

## THE NEW REFORM AND EMPLOYMENT ADJUSTMENT

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*Abstract:* The on-going macroeconomic and public sector reform programme in Ethiopia is aimed at reducing the relative share of the public economy and public employment. Under labour market conditions of unregulated wages and rightward shifting labour supply curves, conditions that are aided by the reform process, the employment response in the private economy is contrary to expectations.

### I. INTRODUCTION

The main elements of the on-going institutional and economic reforms in Ethiopia are outlined and reviewed in many publications [62,63], [43,p.1], [44,p.1], and [5,p.8]. These reforms have diverse objectives, serving in some way, the cause of market liberalization, economic development and the improvement of social welfare.

The focus of this short paper is on the employment effects of these reforms. It may be argued that any reform measure affects directly or indirectly the level and structure of employment. This calls for a complete coverage of government legislation, measuring and analyzing the employment effect of each proclamation, decree, regulation, or government directive. While this approach may give the study a semblance of comprehensiveness, it is difficult to measure net employment effects in this way and may not even be necessary to explain the employment changes arising from public sector reform measures. Part of the problem emanates from the difficulties in defining stable cause and effect relationships. A particular legislation affects many macroeconomic goals, including employment, and the direct and indirect employment effects may tend to be diffused. The other problem arises from the fact that policy reform, in practice, is an on-going activity with new legislations which have both short- and long-run as well as direct and indirect employment effects being introduced all the time (thus, complicating the task of model specification).

Instead, we focus on the main reforms introduced so far (following the adoption of the World Bank and the International Monetary Fund sponsored structural adjustment programme for the country) and on their short-run employment effects by interpreting the provisions in the legislations themselves, and not using a formal econometric model of the kind suggested above (for which there is also an utter dearth of information).

## II. THE WORK-LEISURE CHOICE, THE RESERVATION WAGE AND PARTICIPATION

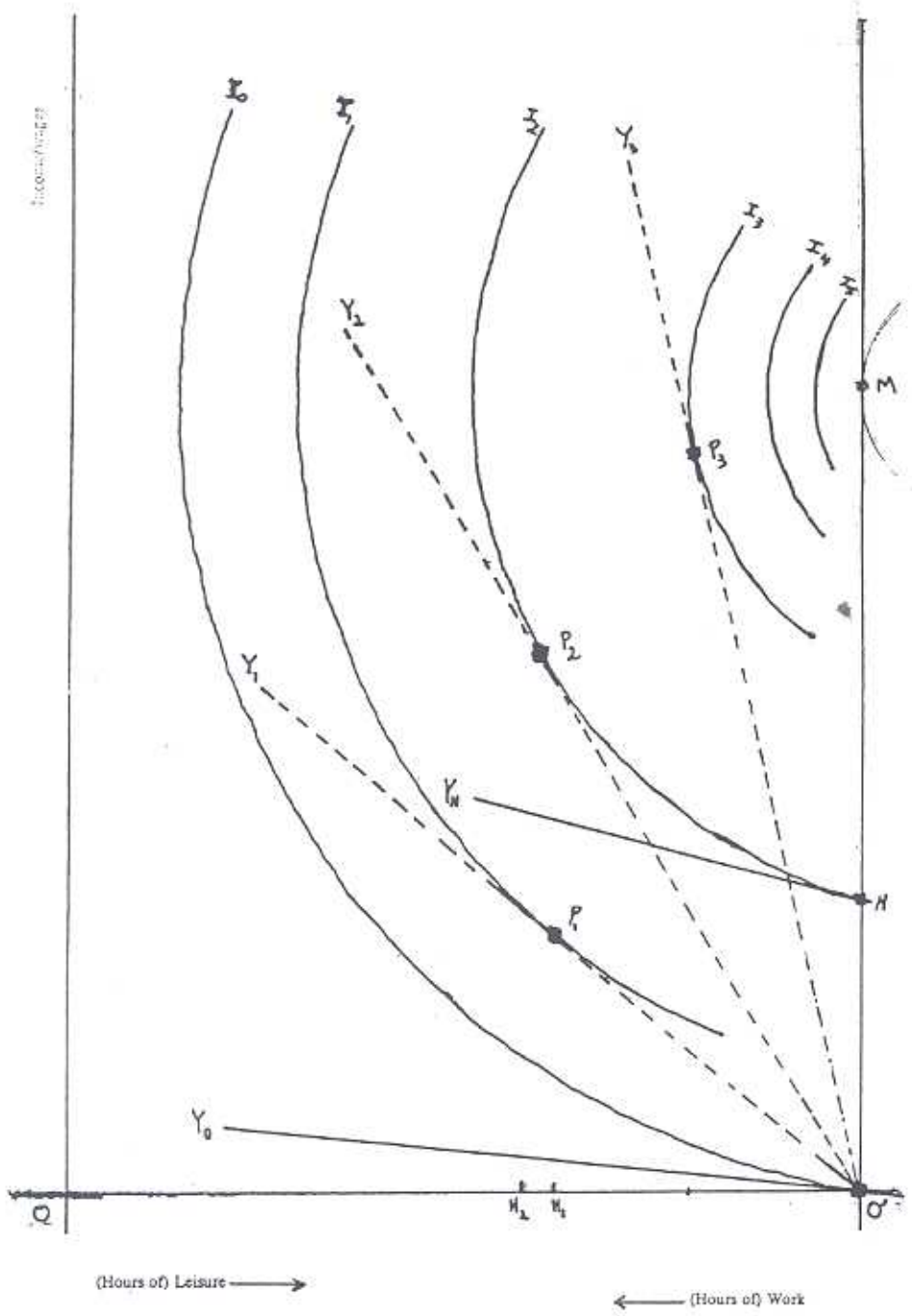
Given the individual worker's indifference map<sup>1</sup> (as shown in the accompanying diagram), a corner solution is provided at a wage rate of zero, with the worker not participating in the labour force and with the reservation wage (i.e. the minimum wage rate that induces participation) equal to the slope of  $O'Y_0$  line, or  $y_0(h)$ , at its minimum. As the wage rate rises above  $y_0(h)$ , participation increases, gradually reaching a maximum (somewhere between  $p_1$  and  $p_2$ ) and then declining.  $O'P_1P_2P_3M$  traces the equilibrium solutions where the worker's subjective valuation of the opportunity cost of leisure (given by the slopes of the indifference curves) equals the going wage rate (given by the slope of the broken lines).

