FACTORS DETERMINING PRIVATE INVESTMENT IN

ETHIOPIA

BY

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ABSTRACT

This paper attempts to identify the macroeconomic variables determining private investment using a time series data over the period 1975 to 1998. In addition to this, faced with two apparently different periods both in ideology and policy –orientation over the period, to see the performance of macroeconomic variables performance after post-reform period in general, private investment trend in particular in comparison with pre 1992 will be reviewed at length. This is done, due to the problem faced to estimate the two periods separately because of the short –time period for the later. Thus it is hoped that the review of macroeconomic variables using levels, ratio and average growth rate have been employed to help enable the reader to have the insight of the policy change effects since the reform.

All data used in the analysis are secondary data collected from different government agencies such as government Ministries and academic institutions. The model used in econometric regression is an eclectic version of flexible accelerator model designed to capture some of the key determinants of private investment behaviour. In this study, however, due to difficulty in identifying the theoretically correct

specification and obtaining the necessary and reliable data in Ethiopia, this paper does not attempt to build and estimate a full-scale structural model of private investment in Ethiopia. As a result, it is more of exploratory data analysis. Accordingly, macroeconomic variables included in the regression are real per capita GDP growth rate, public investment, credit availability to private sector, foreign exchange reserve availability, real exchange rate, consumer price index and government budget deficit. The estimation results show that real per capita GDP growth rate, credit availability to private sector and foreign exchange reserve availability appear to have had positive impact and significantly affect private investment in the country. While real exchange rate, consumer price index and with lesser extent of government budget deficit look to have had negative effect on private investment in Ethiopia over the period 1975-1998.

Public sector investment unlike the recent empirical findings in developing was found to substitute the private sector in Ethiopia rather to complement it. This is not surprising because the majority of the years estimated had fallen in the period where government capital budget, which is used as a proxy public investment, used to establish state-owned enterprises. On the other hand, the remaining years out of 24

that expected to have the positive impact out weighed by seventeen years negative influence. Real exchange rate was also found to influence the sector negatively over the period. The result looks confirmed the existing situation of real exchange rate in both periods. The first, pre-reform period used to be with multiple and over valuation which acted as a tax on export while the post-1992 is the devaluation period with gradual adjustment to the parallel market having negative impact on the returns to investment as it increases the cost of capital goods imported in a short time period.

Definitions and Abbreviations

Definition

<u>Domestic Investment</u>: - refers to investment committed or made by domestic investor. Domestic investor in this study denotes Ethiopian or foreign national permanently residing in Ethiopia having made on investment and Ethiopian born foreign national desiring to be considered as a domestic investor.

<u>Approved Investment Projects</u>: - refers to investment projects that have received investment permits either from EIA, or from the regional investment bureaus.

<u>Projects under implementation</u>: - refers to those approved investment projects which have started practical activities such as civil engineering works, Construction of factory buildings, purchasing of machineries and equipment but not started production or service rendering.

<u>Projects that have Commenced Operation</u>: - refers to those approved projects, which have either partially or full completed their implementation phase and began production or services.

<u>Terminated</u>: - refers to projects whose investment permits are returned by the investor, or projects whose investment permits are cancelled as per article16-2 of the investment proclamation No 37/1996.

<u>Inactive projects</u>: - refers to those projects in 1992 and 1993 and have not yet started their implementation program so far.

Abbreviation

AMRY – Average Marginal Rate for the year

EFDRE – Federal Democratic Republic of Ethiopia

EIA – Ethiopia Investment Authority

ERP – Economic Reform Program

G & NFS – Goods and net factor Services

G &S – Goods and Services

MEDaC – Ministry of Economic Development and Cooperation

MOF– Ministry of Finance

NEB– National Bank of Ethiopia

SAP– Structural Adjustment Program

SSACS– Sub-Saharan African Countries

TGE– Transitional Government of Ethiopia

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I. Introduction

It is commonly and widely thought that investment is the engine of growth. Following this view, a number of empirical studies have been made on source of economic growth. These studies have produced import findings. These findings have claimed that capital accumulation is by far the most important contributor to economic growth in developing countries followed by addition of labour inputs (Robinson and Sherman. 1971 Otai and Villanueva 1973). The view that capital accumulation matter so much in developing countries is also consistent with what is known about the pattern and process of economic development .It is also intuitively plausible that developing countries lack capital and are much less technically advanced. For capital scarce and labour abundant economies providing workers with a little more capital to work with can increase productivity and out put very significantly.

With this view many developing countries have designed their development strategy since the end of World War II. These strategies are different among these developing countries. Some have followed out- ward looking development strategy while others have pursued in-ward looking development strategy. Countries followed by out-ward looking development strategy have put at the centre the prime role of private sector while the in word looking known with pervasive role of public investment in the economy.

Because of the contraction of aggregate demand in many developing countries which

also associated with different external shocks, "import substitution strategy " got dissatisfaction as it depends on narrow domestic market and public sector dominated investment. Therefore, there is a growing realization that the recovery of private sector is required as it leads to higher efficiency of scarce resource use and adjusts to the changing global situation. It is now widely accepted that the expansion of private investment should be the source of economic growth. The recovery and expansion of private sector also central to the success of adjustment and sustainable economic growth. To this effect, the role of private sector as compared to public investment has also been investigated. It has been argued that the marginal productivity of private investment is mush higher and thus plays a more important role in the growth process than does public investment (Khan and Recinhart, 1990).

Recognizing the importance of private investment for economic growth, recent attention is focusing on its determinants taking in to consideration the specific situation of developing countries that is lack of data availability such as on capital stock, real wages, real financial service return rates for debt and equity, and imperfect capital markets.

Among the developing economies those who have pursued the development of import substitution strategy, Ethiopia was used to be one country. During the period 1974-1991, for almost two decades, the country had been following the socialist; Marxism-Leninism was being the guiding ideology and central planning is the main instrument of economic transformation. During this period, the private sector was severely restricted

from the participation in the economic activities in the country by the promulgation of the proclamation No. 26/1975, (the nationalization proclamation). As a result, private investment as percentage to GDP was being significantly dropped. For instant, it was dropped from 6.8 in 1975 during very beginning of the policy shift to socialist ideology to 1.9 % in 1989 where the socialist government recognized what was going on in the economy and declared what it called " mixed economy". Then after, the private sector start to recover and this sign of recovery was reinforced by complete move of the policy from the Socialist ideology and import substitution to market based and out-ward looking development strategy since 1992.

The transitional Government of Ethiopia, which took power from the socialist regime, had led the country for about four years with the principle of market – based economy. In order to materialize the intention of putting the private sector at fore front in the economy, the Transitional Government promulgated investment proclamation No. 15/1992. The newly promulgated investment proclamation has created good investment environment particularly for domestic investors, which lifted the majority of restrictions to the private investors. After exercising for some years this proclamation, two successive amendments have been made with the objective to enhance the participation of both domestic and foreign investments. Particularly, the last proclamations No. 37/1996 have made remarkable progress with regard to the participation of foreign investments aimed at attracting substantial foreign capital. With regard to the institution to implement investment policy and incentives, "Investment office of Ethiopia," which then renamed "Ethiopia investment Authority (EIA)," was established. The authority is accountable for investment Board that is chaired by prime minister. Along with this

office, Regional Investment Bureaus were established to implement investment policy and incentives as the country have pursued decentralization of political power to regional states. Regional states have the power to formulate and have their own respective investment policy and incentives with in the environment of the federal investment policy and incentives.

As a result, a significant recovery in private sector has been observed since 1992. This could be revealed based on the number of projects approved by the Ethiopia investment Authority and Regional investment Bureaus. Following the issuance of proclamation No. 15/1992, beginning from July 1992 up to January, 2000, 5369 projects have got permit (investment licences), with planned investment capital of 56,782,72 billion Birr and these projects when put in to operation they are supposed to create job opportunity for about 256, 947 and 477,781 permanent and temporary respectively. Out of which 5,144 projects are domestic investment licensed and con thought to create for about 227,061 permanent and 432,690 temporary employment opportunities. In spite of the enormous number of projects licensed, the real investment rate is by far less than satisfactory. For instance, out of the licensed project stated above only 28,25 percent have been put into operational and 19.05 have started implementation process. The remaining more than 50% project did not yet start any process of realization of the projects. Obviously, these show that there is some other problems behind to be investigated despite the various measures and gradual amendment of investment proclamation to further encourage and promote private sector. Thus the evidence that during the past seven years the ratio of actual (real) investment to planned investment over seven years period was very low. This low achievement rate is despite considerable effort to

remove macroeconomic imbalances, the introduction and gradual amendment of investment legislation with generous incentives and an attempt to remove the restrictions imposed on private investment in the past legislations.

The reasons for the poor performance of private investment during the Derg regime (1975- 1991) are many, among them some are restrictive polices (both on amount of capital i.e. ceiling and line of business that is not more than one business) a constraining business environment (such as credit restrictions to the private sector), and the over all uncertainty about the existing situation and future course of economic policies because of the impression of the early nationalization during the Derg regime.

In spite of the relative increase in private investment since the introduction of Economic Reform Program (ERP), private sector response has been the least sati factory aspect of ERP.   The ratio of private investment to GDP averaged 4.8 per annum for the period 1975-1998.   When it is observed by separating the two distinct policy courses during the period 1975-1991, the average rate was 3.5 per annum while the remaining period averaged 7.9 percent to GDP.   However, it has been showing a significant progress over the previous period, still the rate is very low as compared to the average rate for Sub-Saharan African counties excluding South-Africa. For instance, during the period 1986 -1998 11.7 percent for Sub-Saharan African Countries, while for the same period the average rate for Ethiopia was 5.5 percent per annum. The rate of private investment growth for Ethiopia even lower than this figure if account is taken for the "investment transfer" from the public to private sector as the result of privatisation program under

structural Adjustment Program (SAP). Thus, the low level and rate of growth of private investment has been a major problem and will be in the future confronting policy makers in the country.

