

Macroeconomic and Labour Market Policies for Growth and Resilience to the Global Economic Crisis

A Background Paper Prepared for the Symposium Organized at the Occasion of the Celebration of the 90th Anniversary of the International Labour Organization (ILO)

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List of Acronyms

AGOA African Growth Opportunity Act

EBA Every Thing But Arms

SSA Sub-Saharan Africa

IMF International Monetary Fund

ODA Official Development Assistance

ILO International Labour Organization

FDI Foreign Direct Investment

HICES Household Income Consumption Expenditure Survey

WMS Welfare Monitoring Survey

MDGs Millennium Development Goals

SDPRP Sustainable Development and Poverty Reduction Program

PASDEP Plan for Accelerated and Sustained Development to End Poverty

TOT Turn over Tax

VAT Value Added Tax

TVET Technical Vocational Education Program

NBE National Bank of Ethiopia

MSE Micro and Small Enterprise

IHDP Integrated Housing Development Program

CSRP Civil Service Reform Program

ADLI Agricultural Development Led Industrialization

CSA Central Statistical Agency

MOFED Ministry of Finance and Economic Development

MOLSA Ministry of Labour and Social Affairs

LICs Low Income Countries

WEO World Economic Outlook

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Introduction

Ethiopia has had one of the fastest growing non-oil and non-mineral economy in SSA (IMF, 2008). Real GDP growth averaged 11.8 percent during the five year period ending in 2007/08. Overall real GDP growth is forecast at 11.2% for this fiscal year (2008/09), although the IMF put the growth prospect at 6.5% percent in view of the implication of the global slow down on the Ethiopian economy.

The global financial crisis has been evolving by the day and has now transformed in to economic crisis. The financial crisis has further deepened despite the various bails out and stimulus packages introduced by the advanced economies from where it has originated to start with. A recent Study by the IMF (March 2009) has summarized the current status of the financial crisis as follows: **“The impact of the financial turmoil on the real activity has become increasingly evident, propagating beyond its initial epicentres [the USA] to affect other advanced economies, emerging markets and Low Income Countries(LICs)”**.

Although some may like to believe that countries that are less integrated to the global economy are less affected by the global financial crisis, serious research works such as those conducted by the IMF shows that Low Income Countries (LICs) especially those in Sub-Saharan Africa (SSA) are likely to be impacted indirectly through various channels: decline in ODA flows, decline in demand for exports and air transport services, reduced tourist flows, less FDI, a decline remittances, etc. The study indicated that the impact in the medium-term is likely to be serious. The financial crisis and its antecedents also create a pressure on the budget especially in those countries with limited foreign reserves. The second round effects may also impair the financial services of the domestic banking system which in turn affects domestic economic activity in the LICs, particularly the SSA countries.

The cumulative impact of all these on employment and poverty is obvious depending on the degree of integration of countries to the global financial system. This paper, prepared as a background document for the Symposium organized at the occasion of the celebration of the 90th Anniversary of the International Labour Organization (ILO), to be held on the 28th of April 2009 here in Addis Ababa is aimed to taking up this agenda in the context of Ethiopia. The Symposium is part of the high-level national events on **“Social Dialogue on Decent Work for a Fair Globalization”** that are being planned in many other countries including Ethiopia.

The paper is entitled **“Macroeconomic and Labour Market Policies for Growth and Resilience to the Global Economic Crisis”** is structured as follows. Chapter I set the stage for subsequent discussions by providing an overview of recent socio-economic developments of the country. The role of fiscal policy in sustaining long-term growth and poverty reduction its achievements so far and the fiscal stress being felt in recent years is analyzed in Chapter II. Chapter III describes labour market policies/strategies and employment/unemployment status in Ethiopia. Notwithstanding the limitation on availability of comprehensive data/information on employment and unemployment, the status of current employment and its future prospects in view of the challenges will be assessed. The link between macro (fiscal policy) and employment creation will also be

discussed. Chapter IV outlines Government's Policy Responses for Resilience to the Global Financial and Economic Crisis. Here, the channels of transmission, their respective relative impacts and the degree of resilience to the challenges will be assessed. Here distinction will be made of pre-crisis immediate twin macroeconomic challenges and those possibly impacted indirectly by the global slow down. Chapter V summarizes and concludes.

I. Taking stock of Recent Socio-economic Developments

The last five years ending in 2007/08 witnessed annual average real GDP growth rate of 11.8 percent. This period has also witnessed the beginnings of two peculiar changes in the economic landscape of this country: a shift to a higher growth path and more diversified sources of growth. In the past (up until 2002/03), growth has been volatile due to terms of trade effects and weather induced fluctuations in the agriculture sector. However, following the recovery commencing in 2003/04, growth has been very much sustained and complemented by strong performance in the construction, manufacturing, trade and tourism, banking and insurance, and real estate sectors/sub-sectors. The construction sector has been spurred by the much needed public sector investment in infrastructure (roads, rural infrastructure development including food security, telecom, power, irrigation, etc) and private sector expansion as well. Even when the drought year of 2002/03 is included in to the computation of the growth performance in the recent past, real GDP growth averaged 9.5 percent (about 2 percentage point lower than the average growth excluding the drought year) during the six-year period ending in 2007/08 while real per capita GDP growth averaged 6.5 percent (Table 1.1).

Even with this adjustment for recovery from drought, the growth performance realized has been considered commendable. For instance, according to the May 2008 International Monetary Fund (IMF) Article IV consultation staffs Report, Ethiopia has had the fastest growing non-oil and non-mineral economies in Sub-Saharan Africa. This is well above the level of 7 percent per annum originally estimated to have been needed to reach the goal of halving the proportion of the population living below the poverty line. Real per capita GDP has been increasing at an annual average rate of about 7 percent during the four year period ending in 2006/07. Real per capita GDP has reached around USD\$205 by the end of 2007/08 from around USD\$120 in the mid-1990s¹.

One of the MDGs related to the growth performance of the economy is achieving Goal 1 of the MDGs. Pursuing broad-based growth through focusing on agriculture and rural development has been at the centre of Ethiopia's poverty eradication agenda. Based on the analysis of the 2004/05 Household Income Consumption Expenditure Survey (HICES), growth has been translated into significant poverty reduction, particularly in rural areas. Real per capita Consumption expenditure of average Ethiopians has increased by 50 percent on average over its level in 1995/96. This has resulted in a notable decline in poverty incidence from 47.5 percent in 1995/96 to 39.3 percent in 2004/05 in rural areas. Poverty gap index also declined from 13.4 percent to 8.5 percent in rural areas during the same period – signifying a decline in the depth of poverty. On the other hand, urban poverty incidence has increased from about 33 percent in 1995/96 to about 35.1 percent in 2004/05 although the depth of poverty has declined from 9.9 percent in 1995/96 to 7.7 percent in 2004/05.

¹ Ministry of Finance and Economic Development (MoFED). 2002. Sustainable Development and Poverty Reduction Programme. Addis Ababa, Ethiopia.

Table 1.1: Annual Percentage Change (Percent) in Gross Domestic Product (GDP)

Item	Annual Percentage Change						Five Years Average (Percent)	Average including Drought Year (2002/03)
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08		
Agriculture and Allied activities	-10.5	16.9	13.5	10.9	9.4	7.5	11.6	8.0
Industry	6.5	11.6	9.4	10.2	10.2	10.4	10.4	9.7
O/w: Manufacturing	0.8	6.6	12.8	10.6	8.3	7.1	9.1	7.7
O/w: Construction	13.6	19.5	7.5	10.5	10.9	11.3	11.9	12.2
Services	6.0	6.3	12.8	13.3	14.3	17	12.7	11.6
O/w: Distribution services	5.5	6.4	14.7	14.2	16	15.2	13.3	12.0
O/w: Other Services	6.5	6.1	10.9	12.5	13.1	14.2	11.4	10.6
Total GDP at 1999/2000 Constant basic prices :	-2.1	11.7	12.6	11.6	11.4	11.6	11.8	9.5
Real Per Capita GDP	-4.9	10.5	8.8	7.8	8.2	8.3	8.7	6.5
General Inflation	10.9	7.3	6.1	10.6	15.8	25.3	12.7	13.0

Source: MoFED

The poverty analysis work based on the 2004/05 HICES has pointed out that the growth impact of poverty reduction has been dampened by increased inequality particularly in urban areas as reflected by the significant increase in the Gini Coefficient (a measure of inequality) from 0.34 in 1999/00 to 0.44 in 2004/05. The increase in poverty incidence in urban areas has to a large extent been attributed to increased income inequality. On the other hand, in rural areas, inequality as measured by the Gini Coefficient has declined from 0.27 in 1995/96 to 0.26 in 2004/05. That seems to be the reason for the significant decline in income poverty in rural than in urban areas. The poverty analysis work based on the 2004/05 HICES also showed that the inequality elasticity of poverty stood at 1.8 in 2004/05. This means that as inequality measured by the Gini Coefficient increases by 1 percent (other things equal), poverty head count increases by 1.8 percent. This indicates that the Government has to undertake broad-based and pro-poor programmes (such as the urban housing programmes and Small and medium enterprise developments) in a more structured manner to redress inequalities through neutralizing the poverty increasing impact of inequalities in urban areas

Sustaining the hitherto achieved growth, among others, is central to achieving Ethiopia's development objectives. The on-going investment expansion in growth enhancing sectors: Roads, Telecommunication including Information Communication Technology (ICT), Power Sector Development including Universal Electricity Access Programme (UEAP) and

Irrigation development is meant to sustain the recent growth momentum in the coming years. The last three years commencing in 2005/06 has also witnessed the initiation of programs/projects with particular focus on urban areas.

The narrow base of the modern industrial sector in terms of job creation in the face of rural-urban migration may have contributed to increased poverty level in urban areas.

Table 1.2: Poverty in Ethiopia: 1995/96, 1999/2000 and 2004/05

Year/Period	National			Rural			Urban		
	P ₀	P ₁	P ₂	P ₀	P ₁	P ₂	P ₀	P ₁	P ₂
					Level				
1995/1996	0.455	0.129	0.051	0.475	0.134	0.053	0.332	0.099	0.041
1999/2000	0.442	0.119	0.045	0.454	0.122	0.046	0.369	0.101	0.039
2004/2005	0.387	0.083	0.027	0.393	0.085	0.027	0.351	0.077	0.026
	Percentage change (Percent)								
1995/96-1999/2000	-2.7	-7.7	-12.2**	-4.3*	-8.9**	-12.9*	11.1	2.0	-7.1
1999/2000-2004/05	-12.4**	-30.0***	-39.8***	-13.4***	-30.8***	-40.6***	-4.7	-23.6***	-33.5***
1995/96-2004/05	-14.8***	-35.4***	-47.1***	-17.1***	-37.0***	-48.3***	5.9	-22.1***	-38.2***

Source: MOFED, 2008

There have been significant developments in terms of pro-poor activities in urban Ethiopia since 2005/06. The on-going SME development activities, the urban Low Cost Housing Programs and the recently introduced Women and Youth packages are aimed at addressing urban poverty. The urban housing program complemented by the small and medium enterprise development is primarily aimed at achieving two objectives in tandem: addressing the housing problem and job creation for the urban unemployed.

Given that these interventions have been introduced recently, it is too early to assess what impact they will have on the conditions of the urban poor. But judged by what is already in the pipe line in the areas of urban development and housing and Small and Medium enterprise development across towns in Ethiopia, conditions for urban slum dwellers is expected to improve significantly in the remaining 7 years. Thus, there is a reason for optimism regarding the target of improving conditions for urban slum-dwellers. But the impact of the current inflationary pressure coupled with the attendants of the slow down owing to the global financial and economic crisis may have an offsetting impact on the on-going effort to reduce urban poverty in Ethiopia. This is the central theme of this paper and will be pursued in the subsequent chapters of this paper.

The Government's commitment towards poverty reduction and its ultimate eradication via pursuing broad-based pro-poor growth has been and still is very strong and well grounded. The policy and strategy framework across sectors has taken poverty reduction as their central objective. The Agricultural Development Led Industrialisation (ADLI) strategy seem to have begun to bear fruit as reflected in the shift in the growth trajectory of the Ethiopian economy during the last five years ending in 2007/08. There seem to be a sign of hope to transform subsistence farmers into producers of high value crops. The Government has put in place credible and functioning policies, strategies and programmes that reflect the realities of the country. The focus on human capital formation, infrastructure expansion, addressing

vulnerability to shocks, the decentralisation and empowerment process, the capacity building programme are all aimed at speeding up the transformation process on all fronts given the backlog of developmental deficits this country had incurred in the past. The developmental approach is holistic and all rounded.

Overall, Ethiopia is well poised to meet the MDGs if on-going efforts are sustained and scaled up during the remaining seven years. It is particularly worth noting that Ethiopia is on track to meet the education MDGs even with current trends. The Health, water and sanitation MDGs are also within its reach given the on going innovative programmes such as the Health Extension Workers Programme and the Universal Access Programme in regard to achieving Water and Sanitation MDGs provided resources are scaled up in the spirit of the MDGs.