Note, as the wage rate increases (i.e. as the slope of the rays that are drawn from the origin  $O'$  rises), the worker is placed on ever higher indifference curves. Also, as the wage rate rises, beyond the point of maximum participation, the rate of participation declines. It is only natural that the worker prefers to enjoy leisure to work, now that he/she can do so as a result of high wage incomes. If the wage rate rises to infinity (that is the case at  $M$ , where the slope of the  $O'M$  line, or the wage rate line, is tangent to the highest indifference curve possible and is equal to infinity), the individual ceases to work altogether, or participation is reduced to zero.

The effect of high wages and wage increases is thus to reduce participation. The rate of worker participation or employment also declines as a result of the availability of non-wage incomes. The negative employment effect of the level of non-wage incomes is also shown in the accompanying diagram. If  $O'N$  amounts of non-wage income are available to the worker, he/she would demand a wage rate of at least  $y_N(h)$  to participate in work. With larger amounts of non-wage incomes, higher levels of reservation wages would be required to induce participation.

Note too, that the reservation wage, given the indifference map, has a value in the range of  $y_0(h)$  and infinity<sup>2</sup>. It gradually increases starting from its lowest value at  $O'$  [equal to  $y_0(h)$ ], where the lowest indifference curve possible is just tangent to the reservation wage line, and reaches its maximum value of infinity at  $M$  [equal to  $y_M(h)$ , the slope of the vertical line  $O'M$ ]. As the wage rate increases (or as the worker moves onto higher indifference curves) the minimum wage required to induce participation (the reservation wage) increases.

### The Work-Leisure Choice and Participation



The implications of the above propositions for public policy are fairly obvious. Public sector reform may aim at improving workers' welfare (try to place the worker on the highest possible indifference curve) or increasing worker participation. The two goals are different. To achieve the former one tends to  $M$ , while the latter goal is achieved at the wage rate which induces maximum participation. But both goals relate to the wage rate, and to the availability or non-availability of non-wage incomes. Furthermore, the higher the wage rate, the higher will be the reservation wage that induces participation. In other words, the reservation wage and the wage rate are positively correlated. They are both inversely related to the rate of participation as are non-wage incomes. High wage levels and wage increases, minimum wage legislation and the availability of non-wage incomes to the worker (such as dividends, rent incomes, business profits, family income, pensions, etc.) adversely affect participation in work, i.e. employment.

### III. THE EMPLOYMENT STRATEGY OF PUBLIC SECTOR REFORM

Estimates of the relative size of the public economy and of public employment are scanty, with many gaps, and have limited coverage. The most comprehensive estimate of the relative size of public employment is produced by the Ministry of Labour and social Affairs Survey in 1983 [52, p.45].

Table 1  
Estimate of the Relative Size of Public Employment<sup>(1)</sup>, 1983

Sectors	Estimate of Public Employment	Estimate of total wage-employment	Share of Public Employment (percent)
Agric., Forestry & Hunting	103,705	103,802	99.9
Manufacturing	179,206	217,184	82.5
Construction	45,176	46,551	97.0
Wholesale and Retail Trade	15,057	51,445	29.3
Transport, Storage, & Communic.	34,744	37,176	93.5
Community, Social & Personal Service	147,942	223,522	66.2
Others <sup>(2)</sup>	27,495	28,885	95.2
Total	553,325	708,565	78.1

Notes: <sup>(1)</sup> Excludes "private sector" employment in agriculture, forestry, and hunting

<sup>(2)</sup> "Others" includes mining and quarrying; electricity, gas & water; and finance, insurance, real estate and business services.

Source: Ministry of Labour and Social Affairs (1984), p. 45

While the relative accuracy of the public employment estimate in the above Table is confirmed by a subsequent survey and reports, the estimates of the total wage-employment are off the mark by large magnitudes, because of gross under-estimation of the level of "private sector" wage-employment<sup>3</sup>. The MLSA 1983 Survey itself notes that wage-employment in private agriculture and in all establishments "employing less than 10 persons" was excluded, the geographical coverage of the survey was incomplete and there was under-representation of employment in the private sector "construction and transportation services" [54, p.45]. An important omission is also the military under the Ministry of Defence and the police force (although the civilian employees of these establishments are included in the survey) which are perhaps twice as numerous as the public sector employees. A 1986 survey [53] estimated the total public sector employment at 539,464, indicating a 2.5 percent drop over its 1983 level<sup>4</sup>. This survey also shows the distribution of public employment between workers of the public enterprises, who are governed by the Labour Law (Proclamation No. 64/1975) and numbered 299,934 or about 56 per cent of total public employment, and the civil servants working on the basis of the Civil Service Commission rules, (Order No. 23/1961), totalling 229,156 or 42 per cent of the total public employment.

Thus, the true share of public employment is much lower than indicated by these estimates, if the base is total wage-employment in the economy. However, the public economy and public employment dominate in the relatively large sectors of economic activity which provide relatively better pay and stable employment. That the public economy is dominant in certain areas of economic activity is also evident from the results of specific surveys. For example, the most comprehensive Small-scale industry (SSI) survey ever conducted in Ethiopia, [40], estimated the total number of SSI establishments and wage-employment in 1985 at 7,684 and 36,846, respectively<sup>5</sup>. This shows the relative smallness of wage-employment in the organized or "formal" sectors of private manufacturing. According to a recent industry survey, which covers the relatively large industrial enterprises [1], the shares of the public economy in total manufacturing production, fixed capital assets and employment are, respectively, 96, 97 and 93 percent<sup>6</sup>.

Perceptions about the relative productivity or efficiency of public employment vary<sup>7</sup>. One view is that under the socialist management of the economy public employment expanded considerably, especially in the services and in administration, which harboured a large share of "non-productive" activities. Elaborate hierarchical control, coordination and monitoring systems engaged large numbers in relatively unproductive work, unnecessarily inflating labour cost and raising the real prices of industrial output. Long delays, red-tape, graft and corruption characterised the bureaucracy and indicate that the public sector system is perhaps over-manned as well. In addition, in times of economic difficulties, which is often the case, excess capacity occurred in the public economy, with large numbers of paid workers waiting for spare parts, industrial inputs, or even increases in the demand for their produce or service in order to be engaged optimally. These indicate potential redundancies in the public economy, and suggest that redeployment and/or retrenchment is possible through lay-off and streamlining. Under such conditions, a public sector "leaning" programme would make it relatively more efficient and cost-effective.