The objective of this paper is an attempt to identify major determinants of macro economic variables on private investment during the period 1975-1998. Specific objectives of the study are: - to identify macroeconomic variables that explain the low level and rate of investment growth, to analyse the effect of policy changes on private investment growth over the period under consideration and lastly to draw some conclusions remarks.

As will be shown later, the studies on determinants of private investment are few and far in between. The paper has a number of limitations in many aspect (1) the problem of identifying the correct model specification (2) the adequacy and reliability of data on macroeconomic variables in general and data on private and the limited knowledge about the subject matter and (3) few and limited theoretical and empirical literatures on the determinants of private investment are among the factors that limit the scope of this paper. Adding to these limitations are the period under study includes two virtually distinct policies, which supposed to have opposite impact on the private sector. Though it is difficult to draw firm conclusions, it may be useful in identifying major problems that hinder the investment activities in the country.

The source of data for both trends and empirical analysis of the determinants of macroeconomic variables on private investment are secondary. These data are

collected from different Government Ministries and institutions in the country with few data sources from international organization (such as IMF, WB, ECA etc). The coverage of the data is uncertain since not all enterprises are registered. Aggregate investment data might miss most of data on non-formal unregistered private investments. Another problem of the data is the inadequacy and unreliability for some of macroeconomic variables included in the study. As a result, it is difficult to produce strong policy conclusions. Nevertheless, the results have highly suggestive of important area for policy action.

The methodology used in an attempt to learn more about the determinants of private investment activities in the country, is econometric regression using OLS method over the period 1975 to 1998. Following the approach taken in recent study of national savings behaviour (Aghevli et. al 1990), this paper provides a preliminary look at how various macroeconomic variables have affected private investment activity during this period in Ethiopia. Among the factors examined in the regression analysis are the following (a) real per capita GDP growth rate; (b) public investment to GDP (c) credit availability to GDP; (d) foreign exchange reserve availability to GDP; (e) real exchange rate; (f) consumer price index and (g) government budget deficit to GDP. Because of the difficulty in identifying theoretically correct specification and obtaining the necessary data, this paper does not attempt to build and estimate a full-scale structural model of private investment in the country. Rather, it is more of an exploratory data analysis, however, the results of this study may be useful in identifying the more fundamental relationships between private sector investment and macro economic variables in Ethiopia, which can then be used for appropriate policy direction

in this country.

The paper is organized as follows: the second chapter deals with the over view of the performance of Ethiopian economy over the period under study with more emphasis on recent macroeconomic variable of the post – 1992. The third chapter deals with the literature survey of the determinants of private investment. In the fourth chapter the performance of private invest separately seen by dividing the period in to two with the interest to see the private sector in two-policy environment. Chapter five deals with the empirical analysis of the determinants of macroeconomic variables using econometric regression. In the empirical analysis of the determinants of private investment, OLS will be used.   The final chapter will present the concluding remarks.

II. OVER VIEW OF ETHIOPIAN ECONOMY

2.1 Aggregate Output

The prior indicator of the status of once economy is its Gross Domestic Product (GDP)

and its growth rate. According to this indicator, gross domestic product growth rate by

industrial origin at 1981 constant factor cost during the year between 1981-19991, on

average was at about 2.0 per cent per annum during the last decade of the Socialist

regime (here after called Dreg regime) ending in1991. On the other hand, population

growth had been growing at 2.6 per cent per annum during the same period. From the

two indicative figures, it can be suggested that during this period, the GDP per capita

had been dramatically declining (See table2.1).

Annual Average Growth Rates of GDP by Industrial Origin at 1981 Constant Factor

Cost.

Table 2.1

Sector	Annual Average Growth Rate (%)			
	1981-9991	1981-1992	1981-1998	1993-1998
1.Agriculture and Allied	1.2	1.4	2.1	3.4
Activities 1.1 Agriculture (proper)	1.0	1.2	2.3	6.6
2. Industry	1.3	0	1.7	7.3
3. All Services	3.6	2.8	3.9	7.7

4. GDP at constant factor cost (1981)	2.0	1.7	2.7	5.5
5. Population	2.6	2.7	2.9	3.1
6. Real per Capita GDP	−0.4	−1.0	−0.1	3.2

Source: Average Growth Rates are Computed From appendix A, table A1

<u>NB</u>: All Growth Rates shown have been computed by using Ordinary Least-Squares Method.

Contributing factors to be mentioned among others were, the open and protracted war, the recurrent draught created during the period, and moreover, the centrally planned economy and the rapid and intensified state owned parastatals had led the economy to dramatically turn down due to the inefficient utilization of scarce productive resources which had resulted in high opportunity cost.

The Derg regime begun with the confiscation of the private property, by the tenet of "Social and Communal ownership" and the private sector was marginalized and moreover, legally prohibited from not having more than one business line. The business line allowed for the private sector was in the area of small and medium industries with ceiling capital of 500,000 Ethiopian Birr. The regime was over thrown through military

struggle and the period preceding the war was one of dramatic structural change. After the advent of peace, a process of economic reform has undertaken since the advent of peace and at the same time the government has made an effort to pursue prudent financial policies based on fiscal discipline while strengthening democratic participation as per the agreement on the charter of the transitional government. After the establishment of the transitional government then Federal Democratic Republic of Ethiopia (FDRE) has launched a wide range covering "Economic Reform Program (ERP)" to help enable the economic recovery since 1992. The post economic reform program spanning 1992 to 1998 is the special interest of this study to see the respond of the private sector to the rapid structural and institutional reforms undertaken.

A recovery in economic performance has been registered since the introduction of economic reform program. Real GDP by industrial origin grew at an average rate of about 5.5 per cent per annum during the period 1992 to 1998. According to the classification of Ministry of Economic Development and Cooperation (here after MEDaC), GDP comprise three sectors, Agriculture and Allied activities, Industry, and All Services. According to this classification, the profound real GDP growth rate has come from two sectors. The up surge in industrial and Service sectors which grew on annual

average rate of 7.3 and 7.7 per cent respectively over the year 1993 – 1998. The intensive emergency recovery and rehabilitation effort, and accompanied by economic reform program made possible the incapacitated manufacturing sector efficient as a result of improved availability of inputs and spare parts. Further, the Economic Reform Program has helped rectify both factor and product markets distortions. The performance of agricultural sector has also registered significant average growth rate per annum over the period, given the recurrent draught occurred in 1994. During the post reform period ending 1998 the sector grew on average 3.4 per cent per annum from the historical growth rate of one per cent per annum.

Another stance to look at the economy is the expenditure side of GDP, to have the insight of the resource gap. As most of the Sub- Saharan African countries, Ethiopia also known to be with huge resource gap. The share of the three components of aggregate demand (private expenditure, government expenditure and investment or gross domestic capital formation) as shown in the table below revealed that 82, 11 and 20 per cent of GDP in 1998 respectively. This shows that the country's domestic expenditure significantly exceeds domestic production. The excess, 13 per cent, indicates the resource gap (i.e. exports – Imports). The performance of the external

sector, which will be discussed in the next sub-section, showed that although, exports have shown a satisfactory performance since 1992, it failed behind the growth of imports as reflected by its average 15 per cent share of GDP in contrast to a more than 28 per cent share in GDP of imports in 1998. Domestic saving (measured as a residual between GDP at current market prices and consumption expenditure) and Gross Domestic Capital Formation (GDCF) has exhibited an increasing trend both in level terms and relative to GDP through out the post reform ending in the 1998. The

Expenditure on GDP at Current Market Prices (1991- 1998)

Table 2.2

Expenditure Components	Annual Average growth rates	Share as % of GDP (1991)	Share as % of GDP (1998)
Gross domestic expenditure	11.6 10.3	1072 95.5	113 93.2
Consumption expenditure	12.1	16.5	11.3
Government	10.1	80	81.8
Private	15.3	10.4	20.2
Gross capital Formation	(29.9)	(-6.9)	(13.3)
Resource Balance	23.9	5.5	15
Export of G&S	19.9	12.5	28
Import of G&NFS	11.1	---	---
GDP at Current Market prices			
Domestic Saving	22.1		6.8
Net factor Income from Row			
Net current transfer from Row	(5.9)		0.55
	11.8		7.5
Gross National savings			

	19.0		13.8

Source: Figures are computed from Appendix A, table A2

<u>Note:</u> – –Annual average growth rates shown have been computed by OLS method

–Numbers in the parenthesis are negative growth rates

Share of Gross Domestic Capital Formation in GDP has almost doubled (20.2%) after post reform period under consideration from a mere 10.4 per cent of GDP at the very beginning of the reform program 19991. During the same period domestic saving increased from 3.4 per cent of GDP to around 7 per cent of GDP ending the 1998. Domestic saving has still managed to finance only one – third of the Gross Domestic capital Formation. This suggests that the resource gap is financed from external sources, which has its implication for the economy in debt service burden in the future.

2.2 Inflation Trends in Ethiopia

In general in Ethiopia, the rate of change in over all price level (inflation) has been traditionally moderate in standard of other Sub-Saharan African countries (table 2.3). There were few years that the ratio was in double digit. According to some other studies these years coincided with the occurrence of the historical recurrent draught that has resulted in crop failure and food supply shortage as the country's agricultural sector virtually depend on rainfall. The sector provides about 80 per cent employment and 95 per cent of agricultural supply comes from small-scale private peasant holdings. Thus, it is not surprising that if said the two-digit inflation occurrence is as the result of crop failure due to rainfall shortage. Although, the reason behind for low inflation in Ethiopia is not certainly known, presumably, contributing factors are the low level of economic development coupled with the leading role of agricultural sector in the economy, featured by non-monetization and the nature of macroeconomic policies pursued are believed to have strong bearings on this out come.

Inflation trend in Ethiopia and average for SSACs excluding South Africa

Table 2.3

	1980	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96

Ethiopia	12.5	1.9	7.3	3.4	-.25	18.4	4.6	9.5	2.2	9.6	5.2	20.9	21.9	9.9	1.7	13.4	0.9
SSACs	35.7	37.0	40	65	25.6	23.9	22.8	19.9	32.6	17.6	29.2	34.4	34.6	19.1	191.3	134.9	28 2.