The question being posed now and is to be analyzed in the subsequent sessions is whether the current socioeconomic development momentum would be maintained, how this could be achieved given the added challenges brought about by the global slow down compounded by the structural problems of the Ethiopian economy (low income and saving, low productivity, limited capacity and vulnerability to various shocks). The global focus on MDGs has been overshadowed by the events that followed the global financial and economic crisis. What could Ethiopia do in the midst of these developments through its macroeconomic policies (fiscal policy) to strengthen the resilience of the economy to the global crisis? The assessment will be particularly tuned towards the implication of the slow down on the labour market and how this could be reversed through creating an appropriate **'fiscal space'** consistent with addressing the macroeconomic imbalances currently faced by the Government of Ethiopia. The responses to the challenges need to be consistent with existing realities and the specific nature of the challenges being faced. For instance, the developed economies from where the crisis originate have been and are introducing various stimulus and bail out packages to stimulate demand. Those same prescriptions may not apply or may not even be feasible for Low Income Countries (LICs) in general and Ethiopia in particular. A tailor-made approach with focus on the supply side of the economy seems to be the best course of action to be pursued for countries like Ethiopia where accelerating growth while maintaining macroeconomic balances is of the essence.

II. The Role of Fiscal Policy in sustaining long-term Growth

2.1. Overview Ethiopia's Fiscal Policy

At this juncture, it is worth outlining the salient features of Ethiopia's fiscal policy landscape before embarking on the review of the outcomes of the policy and the tensions being felt while addressing emerging challenges as the global crisis takes its toll in the developed economies.

In the context of Ethiopia, Government's primary fiscal policy objective is to maintain a fiscal stance that is prudent and at the same time addresses the development needs of the country.

On the expenditure side, the focus of the Government is on maintaining the deficit at a sustainable level while at the same time increasing spending in key poverty oriented priority sectors. The Government also understands the need to balance the tremendous demands for services and investments with the need for macroeconomic discipline, which will protect the poor from inflation, and maintain the economic stability needed for private sector growth to **create jobs and income and there by help achieve the Government's overriding objective of poverty reduction and its ultimate eradication**. The Government's intention is to expand investments in education, health and infrastructure as fast as possible, but only to the extent affordable with rising domestic resource and aid inflows.

On the revenue side, the Government is determined to lay the foundation for strong revenue performance via rendering the domestic productive sectors of the economy (agriculture & industry) the revenue base of the country. The bulk of Ethiopia's tax revenue (about 50 percent) has been and still is generated from import duties and taxes which by itself is one source vulnerability as globalization and economic and trade integration sets in. The envisaged commercialisation of the agricultural sector and export-led industrial expansion are expected to be the major sources of additional revenue generation during the implementation of Ethiopia's Five Year Development Plan (2005/06-2009/10) entitled Plan for Accelerated and Sustained Development to End Poverty (PASDEP) and beyond. It is also expected that revenue performance will benefit fully from the tax reform measures implemented since 2001, including improved tax administration.

In terms of inter-governmental fiscal transfer, the fiscal transfer to regional governments will continue to be effected through a credible and transparent budget subsidy formula, and this will take into account criteria for equity and efficiency. With the view to deepening the decentralization process, *Woredas* are being fully empowered to take up expenditure and revenue assignments within their competence. The recently revised fiscal transfer formula was issued in May, 2007.

The on-going efforts to addressing implementation bottlenecks at the local level, strengthening efforts to transform the agriculture sector and the rural economy, the ongoing programme of export diversification and industrial expansion, the on-going infrastructure expansion and lagged effects of investments in human development,

promoting productive employment through strengthening small and medium enterprise development are expected to drive higher output growth and hence real GDP which will in turn help scale up domestic resource mobilization and hence its allocation to achieve the envisaged development objectives.

2.2. Fiscal Policy: What has it Achieved so far?

If the fiscal policy of the Government is to be judged by what it has produced during the recent past, the achievements so far could be reasonably rated as commendable. This could be seen against the following achievements. Looking at recent developments, tax revenue has been increasing at the rate of 24 percent over the five-year period ending in 2007/08. Looking back from the early 1990s, in absolute terms tax revenue increased from less than 2 Billion ETB in 1992/93 to about 24 Billion ETB by the end of 2007/08. This is more than twelve-fold increase in a space of one and a half decades.

However, the recent food price surge seems to have distorted this picture when tax revenue performance is seen in relative terms, i.e. as a ratio to GDP at current market prices. Although this is a standard measure of performance, the outcomes should not be taken at face value in view of two important factors: (i) agriculture's direct contribution to tax revenue being less than 1 percent of GDP while food inflation is the major driver of Ethiopia's inflation (ii) given that this relative measure is derived from two values reported in nominal terms both in the numerator (tax revenue) and denominator (GDP in current market prices). But the value in the denominator is the one most affected by the food price surge. Thus, the recent declining tendency in the tax to GDP ratio needs to be interpreted cautiously before jumping in to conclusions that puts a question mark on the existing tax policy. Tax holidays and exemptions are also factors that need to be factored in while before drawing unbalanced conclusions regarding tax policy.

On the expenditure side, the Government's fiscal policy has been driven by its commitment to expand economic infrastructure (particularly roads) and social infrastructures such as education and health facilities in its endeavor to expand human capital which are critical for sustainable growth and development. There is also investment expansion undertaken by the non-financial public enterprises such as the Ethiopian Telecommunication Corporation and Ethiopian Electric Power Corporation. These investments are undertaken from the resources of the respective enterprises without competing treasury resources. Infrastructure expansion by both the Government and its affiliated companies is believed to create conducive environment for private sector investment. Given the realities on the country, the Government of Ethiopia is of the view that public investment is pre-requisite for private investment to be forthcoming. The existing new trend in the distribution of private investment projects² across regional states (including in emerging regions) is a testimony to this. Although, investment expansion by public enterprises may not have direct fiscal implications, it has had a direct bearing on the balance of payment via their demand for foreign currency to the extent

² Ethiopian Investment Agency

their activity demands foreign exchange. This is what the government is being faced right now. On the other hand, addressing the on-going inflationary pressure has called for mobilizing treasury resources or otherwise tax cuts on some food items such as the VAT, TOT and sur-tax on some food items.

Financing the cost of social and economic development programmes and strategies is a key requirement to achieve the goals and objectives of national development plans such as the PASDEP and hence the MDGs. The MDGs are the minimum development objectives that Ethiopia should aspire for given its past developmental deficits. The PASDEP is a medium-term Plan that serves as a vehicle towards achieving Ethiopia's MDGs Plan and by extension Ethiopia's vision of becoming a middle income country in about 20 years time. Thus, in the context of Ethiopia, all efforts have been geared towards full-scale implementations of programmes articulated in the then SDPRP and now PASDEP.

The overall resource envelope constitutes domestic revenue and external grants while expenditure is composed of capital and recurrent expenditures allocations across sectors/functions. The resulting fiscal deficits have been bridged through external and domestic borrowing. The Government of Ethiopia has expanded its spending (particularly capital spending on priority pro-poor sectors) while keeping its fiscal deficit under close scrutiny.

Table 2.1: Recent Trends in Public Finance (In Million ETB)

Items	2001/02 Actual	2002/03 Actual	2003/04 Actual	2004/05 Actual	2005/06 Actual	2006/07 Actual	2007/08 Pre. Actual
Domestic Revenue	10409	11149	13917	15582	19530	21797	29794
O/w: Tax Revenue	7926	8243	10906	12398	14159	17354	23801
External Grants	2424	4554	4002	4565	3732	7583	9911
Domestic Revenue & Grants	12832	15703	17918	20147	23262	29381	39705
Recurrent Expenditure including SP	11526	14191	12238	13452	15284	17209	22794
O/w: Defence	2610	2341	2452	2920	3009	3005	3453
Capital Expenditure	6129	6313	8271	11343	14042	18398	24121
Total Expenditure including SP	17655	20504	20509	24795	29325	35607	46915
Fiscal Deficit including grants	-4823	-4802	-2590	-4648	-6064	-6227	-7210
Fiscal Deficit Excluding grants	-7247	-9355	-6592	-9213	-9795	-13810	-17121
Financing	4823	4802	2590	4648	6064	6227	7210
External (Net)	4905	3865	2399	2384	1512	1913	2396
Domestic (Net)	309	1653	2147	3492	2735	6246	6580
GDP @ Current Market Prices	66557	73432	86661	106473	131641	171834	245585

Source: Ministry of Finance and Economic Development (MoFED)

As a ratio to GDP at current market prices, total resource during the seven years period ending in 2007/08 averaged 18.8 percent of GDP at current market prices. On the other hand, total spending (allocation) averaged 23.4 percent of GDP at current market prices.

This has resulted in a fiscal deficit including grants of -4.6 percent of GDP at current market prices. The resultant fiscal gap has been financed from two sources: net external borrowing (2.9 percent of GDP at current market prices) and net domestic borrowing (2 percent of GDP at current market prices). This shows that total external financing (both grants and financing below the line) averaged 6.4 percent of GDP during the period ending in 2007/08. As shown in Table 2.2 below, net external borrowing (financing below the line) has been declining over the years, from 7.4 percent of GDP in 2001/02 to 1.0 percent of GDP in 2007/08 while net domestic financing of the deficit increased from 0.5 percent of GDP to 2.7 percent of GDP by the end of 2007/08. This shows that although external finance that passes through the budget seem to have increased significantly over the period in absolute terms (to around 1.5 Billion USD from around 500 Million USD towards the end of the 1990s), it has still been low seen relative to GDP at current market prices. External finance has also been levelling-off following the aftermath of the May 2005 Election.

Table 2.2: Recent Trends in Public Finance: As Percent of GDP at Current Market Prices (%)

Items	2001/02 Actual	2002/03 Actual	2003/04 Actual	2004/05 Actual	2005/06 Actual	2006/07 Actual	2007/08 Pre. Actual	Average 7- Years
Domestic Revenue	15.6	15.2	16.1	14.6	14.8	12.7	12.1	14.4
O/w: Tax Revenue	11.9	11.2	12.6	11.6	10.8	10.1	9.7	11.1
External Grants	3.6	6.2	4.6	4.3	2.8	4.4	4.0	4.3
Domestic Revenue and Grants	19.3	21.4	20.7	18.9	17.7	17.1	16.2	18.8
Recurrent Expenditure including special programmes(SP)	17.3	19.3	14.1	12.6	11.6	10.0	9.3	13.5
O/w: Defence	3.9	3.2	2.8	2.7	2.3	1.7	1.4	2.6
Capital Expenditure	9.2	8.6	9.5	10.7	10.7	10.7	9.8	9.9
Total Expenditure including Special Programmes³	26.5	27.9	23.7	23.3	22.3	20.7	19.1	23.4
Fiscal Deficit Including Grants	-7.2	-6.5	-3.0	-4.4	-4.6	-3.6	-2.9	-4.6
Fiscal Deficit Excluding grants	-10.9	-12.7	-7.6	-8.7	-7.4	-8.0	-7.0	-8.9
Financing	7.2	6.5	3.0	4.4	4.6	3.6	2.9	4.6
External (Net)	7.4	5.3	2.8	2.2	1.1	1.1	1.0	3.0
Domestic (Net) ⁴	-0.2	1.2	0.2	2.2	3.5	2.5	1.9	1.6
Domestic (Net): Banking and Non-Bank Sources	0.5	2.3	2.5	3.3	2.1	3.6	2.7	2.4

Source: Ministry of Finance and Economic Development (MoFED)

³ Special programmes are the demobilisation of soldiers and rehabilitation programmes which have arisen from the Ethio-Eritrea War.

⁴ In addition to net domestic bank and non-bank sources, this figure includes privatization receipts and float/unidentified financing.

The Table also shows that domestic revenue on average accounted for 14.4 percent of GDP during the seven-year period ending in 2007/08. It has been increasing at an average rate of 19.6 percent during the same period. Tax revenue on average accounted for over 11 percent of GDP during the same period. It has been increasing at an annual average rate of about 21 percent during the same period. The Table also shows that total resource (domestic revenue including grants) on average accounted for about 19 percent of GDP at current market prices during the same period. It has been increasing at annual average rate of about 21 percent during the same period.

The analysis above indicate the extent to which the current domestic revenue base has fallen short of the development needs of the country despite the fast increase in tax revenue over the last several years. The development need (spending) driven by front-loaded investment during the first three years of the PASDEP (2005/06 to 2006/07) has increased dramatically faster than recurrent expenditure. Even the budget composition has shifted from the dominance by the recurrent expenditure to that by capital expenditure. As shown in Table 2.3 below, the recurrent: capital mix successively declined from 69:31 in 2002/03 to 48:52. This means that the share of capital expenditure in total consolidated public spending increased from 31% in 2002/03 to 52% by the end of 2006/07. Capital expenditure witnessed a significant surge at an annual average rate of 26 percent per annum while recurrent expenditure increased by just half of this rate (at 13 percent per annum) during the same period. Capital expenditure as a ratio to GDP increased from 8.6 percent of GDP in 2002/03 to about 10 percent of GDP in 2007/08 while the recurrent component declined from 19.3 % of GDP in 2002/03 to a little over 9 percent by the end of 2007/08. But with in the recurrent expenditure, wages and salaries have been increasing at an annual average rate of 21 percent during the same period as depicted in Table 2.3 below. The significant increase in wages and salaries in 2005/06 (34.4%) is explained by increased salary scale for civil servants during the 2005/06 fiscal year.