An alternative view point about public sector employment under socialism is that civil servants and workers in government owned enterprises worked over-time without pay and offered free service in various committees. Senior officers of government held simultaneously many responsibilities and participated, as most public servants did, in civil functions outside the office and in various "campaigns" which the government organized without being compensated in return. This line of argument suggests that the public economy is under-manned, and if the activities outlined are in the nature of economic goods (which are not inferior goods), public sector reform would lead to an increase in the level of public employment (as free labour is substituted by paid work).

There is also another view about the direction of public employment, which is that "reform" may necessarily result in "new" employment as well as job loses in departments and enterprises facing expenditure retrenchment. The net employment effect of reform is thus difficult to measure and may become obvious, if at all, only in the long term.

In the light of the above, what is the employment strategy of the on-going macroeconomic and public sector reform measures? To what extent are the recent reforms introduced by the Transitional Government of Ethiopia affecting public employment in particular and wage-employment in the economy generally?

The reform measures which affect output and employment can perhaps be divided into three groups. First, a principal concern of the reform has been the *reorganization of the public sector system* itself so that it would become, in the end, relatively "smaller" (than the private economy) and more efficient and cost-effective (than it was in the past). This is closely related to budgetary reform, which, in the light of the experiences of countries undergoing structural adjustment, often entail expenditure retrenchment and restructuring, and revenue growth enhancement and consolidation. Together, these provide the major ingredients of a public sector "leaning" programme, which give the public sector system a new direction and responsibility (in the area of economic regulation) and render it relatively efficient and cost effective in the delivery of public goods.

The reform measures introduced so far and contributing towards the enhancement of the above objective include the reorganization of the ministries, the establishment of regional self administrations, the introduction of public enterprise reforms, retrenchment and restructuring of government expenditures and, perhaps, the new labour law.

Second, there are some policy measures taken with a view to *changing the public and private economy balance*. The aim is to transfer responsibilities and assets from the public to the private sector, so that the latter and market forces have dominant roles to play in the national economy. Obviously, this calls for a new relationship between the government and the public and private economies on the one hand, and between the private and public sector economies themselves, on the other. The reform measures directly aimed at distorting the public/private economy balance are few and can be evaluated in terms of their effectiveness to achieve the indicated objective<sup>8</sup>.

Third, and related to the above is the *enhancement of the growth and development of the private economy*. Toward the realization of this goal a number of reform measures were recently introduced including price and market deregulation, a new investment law, monetary and foreign exchange policy changes, fiscal policy reforms, and measures to diversify and increase investment finance. Some of these reform measures have direct employment effects while others affect employment only indirectly.

#### IV. THE EMPLOYMENT EFFECT OF THE REFORM MEASURES

All the three aspects of reform, viz. reforming or reorganizing the public economy, changing the relative public/private sector balance, and enhancement of the development of the private economy, affect employment growth.

##### 4.1 Public Sector Reform<sup>9</sup> and its Employment Effect

The aim of the new labour law (Proclamation No.42/1992) is perhaps "industrial peace" which may possibly affect employment indirectly and in the long-run. However, it is uncertain that Proclamation No. 42/1992 will achieve this goal more effectively than the laws it repealed<sup>10</sup>. Workers argue that the new law denies them job security which the previous law, Labour Proclamation (No.64/1975), gave them. Employers, on the other hand, think that the new labour law does not give them the freedom to act in matters of employment and conditions of work as much as they wish. Beyond that Labour Proclamation No. 42/1992 appears to be neutral in its short-term employment effect.

The reorganization of government, which is the other element of reform, has taken several forms (see Table 2). One aspect of the reform is reducing the size of government and streamlining central government institutions, including the ministries. As a direct outcome of the reform process, some institutions are scrapped, the two sectoral ministries in agriculture, trade and construction are collapsed into one ministry in each case, three new ministries (that had not been there as ministries prior to the coming of the Transitional Government) are established, and all public institutions and ministries are required to introduce internal reorganization. The result of these processes has been a marked reduction in overall personnel size in central government institutions which was achieved through large-scale dismissals, lowering the pensionable age, and compulsory retirement of eligible pensioners. Large numbers of civil servants were also allowed to "float" (go on forced leave of absence from work with pay), for several months in some cases, pending dismissal or relocation decisions.

However, the main feature of the reform had been the institutional replication in the regions (Proclamation No. 41/1993) and that has the potentials for employment expansion (see especially the last two rows in Table 2). Following the issue of the Regional Government Establishment Proclamation (Proclamation No. 7/1992), and the proclamation defining the powers of governments (Proclamation No. 41/1993), there has been a relocation of some public employees from the "centre" to the regions and the employment of others in the "regional bureaus".

**Table 2**  
**The Reorganization of Government**

Government	Proclamation No. 8/1987	Proclamation No. 41/1993
Ministries <sup>(1)</sup>	20 (Art. 15)	20 (Art. 3)
State Committees <sup>(2)</sup>	2 (Art.37)	
Commissions, the National Bank, Authorities and Institutes <sup>(3)</sup>	16 (Art. 41)	12 (Art. 25, 57)
Branch Offices	All to continue (Art. 59)	
Regional Planning Offices	As per ONCCP Proc. 262/1984. There were 8 such offices	
Regional Administrations:	Regional, Awraja and Wereda administrations to continue until the establishment of autonomous regions (Art.60)	
Executive Organs of Regional Self-Governments:		Regional offices plus (No. of regions X 17 "Bureaus") (Art. 33) <sup>(4)</sup>
Executive organs at Wereda and other regional administration levels:		not defined (Art. 58)

Notes: <sup>(1)</sup> The Ministry of State Farms Development and the Coffee and Tea Development Ministry in (Proc. 8/1987) are replaced by the Ministry of State Farms, Coffee and Tea Development in Proc. 41/1993. In place of the two ministries, Urban Development and Housing and the Construction Ministry, (in Proc. 8/1987) there is only one Ministry of Public Works and Urban Development in Proc. 41/1993. Likewise, instead of the former ministries of Domestic Trade and Foreign Trade, there is one Ministry of Trade in Proc.41/1993. Three new ministries are introduced by Proc. 41/1993: the Ministry of Natural Resources Development and Environment Protection, the Ministry of Economic Co-operation and the Ministry of Planning and Economic Development. The last two constituted the two "state committees" in Proc. 8/1987. ONCCP stands for the "Office of the National Committee for Central Planning".