Continued…

	1997	1998	1999
Ethiopia	-6.2	2.3	4.8
Sub-Saharan African Countries	115	132	112.0

Source: - National Bank of Ethiopia (Ethiopia)

- Economic development Indicators for SSACs

After post-reform the prices also dropped significantly, especially in contrast to average rate of 20 per cent two years before the reform. In 1993, annually inflation rate registered only 10 per cent and this favourable performance was achieved in spite of the adverse effects on prices induced by the sharp devaluation of Birr (Ethiopian currency) in October 1992. The average annual rate hardly exceeded 10 per cent in most post-reform period beginning from February 1992 reflecting that inflation was contained in single digit. This is attributed to a combination of factors. The main reasons mentioned for this achievement are, inter alia, tight fiscal and monetary management, domestic production recovery, interest rate adjustment, and the relative stability of nominal exchange rate (MEDaC, 1999). In Ethiopia for the post - reform years with timely seasonal and fair distribution of rain fall through out the region would

led to good crop harvests, given the sluggish aggregate demand coupled with demobilization of huge army force after advent of peace have remarkably contributed to the contain of inflation below two digit as opposed to the experience of other transitional economies. The impact of good weather that lowered the prices of good and services should be given special attention, especially in view of the fact that the movement in prices are historically connected with seasonally and fair distribution of rain fall.

It is therefore that the rate of inflation has not been so tempered so much through boosting supplies as through managing demand. This is to mean that as and when private investment recovers and there is also a recovery in effective demand and hence inflationary pressures are likely to be up warding. All though price rose in 1995, the recent trend marked once again the beginning of a downward trend, to the extent of coming down to as low as 0.9 per cent in 1996, and further down to 6.2 per cent below zero the following year. However, it again registered positive rate for the following two year, 4.8%, particularly in 1999 (see table 2.3).

Nevertheless, the general price level in Ethiopia is still fair to say lower by other standard of transitional and developing economies .The deceleration of inflation rate

coupled with up ward revision of nominal interest rate enabled the real interest rate to

be positive on annual average rate basis

Table 2.4 Exchange rates, Foreign Auction Markets and Real Deposit Rates after 1992
Devaluation.

Year	Foreign Exchange Auction				Parallel Market		Real deposit interest rates
	Rates in Birr per $ (end year rates)						
	Marginal	Highest	Lowest	AMFY	End year	Average for the year	
1992	5.10	6.56	5.00	5.01	7.60	7.60	−12
1993	6.22	6.52	5.90	5.77	6.80	7.05	2.6
1994	6.32	6.45	6.25	6.25	7.70	7.30	11.5
1995	6.85	6.55	6.32	6.32	7.55	7.64	6.0
1996	7.05	7.16	6.99	6.47	7.18	7.16	5.5
1997	8.12	7.21	7.00	6.88	8.00	7.89	3.7
198	8.13	8.15	8.05	8.02	8.2	8.05	1.2

Source: national Bank of Ethiopia, 1999

Another achievement of the reform process is the narrowing of the difference between
the official and parallel exchange rates. The efficiency of the auction market, as
measured by some parameters, has constantly been improving during 1993 to 1999.
The average spread between the highest and the lowest bid rates stood at 1.7% in the
first half of 1996 after declining from 18.9% in 1995 and 4.8% in 1996 (NBE, 1999). The
narrowing of the spread in these parameters is an indication of the efficiency of auction
market .In general, given the over all tendencies that the marginal auction rate to
depreciate and that the parallel exchange rate remain stable, the probable out come in
the near future is towards complete convergence of the two (see table 2.4).

2.3 External Sector and Balance of Payment (BOP)

The structure and level of development of the economy, its openness, resource endowments and past economic policies pursued to large extent determine the export structure of a country. Being underdeveloped economy that heavily depend on agriculture; the structure of Ethiopian exports is dominated by agricultural products, which alone accounted for more than 90 per cent of the export proceeds of the country. Among the agricultural products, coffee accounts for the lion's share with around 70 per cent of agricultural export and 60 per cent of the total export proceeds. Hide and Skins and "Chat" distantly followed second and third accounting on average for 12 and 7 per cent of the total exports, respectively.

Table 2.5 Major Commodity Export Share as percentage of the Total Export

Item/Year	1991	1992	1993	1994	1995	1996	1997	1998
Coffee	0.53	0.59	0.59	0.58	0.66	0.67	0.64	0.73
Hide and Skins	0.17	0.21	0.17	0.16	0.14	0.13	0.10	0.09
Chat	0.04	0.02	0.08	0.08	0.06	0.07	0.06	0.07

Source: Calculated from table 2.6

Coffee has been the dominant export item as far back as the 1960s making-up on average 55 – 60 per cent of the total exports. Recent data from the NBE indicate that coffee has now becoming even more dominant. From 1994 to 1997, coffee alone accounted for 66 per cent of the total exports on average. Hide and skins were the second important export items that successively showed a trend of improvement until it reached its peak of 21 per cent of total exports in 1992 (NBE, 1994).

Table 2.6 Value of Exports by Major Commodity Groups in '000 Birr'

Item/ year	1991	1992	1993	1994	1995	1996	1997	1998
Coffee	288451	163824	475127	718019	1799035	1724008	230739	2827947.2
Hides and skins	92206	58645	134515	203610	373549	321001	372253	347642
Pulses and oil seeds	19349	769	5226	71891	153418	119162	161279	417798.8
Chat	20422	5073	65727	107932	172339	174444	217958	272606.4

Total	54248 5	27902 6	80081 4	12387 29	27320 44	25390 8	36177 90	3865994 .4

Source: National Bank of Ethiopia

An encouraging performance has been registered in export sector during the post-reform period. The trade balance has never got surplus, however. Export earnings have registered a continuous revival from 154 million USD in 1992 just one year before the beginning of the reform to 600 million USD in 1998. The recovering of export sector during the post-reform period, due mainly to the reform program package under taken with the objective to encourage the sector. Among the policy measures under taken to remove the bias against the export sector are, the devaluation of exchange rate by 58% (i.e. 2,07 Birr / USD to 5.0 Birr /USD/ and gradual adjustment to the parallel exchange rate (un official rate), Introduction of foreign exchange auction market, the suspension of taxes and duties on export goods except on coffee in January 1993, the introduction of export duty draw back scheme in August, 1993, subsequent reduction and elimination of the foreign exchange surrender requirement ,and allowing of exporters to open foreign exchange deposit accounts in commercial banks. With regard to imports, a gradual step by step measure have been under taken to liberalize protected domestic

marks to induce competition on domestic market and hence efficient utilization of scarce resources. Accordingly, the maximum tariff rate was reduced to 50 per cent from the high of 230 per cent. The numbers of tax exemption were also declined from 327 to 138, and the weighted average tariff rate has been brought down to 21 percent. Simplification of the system of import licenses and reduction of the negative lists has also been under taken as part for simplification and standardization of customs clearance procedures (FDRE, 1996b).

The above-mentioned measures undertaken to liberalize the external sector have helped the private sector recovering in external sector. The participation of the private sector which had been marginalized during the socialist (Derg) regime has become dynamic with its share in export earnings growing continuously from 18 percent in 1992 to 63 percent in 1997 (see table 2.7). How ever, the revival in private sector participation has not been changed significantly either in the volume or the diversification of export from the traditionally exported goods (coffee, hide and skin, oil seeds and pulses which are virtually all agricultural commodities). As shown in Table 2.6 Ethiopia's export has been and still is highly dependent on a few agricultural products. Undoubtedly, this

structure of exports makes the country's external sector susceptible to adverse shocks

that affect both the agricultural and industrial sectors of the Ethiopian economy.

Table 2.7 Annual Foreign Exchange Earnings from Merchandise Export. (In Million Birr)

Operator/Year	1992	1993	1994	1995	1996	1997
Private Sector	74.4	158.9	264.4	1317.8	1344.4	2084.0
Government	318.6	393.3	367.2	1418.4	1150.5	1223.8
Total	392.8	552.3	631.6	2736.2	2494.9	3307.8
Share of total (%)	100	100	100	100	100	100
. Private	18	28.8	41.9	48.2	53.9	63.0
. Government	82	71.2	58.1	51.8	46.1	37.0

Source: National Bank of Ethiopia.

Triggered by the demand due to the recovery and reconstruction, imports have also

showed significant increase over the post-reform program period. Merchandise import

was valued at 874.8 million USD in 1992, which now rose to 1.45 billion USD in 1998.

The lion share of imports has been accounted for by capital and consumer goods, which

altogether accounted for 64% of imports during the period 1992 -1997

Imports by End Use

Table 2.8

(In Million USD)

Item/ year	! 992	1993	1994	1995	1996	1997	1998
Raw Material	13.7	20.6	14.9	20.9	29	31.2	32.6
Semi finished G.	76.9	94.9	129.3	182.8	253.2	269.8	267.5
Chemicals	7.9	35.3	33.1	36.6	51	58.9	51.1
Fertilizers	43.0	3.8	11.8	44.3	101.4	109	110.9
Textile M.	8.7	11	11.8	17.4	24.3	26	25.9
Fuel	120.4	198	222.3	168.9	214.9	231.9	224.5
Capital Goods	226.0	382.0	238.6	333.7	460.2	515	485.7
Transport	162.6	251.9	109.6	140.2	192.2	234.1	201.3
Agricultural	1.2	2.7	5.8	20.4	28.2	32.3	35.10
|Industrial	62.3	127.4	123.2	173.1	239.8	248.6	249.3
Consumer Goods	260.2	334.7	291.3	340	425.1	322.5	406.9
Durables	66.4	81.6	79.7	90.9	113.7	118.6	114.0
Non Durables	193.8	253.1	211.6	249.1	311.4	203.9	292.8
Food	131.0	167.4	126.4	180.6	215	109.9	208.5
Medical	16.5	38.2	37.3	35.2	41.4	41.7	40.6
Textiles	34.3	21.3	20	20.2	25.3	25.8	25.7
Total	874.8	1051.8	914.6	1063	1412.9	1403.1	1450.5

Source:- National Bank of Ethiopia.