Table 2.3: Trends in the Major Components of Recurrent Expenditures by Functional Classifications, Million ETB

Item	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Wages and Salaries	3789	4001	5162	5949	7995	9637
Materials	4130	4753	4441	4819	4881	5624
Wages and Operating Expenses	7919	8755	9603	10768	12876	15261
Total Recurrent Expenditure	10555	13527	11961	13219	15234	18552
Memorandum:						
Wages and Salaries as % of Total Recurrent Expenditure (%)	35.9	29.6	43.2	45.0	52.5	51.9
Wages & Salaries as % of GDP @ CMP	5.7	5.4	6.0	5.6	6.1	5.6
Annual Change in Wages and Salaries (%)		5.6	29.0	15.2	34.4	20.5
Recurrent: Capital Mix (%)	65:35	69:31	60:40	54:46	52:48	48:52

This significant surge in capital expenditure and the increase in wages and salaries signify the progressive increase in the scope and magnitude of government operations, particularly seen in the light of the devolution process that has been taking root in Ethiopia. The first wave of devolution and decentralization started in the mid 1990s (starting 1993/94), power having

been devolved and resources decentralized from the centre to regional states. The second wave of devolution and decentralization started in 2002/03 in which power has been further devolved and resources decentralized from the region to the *Woredas*. Since then, *Woredas* have become important centres of socio-economic activity in the four largest regional states of the country (Oromiya, Amhara, Southern Nations and Nationalities Peoples Region and Tigray). This demands huge resources (finance) and explains the increased size of Government operations.

The revenue generating capacity of regional states has been very much limited in which regions altogether on average account for about 21 percent of total consolidated revenue as shown in Table 2.4 below. On the other hand, the expenditure responsibilities of regional states are very huge. The ratio of total consolidated expenditure of regional states to that of consolidated general government expenditure increased from about 30 percent in 2002/03 to over 42 percent in 2007/08. Of the total consolidated expenditure of regional states, the recurrent component has increased faster from about 34 percent in 2002/03 to 62 percent by the end of 2007/08. The bulk of spending in this component is accounted for by social services which increased from 75 percent of regional recurrent expenditure in 2002/03 to over 80 percent in 2007/08. This is not surprising given the fact that social services (education and health) are the most decentralized activities. On the other hand, regional states' consolidated tax revenue share in total consolidated general government tax revenue remained at a mere 19 percent on average during the last six years ending in 2007/08 which calls for huge resource transfer from the federal government to regions.

Table 2.4: Key Regional Finance Parameters: As a ratio of the respective National Values (%)

Item	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Domestic Revenue	18.9	18.9	22.2	22.9	22.5	20.1	18.4	20.6
Tax Revenue	18.3	19.0	19.9	21.7	20.2	18.6	17.2	19.3
Total Expenditure	30.8	30.4	37.6	35.7	38.3	37.6	42.4	36.1
Recurrent	33.9	33.6	47.4	47.2	53.9	56.5	61.6	47.7
o/w: Social Services	71.2	75.3	80.8	81.9	82.2	81.1	80.4	79.0
Capital	25.0	23.3	23.2	22.0	21.4	19.9	24.3	22.7
o/w: Social Services	30	27.7	20.3	34.5	15.6	10.7	12.9	21.7

Table 2.5: Trends in Consolidated Regional Finance, Values in Million ETB

Item	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Domestic Revenue	1964	2105	3088	3571	4397	4385	5487
Tax Revenue	1453	1565	2165	2686	2854	3234	4092
Total Expenditure	5438	6234	7717	8849	11234	13386	19886
Recurrent	3906	4764	5799	6348	8236	9718	14033
Capital	1532	1470	1918	2501	2998	3668	5853
Domestic Revenue (National)	10409	11149	13917	15582	19530	21797	29794
Tax Revenue (NATIONAL)	7926	8243	10906	12398	14159	17354	23801
Total Expenditure(National)	17655	20504	20509	24795	29325	35607	46915
Recurrent Expenditure(National)	11526	14191	12238	13452	15284	17209	22794
Capital Expenditure(National)	6129	6313	8271	11343	14042	18398	24121

As noted above, given the existence of mismatch in aggregate own revenue mobilization and expenditure responsibilities vis-à-vis the federal government and regional states; block grant transfer is the most important source of financing for regional governments. Up until 2007/08, federal block grants accounted on average for 80% of the total regional resources. All regional states except the Addis Ababa City Administration benefited from Federal block grant system. In recent years, the growth of Federal transfers to Regions via the federal block grant formula has been significant. The average increase in the block grant transfer from the federal government to regions was about 12% between 2001/02 to 2004/05. Since then, the rate has increased significantly to 45% in 2007/08(MOFED, 2008). Overall, federal transfers to regions have almost tripled in a period of 5 years, from 4522 Million ETB in 2002/03 to 13532.5 Million ETB in 2007/08.

The priority sectors of the Government as outlined in PASDEP are to a larger extent administered and financed by the regional governments. Thus, to attain the various targets articulated in the Plan, it is of paramount importance to scale up financial resources at regional and *Woreda* levels. More over, the *Woreda* decentralization process requires more financial resources, aggressive capital expenditures financed projects being implemented at regional and *Woreda* levels even by the federal government including the construction of elementary and secondary schools, training of agricultural and health extension workers, construction of health facilities & erection of water facilities.

Thus, expansion of the various government services at the grass root level requires more financial resources at regional and *Woreda* levels. Along side the block grant transfers, there are a number of specific purpose grant transfers from the federal government to regional states. Specific purpose grants are federal resources and are indicated in the budget lines of federal executive bodies. However, actual budget execution is the responsibility of regional governments. Food security, Productive Safety Net Program (PSNP), Public Sector capacity Building (PSCAP), HIV/AIDS and Water, Sanitation and Hygiene (WASH) programs currently consists of specific purpose grants. These programs account for a larger proportion (about 23%) of the total regional spending from regional budgets in 2007/08.

Overall public spending on pro-poor sectors increased from about 43 percent of total public spending in 2001/02 to over 64 percent by the end of 2007/08. As a share of GDP, over all public spending on pro-poor sectors more than doubled from about 6% in 2001/02 to over 12 percent by the end of 2007/08. The government has taken various efforts to increase budget allocation to priority pro-poor sectors such as education, health and HIV/AIDS, water and Sanitation, agriculture and rural economy, food security and roads.

On average, over 90 percent of capital budget has been allocated to pro-poor growth enhancing and social sectors: Agriculture, Rural Development and Food Security, Roads, Irrigation, Water Supply and Sanitation, Education, Health and HIV/AIDS.

Table 2.6: Trends in the Share of Pro-Poor Sectors' Spending in Total Public Spending (%)

Sector	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	7-Year Average
Education	15.0	16.6	20.6	19.8	21.8	23.7	21.3	19.8
Health	6.3	5.1	4.3	4.9	4.6	6.6	7.3	5.6
Agriculture and Food Security	8.5	7.2	12.2	15.0	15.2	12.9	11.7	12.3
Road	11.3	10.3	9.7	11.3	12.4	14.1	17.9	12.3
Water and sanitation	4.2	4.1	3.3	6.0	6.1	5.7	6.1	4.1
Total	45.3	43.3	50.1	57	60.1	63	64.3	54.2
Memorandum Item: Spending on Poverty-Oriented Sectors as a Ratio to GDP at CMP (percent)								
Poverty-Oriented Spending	6.1	11.7	11.7	13.2	13.4	13.0	12.2	11.8

The role of external finance in shaping the fiscal landscape of the country is significant as it stands now. On average, external finance accounts for about 34 percent of total capital expenditure during the seven -year period ending in 2007/08. It is to be noted that the Government of Ethiopia has been known for its fiscal prudence for keeping recurrent spending within its available means even at the worst of times. After the 1994/95 fiscal year, a good share of development expenditure has been increasingly financed from treasury resources. The share of treasury resources in capital expenditure has been consistently increasing from about 45 percent in 2001/02 to about 76 percent by the end of 2007/08 while the share of external resources has declined from 56 percent in 2001/02 to about 24 percent during the same period (end of 2007/08).

As noted earlier, the external component of deficit financing has been on the decline since 2001/02. The impact has been severe particularly since 2005/06 and has not recovered since then. This has been accompanied by an increase in the domestic component of deficit financing which reached its peak in 2006/07(3.5 percent of GDP). This may have contributed its part to the inflationary pressure witnessed since 2005/06. But attributing the current inflationary pressure to the increased public expenditure may not be warranted as a host of other structural and demand factors including increased world prices are believed to have impacted on the current inflationary pressure.

Table 2.7: Composition of General Government Capital Expenditure (In Millions Ethiopian Birr)

Item	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	Actual	Actual	Actual	Pre. Actual	Pre. Actual	Pre. Actual	Budget
Domestic Source	2741	3265	5403	8376	10785	13832	18277
External Loan	2275	1852	1821	1454	1061	1484	1810
External grants	1112	1197	1047	1513	2196	3081	4034
External Total	3387	3049	2868	2967	3257	4565	5844
Total Capital Spending	6128	6314	8271	11343	14042	18397	24121
Share of Treasury (%)	44.7	51.7	65.3	73.8	76.8	75.2	75.8
Share of External Loan + Assistance (%)	55.3	48.3	34.7	26.2	23.2	24.8	24.2

Regarding the current debt situation (external debt) of the country, the Multilateral Debt Relief Initiative (MDRI) was agreed in 2006, following the Heavily Indebted Poor Countries (HIPC) debt relief agreed in 2005. Both initiatives have helped reduce Ethiopia's external public debt significantly. According to the IMF's Article IV Consultation Staff Report⁵, Ethiopia's external debt stock has declined from about \$6.2 Billion USD in 2001/02 to \$2.3 Billion USD by the end of 2006/07 (as at June 2007).

As a result, total stock of external public debt as a ratio to GDP also declined from nearly 84 percent of GDP in 2001/02 to about 13 percent of GDP by the end of 2006/07 (as at June 2007). As a result, debt ratios have fallen well below the sustainability thresholds. For instance, the Net Present Value (NPV) of debt to exports ratio stood at around 40 percent by the end of 2006/07 (as at June 2007). Besides, external debt service as a ratio of exports of goods and non-factor services has also declined from about 8 percent in 2002/03 to 5 percent by the end of 2005/06. This leaves a significant fiscal room (space) for Government's growth-oriented endeavour such as investment financing especially in the infrastructure and human development sectors. The Government is still committed to continue seeking grants and concession loans; and all the loans contracted after the HIPC completion point (March 2004) are on a highly concessional terms. The impact of new loans and the huge financing need for the PASDEP on the existing portfolio is critically viewed against the issue of debt sustainability.

The Ministry of Finance and Economic Development has already prepared a debt management strategy, which is updated every year. The strategy is used to gauge the level of debt sustainability indicators such as debt service to export ratio, Net Present Value (NPV) of debt to GDP ratio, NPV of debt to export ratio, etc. and considers alternative scenarios, mainly checking sensitivity to export shocks and real economic growth rates.

⁵ International Monetary Fund (IMF), The Federal Democratic Republic of Ethiopia. July 2008. Statistical Appendix, IMF Country Report No. 08/260.

2.3. Fiscal Stress in the face of maintaining Macroeconomic Stability: A Diagnosis

From the foregoing review, the recent features that characterize the Ethiopian fiscal landscape could be summarized as follows: significant increase in spending driven by capital expenditure on pro-poor priority sectors and the recurrent component driven by spending on wages and salaries, increase in tax revenue collection albeit not commensurate with spending needs, a lag in external finance flows though it increased modestly in absolute terms.

Has fiscal policy been expansionary? Has actual fiscal performance (both in terms of spending and revenue collection) fallen short of the budget? What are the characteristic features of an expansionary fiscal policy? Could the current inflationary pressure be attributed to fiscal expansion?

Fiscal deficit including grants as percent of GDP could be one important indicator of expansionary fiscal policy. The other related indicator is domestic bank borrowing as percent of GDP. But it is difficult to tell their respective threshold levels above which they are rendered expansionary. What is important is to see those indicators against the prevailing level of inflation and the behaviour of other related macro variables.

Fiscal deficit including grants was projected at about 6 % of GDP on average during the PASDEP period while inflation was targeted at 8 percent on average. Domestic bank borrowing was also projected at 4 percent of GDP during the period of the PASDEP. The implicit message in the higher level of projected deficit and domestic borrowing rates was that external resources need to be scaled up in the course of implementing the PASDEP. This is because external finance flow was projected with business as usual scenario in the PASDEP although costs were supposed to be MDGs-consistent.

Looking at the out-turn for the first three years of PASDEP implementation, fiscal deficit including grants stood at 3.9%, 3.6% & 2.9% in 2005/06, 2006/07 and 2007/08 respectively. Net domestic bank borrowing as % of GDP stood at 3.5%, 2.5% and 1.9%, respectively. Judged by the three-year average alone, the outcome for both parameters has been way below the target in the PASDEP. One of the reasons for the increase in net domestic bank borrowing in 2005/06 is the huge decline in external finance following the aftermath of the May 2005 election. From the out-turn figures, one can easily judge that fiscal deficit has been checked within limits taking into consideration external finance flows. For instance, a threshold deficit level of 3% was considered a 'red line' until recently. This has changed recently (since the first quarter of 2008/09) with the elimination of domestic bank borrowing aimed at addressing macroeconomic imbalances that are being faced by the Government. Looking at past trends, fiscal deficit has been higher in the pre-PASDEP periods. But this was accompanied by higher external finance flows. The post-PASDEP period has been characterized by a surge in public spending with a less commensurate increase in external finance flows.