<sup>(2)</sup> The following four institutions (in Proc. 8/1987) are not included in Proc. 41/1993: The Price Study and Policy Institute, the Building and Transport Construction Design Authority, the Water Resources Commission, and the Defense Industries Commission.

<sup>(3)</sup> 17 and not 20 bureaus because defense, foreign affairs and central banking functions are not regionally replicated

Although, as shown later, this raises questions about the "quality of employment"<sup>11</sup> and may prove difficult to justify on economic grounds, it is estimated that the regionalization programme, if fully implemented, may result in net additions to public employment. However, there is no indication that the possibilities exist for a full implementation of the regionalization programme at present, and what is observed on the ground is the substitution of old public sector functionaries by new "loyalists" in the regions. Only a few "regional bureaux" are established in some regions, and bureau replication at sub-regional level administrations are not yet reported.

The reorganization of the public enterprises, the other aspect of public sector reform, is being carried out on the basis of the Public Enterprise Proclamation (Proclamation No. 25/1992)<sup>12</sup>. Previously public enterprises were organized under the "corporations" of certain ministries. In 1990, the Ministry of Industry, for example, owned and managed a total of 164 establishments organized under 10 corporations (and 4 share companies) [48, p.v]. The changes introduced by Proclamation No. 25/1992 are basically two: the "corporation" system is replaced by a "board" system of industrial management, and the enterprises are given a degree of autonomy that permits independent action in matters relating to enterprise economic management.

It is unclear whether the board system introduces efficiency and cost-effectiveness to public enterprise management any more than the previous system it replaced did. If some public enterprises are reported to be "profitable" after the reform, their success may have more to do with foreign grant and loan financing of imported inputs than with the change in management. The corporation system of industrial management was adopted as a cost saving measure. It was also regarded as an efficient method of using scarce technical and managerial skills and services concentrated at the corporation level. Since some functions previously concentrated at the corporation level are now distributed to the enterprises, the "board" system may lead to some employment increase in these critical areas. However, the over-all employment effect of the reform, if any, are likely to be indirect and are only likely to be felt in the long-term (through the growth of the public enterprises made possible by the changes from a corporation to a board management system).

What is evident in the short term, however, is that some public enterprises have been closed and others allowed to operate with a reduced work force. Among the enterprises that were closed are the Ethiopian Import-Export Corporation (ETMEX), Marine Transport Authority, Ethiopian Building Construction Authority (EBCA), and Development Projects Studies Authority (DEPSA). A factor that complicates the measurement of net employment effects of closure is that some of these enterprises have reappeared in a new form and with reduced staff. For example, ETMEX is partly replaced by a new public enterprise, Ethiopian Whole Sale Trading Company (EWSTC) and EBCA by the new Awash Construction Enterprise (ACE).

Institutional reform, the aspect of public sector reform discussed above, is closely related to government budgetary reform, the twin objective of which is expenditure retrenchment and restructuring and budgetary balance. The argument for retrenching government expenditure has been that it is possible to do so (because a major cutback in

defence expenditures can be made) and that the resultant "peace dividend" can be used to expand economic capacity. A cutback in defence expenditures, permits, in the limit (i.e. at a zero level of defense expenditure), the use of some 42 per cent of the normal expenditure budgets of government in the development of economic infrastructures, to reduce excess capacity in public enterprises, and to enhance the development of private industry [57]. In other words, public expenditure retrenchment and restructuring is an important element of the public sector reform measures.

In practice, reducing the level of government expenditures is proving a difficult task. The planned devolution of power to the regions (increased bureaucratization), the need to combat increased lawlessness and political instability, the management of "transitional politics", and the carrying out of large-scale relief and rehabilitation programmes are requiring financial resources in excess of the economic capacity to pay for these things. Expenditure retrenchment is also advocated at a time of declining government domestic revenues [54, p.33], caused in the main by a sharp drop in incomes and by tax administration difficulties. It is also difficult to establish whether expenditure restructuring has been growth enhancing. While the cutback in defence expenditures is sizable, there has been little change (if any) in the real expenditure allocations to health, education and economic infrastructure.

Therefore, the employment effect of this particular measure is difficult to assess. Retrenchment of expenditure is deflationary and the contraction of economic activity it implies can only result in job losses. The restructuring of government expenditure along growth enhancing lines, on the other hand, is expansionary and has the potential to increase employment. But there is no conclusive evidence that the Transitional Government of Ethiopia has succeeded in restructuring public expenditure in such a way that economic growth can result from it.

The conclusion which can be drawn is that public sector reform measures have brought about a reduction in the level of public employment. In the view of the Transitional Government, existing government ministries and institutions are "over-staffed" and retrenchment is an inescapable course to take<sup>13</sup>. According to government policy papers, the number of public employees to be retrenched as a result of the reform measures are estimated at about 80,000 (or about 15 percent of the total public sector employment)<sup>14</sup>. These figures do not include the demobilized soldiers (demobilized as a result of change and reform) variously estimated at between 500,000 and 1.2 million who are contributing to the accentuation of the unemployment crisis in the economy [41, p.27],[9]. There is also a large group of "displaced" persons (following disturbances in various localities), and "returnees" (who were previously refugees in neighbouring countries) who are contributing to unemployment growth. According to a World Bank report, the "displaced, returnees, and ex-soldiers" together are estimated at 2.1 million [44, p.22], which constitutes a sizeable addition to labour supply. Furthermore, the predictions for 1994 are that the famine afflicted population can rise upto 10 million or more, which may result in large-scale migrations to the towns and other centres of population concentration (such as refugee camps, state farms, etc.). There is also a large increase in labour supply induced by population growth (estimated at about 3 percent per annum).

Thus the overall effect of public sector reform and these demographic developments is to shift the labour supply curve to the right. In as much as it is the "educated" and/or the relatively "skilled" workers that have left the public sector system, it is the specific supply curves that would be so shifted. But, that also holds true (following our review of the demographic developments) of the situation in the labour market generally.

In terms of the Model described in section 2, the effect of public sector reform is to create a labour market situation similar to that faced by a monopsonist. The labour supply curve is positively sloped (and not the perfectly elastic one of the competitive market) and is pushed further towards the right further pushed to the right with a drop in the level of the reservation wage. Excessive unemployment and the absence of wage regulation (there is no minimum wage legislation in Ethiopia) permit the wage rate to drop to any level to adjust or equilibrate the market [62]. This precipitates a move in the direction of  $MP_3P_2P_1O'$  and toward  $I_1$ , indicating a continuing deterioration of the conditions of the working population (i.e. the relocation of the worker on a lower indifference curve).