Chronic trade deficit has remained the dominant feature of Ethiopia's merchandise external sector for a long period of time. This trend has also kept on even during the post-reform period as export earnings have still fallen behind the import bill. However, the resource gap has been bridged by huge in flow of foreign capital. The official foreign capital inflow has helped the recovery of the reserve position. As a result, the reserve position that reached a mere 4.3weeks of import in 1992 recovered to 33.1 weeks of import in 1996 but slightly declined to 22.6 weeks of import in 1997. It also further declined to 18 week of import in 1998. The fact that the recovery of the reserve position of the country relied much on the external resources puts a question on the sustainability of the reserve position and should cause a concern for urgent need of export base diversification in order to boost earnings from export of the country.

Table 1.7 Indicators of Balance of Payment Position (BOP)　　　(In Million USD)

	1992	1993	1994	1995	1996	1997	1998
Exports	542. 5	222. 4	279. 6	453.6	410. 2	604. 4	600
Imports	874. 8	1051. 8	914. 6	1063	1412. 9	1403. 1	1456. 5
Trade Balance	**- 332. 3**	**-829.4**	**- 635. 1**	**- 609. 4**	**- 1002. 7**	**-798.7**	**- 850. 5**
Net Services		-23.1	10. 9	60. 8	95. 1	99. 6	88. 7
Private transfer		247. 9	246. 9	311. 2	313. 4	258. 1	334. 1
Current Account Balance		**-604. 4**	**- 377. 2**	**- 237. 4**	**-594. 2**	**- 448. 7**	**- 427.8**
Capital Account		-128	236. 3	8. 6	-11. 3	- 54. 9	174. 8
Errors and Omissions		233. 5	23.6	- 37. 6	124. 7	- 116. 9	- 145. 9
Over all Balance		**- 98. 8**	**167.7**	**161. 6**	**- 89. 1**	**- 386. 7**	**- 107. 5**
Reserve in Weeks of Imports	4.3	14. 7	28.3	30. 2	33. 1	22. 6	18

Source: National Bank of Ethiopia

2.4. Public finance

The expanded role of the government in all aspects during the period 1974 to 1991 resulted in significant development of the public sector relative to others. Government diversify its role, to provide basic infrastructure and social services while at the same time engaged in the production and distribution of consumption goods and services, which entailed that the establishment of a number of institution and parastatals enterprises to achieve the set development strategy. As a result, the out come of these development put pressure on government budget which led to persistent and widening fiscal deficit and other macroeconomic imbalances.

Government performance Indicators

Table 2.10   (In million Birr)

Year	Domestic Revenue	Total Expenditure	Deficit	GDP	Ratio to GDP			Percentage charge over the previous year			
					Revenue	Expenditure	Deficit	Exp	Rev	Def.	GDP
1981	1757.1	2296.5	−539.4	10721.3	16.4	21.4	−5.0	--	--	--	--
1982	1876.6	2649.8	−773.2	11280.9	16.6	23.5	−6.9	15.4	6.8	15.4	5.2
1983	2174.5	3807.6	−1633.1	12540.0	17.3	30.4	−13.0	43.7	15.9	43.7	11.2
1984	2293.8	3198.1	−904.3	11849.3	19.4	27.0	−7.6	16.0	5.5	16.0	5.5
1985	2323.2	3924.5	−1601.3	13876.2	16.7	28.3	−11.5	22.7	1.3	22.7	17.1

1986	2806.1	4131.1	−1325.0	14493.3	19.4	28.5	−9.1	5.3	20.8	5.3	4.4
1987	2925.8	4136.3	−1210.5	15501.2	18.9	26.7	−7.8	0.1	4.3	0.1	7.0
1988	3467.1	5058.1	−1591.0	15996.9	21.7	31.6	−9.9	22.3	18.5	22.3	3.2
1989	3899.2	5912.4	−2013.2	16873.4	23.1	35.0	−11.9	16.9	12.5	16.9	5.5
1990	3142.8	5369.2	−2226.4	17821.7	17.6	30.1	−12.5	9.2	19.4	9.2	5.6
1991	2706.7	4852.4	−2145.7	19815.6	13.7	24.5	−10.8	9.6	13.9	9.6	11.2
1992	2207.9	4205.3	−1997.4	20793.0	10.6	20.2	−9.6	13.3	18.4	13.3	4.9
1993	3191.2	5219.4	−2028.2	26552.0	12.0	19.7	−7.6	24.1	44.5	24.1	27.7
1994	3938.8	7093.8	−3155.0	28355.0	13.9	25.0	−11.1	35.9	23.4	35.9	6.8
1995	5912.7	8372.0	−2459.3	34063.0	17.4	24.6	−7.2	18.0	50.1	18.0	20.1
1996	6966.1	10194.0	−3227.9	38771.0	18.0	26.3	−8.3	21.0	17.8	21.8	13.8
1997	7877.4	10017.2	−2139.8	41465.0	19.0	24.2	−5.2	1.7	13.1	1.7	6.9
1998	8400.1	11460.0	−3059.9	45188.8	18.6	25.4	−6.8	14.4	6.6	14.4	9.0

Source: −Revenue and Expenditure accounts – Ministry of Finance, Data on GDP are from MEDaC

Leaving aside the question of the desirability and feasibility of growing of the public sector, the decade 1980s marked with significant growth both in total government expenditure and revenue. However, annual growth in total expenditure (averaging about

9 per cent) had exceeded growth in revenue, which averaged at around 6 percent per annum during this period. By the year 1990, total expenditure stood up the level of Birr 5369.2 million (30 per cent of GDP) while revenue was Birr 3142.8 million (17.6 percent of GDP). Both revenue and expenditure attained their peak performance level during the Derg regime in 1989 amounting to 23 and 35 percent of nominal GDP respectively.

A part from fast growth of revenue, government expenditure during the Derg period had also serious structural problems. Capital expenditure during this period accounted for around 29 percent of total expenditure on average, while the remaining 71 per cent attributed to recurrent outlays. A significant portion of the recurrent budget used to be allocated for defence out lays, which in later years of Derg claimed to be accounted for 30 per cent of the total recurrent expenditure. Despite remarkable growth in revenue, the Derg period was marked by worsening budget deficit as a ratio to GDP increased from 5 in 1981 percent to about 12 per cent in 1990.

After the over thrown of the Derg regime the transitional government of Ethiopia, established in July, 1991,have initiated a market based economic policy accompanied by a comprehensive economic reform program. As stated on the statement of the

objectives of the reform program, among the stated objectives was rectifying the fiscal ills and attain a consolidated government budget (TGE, 1992). The strategy to achieve the objective was rationalizing the role of the government in the economy, reorientation of the expenditure and reinforcing through enhancement of revenue performance at the same time. Reviewing the reform program for fiscal policy and stating the policy measures that have been undertaken is beyond the scope of this study. The purpose of looking at the public sector in this paper is whether there is a change in fiscal trend during the post-reform period, which supposed to have substantial signal to private sector,

Given the strong recovery in domestic production (particularly industry and service sectors) and enhanced inflow of external resources have helped government attain a prudent and sound fiscal environment during the post- reform period ending in 1998. Fiscal deficit excluding grants declined subsequently from about 11 per cent of GDP in 1991 to about 5 percent of GDP in 1997. It again rose to around 6.8 per cent in 1998. Government borrowing from the domestic banking system gradually declined and government began to effect net repayment of loan owed to the banking system since 1995 sizable portion of the budget was financed from the external sources. The over all

improvement in fiscal soundness also witnessed by the capacity of the government to finance increasingly large part of capital expenditure out of domestic revenue having fully covered the recurrent portion of total expenditure.

The structure Of Government Expenditure (1986-1998)

Table 2.11   (In million Birr)

Year	Recurrent Expenditure	As% of Total	Capital expenditure	As % of Total	Total Expendi.	Capital Expend as % GDP	Recurrent Expendi. As% GDP	Total expendi. As % GDP
1986	2659.3		1471.8		4131.1	10.2	18.3	28.5
1987	2754.1	64.4	1382.2	35.6	4136.3	8.9	22.5	26.7
1988	3598.9	66.6	1459.2	33.4	5058.1	9.1	23.5	31.6
1989	3972.7	71.2	1939.7	28.8	5912.4	11.5	22.0	35.0
1990	3929.1	67.2	1440.1	32.8	5369.2	8.1	22.4	30.0
1991	3640.1	73.2	1214.1	26.8	4854.2	6.1	18.4	24.5
1992	3253.5	75.3	951.8	24.7	4205.3	4.6	15.6	20.2
1993	3434.5	77.6	1784.9	22.4	5219.4	6.7	12.9	19.7
1994	43399.5	65.8	2694.3	34.2	7093.8	9.5	15.5	25.0
1995	5215.5	62.0	3156.5	38.0	8372.0	9.3	15.3	24.6
1996	5582.2	62.3	3562.6	37.7	10194.0	9.2	14.2	26.3
1997	5716.2	57.8	4299.9	42	10016.0	10.4	13.8	24.2
1998	7094.9	62.0	4265.1	38	11460.0	9.4	15.7	25.4

Source: - Compiled from MOF Revenue and Expenditure Accounts

Domestic revenue has achieved about 21 per cent annual average growth rate, the

period spanning 1992 to 1998. In absolute terms, it increased from about Birr 2.2 billion in 1992 to an estimated Birr 8.4 billion in 1998. Its ratio to GDP thus increased from 10.6 per cent in 1992 to around 19 per cent in 1998. Performance of government expenditure has also been equally impressive .Its growth averaged 15.4 per cent per annum for the period 1992 to 1998 which is well below the rate of growth in revenue collection. Un like the Derg period, much of the growth in total expenditure was accounted for by capital expenditure whose share in total spending increased from 22.6 per cent in 1992 to 42 per cent in 1997. In 1998, however, the share of capital and recurrent expenditure was 38 and 62 per cent respectively owing to less than satisfactory performance of capital projects and perhaps, this might be due to the effect of the Ethio-Eritrean boarder conflict since may 1998.