How big Ethiopia's fiscal deficit compared to its SSA peers? According to the IMF's Regional Economic Outlook (April 2008), in 2006/07, fiscal deficit including grants averaged 3.2 % , 3.9%, 0.8% and 2.3% for Kenya, Tanzania, Rwanda and Uganda respectively. Their respective inflation rate stood at 9.8%, 7.0%, 9.4% and 6.8% during the same year. As noted above, Ethiopia's fiscal deficit including grants averaged 3.6% while inflation averaged 16% on annual moving average basis. Thus, Ethiopia's fiscal

deficit is very much comparable to that of its SSA peers. What makes it a concern is when it is seen against the inflationary situation that Ethiopia has been in recent years, particularly since 2005/06.

The expansion of public universities which increased from 8 in the pre-PASDEP period to 21 currently, the deployment of over 50,000 agricultural extension workers, the launching of the health extension workers program (HEP) with a phased deployment of health extension workers with a target of reaching 30,000 (with 84% already deployed by the end of 2007/08), the implementation of the road sector development programs have been shaping the fiscal landscape of the country in recent years.

This is consistent with the increase in wages and salaries with in the recurrent component of public spending as noted above. As will be seen in the next section on labor market policies and strategies, the number of public employees has increased from its level in the early 2000. For instance, the number of federal government employees increased by about 92 percent in 2006/07 compared to its level in 1999/00 while regional government employees increased by about 65 percent. At national level, government employees increased by about 68 percent (annual average increase of about 9 percent). In 2006/07, regional states altogether account for about 90 percent of government employees.

Short falls from the budget in both resource allocation and revenue mobilization have been examined taking per capita values in both cases. The short-fall in spending has been more significant than the short fall in tax revenue collection. For instance, total capital expenditure fell short of the budgeted amount by an average of 12 percentage point. This is largely attributed to short falls in the external component of the budget (loans and grants). On the other hand, tax revenue fell short of the budgeted amount by an average of 5 percentage points.

Table 2.8: Trends in Per Capita Public Resources & Spending (Actual Versus Budget), ETB

Item	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Expenditure							
Actual Expenditure	279.4	316.4	308.4	363.0	418.9	491.8	626.4
o/w : Recurrent	182.4	219.0	184.0	197.0	218.3	237.7	304.3
Capital	97.0	97.4	124.4	166.1	200.6	254.1	322.0
Budgeted Expenditure	284.0	315.7	323.0	411.9	501.4	577.8	700.9
o/w : Recurrent	189.4	203.9	201.0	212.8	231.2	266.2	331.7
Capital	94.7	111.8	122.0	199.1	270.2	311.7	369.2
Domestic Revenue							
Actual	164.7	172.1	209.3	228.1	279.0	301.1	397.8
Budget	185.1	202.4	197.6	264.8	311.7	354.8	445.1
Tax Revenue							
Actual	125.4	127.2	164.0	181.5	202.3	239.7	317.8
Budget	132.5	144.0	156.9	195.7	221.6	256.5	326.4
External Grants							
Actual	38.4	70.3	60.2	66.8	53.3	104.7	132.3
Budget	53.4	43.1	70.3	85.7	103.3	122.1	140.9

Table 2.9: Trends in the Ratio of Actual Per Capita Outcomes and Per Capita Budget (%)

Item	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	Average
Total Expenditure	0.98	1.00	0.95	0.88	0.84	0.85	0.89	0.91
Recurrent	1.0	1.1	0.9	0.9	0.9	0.9	0.9	0.95
Capital	1.0	0.9	1.0	0.8	0.7	0.8	0.9	0.88
Domestic Revenue	0.89	0.85	1.06	0.86	0.90	0.85	0.89	0.90
Tax Revenue	0.95	0.88	1.05	0.93	0.91	0.93	0.97	0.95
External Grants	0.72	1.63	0.86	0.78	0.52	0.86	0.94	0.90

The other dimension has to do with the financing of non-financial public enterprises (telecom and power) activities. There has been huge expansion by those public utilities in the areas of rural telecom and power. This has been considered essential as it is expected to facilitate the activities of private business operators all over the country. The utilities finance their operation from their own resources and have no direct fiscal implication. Their impact has been felt through the pressure on the balance of payment to the extent that their activities demand foreign currency. But the demand pressure on the overall economy given that supply response could not be automatic should not be understated. Related to this, the Government has decided to reduce public enterprise domestic borrowing from 4.4% of GDP in 2007/08 to 2.5% of GDP in 2008/09 and subsequently monitor their borrowing

In conclusion, fiscal stress has been accentuated by the lower than expected flow of external finance in the spirit of implementation of the PASDEP and hence MDGs. The high-growth and high-inflation situation made it susceptible to expansionary fiscal policy. However, still the out turn for key fiscal targets has been far lower than the plan. It is also noted that the expansion of government operation have been aimed at building the human capital and infrastructure base of the country which is a pre-requisite for sustained growth through creating a conducive environment for private sector development and job creation.

The fiscal stress could be relieved through pursuing the on-going improvement in tax administration and revenue collection and at the same time broadening the tax base (this could be a medium-term undertaking). In the short-term, it is important to further prioritize spending through still focusing on growth enhancing sectors and delivery of social services to the poor and vulnerable. Strict follow up on tax holidays/exemptions granted to attract private investment as the period of exemption lapses so that they are captured in to the formal tax system is also of paramount importance.

III. Labour Market Policies/Strategies and Employment Status in Ethiopia

3.1. The Overall Policy/Strategy Direction for the Labour Market in Ethiopia

As it stands now, there is no comprehensive national employment policy/strategy in the country. An employment Strategy Paper is currently under preparation by the Ministry of Labour and Social Affairs (MOLSA) with technical and financial support from the ILO Office in Addis Ababa.

However, this does not mean that there is a policy/strategy vacuum in the Labour market. The Government has pursued a holistic approach in addressing the employment /unemployment agenda. To start with, one important dimension of the ADLI Strategy is its focus on adequately utilizing the labour resources of the country. Industrialization being the ultimate goal of ADLI, the focus in industrial development is also on labour intensive agro-processing industries.

The on-going preoccupation on small and medium-enterprise development (SMEDs) with the necessary interface with TVETs is also aimed at creating job opportunities for the youth. The urban low cost housing program initiated recently is also aimed at achieving two objectives in tandem: addressing the housing problem and creating jobs. The on-going youth and women's package is also aimed at addressing the employment agenda. More over, the government strongly believes that the private sector should be the biggest and ultimate employer. The hither to effort in expanding infrastructure and human capital is all meant to create a conducive environment for the operation of the private sector which in turn would help expand employment generation. As articulated in the PASDEP, one of the pillar strategies of the PASDEP is job creation.

In general, when it comes to assessing the impact of growth on employment creation, the growth process is more important than the growth itself. For any growth to impact on job creation and help reducing poverty, it needs to be broad-based and pro-poor. What does pro-poor broad-based growth mean? The focus needs to be on enhancing income earning capacity of people, particularly youth and women. Enhancing productivity of both land

and labour through building human capital has been and still is the direction pursued by the Government of Ethiopia in its endeavour to concurrently address the unemployment/employment agenda. The overwhelming fact of the labour market in Ethiopia is the rapid growth of the supply of labour. The labour force is growing much more rapidly than the population as a whole because of Ethiopia's demographic profile. There are many more under 15 year olds entering the work force each year than there are old people living the labour force.

3.2. The Status of Employment/ Unemployment and its Prospects

Making a formal link between economic growth and employment has been hindered by lack of comprehensive adequately disaggregated and consistent time serried data on employment/unemployment that let us track the links between economic growth and employment creation. The central Statistical Agency has been providing labour force and related data with varying scope. These include the 1976 Addis Ababa Man Power and Housing Sample Survey, the 1978 Survey on Population and Housing Characteristics of Seventeen Major Towns, the 1980/81 and the 1987/88 Rural Labour Force Surveys and the 1984 & 1994 Population and Housing Census. The 1996 and 2002 Informal sector surveys also provide relevant information (CSA, 2006).

However, the results of these survey programs have not been comparable to enable researchers consistently track developments in the labour market. Comprehensive national labour force information representing both the rural and urban areas was recently provided through the 1999 and 2005 Labour Force Surveys. The CSA has also launched a biannual Employment Unemployment Survey in October 2003 and April 2004 and for the third time in April 2006. This survey program is intended to cover only urban areas given that unemployment is an urban rather than a rural phenomenon. Urban unemployment, particularly youth unemployment has been and is growing areas of concern for the Government. It has been indicated by the CSA that this program will be conducted in a regular manner in the years to come.

According to the 2006 Urban Employment Unemployment Survey, urban unemployment has consistently declined from 26.2 percent in 2003 to 22.9 percent in 2004 and further to 16.7 percent in 2006. Unemployment rate has been consistently higher among females than males across the years, 35.2% in 2003, 30.6% in 2004 and 22.1% in 2006. The corresponding rates for males stood at 17.6%, 15.8% and 11.5% respectively.

The other side of the coin is urban employment. This part of the paper provides an overview the urban employed population Ten years and over by major occupations and by major industrial divisions they are engaged in and by type of employer (employment status).

Looking at the employed population by major occupations, the just cited survey showed that nearly three-fourths of urban employed population of the country is engaged in three almost equally important major occupations, namely: services, shop and market sales workers (25.5 percent), elementary occupation (23.6 percent), and craft and related activities (22.1 percent). Professionals together with technical and associate professionals make up about 10 percent of the employed population while those persons working in legislator and senior officials took the smallest share constituting 2.5 percent of the total employed urban population of the country.

Looking at the employed population by major industrial divisions, as expected, most urban employed population are absorbed by wholesale and retail trade, and manufacturing activities, making up 22.7 percent and 15.3 percent, respectively. Those who are engaged in hotel and restaurant, public administration, private households; agriculture; education, health and social work; other social, cultural and personal and household activities constitute 7 to 10 percent. Extra-territorial organizations; mining and quarrying; financial intermediation, electricity, gas and water supply and real estate contributed little share in terms of creating employment.

Looking at the distribution of urban employed population by employment status of a person, at country level (urban) level, the bulk of employed population was constituted by self-employed (41.8 percent) followed by those employed by government and public enterprises (18.8 percent) and private organization (18.2 percent). As can be seen from

the Table below, paid employees altogether constituted about 45.4 percent of the total working population. Paid employees consist of employees of government, public enterprises, private organization, and NGOs and Domestic employee. Unpaid family workers have a substantial share (10 percent). The information in summary Table 3.1 further shows that males are dominant in paid employment. The proportion of private organization employees among the males is about twice that of the females. Similarly, the proportion of males in government employees is more than one and half times higher as compared to their female counterparts. However, higher proportion of females than males are found among domestic employee and unpaid family workers. The proportion of females in self-employment also exceeds that of males.

As noted above, the only comprehensive and consistent time series data/information available on employment is the one generated through the 2006 urban employment/unemployment survey conducted by the CSA in April 2006. This provides at least the big picture though still not amenable for further disaggregation to see other dimensions such as the informal sector. Those engaged in this important activity seem to be lumped in either of the categories of self-employed unpaid family workers employers, etc. According to this survey, the total number of employed population ten years and over in 2006 stood at 3,839,274 of which 55% are males and 45% are females.

As shown in Table 3.1 below, the number of Government employees increased by about 26 percent from October 2003 to April 2006 while that of public enterprises showed 8 percent increase over the same period. The number of employees of Private Organizations increased by 57 percent over the same period while that of NGOs increased by 35 percent. Domestic employees dropped by 13 percent during the same period. The self-employed, unpaid family workers, employers and 'others' witnessed an increase of 34%, 57%, 71% and 170%, respectively during the same period. This shows that the biggest increases have been witnessed by members of cooperatives and apprentices (170%) followed by employers (71%) private organization employees (57%), self employed (57%) and government (26%)

As indicated in the Table, with in paid employment, private organizations have become increasingly important in absorbing the labor force as shown by the increase in its share of employed population from 16% in 2003 to 18% in 2006(about 2 percentage point increase in three years). As noted above, it also witnessed a significant increase (57%) in the number of employed persons between 2003 and 2006. The Government (proper) is the second biggest employer with in paid employment accounting for 17 percent of total employed population (a decline of 1 percentage point from 2003).

It is to be noted that this is consistent with Government policy that the private sector will be the ultimate employer in the future as it gains momentum. Self employment being the largest single employer out side of paid employment constituting 42% of the employed population in 2006. It has remained constant compared to its relative importance in 2003.