#### 4.2 The Public/Private Sector Balance and Employment

A specific policy pursuit of the TGE has been the deliberate distortion or change of the public/private economy balance so that the latter and market forces become dominant features of the economy. Two types of measures are proposed in this connection. On the one hand, government expenditure retrenchment and restructuring are to be used to deflate the public economy. On the other hand, other reform measures are introduced to enhance the transfer of assets and other resources from the public to the private economy.

The limitations of the first measure is already discussed (see previous section). During the past three years (since the adoption of SAP), the Transitional Government has failed to introduce a radical departure from the past budget practice: it was not possible to reduce significantly the level of government expenditure, and to restructure government expenditure along growth enhancing lines.

With regard to the second measure, that of public asset transfers to the private sector, the new economic policy document [62], identifies the specific enterprises to remain in government hands. These include large-scale engineering and metallurgical, fertilizer, and pharmaceutical plants and industries which supply strategic raw materials to major chemical industries<sup>15</sup>. The rest are targeted for liquidation or transfer to the private economy through sales and other modes of "de-nationalization".

The proclamations that permit the dissolution of public enterprises (Regulations No. 5/1992, and No. 126/1993) are issued to facilitate the transfer of some of these public enterprises to the private sector. The government, on the basis of these regulations and the provisions of Proclamation No. 25/1992 (Art. 47), can declare uneconomic enterprises bankrupt or force their closure to minimise loss. Alternatively, ailing enterprises can be re-established under a new management, or such enterprises would be able to transfer their assets to private buyers or enter into negotiations to permit non-government equity participation.

Although some enterprises are closed as a result of the policy measures<sup>16</sup>, no large-scale transfer of public assets to the private economy has been recorded to-date. The details on asset transfers, which presumably are drawn to make the exchanges attractive economic propositions, have not been made public so far. But a main problem has been and remains the lack of domestic buyers, and foreign buyers have so far shown little interest in loss making businesses.

Recent reports on SAP experiences elsewhere in Africa corroborate the above trend. Liquidation and closure of public enterprises are more numerous than asset sales. Planned privatization (or sales of government property) outstrips "actual" privatization (or actual asset transfers) several fold; and years of active discouragement and failure to develop national private entrepreneurial capacity and poor credit facilities have curtailed large private domestic buying of public assets in most cases [8].

Since public enterprises are being re-organized (and this has often resulted in a decrease of employment in specific departments), while no major asset transfers to the private economy have occurred, the net employment effect of the policy is possibly negative. The extent of public employment reduction is perhaps difficult to measure, partly because one is dealing with an on-going process and partly because the employment status of affected workers changes all the time<sup>17</sup>.

In terms of the Model in Section 2, the effect would be to increase labour supply and push the level of wages down in specific and general labour markets, i.e. cause a relocation of the worker on a lower indifference curve (indicating a further deterioration in the working conditions) than previously.

### 4.3 The Development of the Private Economy and Employment

The main strategic consideration in current government reform measures is the development of the private economy. Among the measures taken to enhance growth of investment, output and employment in private industries is the recent deregulation of prices and markets. The measure is apparently aimed at improving the rate of return on investment, by allowing the upward adjustment of market prices, while keeping a regime of price regulation in areas where market failures are noted [58]. Early reports indicate that the observed rise in real incomes of cash crop farmers, following market liberalization, is not accompanied by increases in supply or production. This lack of supply response is also observed in relation to foreign exchange rate adjustments. Exports could not increase as much as expected because domestic prices also soared following the devaluation of the Birr. But, a major factor behind the lack of supply response is a structural one: the land market has not been liberalized and farmers and entrepreneurs generally could not respond to the price and foreign exchange incentives provided by the reform measures.

A main objective of monetary reform under SAP<sup>18</sup> is to contribute to economic stability by maintaining low to moderate seigniorage and a level of the "real interest rate" that is neither "highly negative" nor "highly positive" [66, pp.48-51]. A mark of the

relative success of monetary policy is that the growth of inflation has so far been low or moderate. However, the underdeveloped capital market and the low level of monetization of the economy limit what can be achieved by an improved monetary reform stance; and the extreme dependence on foreign financial grants and loans to finance the foreign exchange needs of the economy shows the vulnerability of the (monetary) system.

The fiscal reforms introduced recently have diverse objectives, including improving the welfare of low paid workers<sup>19</sup>, raising the level of industrial production<sup>20</sup>, and restructuring output (special fiscal incentives for export-gearred production)<sup>21</sup>. The Investment Proclamation (No. 15/1992) provides administrative services (through the Investment Office of Ethiopia) and fiscal incentives and makes arrangements for land and water allocations to investors in the private economy.

Although these reforms, as a package, are taken to enhance the development of the private economy, which is the centre-piece of the reform strategy, the resultant rate of increase of investment and output has been less than what is required to absorb the reduction in public employment. The expectations have been that growth of the private economy should go beyond absorbing the unemployment created by the public sector reform measures<sup>22</sup>. But the rate of unemployment is rising in the economy: a grave school-leaver problem is developing, steep drops in agricultural production and law and order problems in rural areas are causing migrations to the towns, it is already shown that public sector reform had resulted in large-scale dismissals and there is a large increase in labour supply induced by population growth. These create, once again, labour market conditions which are characterized by a continuing right-ward shift of the labour supply curve and a sharp drop in the reservation wage. Two issues require elaboration: the problems of the "private sector development strategy", and the issue of employment adjustment to labour market conditions of increasing labour supply and flexible wage rates.

#### 4.3.1 The Problems of the Private Sector Development Strategy

Recently, inspite of increased imports of fertilizer and other inputs, (private sector) agricultural production has not increased over previous levels. Adverse weather conditions, failure to introduce land reform, continuous abuse of the physical environment and political instability are among the factors contributing to a decline in agricultural production. During 1989-1991, excess capacity was developing and there were steep falls in the level of industrial production. In the succeeding years it was possible to increase industrial production and reduce excess capacity by direct financing of raw material and other input purchases from abroad. Since the major sources of this finance are foreign loans and grants provided under SAP its sustainability over the longer-term is in doubt. But, the GDP share and structure of private industrial production remain unchanged (still accounting for only about 4 percent of GDP, as it was in 1974/75, and dominated by food and textile production). There are many reasons explaining the lack of growth in private industry.

