Group, Addis Ababa, 15-18 January 1992.

- [8] Eshetu Chole and Makonnen Manyazewal, "The Macroeconomic Performance of the Ethiopian Economy 1974-90", Paper Presented at the First Annual Conference on the Ethiopian Economy, Organized by the Department of Economics of Addis Ababa University, Nazareth, 22-26 November 1991.
- [9] Eshetu Chole, "The Ethiopian Economy: Current State, Policy Environment and Future Prospects", Study Prepared for the Canadian International Development Agency (CIDA), January 1990.
- [10] Gelb, Alan H. and Cheryl W. Gray, *The Transformation of Economies in Central and Eastern Europe: Issues, Progress and Prospects*, Washington, D.C.: The World Bank, 1991.
- [11] Gulhati, Ravi, *The Making of Economic Policy in Africa*, Washington, D.C.: The World Bank, 1990.
- [12] Hoeven, Rolph van der, "Adjustment with a Human Face: Still Relevant or Overtaken by Events?", *World Development*, Vol. 19, No. 12.
- [13] International Federation of Red Cross and Red Crescent Societies, Appeal No. 27/92, May 8, 1992.
- [14] _____, "Ethiopia: Drought and Post-Conflict Emergency Assistance", Situation Report No. 04/91, March 26, 1992.
- [15] Jolly, Richard, "Adjustment with a Human Face: A UNICEF Record and Perspective on the 1980s", *World Development*, Vol. 19, No. 12, pp.1807-21.
- [16] Jolly, Richard and Rolph van der Hoeven, "Editor's Introduction", *World Development*, Vol. 19, No. 12.
- [17] Kågaard, Robert, *Adjusting to Reality: Beyond "State Versus Market" in Economic Development*, San Francisco: ICS Press, 1991.
- [18] Preston, Lewis T., "Memorandum and Recommendation of the President of the International Development Association to the Executive Directors on a Proposed Credit to Ethiopia for an Emergency Recovery and Reconstruction Project".
- [19] Proclamation No. 15/1992, "A Proclamation to Provide for the Encouragement, Expansion and Coordination of Investment", *Negarit Gazeta*, 51st Year No. 11, Addis Ababa, 25 May 1992.
- [20] Proclamation No.7/1992, "A Proclamation to Provide for the Establishment of National/Regional Self-Governments", *Negarit Gazeta*, 51st Year No. 2, Addis Ababa, 14 January 1992.
- [21] Sesser, Stan, "A Nation of Contradictions", *The New Yorker*, January 13, 1992.
- [22] Stewart, Frances, "The Many Faces of Adjustment", *World Development*, Vol. 19, No. 12, pp. 1847-64.
- [23] Transitional Government of Ethiopia, *Economic Policy of Ethiopia during the Transitional Period*, Addis Ababa, November 1991.
- [24] Winrock International Institute for Agricultural Development, *African Development: Lessons from Asia*, Baltimore, Md., 1991.
- [25] World Bank, "Ethiopia: Towards Poverty Alleviation and a Social Action Programme - Preliminary Mission Conclusions", Addis Ababa, May 7, 1992.
- [26] World Bank, *World Development Report 1991*, London and New York: Oxford University Press, 1991.
- [27] World Bank, *Targeted Programs for the Poor during Structural Adjustment*, Washington, D.C., 1988.