Table 3.1: Trends in Number of Employed Population Ten Years of Age and Over by Employment Status (Number)

Employment Status	October ,2003			April 2004			April 2006		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Paid Employment	830550	537292	1367842	846916	562773	1409690	1009920	731355	1741275
o/w: Government	356648	167212	523860	370627	181857	552484	428324	229309	657632
Public Enterprises	39085	20902	59986	40639	18431	59070	41993	22583	64576
Private Organizations.	320820	124180	445000	334865	136393	471258	457718	239732	697450
NGOs	39085	14754	53839	40639	15974	56613	48291	24321	72612
Domestic	74912	210245	285157	60146	210118	270264	33594	215411	249005
Self Employed	649783	550817	1200600	648598	530826	1179424	850349	753939	1604287
Unpaid Family Workers	113997	130327	244324	84529	121648	206177	163771	220623	384393
Employers	11400	4918	16318	11378.91	4915	16294	20996	6949	27945
Others(Members of COPs, Apprentice,etc)	22799	7377	30176	34137	6144	40281	58790	22583	81373
Total	1628529	1230732	2859261	1625559	1226305	2851864	2103825	1735449	3839274

Source: The 2006 Urban Employment Unemployment Survey, CSA, July 2006⁶

Table 3.2: Trends in the Share of Total Employed Population Ten Years and over by Employment Status and Year (%)

Employment Status	October 2003			April 2004			April 2006		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Paid Employment	51	44	48	52	46	49	48	42	45
Government	22	14	18	23	15	19	20	13	17
Government Enterprises	2	2	2	3	2	2	2	1	2
Private Business	20	10	16	21	11	17	22	14	18
NGOs	2	1	2	3	1	2	2	1	2
Domestic	5	17	10	4	17	9	2	12	6
Self Employed	40	45	42	40	43	41	40	43	42
Unpaid Family Workers	7	11	9	5	10	7	8	13	10
Employers	1	0	1	1	0	1	1	0	1
Others(Members of COPs, Apprentice,etc)	1	1	1	2	1	1	3	1	2
Total	100	100	100	100	100	100	100	100	100

Source: Computed based on Data in Table 3.1 above

⁶ The discrepancy observed between the figures in this Table and the Survey results is due to Rounding in calculating the levels using the ratios provided in the Survey Report

The objective of this paper is to analyze fiscal policy and its interface with labor market policies with the ultimate objective of assessing their resilience to the global financial and economic crisis. Thus, additional insight with direct fiscal implication could be drawn through further analyzing information on Government employees (civil service employees). The findings drawn based on the information from the Urban Unemployment Employment Survey (in regard to Government Employees) and those derived from the Annual Civil Service Statistics are very much complementary. The conclusions drawn are at least consistent.

Here the information is analyzed from the fiscal perspective. The significant increase in the wages and salaries component of the recurrent expenditure seems to be in part attributed to the increase in government employees both at federal and regional level. Two data points have been used in the trend analysis (the earlier year being 1999/00 and the latest year being 2006/07). As shown in Table 3.3 below, total number of regional states employees increased by over 65 percent over the eight year period (annual average increase of 8 percent). The total number of federal employees has increased by about 98 percent over the period. This is equivalent to an annual average increase of about 12 percent per annum). What is more interesting here is to see that this significant increase has been largely driven by the increase in female employees at federal level by about 360 percent over the period (an annual average increase of 45 percent during the period). The increase in the number of female employees at regional level has also been remarkable. The number of employees at country level has increased by about 68 percent (male 55% and female 102%). This increase in the number of government employees must have been attributed to the deployment of health extension workers, the deployment of agricultural extension agents and the hiring of staff to the newly established public universities. Regional states employees accounted for 90% of total government employees in 2006/07.

Table 3.3: Trends in Federal and Regional States' Employees between 1999/00 and 2006/07

	1999/00			2006/07			2006/07 Change over 1999/00 (%)		
	M	F	T	M	F	T	M	F	T
Regional Governments Total	210994	83951	294945	331519	156274	487793	57.1	86.1	65.4
Federal Government Total	24407	5272	29679	32643	24268	56911	33.7	360.3	91.8
The Whole Country	235401	89223	324624	364162	180542	544704	54.7	102.3	67.8

Source: Federal Civil Service Agency, Annual Civil Service Statistics, June 2007

In conclusion, it is unlikely that employment will be expanding at the pace exhibited in the recent past. It may have been essential given the increased volume government operations both at federal and regional levels. The business process re-engineering (BPR) program currently in progress will help further streamline civil service operation with the ultimate objective of creating a civil service that is efficient, transparent and accountable. This would help save government's costs in delivering services to its citizens. Moreover, the operation of the private sector will be further enhanced as bureaucratic bottle-necks are removed through the BPR. This would help relieve the fiscal stress that is currently being felt.

Thus, the future for employment expansion is with the private sector as evidenced by the findings above. Macro policies such as interest rate and credit policies may need to be

reviewed with the objective of further stimulating private sector development with particular focus on small and micro enterprises development (SMED) which is strategically linked to large enterprises to enhance more value addition. This would help enhance vertical integration through strengthening complementarities within the domestic economy.

Currently private employment opportunities are being created through sustained government effort to enhance private sector investments, a big push in infrastructure development, expanding services industry and promoting the ever rapidly growing horticulture industry.

The Government's program focuses on strengthening the small-scale manufacturing enterprises, as they are the foundation for the establishment and intensification of medium and large scale industries besides opening opportunities for employment generation for those not engaged in the agricultural sector. It also serves as a source of alternative/additional income for those involved in agriculture. Achievements in the areas of textile and garments, metal and woodwork, food processing, construction work, municipality services could be cited as best practices. For instance, on-going efforts in this area have contributed towards reducing unemployment rate in Addis Ababa.

According to the Annual Progress Review Report on the first three years PASDEP implementation (MOFED, 2008), during 2006/07 and 2007/08, about 22,275 and 57,607 micro and small enterprises (MSEs) were organized and promoted, respectively. During the period, through the promotion of 199,467 MSEs, 515,000 job opportunities were created. The achievement in terms of job creation & MSEs Development are the outcomes of the multidimensional supports provided for the MSEs. The following are the major ones:

a) **Creating enabling environment:** In order to improve the regulatory environment for MSEs, one stop service centres have been established in all major cities and towns. A total of 760 one stop service centres have been opened and started operation between 2006/07 and 2007/08. These centres have helped to improve regulatory and related municipal services accorded to MSEs;

b) **Providing industrial extension services:** About 4000 extension agents have been working in the MSEs Development program delivering industrial extension service to small businesses in cities and towns all over the country;

c) **Availing credit:** In line with the MSEs development programme, a total of Birr 436.3 million and Birr 651.7 million had been supplied by all regional MFIs for the MSEs in 2006/07 and 2007/08, respectively;

d) **Provision of working premises:** Another area of support provided for the MSEs has been alleviating of the shortage of production premises. Accordingly, the construction of production premises had been completed and handed over for the MSEs organized in all regions.

e) **Creating market linkages:** Another area of support provided to MSEs is in the area of creating market linkage. Accordingly, significant effort has been made to link MSEs with government construction works particularly with the on-going Integrated Housing

Development Program (IHDP) spearheaded by the Ministry of Works and Urban Development. Encouraging linkages have also been created among MSEs engaged in the food processing sector.

f) Creating linkages between TVET and MSEs: In view of achieving technology development and its transfer, significant stride has been made in creating linkage between TVET and MSEs.

With regard to the informal sector, interventions need to be devised to render the informal sector more productive. The focus should be on enhancing their capacity through devising holistic and structured programs to increase productivity of the sector. The vertical and horizontal linkages with in the respective activities of informal sector operators need to be given the utmost emphasis. As it stands now, the sector does not seem to be integrated with the formal (modern) sector. There is no latest Survey on Informal Sector. The first was conducted in 1996 followed by the last in 2002. According to the 2002 Informal Sector Survey conducted by the CSA, the total number of persons engaged stood at 997,380 of which 799,353(80%) were operators and the remaining 198,027(20) employees. Women dominate in both categories (operators and employees). The share of women in the total number of persons engaged, operators and employees stood at 60%, 59% and 65% respectively.

Table 3.4: Distribution of Number of Persons Engaged in the Informal Sector by Sex: 2002

Sex	Operators		Employees		Total No. Persons Engaged	
	Number	(%)	Number	(%)	Number	(%)
Male	328,808	41.13	70,276	35.49	399,084	40.01
Female	470,545	58.87	127,751	64.51	598,296	59.99
Total	799,353	100.00	198,027	100.00	997,380	100.00

Source: Survey of the Informal Sector

IV. Policy Responses for Resilience to Global Financial and Economic Crisis

The discussion above has documented the salient features of Ethiopia's fiscal policy regime and its outcomes. This has been complemented by an overview of the policy/strategy orientation towards the labour market in Ethiopia followed by a review of the employment/unemployment situation and its prospects in Ethiopia. This sets the stage for the assessment of the possible impact of the global financial and economic crisis on Ethiopia. This section being the culmination of the discussion will dwell on outlining Government's policy responses aimed at mitigating the impact of the crisis, assessing the degree of vulnerabilities and possible impacts and the possible channels of transmission. This chapter culminates with assessing the degree of resilience to the challenges /crisis.

On the eve of the global financial crisis and even when it has been taking root in the developed world, Ethiopia has been grappling with challenges of global dimensions such as the food crisis and the oil price shock. The unprecedented oil price increase has depleted the country's foreign reserves. The recent drop in oil prices has been a huge relief and has helped build international reserves. Although food prices have begun to decline globally, they have not yet declined as desired in Ethiopia. Thus, the impact of the global financial crisis is an additional dimension to the challenges already faced by Ethiopia. Thus, the policy responses to the pre-crisis challenges and post-crisis challenges need to be properly tailored.

To start with, the existing major structural challenges that characterize the Ethiopian economy have had direct bearing on the resilience of the macro economy to shocks (both external and internal). The common structural bottlenecks include: Low level of income and saving, still low level of productivity of the agricultural sector, the economy's vulnerability to shocks (drought and terms of trade shocks), limited implementation capacity, particularly at lower levels of administration, low level of infrastructure base and still low level of human capital.

The Government has been striving to address structural challenges as articulated in the PASDEP. The growth effort sustained during the last five years is reflected by the fastest increase in Per Capita GDP (from 136 USD in 2002/03 to 205USD in 2007/08), the significant increase in crop production driven largely by the increase in yield particularly since 2003/04, the on-going effort to expand irrigation including water harvesting and small river diversion has been aimed at mitigating the impact of rain failures on small holder farmers. The on-going export diversification (for instance floriculture) is also meant to broaden the export base (126 Million USD generated from this export item alone in 2007/08). The on-going business process re-engineering within the framework of the Civil Service Reform Program (CSR) has also been meant to establish efficient working system, enhance the capacity of civil servants and render them efficient. The on-going infrastructure expansion (in roads, Telecom and Power) and the on-going human capital development effort particularly the establishment of new public universities (from 8 three years ago to 21 public universities currently) have also begun to show positive and encouraging results. As a result, with regard to infrastructure expansion, road density per 1000 square kilometre has increased from 33 in 2002/03 to 40 by the end of 2007/08 (the target being to reach the SSA average of 54 by the end of the PASDEP period). Access to electricity has doubled in four years time, from 16% in 2004/05 to 33% in 2007/07 (the

target being to reach 50% of the population by the end of 2009/10). These have been on-going efforts aimed at redressing structural problems of the Ethiopian economy. Understandably, these developments are critical for sustaining Ethiopia's long-term growth and realizing Ethiopia's vision of becoming a middle income country in 20 years time.

These on-going growth efforts have been threatened by twin challenges of global dimension: inflation driven by food inflation and the pressure on the balance of payments (BOP) driven by the increase in oil prices (until July 2008). One may argue that oil price increase is no more a problem for Ethiopia. But its consequence has been significant through depletion of foreign reserves. This has resulted in shortage of foreign currency while the National Bank of Ethiopia is striving to build its reserve position. The current reserve position (about 1 months of next year's import cover) is below the minimum reasonable threshold level of 3 to 4 months (NBE, 2008).

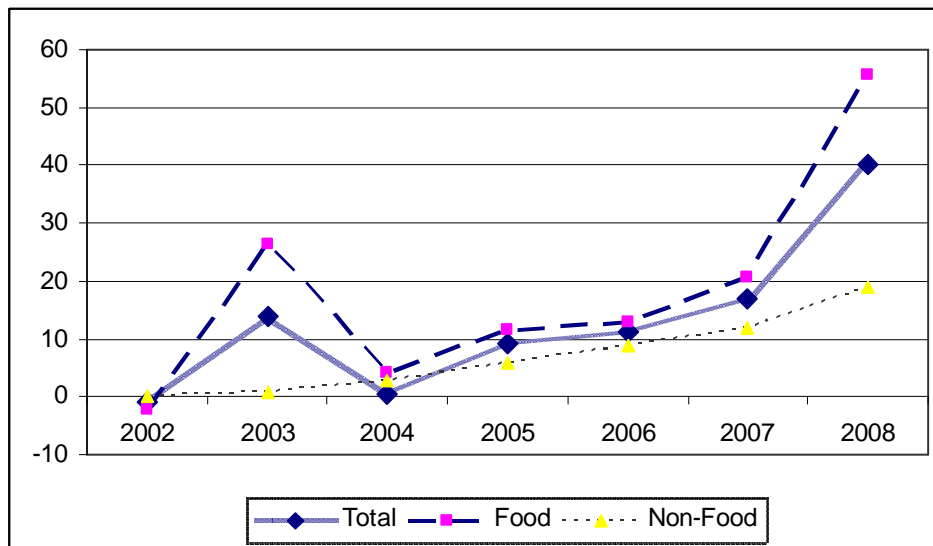
4.1. Government's Policy Response to the Immediate Twin Challenges

4.1.1. Inflation

The on-going inflationary pressure is a new phenomenon for Ethiopia. Historically, Ethiopia has been known for being a low inflation country (save some drought years of 1984/85, 1991/92 and 2002/03 when inflation peaked to as high as 20 percent). Thus, inflation had been associated with the performance of agricultural production, particularly major crops production which constitutes the bulk of agriculture GDP (about 50 to 60 percent of agriculture value added on average). Food items also constitute about 60 percent of household spending.

However, what made the recent food price hike unique is that it has been coincided with high economic growth of above 10 percent. Inflationary pressure driven by food inflation has begun to pick up since 2005/06 and has still remained high (at 46.1% in February 2009 on a period average basis) following a huge surge in 2006/07 and 2007/08.