One does not see any long-term planning in the present design of private industry development. There is also no observed priority setting or strategic consideration in investment selection. In a state driven economy where twenty years of active "discouragement" of private initiatives and the market system have virtually eradicated the embryonic entrepreneurial class (or promoted its concentration in the public economy), it is difficult to change the relative GDP share of the private economy in the short term. The entrepreneurial class is not well formed in the society and foreign businesses have not made their inroads in the Ethiopian economy.

The situation is not helped by closing public institutions such as Development Projects Study Authority (DEPSA) because, as is shown later in this section, a major problem is the failure to make good investment decisions (which relate to the investment evaluation, selection and implementation processes) and these public institutions could have provided invaluable service and guidance to prospective investors in the private economy.

Sometimes government reform measures lack coherence and appear to send conflicting signals to prospective investors. Under Article 10(1,2) of the Regional Government Establishment Proclamation (No. 7/1992), the regional self-governments exercise "legislative, executive and judicial powers in respect of all matters within their geographical areas..." and have responsibilities in such matters as planning, directing and supervising social and economic development programmes. Proclamation No. 7/1992 clearly conflicts with the law which defines the functions and responsibilities of the Ministry of Industry (i.e. Proclamation No. 8/1987). The organizational problem introduced by this proclamation is further complicated by the Investment Proclamation (No. 15/1992), which assigns the role of land and water allocations for industrial activities to Regional Self-Administrations (Articles 9 and 10), the role of determining the investment incentives to prospective investors to the "Investment Office of Ethiopia" (Part II), and the role of licensing industrial enterprises to the "appropriate authority" (Article 18). But, the "appropriate authority" is not properly defined, and the regional self-governments are not established in all regions. Is it the Ministry of Industry or the Regional Self-Governments that constitute the appropriate authority? Two proclamations were later issued supposedly to mend the anomaly: the Investment Amendment Proclamation (No. 31/1992), which reassigns the tasks of the "Investment Office" to the Regional Self-Administrations, and makes them also the "appropriate authority"; and the Definition of the Powers of Regional Governments Proclamation (No. 41/1993), which establishes "industry bureaus" in the self-governments replicating the functions of the Ministry of Industry. In the light of these changes, the functions and responsibilities, if any, of the Ministry of Industry and of the Investment Office of Ethiopia are unclear<sup>23</sup>. Since there are no more than 8000 industrial enterprises in the country, it is difficult to provide economic justifications for their management by an enlarged and hierarchical bureaucracy. Furthermore, with "critical skills" unavailable or in short supply in the economy generally, it is difficult to show how the regional offices would be able to staff them and where the financial resources for the purpose would come from. This bureaucratization process also counters the precepts of "public sector reform".

Prospective investors are also responding with caution to the system of industrial licensing (Regulation No. 8/1990) and to the investment incentives (provided in the Investment Proclamation No. 15/1992). According to the Industrial Licensing Regulation, industrialists are required to obtain from the Ministry of Industry various types of licenses and permits to function in the economy: temporary license (to facilitate industrial establishment), permanent license (given upon satisfactory completion of formalities and fulfilment of obligations to various government bodies), expansion and renewal permits, etc. as the case may be.

Table 3  
Response to the System of Industrial Licensing  
and the Investment Incentives

Year	"Temporary License" Issued (TL <sub>t</sub> )	"Permanent License" Issued (PL <sub>t</sub> )	Ratio PL <sub>t</sub> /TL <sub>t-1</sub> (percent)
1989/90	1111	339	-
1990/91	2355	312	28.1
1991/92	4076	643	27.3
1992/93	2711	464	11.4

Source: Ministry of Industry, *Private Industry and Handicrafts - Annual Report* (in Amharic), Various years.

Assuming that permanent licenses are issued to applicants that are holders of temporary licenses during a previous period, the performance indexes (shown in Table 3) can be computed for the system of industrial licensing and the system of investment incentives. Undeterred by the small fees to pay<sup>24</sup> and in order to get the benefits provided by the Investment Proclamation No. 15/1992 (which includes land allocations, fiscal incentives, duty free import privileges, etc) Prospective investors apply for "temporary license" in large numbers. But, they soon get discouraged when faced with the stringent requirements for "permanent license": The only course open to them is to withdraw (if by doing so losses can be minimized), stay on temporary license for another period (if the requirements for permanent license can be met in due time), or operate as an underground or informal business. The decision to go underground is often made by small firms, which lack visibility and which have a relatively large labour cost component, and estimate to break even or minimize cost by using own labour and withholding tax and other payments to the government. In all cases the trend is to reduce participation (see last column of Table 3). The failure on the part of prospective investors to establish legitimate businesses is discouraging to new investors. Even fewer numbers than before apply for license, and if the discouraging situation persists, the rate of participation in the informal sector drops.

Lack of progress in other areas also adversely affects the development of private industry. So far the development of suitable land policy has eluded policy makers. Although the Urban Lands Lease Proclamation (No. 80/1993) has been issued, there is no indication yet that it is implemented in any urban area. No changes have been made to the ownership and management practice of rural lands. The civil administration is in a state of flux, bureaucratic obstacles frustrate the search for legitimate activity, all contributing

to an increase in the real interest rate on risk capital and adversely affecting the "investment climate".

#### 4.3.2 The New Conditions in the Labour Market and Employment Adjustment

Excessive and increasing levels of unemployment, low wages and the absence of wage regulation are favourable to the growth of private industry. Under 4.3.1 some of the major obstacles to the growth of the private economy are indicated. There are also other factors relating to employment adjustment difficulties.

The redeployment of retrenched public employees in private industry is not progressing as well as expected, mainly because of lack of growth in the private economy<sup>25</sup>. Public employees are better educated, skilled and more experienced than workers in private industry [58]. Unfortunately, the private economy is incapable of generating sufficient demand for school leavers and the workers "released" from the public sector system.

Even if it is to be argued that lack of skills may constrain employment expansion in private industry, the current skills development programmes appear to be defective. The number of trainees from the private sector and the duration of skill training at the Ethiopian Handicraft Centre of the Ministry of Industry, the major industrial skill training facility in the country, are decreasing. The content of training is also changing from that of "skill development" to "management and orientation lectures".