In line with the government's priority area of intervention, road construction and social sector kept on obtaining an increasing share of public capital expenditure, while the share of agriculture, industry and mining has declined. The gap is, supposedly, bridged via the participation of the emerging private sector in those productive sectors. Near one- fourth of the total capital expenditure was channelled to roods construction while the share of education and health sectors in total expenditure almost double as

compared to its level at the beginning of the reform period.

Recurrent expenditure grew at a lower rate than capital expenditure during the reform period and its ratio to GDP dropped from a pre-reform period of 22 per cent to about 15 per cent in recent in recent years. The share of defence in recurrent spending has substantially declined from 45 per cent during the last there years of the Derg to about 14 to 15 per cent in 1996 and 1997 (see for detail Appendix---).

2.5 Monetary Aggregate and Banking

2.5.1 Monetary Aggregate

Monetary aggregates have used to be the indicator of over all macro-economic performance. This is because, monetary aggregates can be influenced both by the level of economic growth and economic policies. During the period of the Derg regime, for instance, the widening budget deficit was financed virtually from domestic bank borrowing which claimed to be the main source of monetary expansion. The foreign capital inflow was so small that it had little role on the expansion of monetary base (M2). Despite the prevalence of the negative real interest rate on deposits, savings have been growing on average rate of 10 per cent per annum during the Derg mainly because of the absence of alternative investment outlet for the private sector financial resources. The absence of alternative investment outlets had helped the government to channel cheap financial resources to government owned enterprises. These cheap financial sources again had fostered the expansion of the state owned enterprises with relatively stable macro-economy.

The stability of macroeconomic variables did not sustain for a long time, as it came at the expense of a week economy and financial sector performance. During this period,

the private sector legally restricted not to engage in financial sector. As a result, there

was only one commercial bank owned by the government with the lion share of both

deposits and credit and a few not more than two specialized banks, which again owned

by the state.

Trends in monetary Aggregates

Table   2.12

(In Million Birr)

Item	1991	1992	1993	1994	1995	1996	1997	1998	1980 – 1990	1991 – 1998
Domestic credit	8937	10106	12167	12744	13873	15411	17146	18931	12.0	9.8
. Claims on Gov.	6022	7032	7825	9616	9024	7888	8797	9372	15.7	3.2
. Claims on other	2915	3072	4342	3128	4849	7523	8349	9559	7.6	20
Foreign Assets (net)	288	403	810	3765	4659	6236	5551	5724	−4.1	48
. National Bank	138	108	159	2143	2345	4901	2874	1963	--	--
. Commercial bank	150	295	651	1622	2314	1335	2677	3761	--	--
Brother items (Net)	1263	1498	2455	4910	4529	5991	6185	6034	--	--
Broad money	7962	9011	10522	11599	14003	15655	16511	18621	11.6	12.1
Money (M1)	6135	6845	7712	8373	9909	9917	9980	10970	12.2	7.5

. DD	2314	2529	2827	3214	4066	4261	4803	6220	13	14.4
. Cur. In circulation	3821	4316	4885	5159	5843	5657	5178	4750	11.6	1.8
Quasi Money	1827	2166	2810	3226	4094	5737	6531	7651	9.7	21.6
. Saving deposit	1679	2002	2459	2845	3649	4984	5699	6485	13.1	20.6
. Time deposits	148	164	351	38	445	753	832	1166	−6.1	29.6

Source: - National Bank Of Ethiopia (NBE)

The reforming of the financial sector and monetary policies pursued were at the centre of Economic Reform Program launched since 1992 with a broader objective of stabilizing the macro-economy and create an effective and efficient financial sector which enabling to facilitate fast economic growth. A number of reform measures have been taken along this line including the adjustment of interest rates, so as to render positive interest rates on financial assets and allowing for market determination of the interest rates by setting only the minimum deposit and maximum lending rates. Since January 1998, however, the ceiling on the lending rate was removed. Discriminatory interest rates for credit to channel to privileged sector and clients had been also suspended to rectify market distortions. Allowing the private sector in financial sector that had been marginalized from this sector during the Derg was also among the ERP. As a result, seven commercial banks, nine insurance companies and nine micro-financial institutions and have started their financial inter miadatry role in the economy

(national bank of Ethiopia, 1999). Another financial reform measure under taken was, permitting specialized banks to participate in commercial banking activities. A bi-weekly auction market for treasury-bills with three categories of maturities introduced since January 1995 that has helped avoid the crowding out effect of the government borrowing from the domestic banks while laying the ground for capital market development in Ethiopia.

Unlike the period of the 1980s when bank claims on central government grew by about 16% per annum, the post reform period witnessed at 3.2% annual growth rate. Hence, growth in the stock of domestic credit averaged 9.8% for the period 1992 –1998, despite a remarkable growth (20% per annum) in credit to non- government borrowers. Moreover, the share of government borrowing in total domestic credit declined to 49.5% in 1998 from a pick of 70% in 191992. This was made possible by the ERP aimed at stabilizing the macroeconomic imbalances in general, the prudent fiscal policy pursued in particular. The foreign assets position of the banking sector, on the other hand, grew by 48% per annum on average since 1992 reversing the 4% decline during the 1980s. Hence foreign assets of the banking sector have been an increasingly

important determinant of the expansion of the monetary base (M2) during the reform period under consideration. The annual average rate of expansion of the monetary during the reform period ending in 1998, therefore, stood at about 12 per cent nearly equal to 11.6% growth during the Derg, but now it is consistent with growth of nominal GDP.

Owing to favourable environment created for mobilization of savings, interest bearing deposits (quasi-money) have been growing at about 21% per annum during the post – reform period. While currency in circulation was declining in absolute terms. This probably reflects that the economic agents' (saving agents) recognition of the opportunity cost of holding money in terms of foregone interest bearings. This opposes markedly about 12% annual average expansion in currency out side banks during the 1980s. Demand deposits on the other hands increased by 14% per annum during the same period which mainly is attributed to the expansion of business activities. Given the commendable developments outlined above, slow down in the growth of outstanding credit to the private sector and modest increase in that of the government has been observed since 1996. On the other hand, the rate of growth in the interest bearing deposits have also decelerated, particularly that of saving deposits.

2.5.2 Banking

With regard to banking activities, owing to the maintenance of positive real interest rates and attainment of economic recovery, deposit mobilization of commercial banks during the post reform years (1992-1998) expanded faster (17.0%). Much of the growth in total deposit during the Derg period was attributed to an average growth rate of 10.2% and 11.9% of demand and saving deposits which supposedly, the influence of negative real interest rate on time deposit in resource mobilization.

During the post reform periods, all types of deposits have been increasing, including time deposit, which has been growing by an average rate of 17.0%. Despite the emergence of the private banks, the commercial bank of Ethiopia (state owned –bank) achieved an average growth rate of 17.0% in deposit mobilization which further helped increase in its average share in total deposit mobilization to 87.6% during the 1992 – 1998. As a result, the liberalization of the financial sector, which involved the establishment of private banking and insurance companies, has not witnessed with a remarkable expansion of private banks and the sector is still dictated by the Commercial Bank of Ethiopia with its monopoly power.

Despite the preferential access to bank credit by the socialized sector, gross credit channelled for non–government borrowers that is the private sector, public enterprises, and cooperatives declined at an average annual rate of 6% per annum during 1981 to 1991. Credit flow to the private sector had showed a declining trend over the period under the socialist regime (derg), reflecting the marginalisation the private sector in the economic endeauovers. The fact that new investment and expansion of public enterprises had been undertaken through government capital budget resulted in decline of their credit absorption at an average annual rate of 8 per cent during the Derg period although they accounted for about 60 per cent of the total credit. Following the lifting of restriction on private sector endeavours as well as discriminatory interest rates among sectors, the flow of credit to private sector during the period 1992 to 1998 had been growing at a faster rate as opposed to the pre- reform. On the other hand, credit flow to the public enterprises kept on declining during the post reform period as a result of the process of privatisation and limited new investment or expansion in public enterprises.

Credit disbursement by Clients

Table 2.13

(In Million Birr)

Client/ Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Public	547.5	1052	877.8	694.2	478.9	454.4	482.	517.4	454	387.5	207.5

enterprise							4				
Cooperatives	23.4	58.9	53	76.3	35	60.2	94.2	169	178	139.7	119.8
Private	227.5	386.5	362.8	284.9	230.3	211.1	172.4	205.4	187.6	204.3	216.5
Total	798.4	1497.4	1293.6	1055.4	744.2	725.7	749	891.8	819.6	731.5	543.8
Share of Total (%)											
– Public enterprise	68.6	70.3	67.9	65.8	64.4	62.6	64.4	58.0	55.4	53.0	38.2
– Cooperative	2.9	3.9	4.1	7.2	4.7	8.3	12.6	19.0	21.7	19.1	22.0
– Private	28.5	25.8	28.0	27.0	30.9	29.1	23.0	23.0	22.9	27.9	39.8

Continue…

Client/ Year	1992	1993	1994	1995	1996	1997	1998
Public enterprise	229.8	627.8	239.7	216.8	621	379.1	163.9
Cooperatives	77	124.7	99.4	425.4	524.7	434.5	550.3
Private	247.1	723.8	1411	2695.9	2949.3	3145.3	3867.1
Total	550.3	1476.3	1750.1	3338.1	4093.6	4018.3	4581.3
Share of Total (%)							
– Public enterprise	41.7	42.5	13.5	6.5	15.2	9.4	3.6
– Cooperative	13.4	8.4	5.7	12.7	12.8	12.3	12.0
– Private	44.9	49.1	80.6	80.8	72	78.3	84.4

Source: National Bank of Ethiopia

The reform measures under taken have shifted the credit structure disbursement in the

post reform period as evidenced by large portion of credit to private sector. Hence, in period 1992 to 1998, the average share of credit to the private sector rose to 70 per cent while of that of public enterprises dropped to 18.9 per cent. The share of cooperative stood at 10 to 11 per cent both before and after the reform program. There has been a general tendency of a slowdown in the rate of growth of credit in recent years as compared to the fast expansion in the earlier years of the reform, which could be explained by the slowdown of the boom in demand for credit at the beginning of the reform program.