Figure 4.1: Annualised Inflation Rate – October 2002 – October 2008 (%)



Source: Central Statistical Agency.

Although no resolve has yet been made on factors behind the on-going inflationary pressure, the likely potential factors are demand pressures and structural changes caused by higher disposable income which improves purchasing power, the on-going improvements in marketing system (crops) through cooperatives coupled with the expansion of telephone infrastructure in rural areas which improve information communication and helped reduce desperate sales by small holder farmers, an improvement in the road network which increased farmers' producers' price margin for crops, the suspension of in-kind food aid and the introduction of local purchases for emergency aid may also have contributed to demand pressure on food price inflation. The agro-processing activities taking place (e.g., farmers' sale of wheat, barely, etc to local processors) as the economy transforms may also have contributed to the overall demand pressure. Another important *factor that explains the high inflation situation is inflation expectation where by high inflation breeds the expectation of even higher inflation*. All this may have pushed prices of grains up to their international parity level. Besides, there has been / is a boom in the construction industry, which increased employment opportunities and which in turn increased income and purchasing power. The increase in international oil price has also both direct and indirect impact on the general price inflation. The inefficiency in the domestic marketing system is also a contributing factor.

On the other end, there are also those who attributed the current inflationary pressure largely to monetary variables, public investment expansion and credit expansion being cited as major culprits. Although the role of monetary factors can not be underestimated, the still unanswered question in this regard is the inability of researchers to discern the relative contribution of non-monetary and monetary variables on inflation. The Government believes that demand pressure and structural factors compounded by inflationary expectations are important factors in explaining inflation in the context of Ethiopia. Given the structure of the economy (less monetized), the role of monetary factors in explaining inflation is believed to be very much limited.

The current inflationary pressure has become a huge concern to the Government as it threatens macro stability and affects low-income earners particularly those in urban areas. Accordingly, measures have been and are being taken by the Government to address the inflation agenda with in a short, medium and long-term time horizon. The ultimate solution in the medium and long-term is to enhanced productivity of the agriculture sector (particularly crops). Crop yield (though it improved in recent years) has not yet reached the desired level (some agricultural researchers claim that it is on average at 2/3 of the desired yield level).

In the very immediate and short-run time horizon, the Government has taken a number of measures to curb inflationary expectations and stabilize prices of food crops. The following short-run measures have been taken by the Government in this regard.

- a) The government has so far imported 520,000 MT of food grains (wheat) using its own resources and has been selling to the urban poor at subsidized prices;
- b) It has removed Value Added Tax (VAT) , Turn Over Tax (TOT) & Surtax on some food items(flours and bread);
- c) Increased the cash-for-work wage rate from ETB 6 to 8 per day in its PSNP with further adjustment under consideration;
- d) Increased Cash transfer rate for labor-poor households in the PSNP ;

Overall, on the fiscal front, the Government announced its intention to reduce fiscal deficit to 1.1% of GDP during this fiscal year (2008/09) from 2.9% of GDP in 2007/08 and to eliminate government domestic borrowing during the current fiscal year (from 2.7% in 2007/08). Related to this, the Government has decided to reduce public enterprise domestic borrowing from 4.4% of GDP in 2007/08 to 2.5% of GDP in 2008/09 and subsequently monitor their borrowing.

On the monetary front, the Government has decided to reduce broad money growth target during 2008/09 to below 20 percent, lower than the 23% growth achieved in 2007/08.

4.1.2. The Balance of Payments (BOP)

Ethiopia's Balance of Payment has been under stress for some time now. The country has sustained one of the highest trade deficits in SSA averaging over 20% of GDP during the last five years ending in 2007/08(MOFED 2008). Although merchandize export earnings has more than tripled during the last seven years ending in 2007/08 (from 452.4 million in 2001/02 to about 1465.8 million USD in 2007/08),trade deficit has been widening during the same period owing to the significant increase in imports to sustain the high growth effort witnessed during the same period. During this period imports of capital goods surged and accounted for more than a third of total imports. Fuel import also averaged about 17 percent of total import bill (about 5 % of GDP) during this same period. According to the National Bank of Ethiopia, total import bill is estimated to reach 9 Billion USD by the end of 2008/09 from about 7 billion USD in the pervious year.

The international fuel price hike had aggravated the BOP situation up until July 2008. In sum, the supply response has not kept pace with the demand growth (import demand). Aggravated by the international oil price rise (until July 2008), foreign reserve position of the country has deteriorated and reached about 1 months of import by the end of 2008. The balance of payment pressure has become the most critical macroeconomic challenge of the government more than any time in the past. As noted above, the twin challenges of inflation and balance of payment pressure being closely related, they need to be addressed in holistic and concurrent manner.

The challenge on the BOP needs to be addressed in a short medium and longer-term time horizon as well. In the medium and long term, the issue boils down to further encouraging private sector participation in the export sector aimed at diversifying and broadening the export base of the country including tourism receipts. The on-going effort aimed at addressing the various constraints/bottlenecks faced by industrialists in the Leather and Leather Products & Textile industries through holding high level discussion (with H.E. Prime Minister) is meant to promote non-traditional exports. The specific policies and strategy measures pertinent to private sector development that have been undertaken so far include: the development of industrial estates in urban areas and small towns, the provision of the necessary locations for small and medium-scale industrial development, the effort waged to augment the capacity of private sector and provision of business development training and extension services, particularly under the framework of the Engineering Capacity Building Programme (ECBP). Besides, efforts have been and are being waged to create conducive environment for business registration and licensing, customs clearance, service delivery and labour regulations are some of the measures undertaken to promote the development of the private sector. Measures are also underway to improve payment systems. This is also complemented by pursuing measures to attract Foreign Direct Investment (FDI) and productive Diaspora investment.

In the short-run, the Government has taken the following measures by way of mitigating the pressure on the BOP:

- a) **The blending of Ethanol with Benzene which started in September 2008 with 5% Ethanol and 95% benzene (5:95)** and the plan to increase the proportion of Ethanol in the blend as more Ethanol is produced by sugar factories as on-going sugar projects comes in to operation is an important step aimed at saving foreign exchange to be allocated for oil imports for which demand is expected to pick up as developed economies revive from the crisis. Studies indicate to the huge potential for Ethanol production.
- b) **Elimination of fuel price subsidy in October 2008 by fully adjusting the domestic price to import parity level:** Accordingly, the prices of gasoline, diesel, fuel oil, and kerosene were adjusted upwards by 6%, 39%, 32%, and 50% respectively. According to World Bank (2009), this measure alone is expected to reduce Government expenditure subsidy for fuel by nearly USD\$250 Million (WB, 2009). This measure has important fiscal and BOP implication: the financial resource diverted from fuel subsidies can be used to subsidize the urban poor and the foreign exchange saved from oil imports (following the decline in international oil prices since July 2008) can be used for importing grain. Besides, fuel subsidies have not been pro-poor and its suspension has

economic rationale. According to World Bank Analysis in 2005, fuel subsidies are not necessary pro-poor. The analysis indicated that petroleum product subsidies including kerosene, are captured disproportionately by the rich. The lowest income quintile receives less than 10% of total subsidies while the top quintile receives about 44 percent. This suggests that the once and for all suspension of fuel subsidy by the government is the right step forward. The government is going to review domestic fuel prices on a monthly basis through the Ministry of Trade and Industry to adjust them as necessary but keeping a margin above world prices in order to build the oil price stabilization fund which has been depleted as the international oil price reached its peak until July 2008.

- c) **Depreciation of the local currency by nearly 15% in January 2009:** In the immediate and short-term, depreciation of the Birr would help to curb the import of, in particular, consumption goods and thereby reduce the pressure on the foreign exchange situation. However, the immediate impact of devaluation on supply response is very much limited (90% of export earnings being generated from primary agricultural products). Given that the country is also import dependent for both consumption and investment, it may even possibly trigger inflation.
- d) **The decision to reduce public enterprise domestic borrowing from 4.4% of GDP in 2007/08 to 2.5% of GDP in 2008/09 and subsequently monitor their borrowing:** This has to do with domestic bank borrowing by the Ethiopian Electric Power Corporation and the Ethiopian Telecommunication Corporation. These public enterprises have been involved in huge capital investment activities in line with the targets set in the Government's development programs as articulated in the PASDEP such as 100 percent access in Telecom services and 50% access to electricity by the end of 2009/10. These public enterprises operate autonomously with their own business plan and finance their operation from their own resources. In this endeavor, they borrow from banks like any business company. Their borrowing has inflationary implication to the extent it pushes aggregate demand (through investment expansion) and BOP implications owing to their foreign currency requirements given that both enterprises are not currently generating foreign currency through their activities (except roaming activities which has started to generate some foreign currency in the case of Telecom). The planned cut in their borrowing is meant to ease the impact on inflation (through reducing demand) and the pressure on the BOP (through curbing their demand for foreign currency). The issue of prioritization of investment has been given due consideration to make sure that such a reduction in investment does not stifle growth.

What has these measures produced vis-à-vis achieving the Government's objective of achieving single digit inflation and easing the pressure on the BOP? With regard to inflation, as it stands now, not much. The monthly food inflation has shown a decline since August 2008, albeit a very slow pace. It is very unlikely that inflation will be brought down even to the level that the IMF has projected (20 percent by the end of 2008/09). The objective could be achieved but it may take more time than originally thought.

With regard to the BOP, the pressure on the reserve has eased thanks to recent drop in international oil prices since July 2008. This relief has helped rebuild the reserve position

which is expected to increase to 1.8 months of import by the end of 2008/09 provided also that external finance is forthcoming in the coming months (such as financial resources from PBS II) as pledged by donors. Given that, debt relief provided under HIPC and MDRI has helped to lower the debt ratio to less than 10 percent of GDP at the end of 2006/07, debt stress may not be a problem in the medium-term. This would create a fiscal space for the Government in its endeavor to achieve macroeconomic balances.

The decline in international oil price is a mixed blessing for Ethiopia. The Government can now focus all its efforts on tackling inflation. The recent across-the-board suspension of fuel subsidy will enable the Government consolidate its effort in fighting inflation. The financial resources that could be saved from fuel subsidy will be channelled to subsidize the urban poor and thereby stabilize food prices. The declining trend international food prices will also be an added advantage if it is sustained.

4.2. Vulnerabilities, Possible Impacts & Channels of Transmission

4.2.1. Vulnerabilities & Possible Impacts

On the whole, there are different strands of opinion regarding the likely effects of the financial and economic crisis on Africa. But there seem to be a consensus among experts on the following points:

- a) Because of Africa's generally weak financial integration with the rest of the global economic system, it is believed that the financial sectors of many African countries (except a few) will not be directly and immediately affected by the unfolding crisis;
- b) In the medium-term, the impacts of the global slowdown brought about by the crisis are going to be severe because of the vulnerability of African economies to even minor shocks;
- c) The shock through which they are transmitted to African economies is not through the credit crunch and lack of liquidity as observed in advanced and emerging economies but through global slow down (recession) that followed this crisis.

The fact that domestic rather than export-driven agriculture accounts for a large share of the economy might somehow help insulate the Ethiopian economy from the impact of the crisis. By all measures, Ethiopia's financial system is the least integrated to the global economic system. There are no foreign banks in the country. However, still domestic banks are expected to have correspondent banks that may be affected by the crisis. This shows that the impact of the global crisis on the Ethiopian economy is not immediate and direct but is likely to be felt as the recession deepens. The huge proportion of the impact is likely to be felt with lags depending on how long the recession lasts. It is also to be noted that the Ethiopian economy is vulnerable to two dimensions of shock: domestic (rain failure) and external (decline in the price of exports). The effects are compounded if both types of shocks take place simultaneously.

Despite the recent robust growth trends, some important macroeconomic indicators point to the economy's vulnerability to shocks likely to be caused by the global slowdown (recession). Table 5.1 below compares Ethiopia's status with that of the SSA average for the year 2008. The inflation rate for Ethiopia is more than twice the SSA average (25.3% versus 11.4%), rate of domestic resource mobilization measured by domestic revenue to GDP ratio

stood at half the SSA average (12.4% versus 24.9%), foreign exchange earning capacity measured by the ratio of exports of goods and non-facto services to GDP stood at less than a third (12% versus 40%), and import capacity measured by months of import cover stood at less than a fifth (1 month versus 5.4 months).

Some qualification may need to be in order regarding the low rate of domestic resource mobilization in Ethiopia compared to that of the SSA. The fact that the agricultural sector which accounts for about 45 % GDP is not being taxed has also contributed to the low rate of domestic revenue mobilization. Ethiopia is a non-oil and non-mineral economy. Revenue to GDP for mineral and oil-rich SSA economies may have pushed up the average for the SSA. In any case, the revenue base of the country is still one of the lowest in the SSA.