Free mobility of labour is essential in terms of resolving problems of market disequilibria (supply shortages or surpluses) in specific labour markets. The implementation of the 1975 land proclamation (Proclamation No. 31/1975), and the government sponsored resettlement programmes of the mid-1980s were, to some extent, aimed at stabilizing peasant households. Peasants needed "official letters" from their peasant association, cooperative or local administrative office to travel in the country. Because of these constraints on the geographical mobility of labour, labour surpluses may be observed in some areas and shortages in others. Under conditions of free competition and free labour mobility the workers themselves paid for the cost of travel and the duration of resolving any labour market disequilibria was relatively short. But under the "socialist management of the economy" such labour movements became outcomes of a planning process with high social cost and prolonged "impact duration". The system of regional self-government (Proclamation No. 7/1992, and No. 41/1993) adopted by the Transitional Government introduces additional constraints on the free mobility of labour. The placement of public sector workers in the various bureaus of regional self-governments is based on the dictates of the "regional policy of the Transitional Government" and not that of the "impersonal competitive market" [61, pp. 9-12]. The controversial "principles" of the regional system (which, in the eyes of government critics, tends to strengthen regional tendencies), the inefficiencies of the placement machineries, and the denial of free choice and fair treatment to all job seekers are some of the major objections to the on-going government programme of public sector reorganization and employment retrenchment<sup>26</sup>.

Past empirical studies of the manufacturing industries in Ethiopia show that downward adjustment of wages and the removal of various forms of capital subsidy may not yield a significant expansion in employment in industry due to low coefficients of elasticities of factor substitution [55, p.60]. This notwithstanding, recent capital/labour ratios (calculated in real terms and adjusted for variations in the number of enterprises) in private industry show large increases over previous levels, and may be wrongly interpreted as indicating slow employment adjustment to investment growth. In a few cases, new capital intensive enterprises are established, which tend to increase employment gradually and slowly, i.e. as revenues from sales are increased and stabilized. But these few cases cannot change the overall picture in such a short time. The plausible explanation for the rise of the capital-labour ratio is perhaps over-invoicing, on the part of reporting enterprise owners/managers of assets because they are no longer bound by the law which sets "capital ceilings" for private investments<sup>27</sup>. They may also do so to benefit from the investment incentives (provided in the Investment Proclamation No. 15/1992) which increase with the size of investment.

Working conditions continue to deteriorate, mainly caused by high levels and rates of unemployment growth and the continued right-ward shift of the labour supply curve, on the one hand, and stagnation or relative low growth of the demand for labour, on the other. These circumstances force wage levels down which, in the absence of wage regulation and non-wage incomes, can decline to the minimum value of the reservation wage,  $y_0(h)$ . It is this continued relocation of the worker on still lower indifference curves that is confirmed by the data in Table 4 below.

**Table 4**  
**Declining Real Wages in Industry**  
**(in Birr per Annum)**

Year	Real Wages in SSIs	Real Wages in LSIs
1984/85	2341	-
1986/87	1771	3649
1987/88	-	3586
1988/89	-	3354
1990/91	1423	-

**Notes:** LSIs refer to large-scale industries, and SSIs to small-scale industries. The deflator is the "Addis Ababa Retail Price - General Index (excluding rent)" series. Two modifications are introduced: (1) the index series is recast according to Ethiopian calendar to correspond to the data on nominal wage rates, and (2) The base year for the price index which was 1963 = 100 is now changed to 1984/85 = 100.

**Sources:** The LSI computations are based on data in Central Statistical Office (now, Authority) (1990). The data for the SSIs are drawn from the Ministry of Industry (1991), (1993), HASIDA (1988). The "General Index" series are obtained from the National Bank of Ethiopia, *Annual Report*, various years.

The deteriorating conditions of the working class, which are reflected in declining real wage levels, are also brought about by *the absence or low levels of non-wage incomes*. The Land Reform of 1975 forbids any person or a business organization from holding rural

land in private ownership (Proclamation No. 31/1975, Article 3(2)). The Urban Land and Extra-Houses Nationalization Proclamation (No. 47/1975) denies any individual or organization the right to hold urban land in private ownership, forbids urban land transfers in any form and limits family or individual ownership of urban property to a "single dwelling house" (Articles 3(2), 4(1), 5 and 11(1)). According to Proclamation No. 76/1975, no industrial or business license would be given to any person who has a permanent job. Individuals without permanent jobs and seeking a licence can obtain it under highly limiting conditions: "No person shall obtain more than one licence nor possess more than one business or establish a branch" (Article 4(2)), and "a commercial activity shall be carried on only by an individual entrepreneur" (Article 4(3)). Although the law permits ownership of an "industrial enterprise" by an organization, the number of individuals participating in the organization is restricted to five (Art. 8(3)). Proclamation No. 76/1975 also sets "capital ceilings" for private investment in private business or industry (Articles 5,6, and 8). In addition, the civil service regulations forbid any public servant from seeking "outside" employment without authorization from the highest official in the organization where he/she works (Proclamation No. 28/1962, Article 81(1,2,3)). Such an authorization would be given, if at all, only after ascertaining that the worker's participation on the basis of his/her request would not in any way compromise with the satisfactory work performance in his full-time/primary job. With the aid of directives and circulars, the previous government made the most rigid interpretation of these provisions in Proclamation No. 28/1962, with the result that secondary employment even "outside working hours" are practically barred for public employees, while job transfers, even within government, required authorization from the highest authority in the civil service system.

Although some of the restrictions on non-wage income formation were eased in later years (for example, "capital ceilings" on investment were gradually increased and subsequently dropped, an individual can now hold simultaneously any number of business interests, etc.), even to-day public employees depend totally on their wage incomes. Thus, non-wage incomes for a public employee are virtually non-existent. The application of the land reform (Proclamation No. 31/1975) also restricted labour mobility in the rural areas and prevented (wherever it was possible to enforce government directives<sup>28</sup>) the peasantry from moonlighting for complementary jobs and incomes (as traders, cobblers, wage-workers, carpenters, self-employed service workers and manufacturers) during periods of recess in agricultural activities. That these restrictions on the geographical and occupational mobility of the peasantry contributed to the accentuation of poverty in the rural areas is widely reported, e.g [46], [56]. The series of highly restrictive laws outlined above also explain why non-wage incomes are low in general, and why great significance is to be attached to public employment. Public employment is perhaps the major source for relatively high and stable incomes, and the private cost of "dismissals" is too heavy to bear<sup>29</sup>. With zero levels of non-wage incomes, a public employee has nothing to fall back on if dismissed from work. In other words, in situations where wage levels are low and falling and where non-wage incomes are either non-existent<sup>30</sup> or very low, a prospective job applicant in public employment lacks bargaining power and becomes a wage or "price-taker".