The post reform period, has also witnessed with the lion share of credit has been coming from commercial Bank of Ethiopia, which still dominating the banking sector. It looks very difficult to compete with CBE who has already achieved economies of scale in the sector. Under this circumstance, it takes time takes time in banking sector to have competitive environment, unless some structural reform will be under taken on this government owned bank (CBE). However, liberalization of financial sector is so sensitive for the economy of like Ethiopia of which the financial sector is so rudimentary. A gradual process of financial sector is required after liberalization of other sectors (domestic market and external sector). However, promoting the competitive environment of domestic financial sector is helpful for efficient allocation of the scarce financial resources.

III. LITERATURE REVIEW ON DETERMINANTS OF PRIVATE INVESTMENT IN DEVELOPING COUNTRIES

It is commonly and widely thought that investment is the engine of economic growth. Those who acknowledge that this is over simplified view of the relationship would nevertheless argue that although other consideration may be relevant, investment is likely to be the major constituting factor to economic growth (Deane 1983). This view has implicitly, and some times explicitly, under pinned substantial elements of government policy in developing countries in influencing the determinants of investment. Following this view, concerned people in the area such as economists, researchers and policy makers have undertaken enormous empirical analyses.

The empirical studies on the source of output growth have produced a number of important findings. These findings have claimed that capital accumulation is by far the most important contributor to economic growth in developing countries followed by addition of labour inputs (Ray 1998, Otani, and Villanueva 1973). The findings that capital accumulation matters so much more to economic growth in developing countries than in developed countries is also consistent with what is known about the pattern and process of economic development. It is also intuitively plausible. By and large,

developing economies lack capital and are much less technically advanced. The only resource in which they have an abundant supply off is unskilled labour force. The growth of such economy will be enhanced by the injection of physical capital embodying low level of technology (Stoneman, p. and J. Vicks, 1988).

For capital scarce and labour abundant countries, providing workers with a little more capital to work with can increase productivity and output very significantly and rapidly (Gross, 1996). This is specially true if investment made in " social capital" such as transport, education and communication facilities are provided as these increase a country's productive capacity and facilitate its direct productive activities (Abramovitz, 1986). At the same time, the use of capital will increase the division of labour and bring with it the gains from specialization, which can be very considerable (Krugman, 1997). There are, therefore, strong a priori reasons for capital accumulation being so crucial to the economic growth of developing countries. That is why governments of developing countries gave more emphasis on capital formation in formulating development plan.

After World War II, most of developing countries followed development strategy of inward–orientation for different reasons. The strategy is explained by heavy

intervention of government in the economy. The economy of these countries is known

by its import substitution policies with a high rate of import protection, multiple and

over valued exchange rates and repressed financial markets (Balassa, 1989; Rodrik,

1995). Recently, however, with the growing dissatisfaction of this development

strategy, due mainly to inefficient performance of public sector dominated investment

activities, market-based development strategy has been gaining a greater degree of

acceptance from both academics and policy makers.

There is also a growing realization that adjustment to the changing global environment

of the 1990s requires the recovery of private investment that leads to a higher

efficiency in the utilization of resource and serves as a positive signal to foreign

investors (Deane 1983; Chhibber, dailamo, and Shafik 1992). Private domestic

investment in developing countries needs to be seen not only as a contributor to

economic growth and employment generation, but also a catalyst to attract foreign

direct capital. Resurgence in private investment is a necessary ingredient of a

sustainable recovery in heavily indebted developing countries (Rodrick, 1989). The

legacy of debt crisis of 1980s, the improved profitability of investment in developed

countries, the integration of European economies and market liberalization of Eastern

Europe have increased the opportunity cost of investing in developing countries (Chhibber, Dailami and Shafik, 1992). Given these facts, it is difficult and unlikely to attract foreign investment in the absence of a strong revival of indigenous private investors in these countries.

Faced with the global economic reality, a large number of countries have undertaken comprehensive economic measures such as macroeconomic and structural adjustments in the recent years. However, as explained by Dani Rodrik (1989) in his cross-sectional empirical analysis of policy uncertainty and private investment in developing countries, the private investment response to the reforms has so far been disappointing. Despite painful comprehensive reforms pursued by developing countries, capital flight has continued and only a few countries have managed what businessmen call " desired investment climate". One important reason is the high degree of uncertainty regarding future policy.

The prevalence of uncertainty of this sort creates a dilemma. For policy reform to be successful, entrepreneurs, workers, and farmers have to respond to the signal generated by the reform (Greene and Villanuva). For example, out ward – oriented exchange rate and trade policies can serve their purpose only if the desired export

response materializes. On the other hand, because physical investment is partly irreversible, the rational behaviour by private sector calls for withholding investment until much of the residual uncertainty regarding the successes of the reforms is eliminated. Knowing the factors that determine or/ and affect the response of private investment is significantly important for policy makers to encourage private investment.

The investment behaviour goes back to Keynes' (1936) " General Theory" who first called attention to the existence of an independent investment decision function in the economy. He observed that investment depends on the prospective marginal efficiency of capital relative to some interest rate that is reflective of opportunity cost of the investment funds. After Keynes, the accelerator principle was the dominant theory of investment behaviour especially during the 1950's and early 1960s.The accelerator theory postulates a linear relationship between investment and output. According to the theory, given an incremental capital/ output ratio, it is easy to compute the investment requirements associated with a given target of output growth. Hence there is a constant ratio of desired capital stock to output. This theory has been criticized by its different limitations. The theory does not consider investors' expectations, profitability, and the cost of capital as determinant of investment behaviour. To capture these limitations the

theory. Jorgenson (1967) and Hall and Jorgenson (1971) have designed the flexible accelerator model based on the optimal accumulation of the capital. They assumed that investment is the function of the level of output and the user cost of capital (which in turn depends on the price of capital goods, the real interest rate and the depreciation rate). This theory has again other drawback by its underlying assumption of perfect competition which disregarded /over looked the role of dynamic expectations of investors behaviour regarding the future prices, interest rate and output.

 In 1969 Tobin had come with the postulate that investment decisions are a function of the ratio of the addition to the value of the form due to an extra unit of capital installed to its replacement cost. This ratio Tobin's q, when it is greater (less) than units, firms would want to increase (decrease) their capital stock. As a result of poor empirical performance of flexible and Tobin's q theory, particularly for developing countries, most researchers have used more of eclectic model of the private investment designed to capture the distinctive institutional and structural features of these developing economies. They have combined the features of flexible accelerator, Neoclassical and structural models in an effort to capture the effects of resource constraints, investment irreversibility, and uncertainty to measure the political and country risk.

The latter branch of the literature is especially designed to capture the determinants of private investment in developing countries, because, it intended to capture some macroeconomic variables, or institutional features that are specific to developing countries. These specific features to the developing countries are highly vulnerable to the world economic shock, large external debt stock, resource constraint, and the role of government in the economy and the level of development and the deepening of financial and capital markets. However, some neoclassical adherents argue that the inclusions of such variables have been resulted in eclectic and ad hoc, with out strong and convincing theoretical basis (Jorgensen, 1969). All these show the attempts made by researchers to improve the theoretical basis of the macroeconomic determinants of private investment in developing countries.

Theoretical models of the determinants of private investment have been applied to the developed countries with a faire degree of success (Bischoff 1969, Clark 1979). Nevertheless, empirical studies have not yet clarified which of these models is a more accurate representation of the way in which capital formation occurred in developed countries. This is more true for developing countries where the assumptions underlying

the standard optimising investment models are usually not applicable.

Empirical studies on the determinants of private investment in developing countries have been few and rudimentary. Most of them have used a much more eclectic model of private investment designed to capture the distinctive institutional and structural features of those economies. They have combined the features of the flexible accelerator, Neoclassical and structural models in an effort to emphasize the effects of resource constraints faced by private investors in developing countries. The results of those studies suggest that expected aggregate demand measured indirectly by out put, domestic credit constraints proxied by credit availability to private sectors, real exchange rate and physical infrastructure proxied by public investment expenditure are important determinants of private investment in developing countries (Sundrajan and Thaku 1980, Tunwai and Wong 1982, Blejer and Khan 1984). Policy reforms and institutional adjustments affect private investment because they affect those determinants.

3.1 DETERMINANTS OF MACROECONOMIC VARIABLES ON DOMESTIC PRIVATE INVESTMENT

Macroeconomic policies may affect economic growth either directly through their effect on the accumulation of factors of production or indirectly through their impact on efficiency with which factors of production are used (Deane, 1983). Macroeconomic stability is important signals to the private sector about the direction of economic policies and the credibility of the authorities' commitment to manage the economy efficiently. Such stability by facilitating long-term planning and investment decisions encourages savings and private capital accumulation (Michael, Ghura, Martin, Roger and Ucer, 1995).

3.1.1. Output Growth and Private Investment

Studies of private investment behaviour have shown that private investment responds strongly to fluctuations to output (Blejer and Khan 1984, Greene and Villanuena 1990). Recessionary developments triggered by demand management policies generally contribute to pessimistic expectations. The interrelationships between investment and output are complex, they work in both directions in the sense that a higher demand for goods and services generate both for new and replacement investment (what economists call the accelerator mechanism) while, further investment, in turn, provides the potential

for more economic growth (the multiplier process). Private investment has been

hypothesized as a positive function of income per capita because of the greater ability of

higher income countries to devote resources to savings. This ability is particularly

important given the imperfection of capital markets in developing countries. Thus, most

investment projects must be financed at least in substantial part, through domestic

savings (Greene and Villaneuva, 1990). Economic recessions triggered through demand

management policies lead investors to postpone investment until recovery takes place.