Table 4.1: Comparison of key macroeconomic Indicators: Ethiopia Versus SSA (2008)

Indicator	Ethiopia	SSA
Real GDP Growth Rate (%)	11.6	5.2
Inflation Rate (Period Average) (%)	25.3	11.4
Broad Money Growth Rate (%)	22.7	24.1
Domestic Revenue as % of GDP (%)	12.4	24.9
Expenditure as % of GDP (%)	19.6	24.1
Fiscal Deficit Including Grants as % of GDP	-2.9	-2.0
Exports of G&NFS as % of GDP (%)	11.9	40.6
Imports of G&NFS as % of GDP (%)	32.2	38.8
Degree of Openness(Imports plus Exports as % of GDP)	44.1	79.4
Current Account Balance Including Grants as % of GDP (%)	-5.8	-2.6
Reserves in Months of Next Year's Import(M)	0.9	5.4

Source: Regional Economic Outlook: Sub-Saharan Africa, April 2008

According to the IMF's recent Study entitled '***The Implication of the Global Financial Crisis for Low Income Countries (March 2009)***', SSA growth has been historically

moving quite closely with global real GDP growth. As global growth slows, SSA is affected mainly by lower real external demand for its exports and declines in commodity prices and the terms of trade. In this Study, the IMF attempted to quantify the impact of the global slow down on individual African Countries. The estimated Dynamic Panel Regression relates real growth in domestic out put to world growth in trade weighted by partner countries and to several control variables: oil prices, non-oil prices, and country fixed effects for a sample of 40 countries over the period 1970-2007. The key findings of the Study were:

- a) A one percentage slow down in the rest of the world has led to an estimated 0.5 percentage point slow down in SSA countries. The effect is felt partly contemporaneously (0.2 percentage point) and partly in the following year (0.3 percentage point).
- b) A non-fuel commodity price induced income reduction by 10 percent tends to reduce growth in the SSA exports by about 1.5 percentage point
- c) An oil price shock tends to be significant only above a certain threshold (5 percent change in prices). A net oil importer in the SSA (with oil imports of 20 percent of GDP), facing a decline in oil prices of say 50 percent could expect an increase in its growth of 0.3-0.4 percentage point. The impact is linear on price changes above the threshold and on oil intensiveness of the economy.

The IMF noted that these estimates are robust but reflect the average effects for an average country and shock and needs to be interpreted cautiously. The estimates may explain only a small portion of the growth variation experienced by SSA countries. Because a broad range of domestic factors may be at work and may closely interact with the shock in determining the effects.

According to the IMF⁷, the direct impact of the global financial crisis on Low Income Countries (LICs) will be stronger for those with higher degree of financial integration as well as those that have begun to access international capital markets (such as Ghana in Africa) or those where direct and indirect foreign financing in local markets was on the rise (such as Kenya, Nigeria, Malawi, Ghana, Uganda and Zambia).

As noted above, Ethiopia's financial system is the least integrated and the country accesses foreign financing through concessional terms only. Thus, the direct impact through the financial system is very much limited. The indirect effects are more important for Ethiopia as the slow down in global growth may reduce trade, remittances, foreign direct investment (FDI) and aid (ODA) flows including the second round effects on the financial sector.

Taking all these factors in to consideration, the IMF in its recent Study⁸ ranked Ethiopia as **Medium Vulnerability Country** in its analysis of Low Income Countries' short run vulnerabilities to the global down turn on the basis of both the most recent projections and various simulations of possible further shocks that illustrate the down side risks to the

⁷ *The Implications of the Global Financial Crisis for Low Income Countries , March 2009*

⁸ *ibid*

baseline projections. For each channel and for all channels, and for all shocks combined, countries are ranked in three vulnerability categories: High, Medium and Low depending on the impact of these shocks on reserves. The analysis does not incorporate further effects on growth or demand.

4.2.2. Possible Channels of Transmission

As noted earlier, the channels through which the crisis would have an adverse impact on the economies of SSA countries in general and Ethiopia in particular as the recession in the developed economies spread will be indirect. These indirect effects include: decline in demand for exports, possible decline in ODA flows, possible decline in FDI flows and remittances. Each will be discussed in turn in the section that follows as far as data/information availability permits. As it stands now, no national initiative has been taken (no exercise has been carried out) to assess the impact of the global financial and economic crisis on the Ethiopian economy. This is a major shortcoming in undertaking this part of the assessment.

a) Decline in Demand for Exports

The origins of Ethiopia's import and the destinations of its export are the developed and emerging markets. According to the 2007/08 export statistics by country of destination (NBE, 2008), Europe followed by Asia and the Middle East are the major destinations for Ethiopian exports accounting for 42% and 35% of total merchandize export earnings, respectively. The African continent accounts for about 14% of total export receipts. Ethiopia's trade with Africa has still remained limited. Thus, given Ethiopia's trade dependence with the countries hardest hit by the global crisis (Europe being hardest hit). This may reduce demand for Ethiopian exports. The price of Arabica coffee has dropped by 24% since July 2008 (World Bank: Global Economic Prospects, 2009). But this does not seem to be significant in the case of Ethiopia. During the first eight months of 2008/09 Fiscal Year, the Unit Price of Coffee declined by a mere 1.5% compared to the same period of the preceding fiscal year (NBE, 2009). The volume of coffee sold has declined by about 10% during the same period. These together have resulted in to an 11.6 % decline in export earnings during the same period. Thus, the decline in price is not the major factor for the fall in export earnings. The fall in coffee export earnings is to a larger extent attributed to a decline in volume coffee sold due to hoarding by some exporters⁹. The government has stepped up measures against hoarding by some exporters to compensate the decline in earnings through increasing the volume of sales in the remaining months of the fiscal year. According to a recent Report by the National Bank of Ethiopia (NBE, 2009), export items that witnessed a decline in prices during the first eight months of 2008/09 compared to 2007/08 were: coffee (1.5%), oil seeds (1%), flower (10%) and gold (7%). Despite the decline in prices for oil seeds, flower and gold, export earning for each has increased by 39%, 22% and 39%, respectively since the decline in volume was compensated by an

⁹ Fortune Volume 9 No. 464, March 22, 2009 page 29: Meles Warns Coffee Exporters against Hoarding

increase in volume of exports by 40%, 36% and 50% respectively. Overall, total export earnings during the first half of 2008/09 has increased by about 17 percent compared to the same period of 2007/08. The foregoing analysis shows that the export commodities for which export earnings showed a decline is attributed to a decline in volume than a decline in unit prices.

On the other hand, oil has seen a 60% decline in price since its peak in July 2008, with a projection of USD\$50 per barrel for the whole of 2009 (World Bank global economic prospects, 2009). This is good news for Ethiopia. The World Bank also projected that metals and food prices will experience a decline. This again has positive implication for Ethiopia. These developments if sustained would help reduce import bill on grain imports and metals for the booming construction sector.

b) ODA Flows

As it stands now, domestic resource mobilization is insufficient for Ethiopia to finance the investment needed for achieving PASDEP/MDGs. Thus, Ethiopia will continue to rely on external capital inflows (mainly ODA, FDI and remittances) to fill the financing gap in the near future. Therefore, a key concern is whether donor pledges to finance development expenditures will be maintained or become less predictable given that such pledges were not fulfilled even during times of global economic boom. The case in point is that the amount of external finance that passed through the budget fell short of the PASDEP target in 2005/06, 2006/07 and 2007/08 by 48%, 22% and 10% respectively. External finance flows were originally projected in the PASDEP taking business as usual scenario (following past trends). In absolute terms, external finance flows reached 1.7 billion USD in 2007/08 (about 20 USD per capita). According to the information from the Multi-lateral and Bilateral Department of the Ministry of Finance and Economic Development, the total amount of loan and grants disbursed during the first eight months of this fiscal year (2008/09) is estimated at \$1.4 Billion USD. This is about 26 percent higher than the amount disbursed during the same period of the preceding fiscal year. Most of the pledges particularly from multilateral financial institutions (World Bank, AfDB, EU and other UN Systems) have been made on a medium-term time frame (three years). It is unlikely that these pledges would be withdrawn owing to the financial crunch. ODA from bilateral sources is more likely to decline than ODA from multilateral sources. Based on disbursements during the last 9 years ending in 2007/08, ODA from multi-lateral sources account on average for about 70 percent of total ODA flows (MOFED, 2009).

c) FDI Flows

According to the World Investment Report 2008, FDI to Ethiopia more than doubled from \$265 million USD in 2005 to \$545 Million USD in 2006. However, it declined to \$ 254 Million USD in 2007. According to the Ethiopian Investment Agency, the number of registered foreign investment projects during the first eight months of 2008/09 increased by about 5.1 % while registered capital declined by about 25 percent. However, these indicators do not warrant any conclusion on trends in FDI as they are only indicative at any period of time.

d) Remittances

In SSA migrant remittances amounted to US\$12 Billion in 2007 and accounted for 2% of GDP for the continent¹⁰. Nigeria, Ghana, Kenya, Sudan, Senegal, Uganda and South Africa received the highest volume of remittances, while in smaller countries such as Lesotho remittances represent up to a quarter of GDP. Remittance flows account for a mere 1.3% of GDP for Ethiopia in 2008 (World Bank Annual Statistics, 2008). Given reports of worsening working conditions, lay offs, wage cuts and reduction in immigrant workers, the full impact of the financial crisis and economic slow down on migrant workers and hence remittance in flow is yet to be felt. According to the National Bank of Ethiopia (March, 2009), during the first eight months of 2008/09, Net Private Transfers showed a 26.6 percent increase and reached USD\$1486.8 Million. Cash transfers through NGOs amounted USD \$475.5 Million, up by 55.7% over the same period of last year while cash transfers by private individuals rose by 1.6 percent to USD\$421.9 Million compared to the same period of last year(2007/08). This also indicates that there is no tendency for remittances to decline.

4.3. How Resilient is the Economy to the Crisis?

The degree of resilience could be assessed through reflecting on the following key questions. Is there a sound macroeconomic policy environment (fiscal, monetary and exchange rate policy)? Are public spending programs domestic-resources intensive and pro-poor which have direct bearing on the labour market? Are the hitherto responses to the pre-crisis macroeconomic challenges consistent with the measures that may need to be taken to address the indirect shocks just outlined? Are there measures being taken to render the public sector (including public enterprises) more efficient, transparent and accountable? Are there measures in the pipe line to revamp domestic revenue mobilization? Are there measures in the pipe line to further improve private investment climate with direct bearing on export earning capacity?

The answer to most of the questions posed is to the affirmative. The government's overriding agenda now is to sustain the hitherto growth momentum through maintaining macroeconomic stability. The government has traditionally shown prudence in its macroeconomic (fiscal) management even during the worst of times. As discussed in chapter II above, the Government's expenditure policy has been growth enhancing and pro-poor. Annual budget allocation to priority growth enhancing pro-poor sectors has been guided by a three-year rolling macroeconomic fiscal framework. As a result, the bulk of public spending (about two-third by the end of 2007/08) currently goes to pro-poor sectors. This is in line with achieving the Millennium Development Goals (MDGs). Given the already high wages and salaries bill and in view of mitigating the inflationary pressure, there is no intention to increase wages and salaries for civil service employees and public enterprises. The Government's intention is to maintain its spending on priority sectors while streamlining and minimizing non-essential administrative costs.

On the revenue side, although domestic revenue has increased significantly, it has not yet kept pace with the spending needs of the country. The revenue base is still narrow. The

¹⁰ Brussels Week Africa, October 27, 2008

fiscal measures taken by the government such as the zero net domestic borrowing balance by the end of the year and the 1.1% of GDP target of fiscal deficit aimed at tackling the current inflationary pressure are appropriate short run measures. The suspension of VAT, TOT and Sur-Tax on some food items (aimed at stabilizing food prices) has had a minimal impact on revenue. Tax revenue is also expected to increase as those operators awarded with exemptions and tax holidays enter in to the tax system. The efforts that have been waged to improve tax administration have begun to bear fruit as witnessed by the significant increase in tax revenue. For instance, according to MOFED, domestic and tax revenue during the first seven months of 2008/09 showed an about 30 and 20 percent increase over the same period of the previous fiscal year (2007/08).

On account of monetary policy, the Government has targeted money supply (broad money) growth to below 20 percent in line with the objective of tackling inflationary pressure. The Government has maintained low interest rate (currently the minimum lending rate is 8%) in the face of inflationary pressure (negative real interest rate). This is meant to encourage investment by the private sector to boost the supply response of the economy and there by creating jobs. The maximum lending rate is 15%. This shows that the growth objective has been given the utmost emphasis.

The fact that most of the spending is intensive in domestic goods and services will help to stimulate domestic economic activity (job creation) with out creating pressure on the balance of payments. The cases in point are the food security and safety net programs, the road sector development programs, and the low cost housing programs and the SMEDs programs which are intensive in the utilization of domestic inputs and labour. The on-going business process re-engineering (BPR) program being implemented is meant to render public sector operations (civil service and public enterprises) more efficient and transparent with significant implication for cost saving.

As noted above, the possible impact of the financial crisis on Ethiopia is indirect mainly through declining demand for exports, a decline in ODA, FDI and remittances which will lead to a decline in overall economic activity. This may in turn lead to a decline in revenue which in turn would lead to a slow down in overall economic activity. As indicated above, judged by current trends in export earnings, ODA, FDI and remittances in which all are on the increase, it is unlikely that there will be a slow down in domestic economic activity.

In any event, the overriding agenda is to check public spending with in limits to tackle inflationary pressure with out compromising spending on priority growth enhancing and pro-poor sectors.