In depressed economic conditions characterised by high unemployment rates in the economy (excessive labour supply), and lack of non-wage incomes (the public economy was dominant in Ethiopia), even a wage rate marginally greater than the minimum reservation wage level, i.e.  $y_0(h)$ , will induce employment expansion. In other words, there could be enough labour supply to meet demand at such a low wage. But workers in employment under such conditions exhibit rent seeking behaviour. To increase the economic rent for their labour, they commit for personal use a portion of their produce, become involved in graft and corruption, increase the rate of absenteeism from work, and attempt to extract concessions from the employer by union action. Thus, the social cost of public sector reform includes not only the relative decline of public employment and the economic hardships resulting from job loss, but also the deterioration of the "quality of employment".

The employers in the private economy also respond to the labour market situation of increasing labour supply and falling real wages in ways that exacerbate the already depressed economic situation. They tend to use own-labour intensively in supervision and monitoring activities, employ extensively family labour and apprentices (to reduce labour cost), informalize their businesses (to break-even by with-holding taxes and other payments to the government), and even reduce the scale of operation (to minimize use of wage-labour).

#### Notes

1. These are a set of curves each showing various combinations of work (income or wage rate) and leisure which yield equal utility. The equation of each curve can be written as  $y(h)$ , where wage rate or income ( $y$ ) is a function of work or hours of work,  $h$ , the derivative  $y_s(h)$  or  $dy/dh$ , (where the subscript,  $s$ , defines the specific indifference curve) is a measure of the wage rate or of the opportunity cost of leisure.

2. It is conceivable that the indifference curve may be so shaped as not to be tangent to the vertical line (which indicates zero participation rate) at any point on the latter, in which case the maximum slope of the tangent line to the indifference curve on the vertical line (i.e. the reservation wage) may be less than infinity.

3. Urban households and the informal economy generally are major sources of wage-employment. It is also widely reported that wage levels in these systems are very low and unstable.

4. There has not been another public employment survey since.

5. Of these 36,846 "persons engaged", 13,212 are proprietors and family workers, 397 are apprentices, and 2216 are temporary workers.

6. See, [4].

7. Two such ideas are discussed in [43, pp.220-221].

8. In fact the only measures introduced in this regard relate to a specific provision of the Public Enterprise Proclamation (No. 25/1992). The "provision" concerns the "dissolution of public enterprises" (Art. 47(1)(c)) and other options to deal with the transfer of assets from the public to the private sector.

9. These relate to institutional reform measures taken by the TGE including the reorganization of public institutions such as the ministries, public enterprises, regional administrations and the system of industrial relations.

10. Among the laws repealed by the Labour Proclamation No. 42/1992 are [13,14,15,16,19,21,22].

11. Many recent reports indicate that "qualified and experienced" workers are being replaced by "political cadres" and supporters of government in the civil service and public enterprises. Numbers change all the time and official estimates are not provided.

12. This Proclamation may be read in conjunction with the new economic policy document [62], which identifies and defines the select group of enterprises to remain in Government hands, the rest being targeted for liquidation, or transfer to the private economy.

13. Some modes of retrenching and redeploying public employees are elaborated by government officials in a recent meeting of representatives. [7].

14. This estimate is provided in many public documents. See, for example, [44, pp.22-23].

15. This particular clause in the policy document is perhaps "futuristic" since Ethiopia to-day does not have such an industrial base.

16. Among the government enterprises that were closed (even before the issue of these proclamations) are the Ethiopian Import Export Corporation (ETMEX), Marine Transport Authority, Ethiopian Building Construction Authority (EBCA), and Development Projects Studies Authority (DEPSA). However some of these enterprises have reappeared in a new form, after some lapse of time, perhaps with reduced staff and under a new management. The Awash Construction Company was such a recreation from the demise of EBCA.

17. For example, government employees reported "dismissed" during one period are "redeployed" in another.

18. See, for example, the Interest Rate Proclamation (No. 29/1992) and the Monetary and Banking Proclamation (No. 83/1994).

19. The increase in the wages of low-income workers was first announced in the Ethiopian Herald (2 October 1992). The downward adjustment of the income tax over previous levels is also reflected in the amended income tax proclamation (No. 29/1992).

20. Reductions in the rates of sales and excise taxes are reflected in cost of production decreases [e.g. 37]. Raw material import difficulties were eased by allowing "franco-valuta imports" [24, 26, and 27]. Foreign exchange made available through the "auction system" and counterpart funds under the Economic Rehabilitation and Reconstruction Programme (ERRP) have also been used to finance the import of raw materials and industrial spare parts.

21. The export tax and duties cancellation proclamation (No. 38/1993), and the export incentive proclamation (No. 69/1993) were introduced to encourage export-gearred production.

22. Very few former public employees found accommodation in self-employment when retrenched.

23. A reinterpretation of the law (by default or elimination) suggests that the Ministry of Industry and the Investment Office of Ethiopia are to be concerned only with "large-scale" industries and "foreign investments" (Proclamation No. 41/1993, Art. 17). Even with this redefinition, the conflict with the regional bureaus over the right to issue licences is unresolved, since "large-scale" is not defined in the law.

24. "Temporary license" fees are in the range of 100 Birr (for an investment of upto 50,000 Birr) to 350 Birr (for an investment of 5 million Birr or more). See, Schedule III of the Industrial License Regulations (No. 8/1990).
25. Other constraints include malfunctioning labour exchange or placement machinery, generation of wrong labour market signals (e.g. the payment of high, above shadow, wages for political positions, use of non-economic criteria in labour selections, etc.
26. These perceptions of government employment policy and practice are widely reported in the private dailies and weeklies and in the monthly magazines. See, also [65]. For the position of government in this debate see, [47] [61, pp. 30-33]. There is a wide rift of opinion on the matter between government and various sections of the public.
27. (Proclamation No. 76/1975) sets the capital ceiling (excluding buildings and land improvements) at 200,000 Birr, although later this has been revised upwards.
28. Some reports indicate that some geographical mobility (especially rural to urban) as well as cyclical occupational mobility (especially from farming to self-employment) took place inspite of the restrictions [2,3].
29. The entire household membership faces economic hardships as a result of job losses by the household head.
30. The only social security scheme available for most public employees is the pension fund. According to present rules (Proclamation No. 199/1963), public employees contribute 4 percent of their gross income toward the scheme and on the basis of the Civil Service Commission Regulations become eligible after the age of 55.

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