There is also fear that such waiting may prevent the take-off investment, especially for

the projects of a short gestation period it often delays recovery itself, and therefore, the

economy might get trapped in a low investment equilibrium   (Serven and Solimano,

1989).

3.1.2   Domestic Inflation Rate

Beside the factor derived from the neoclassical investment model, the domestic inflation

rate affects private investment growth rate. Macroeconomic stability such as low and

predicable inflation is strong signal to ensure a strong response of private investment to

economic investors. The direction of the effects of inflation on savings, investment and

growth is ambiguous in the theoretical literature. According to the Tobin, Mundell

effect, higher anticipated inflation leads to lower interest rate and cause portfolio adjustments away from real money balance to wards real capitals, hence a higher inflation would be expected to lead to higher real investment and faster growth. However, in the case of developing countries with under developing domestic capital and financial markets, the portfolio adjustment would most likely be from real money balance to real assets (e.g. land, live stock, jewelleries, and consumer durable). Which are not usually included in private investment, or denominated in foreign currency through capital fight. Thus higher anticipated inflation in developing countries would be expected to lower private investment. Also in the context of developing countries, inflation may serve as an indicator to the credibility of the authorities commitment to stable macroeconomic environment. The presence of high and variable inflation rate would be expected to lower the credibility of the authorities visa a-vis the private sector and reduces the return on private savings and investment. Thus, high rats of inflation would be expected to lower private investment.

Further more, when the rate of inflation, is highly variable, the extraction of the correct signals from relative price movements are rather difficult task and can lead to an inefficient allocation of economic resources, including capital. There is a number of

transmission mechanism of the effects of inflation on investment and hence growth.   In

the cash - in advance models (e.g. stockman. (1981), anticipated inflation, by raising the

cost of capital accumulation, there by lowering economic growth. In this model an

increase in inflation induces firms to economize in real money balances, thus raising

transaction costs and the value of capital. The resulting increase in the price of capital

goods, leads to a reduction in the rate of investment, which in turn reduces capital

accumulation and growth.

Another effects of increasing inflation raise inflation tax and hence lower the incentive

to work. Since the productivity is supposed to depend on the employment, a fall in

employment leads to a reduction in growth. Also Fischer (19930 has noted that " the

inflation rate serves as an indicator of the over all ability of the government to manage

the economy".

3.1.3 The Foreign Exchange Constraint

Another key factor determining private investment is the access to international markets.

As developing countries' investments have under taken by importing capital goods, it is

supposed that most developing countries are subjected to foreign exchange constraints.

Indeed, this was the origin of debt crisis and again the central focus of the adjustment policies. In consequence, there is a real limit on import capacity, resulting from foreign exchange shortfalls which are in turn caused by inelastic export supply, exogenous fluctuations in export prices, external credit rationing by international financial institutions and exogenous rise in interest rates on the outstanding debt (for details, see Fitzgerad, Jansen and Vos, 1992). This is the likely that for most developing countries, private investment will be highly responsive to import capacity.

3.1.4 Interest Rate and Credit Availability

The user cost of capital is an important factor in investment decisions by the private sector. When the user cost is generally raised by increasing the cost of bank credit through raising interest rate or by increasing the opportunity cost of retained earnings, which is the other main source of investment financing, private investment declines (Jayaraman, 1996). Findings of various empirical studies are not, however, consistent. The negative influence of interest rates on investment is confirmed by certain studies in developing countries (Greene and Villaneuva, 1991, Solimano1992). However, studies by others (Serven and Solimano 1985) have shown that, in the repressed financial markets in developing countries, credit policy affects investment directly through the

stock of credit available to firms with the access to preferential interest rates, rather than through the interest channel). Thus institutional set up of the financial markets is an important factor for the transmission mechanism of the impact of monetary policy and credit policies on private investment.

However, a clear consensus has emerged in recent years that, in contrast to developing countries, one of the principal constraints on investment in developing countries is the quantity, rather than the cost of credit. The rates of return on investment in developing countries are assumed to be quite high, whereas real interest rates in these countries deliberately repressed for the variety of reasons. In such imperfect financial markets, the investor is not expected to equate the current marginal product of capital to its service cost (Serven and Solimano, 1985). Indeed, because the total amount of financing is limited and the price mechanism is not allowed to operate freely, it is logical to argue that the level of available bank credit generally restricts the private investment in developing countries. An increase in real credit to the private sector encourages real private investment as is confirmed by several empirical studies (Fry 1980, Tybout 1984, Blejer and Khan 1984). Thus, institutional set-up of the financial markets is an important factor for monetary policy and credit policies to have significant important on private investment.

3.1.5 Public Sector Investment and Private Sector

Fiscal policy affects private investment through budgetary imbalances (Matin and Wasow 1992). Persistent physical deficits either push interest rates higher or reduce the stock of credit available to the private investment. According to the empirical studies of Jayaraman cross-country analysis of six South Pacific Island countries, a reduction of budgetary deficits or running surplus has found to be encouraging private investment. Another empirical works on developing countries by Khan and Reinhart (1989) has shown that, at the best, public sector investment in developing countries has no significant effect on private investment. Findings of various empirical studies on the relationship between public and private investment have, however, been conflicting. While some say, for instance, Balassa's cross-sectional study (Balassa, 1989) has shown that there exists a negative relationship between the two, Greene and Villanueva (1990), have found a positive association between public and private investments in their cross-sectional study of 23 countries.

Many empirical researches have discovered that public investment that is related to the development of infrastructure and the provision of public goods is complementary to

private investment. Public investment of this type can enhance the profitability of private investment and therefore, raise the productivity of capital. It also increases the demand for private output and augments over all resource availability by expanding aggregate out put and savings (Khan and Reinhart, 1989). In their empirical analysis of Kenyan economy, Matin and Wasow (1992) also found the positive relationship between public investment on infrastructure and private investment. In addition, they found that the failure of controlling current expenditures adversely affected the resources that could have gone to public investment in infrastructure, which would have enhanced private investment productivity.

3.1.6 Exchange Rate Policy

Exchange rate management has clear implications for private investment. To correct the external imbalances from time to time, a real depreciation of domestic currency has been restored by developing countries under adjustment programs. In the empirical researches by Dornbush in1988, Serven in1990, Serven and Solimano in 1993 have identified three main channels through which a real depreciation can affect private investment. They are the real cost of capital goods, real interest rate and real output.

A real depreciation leads to a rise in the import cost of capital, and thus, leads to contraction of non-tradable activities. The higher is the dependency on the imported capital and intermediate goods and the lower is the proportion of tradable goods sector in the countries total economic activities, the greater will be the adverse impact of real depreciation on the level of the private investment (Jayaraman, 1996). In the case of unanticipated devaluation as well as in the case of interest rates being determined by market forces, a devaluation of the currency raises the price level through a rise in the cost of imported capital and intermediate goods and put wage indexation under pressure (Krugman, 1997). In these circumstances given the amount of money supply, real money balance will fall leading to an increase in interest rates. An increase in interest rates will decrease investment, the extent of the decrease being determined by the interest elasticity of demand for investment (Dornbush, Fischer and Startz, 1998).

Devaluation affects the output level by influencing the aggregate demand. Theoretical literatures and empirical studies tell us that the impact of real depreciation in the short-run will result in the contraction of demand. Accordingly, aggregate demand will be reduced. Chhibber and Shafik (1992) made empirical analyses of the impact of devaluation on Indonesian economy. They have found that devaluation in the short-run

has adverse supply-side effects that lead to an output contraction through increased real

costs. As a result, they found the effects of devaluation in Indonesia are contractionary

and private investment fell in the short-run.

However, most of the literatures on both theoretical and empirical studies agree that, in the mid and long-term, if devaluation significantly increases the profitability of exports and thus, the volume of net export, it is likely to increase output and private investment as well. The supporting measures, needed to sustain for the positive medium and long-effects of devaluation, are strong commitment to end uncertainties.

3.2   Evidences From Some Previous Empirical Studies

Blejer and khan (1984) examined the impact of government economic policy on private investment in some 24 developing countries. The study found that the level of private investment activity was related positively to change in expected real GDP, the availability of fund to private investment (measured by change in bank credit in private sector and the level of private capital in flow and public investment. In addition, the empirical results also showed that private investment was negatively related to excess productive capacity. The finding on the relation between public investment and private investment suggests that there is a long run complementary of private and public investment, but there is a sign of substitutability in the short-run. This is to mean in the short-run public investment increase tends to crowd-out private investment activity.

Greane and Villanuera (1991) have conducted empirical study of factors determining private investment on 23 countries. The hypothesized factors to determine private investment and included in the empirical analysis are real GDP, real interest rates, domestic inflation, the debt services ratio and the ratio of debt to GDP. The study has found that except real GDP, the remaining factors were negatively related with private

investment.

Tun Wai and Choung-Huey Wong (1982) studied determinants of private investment in developing countries using modified version of flexible accelerator theory of investment with particular reference to developing countries, which are five in number. Separate equations for each country using the ordinary least square were estimated. The results show that the coefficient of government intervention, change in bank credit to private sector, private sector out put and net capital inflow to private sector are statistically significant and have the expected sign (positive).

Matin and Wasow (1992) studied factors contributed to low level of private investment in Kenya, particularly after the coffee export boom in 1970s and the break up of East African Common Market. The study found out that declining availability of credit to private sector, falling stock of infrastructure capital and the relatively low level of foreign reserve allocation to import relative to 1970s were the main factors behind the decline in the rate of private investment in the 1980s in Kenya.

Most of the empirical literature review mentioned above had used panel data, since panel data have their own limitations in the sense that they suffer from heterogeneity

bias.   Another thing is unfortunately Ethiopia did not include in these panel data (cross-

sectional), studies I came through regarding private investment.