The current low level of international oil prices is also an added advantage in the government's fight against inflation. The government seems to have taken advantage of this situation. It has suspended the fuel subsidy and revised the domestic fuel prices downward by keeping a margin over world prices. The suspension of fuel subsidies has eased the fiscal stress through redirecting the saving from the fuel subsidy towards subsidizing the urban poor. This helps mitigate the impact of food inflation on urban poverty which has been on the increase even before the inflationary pressure set in 2005. Given the lagged effects of the factors that drive inflation and the fact that

inflationary expectations won't wither away easily, getting inflation down to single digits in the short-run is going to be a difficult task. The fact that general inflation has begun to stabilize since August 2008 is by itself encouraging (46% on annual moving average basis in February 2009). Since August 2008, the rate at which inflation is increasing is at a declining rate

On the balance of payments, the current low level of international oil prices (around 50 USD per barrel) is a golden opportunity to build the reserve position. Ethiopia has also secured USD\$50 Million from the rapid access component of the IMF's exogenous shock facility which would help ease the pressure on the BOP. According to the IMF, the additional financing needs of Low Income Countries (LICs) resulting from the crisis could tentatively amount to about \$ USD 25 Billion in 2009. Thus, if the on-going domestic effort is complemented by increases in donor finance, Ethiopia's reserve position could at least be doubled during 2009(to at least two months of import cover). Apart from achieving the inflation objective, the measures taken to check public enterprise borrowing with in limits is to make sure that there is no fiscal spill over to the balance of payments (to maintain a reasonable level of reserve position). Notwithstanding the efforts to raise international oil prices through a cut in production by OPEC countries, the IMF has projected that oil price will not show any significant increase during 2009.

The foregoing analysis and the rationales forwarded all indicate that the macroeconomic and labour market policies being pursued by the Government are resilient to the possible impacts of the crisis. The impact on the labour market is very much limited as on-going programs (with in the PASDEP framework) are to a larger extent domestic resources-intensive (labour and local inputs). The likely impact of possible decline in demand for export on the labour market is also very much limited as export processing firms are currently small in number(those benefiting from AGOA & EBA) given that the export sector is dominated by primary(agricultural) products.

V. Summary, Conclusions & Recommendations

In the context of Ethiopia, the central agenda in the midst of the global slow down is to sustain the hitherto achieved growth in line with the PASDEP/MDGs objectives and the country's vision of becoming a middle income country in the coming 20 years. The aftermaths of the global financial crisis are added dimensions to the twin macroeconomic challenges being faced by the Ethiopian economy. The global financial and economic crisis does not affect each low income country in the same way and by the same magnitude. It even has had positive impacts for some countries at least in the short-run. The case in point in this regard is net oil importing countries such as Ethiopia. In the case of Ethiopia, macroeconomic policy measures (fiscal, monetary and exchange rate) being pursued is tailored from the point of view of achieving macroeconomic stability without compromising the growth agenda. The role of fiscal policy in this has been central in the case of Ethiopia.

From the outset, the Government's primary fiscal policy objective is to maintain a fiscal stance that is prudent and at the same time addresses the development needs of the country.

On the expenditure side, the focus of the Government is on maintaining the deficit at a sustainable level while at the same time increasing spending in key poverty oriented priority sectors. The Government also understands the need to balance the tremendous demands for services and investments with the need for macroeconomic discipline, which will protect the poor from inflation, and maintain the economic stability needed for private sector growth to **create jobs and income and thereby help achieve the Government's overriding objective of poverty reduction and its ultimate eradication**. The Government's intention is to expand investments in education, health and infrastructure as fast as possible, but only to the extent affordable with rising domestic resource and aid inflows. The Government's fiscal policy has been driven by its commitment to expand economic infrastructure (particularly roads) and social infrastructures such as education and health facilities in its endeavor to expand human capital which are critical for sustainable growth and development. Infrastructure expansion by both the Government and its affiliated companies is believed to create conducive environment for private sector investment. Given the realities on the country, the Government of Ethiopia is of the view that public investment is a pre-requisite for private investment. The existing new trend in the distribution of private investment projects across regional states (including in emerging regions) is a clear testimony.

On the revenue side, the Government is determined to lay the foundation for strong revenue performance via rendering the domestic productive sectors of the economy (agriculture & industry) the revenue base of the country. If the fiscal policy of the Government is to be judged by what it has produced during the recent past, the achievements so far could be reasonably rated as commendable. Given the factors that are at work and the structure of the Ethiopian economy (the agriculture sector not being taxed currently and in the face of high food inflation), the recent declining tendency in the tax to GDP ratio needs to be interpreted cautiously before jumping in to conclusions that puts

a question mark on the existing tax policy. Tax holidays and exemptions are also factors that need to be factored in before drawing unbalanced conclusions regarding tax policy.

Thus, the recent features that characterize the Ethiopian fiscal landscape could be summarized as follows: significant increase in spending driven by capital expenditure on growth enhancing and pro-poor priority social sectors and the recurrent component driven by spending on wages and salaries (introduction of the new wages and salaries scale and expansion of government operations and government employment in line with the on-going devolution process), increase in tax revenue collection albeit not commensurate with spending needs, a lag in external finance flows though it increased modestly in absolute terms. This significant surge in capital expenditure and the increase in wages and salaries signify the progressive increase in the scope and magnitude of government operations, particularly seen in the light of the devolution process that has been taking root in Ethiopia.

The Ethiopian fiscal landscape has been under stress in recent years. This has come from two directions: developments within the budget and outside of the budget. The latter has to do with spending by non-financial public enterprises. Their impact has been largely felt through the pressure on the balance of payment to the extent that their activities demand foreign currency. Besides, the demand pressure on the overall economy given that supply response could not be automatic can not be understated as well. Accordingly, the Government has decided to reduce public enterprise domestic borrowing from 4.4% of GDP in 2007/08 to 2.5% of GDP in 2008/09 and subsequently monitor their borrowing

The recent fiscal stress has been accentuated by the lower than expected flow of external finance in the spirit of implementation of the PASDEP and hence MDGs. Although the high-growth and high-inflation situation made it susceptible to expansionary fiscal policy, still the out turn for key fiscal targets has been far lower than what is articulated in the plan (PASDEP). It is worth noting that fiscal deficits including grants had been higher during the pre-PASDEP (up until 2004/05) period than during the post-PASDEP period (starting 2005/06). A huge proportion of the deficit had been financed from external finance during the pre-PASDEP period while the opposite has happened during the post-PASDEP period. Deficit financing from domestic bank borrowing reached its peak (3.5% of GDP) in 2005/06 following the aftermath of the May 2005 election. External finance has levelled off since 2005/06.

The fiscal stress could be relieved through pursuing the on-going improvement in tax administration and revenue collection and at the same time broadening the tax base (this could be a medium-term undertaking). In the short-term, it is important to further prioritize spending through still focusing on growth enhancing sectors and delivery of social services to the poor and vulnerable. Strict follow up on tax holidays/exemptions granted to attract private investment as the period of exemption lapses so that they are captured in to the formal tax system is also of paramount importance.

The Government has pursued a holistic approach in addressing the employment /unemployment agenda. In this regard, one important dimension of the ADLI Strategy is its focus on adequately utilizing the labour resources of the country. Industrialization

being the ultimate goal of ADLI, the focus in industrial development is also on labour intensive agro-processing industries.

The on-going preoccupation on small and medium-enterprise development (SMEDs) with the necessary interface with TVETs is also aimed at creating job opportunities for the youth. The urban low cost housing program initiated recently is also aimed at achieving two objectives in tandem: addressing the housing problem and creating jobs. The on-going youth and women's package is also aimed at addressing the employment agenda. More importantly, the government strongly believes that the private sector should be the biggest and ultimate employer. The hitherto effort in expanding infrastructure and human capital is all meant to create a conducive environment for the operation of the private sector which in turn would help expand employment generation. As articulated in the PASDEP, one of the pillar strategies of the PASDEP is job creation.

In the context of Ethiopia, making a formal link between economic growth and employment has been hindered by lack of comprehensive adequately disaggregated and consistent time series data on employment/unemployment that let us track the links between economic growth and employment creation. In general, when it comes to assessing the impact of growth on employment creation, the growth process is more important than the growth itself. This means that for any growth to impact on job creation and help reducing poverty, it needs to be broad-based and pro-poor. The focus needs to be on enhancing income earning capacity of people, particularly youth and women. Enhancing productivity of both land and labour through building human capital has been and still is the direction pursued by the Government of Ethiopia in its endeavour to concurrently address the unemployment/ employment agenda. The overwhelming fact of the labour market in Ethiopia is the rapid growth of the supply of labour. The labour force is growing much more rapidly than the population as a whole because of Ethiopia's demographic profile. There are many more under 15 year olds entering the work force each year than there are old people leaving the labour force.

According to the 2006 Urban Employment Unemployment Survey, urban unemployment has consistently declined from 26.2 percent in 2003 to 22.9 percent in 2004 and further to

16.7 percent in 2006. Unemployment rate has been consistently higher among females than males across the years, 35.2% in 2003, 30.6% in 2004 and 22.1% in 2006. The corresponding rates for males stood at 17.6%, 15.8% and 11.5% respectively.

According to the same survey, looking at the employed population by major occupations, nearly three-fourths of urban employed population of the country is engaged in three almost equally important major occupations, namely: services, shop and market sales workers (25.5 percent), elementary occupation (23.6 percent), and craft and related activities (22.1 percent). Looking at the employed population by major industrial divisions, as expected, most urban employed population are absorbed by wholesale and retail trade, and manufacturing activities, making up 22.7 percent and 15.3 percent, respectively. Looking at the distribution of urban employed population by employment status of a person, at country level (urban), the bulk of employed population was constituted by self-employed (41.8 percent) followed by those employed by government and public enterprises (18.8 percent) and private organization (18.2 percent).

According to the survey, paid employments constitute about 45 percent of total employed population in urban areas. With in paid employment, private organizations have become increasingly important in absorbing the labor force as shown by the increase its share of employed population from 16% in 2003 to 18% in 2006(2 percentage point increase in three years). It also witnessed a significant increase (57%) in the number of employed persons between 2003 and 2006. The Government (proper) is the second biggest employer with in paid employment accounting for 17 percent of total employed population in 2006. This is consistent with Government policy that the private sector will be the ultimate employer in the future as it gains momentum. Self employment being the largest single employer out side of paid employment, it constituted 42% of the employed population in 2006.

The significant increase in the wages and salaries component of the recurrent expenditure in the budget has been consistent with the increase in government employees both at federal and regional level. Between 1999/00 and 2006/07, total number of regional states employees increased by over 65 percent over the eight year period (annual average increase of 8 percent) while total number of federal employees has increased by about 98 percent over the period. What is more interesting here is to see that this significant increase has been largely driven by the increase in female employees by about 360 percent over the period(an annual average increase of 45 percent during the period). The number of employees at country level has increased by about 68 percent (male 55% and

female 102%). This increase in the number of government employees must have been attributed to the deployment of health extension workers, the deployment of agricultural extension agents, hiring of staff to the newly established public universities. Regional states employees accounted for 90% of total government employees in 2006/07.

Looking forward, it is unlikely that government employment will be expanding at the pace exhibited in the recent past. The hitherto increase in government employment must have been attributed to the increased volume government operations both at federal and regional levels. Thus, the future for employment expansion is with the private sector. Macro policies such as interest rate and credit policies need to be reviewed with the objective of further stimulating private sector development with particular focus on small and micro enterprises development (SMED) strategically linked to large enterprises to enhance more value addition. This would help enhance vertical integration through strengthening complementarities within the domestic economy.

Currently, private employment opportunities are being created through sustained government's effort to enhance private sector investments, a big push in infrastructure development, expanding services industry and promoting the ever rapidly growing horticulture industry.

Given the low level of integration of the Ethiopian economy to the rest of the world, the impact of the global slow down on the industrial and service sectors is believed to be very much limited. Although the economic slow down caused by the global financial crisis and its consequences have had a huge impact on employment and decent work globally, the impact in the context of Ethiopia is limited at least in the short-run. Indirect impacts on the economy through the various channels of transmission such as export earnings, ODA flows, remittances and FDI is not yet felt as shown by the assessment above. Judged by current trends in export earnings, ODA, FDI and remittances in which all are on the increase, it is unlikely that there will be a slow down in domestic economic activity. But the impact in the medium-term should not be understated as the recession in the developed countries deepens. The IMF in its recent Study¹¹ ranked Ethiopia as **Medium Vulnerability Country**.

The Government's response to the immediate twin macroeconomic challenges is consistent with addressing the possible impacts of the global slow down. The measures have begun to bear fruit where inflation has been declining (though slowly) since August 2008. The drop in international oil prices by about 60 percent has provided a room for the Government in its fight against inflation via releasing resources for cereal imports to be distributed to the urban poor at subsidized prices.

The assessment indicates that the macroeconomic and labour market policies being pursued by the Government are resilient to the possible impacts of the crisis. The impact on the labour market is limited because public spending programs are to a larger extent domestic resources-intensive (labour and local inputs). The likely impact of possible

¹¹ ibid

decline in demand for export on the labour market is also limited as export processing firms in Ethiopia are currently small in number(those benefiting from AGOA & EBA) given that the export sector is dominated by primary(agricultural) products.

Creating the requisite fiscal space and ensuring the required interface with other macro policies such as monetary policy and balance of payment (exchange rate) policy is of paramount importance in this uncertain global environment. This would help strengthen the resilience of macroeconomic policies to the global financial and economic crisis. The extent of prudence the Government exhibits in implementing its fiscal policy in such an uncertain situation is very critical. Given the current immediate challenges with which the Government is grappling with (inflationary pressure and balance of payment pressure), there is need for a cautious move to strike an appropriate balance between the objective of sustaining long-term growth and maintaining macroeconomic stability. In the medium-term, a tailor-made approach with focus on the supply side seems to be the best course of action to be pursued in the context of Ethiopia where accelerating growth while maintaining macroeconomic balances is of the essence.

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