However, same home studies, I have seen, are limited in coverage, particularly on the recent private sector performance analysing with macroeconomic variables.   This study try to cover two distinct periods which are both in ideology and in their development policy orientation are virtual different.   The period under empirical study covered from 1975-1998.   The period spanning 1975 to 1991 was the socialist, the so-called "Dreg Regime" and the remaining period covering 1992-1998 has been the period with dramatic change both in ideology and economic development policy orientation. The later period is the particular interest of this study if the private sector responded to this policy change which would have given due emphasis on the role of the private sector in the economy at least on policy orientation.   The analysis used both the development trends in private sector and rigorous econometric regression using macroeconomic variables covering the period under study.

IV. Trends in Private investment in Ethiopia (1975 – 1998)

4.1 The Derg Regime (1975 – 1991)

It seems a promising event, When the Revolution broke out in 1974. The military group that suddenly took power out of the hands of the Emperor, looks realized the underlying economic problems of its predecessors and terminated the feudal relation of production, which was widely recognized impediment to economic development in Ethiopia.

This definitely a relief to the majority of the rural poor through the proclamation of "rural land to the tiller". This put the country one step further to wards equality particularly among the rural people. However, the over all objective of the development of the military government was to build socialist society, Marxism – Leninism was being the guiding ideology and central planning the main instrument of economic transformation.

By means of proclamation No. 26/1975 (the nationalization proclamation), large number of private businesses and properties were nationalized. Proclamation No – 76/1975

issued at the same time restricting private sector operation to a few lines of activities and imposed capital ceilings on them. Only individual business was allowed (with out branches) and private business could possibly organize them selves in the form of partnership and the membership was restricted to 5 persons.

Joint Ventures were allowed by the proclamation No- 235/1983 but only gave the right for the government and foreign investors, with the major share of the government. However, only few joint Ventures were realized over the years those were six, out of which two were liquidated (Melaku Tefera, 1989). Recognizing the over all crisis of the economy and the world situation at a time and the intensified internal instability forced the military government to change policy course, announce the so called "Mixed Economy" in 1989. The change of the policy course had did no more than the proclamation due to the short life of the Derg on the power

3.1.2 Performance of the Private Sector (Derg) (1975 – 1991)

As the policy was so much restrictive and marginalized the private sector, it is not surprising that if the least figures have witnessed from the table as compared with private investment ratio with the average for Sub -Saharan African countries during the same period. During the same period, the average investment ratio for Sub – Saharan African countries excluding South Africa was about 10% of GDP, while that of Ethiopia was on average over the period (1975 – 1991) 2.4 per cent of GDP. On the other hand, public investment to GDP had an increasing trend particularly during the time of the intensification of the establishment of the state – owned enterprises,

Except the last three years. Presumably, the deceleration of public investment after 1989 was due to the effect of policy change.

Table 4.1 Ethiopia and SSACs Private Investment rate as percentage of GDP (1986 – 1998)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	199
Ethiopia	2.0	2.0	2.0	1.9	2.4	2.8	6.0	6.4	5.8	8.5	9.6	10.9	11.
SSACs	8.2	10.8	11.9	11.5	12.8	12.3	12.4	11.8	12.4	12.8	11.7	12.8	10.

Source: – For Ethiopia – Ministry of Economic Development and Cooperation
            – For SSACs – Economic trends in Africa database, August 1998.

4.2 Development of post- 1991 Reform: -

4.2 Towards Decentralized Market- Driven Economy

4.2.1 Investment Policy and Incentives

The first significant move of the new government was the launching of the economic policy of the TGE, in 1991, the central elements were the greater scope it gave to the market mechanism governing the economy, the emphasis it placed on Federalism (TGE, 1991). The overall policy frame work of the TGE and the specific measures after wards largely aimed at the private sector for its proper role in economic activities, and to compress the role of the state to strategic activities (providing infrastructure and promote social development) and hence to create an enabling and conducive environment for private sector.

In order to materialize the intention of putting the private sector a leading in the economy, Proclamation No.15/1992 was promulgated in May 1992. The proclamation was a complete departure from the previous regimes' special investment decree No.17/1990 and joint venture special decree No.11/1989. The new promulgated investment proclamation has created good investment environment particularly for

domestic investors, which allows the participation in Air Transport, Electricity production and distribution, Banking and Insurance.

After exercising proclamation No15/1992 for about four years, a new proclamation No. 37/1996 was promulgated in July 1996 to amend some weak points of the proclamation No. 15/1992. The proclamation No. 37/1996 gave more emphasis on the clarity of some ambiguities prevailed in the first one.

With regard to institution to implement investment policy and incentives, Investment Office of Ethiopia which then renamed Investment Authority of Ethiopia (IAE) was established. The authority is accountable for Investment Board, which chaired by Prime Minister. The responsibility of investment authority of Ethiopia (IAE); process investment application, i.e., issue investment certificates and grant investment incentives as per provided in proclamation. The IAE responsible for investors with and above capital of Birr 250,000(for domestic investors) and USD 500,000 or equivalent for foreign investors[1]. If any investor did not happy by the decision of IAE, the investor can appeal to Investment Board. The decision of the Board is the final. A great process has been made with respect to the institutional arrangement from the previous regime.

Previously the investor goes to respective ministries to get temporary license and for acquisition of investment incentives to the office of investment. Now the investor goes to only IAE to get both investment certificate and incentives.

There are two types of investment rules in Ethiopia.   These are the Federal investment policy and the regional states investment regulations.   The Federal Investment policy under the proclamation no. 37/1996 aimed at improving the living standard of the people of Ethiopia by bringing sustainable economic and social development (FDRE, 1996a).   It was aimed at accelerating, economic development putting the private sector at the centre of which is supposed enable efficient utilization of natural resources which then reinforced by competitive environment and thus create wide employment opportunity.

The country after the socialist regime has been leading on the principle democratic decentralization on the basis of Federalism, Consisting of nine regional states. (Tigray, Afar, Amhara, Oromia, Somalia, Benishangul & Gumuz, SNNP, Gambella, Harrari.) And two administrations (Addis Ababa & Dire Dawa).   Therefore, one of the objective of federalism is to encourage balanced development and integrated economic activity among the regions and to strengthen the inter — sectoral linkages of the economy (FDRE, 1996a).   In fact the policy makes special discrimination in the provision of

incentives particularly tax exemption. The investment incentive council of Ministers (Regulation no. 7/19/96) provides various incentives (tax holidays, and import duty free) based on geographical, capital structural and sectoral criteria. In terms of geographical criteria it was indicated that (FDRE, 19966)

> Where the investment is in Addis Ababa, Nazareth or in a locality with in a radius of 15 km of the main high ways connecting the two cities, the period of tax exemption shall be for one year. Where the investment is relatively under developed regions such as Gamblella, Benishangul & Gumuz, SouthOmo, Certain Zones in Afar, Somali and other regions to be determined by the board, the period of exemption shall be for 3 years (FDRE, 1996a).

While the above tax holidays applies for promoted activities the tax holidays for pioneer activities are 3 years for the city of Addis Ababa and the surroundings while for underdeveloped regions this goes the 5 years and this is given to be 4 years for other locations.

Table 4.2   Tax Holidays by Locations

Location	Type of investment activities	Tax holidays (in years)
Addis Ababa, Nazreth and		

In location with in 15 km of the	Pioneer	3
Main high way connecting two cities.	Promoted	1
Relatively underdeveloped locations: -		
Benishnagul & Gumuz, Gambella,		
South Omo, other regions which will	Pioneer	5
be determined		
by the investment board	Promoted	3
All other locations	Pioneer	4
	Promoted	2

Source: - Ethiopian investment Authority, 1998.

While the above incentive policy is clearly biased towards the less developed regions and it aims to discourage development in already developed regions, the extent to which such policy has attracted investment to wards the less developed regions is a matter for study. To see the extent of this policy using some figures obtained from EIA, these figures show that the incentive policy could not achieve its stated goal of attracting investment to the less developed regions.

Table 4.3 shows that the relatively well-developed regions of Oromia, Addis Ababa, Tigray and Amhara lead investment attraction. Benishangul and Afar still lack the supposed investment attraction as intended to be.

Approved Project of Private investment in National /Regional states/ Administrations (1993 – 1999)

Table   4.3

(In Million Birr)

Region	92/93	93/94	94/95	95/96	69/97	97/98	98/99
Tigray	1121.83	313.19	1329.20(1	368.87	174.47	353.20	153.23
	(12)	(24)	48)	(146)	(19)	(380	(25)
Afar	44.52	500.80	320.23	229.27	–	304.08	283.40
	(1)	(13)	(21)	(29)		(190	(6)
Amhara	32.97	198.16	190.43	825.91	2467.43	288.27	200.3
	(22)	(32)	(73)	(123)	(62)	(59)	(40)
Oromia	113.59	364.19	563.06	1493.36	989.25	2663.045	1463.045
	(43)	(101)	(150)	(273)	(204)	(307)	(98)
Somali	102.00	–	–	6.64	119.19	20.40	19.95
	(1)			(4)	(5)	(6)	(5)
Benishangul	–	34.01	44.46	195.45	88.36	35.6	17.8
& Gumuz		(1)	(5)	(21)	(10)	(6)	(3)
SNNP	34.26	249.68	227.77	334.56	505.01	1108. 38	554.19
	(9)	(20)	(46)	(76)	(161)	(200)	(132)
Gambella	18.95	2.39	0.29	4.37	2.36	8.54	4.27
	(1)	(1)	(1)	(3)	(2)	(4)	(2)
Harari	–	72.75	209.16	52.52	29.82	240.2	46.8
		(2)	(40)	(21)	(5)	(50)	(14)
Addis Ababa	2468.57	2166.14	1818.80	3342.67	3265.98	3033.2	1516.6
	(459)	(360)	(199)	(220)	(277)	(310)	(155)
Dire Dawa	3.28	11.67	8.86	36.79	81.69	–	–
	(11)	(3)	(8)	(12)	(27)		
Total	3940	3913.	4712.3	6908.8	7623.6	–	–
	(549)	(557)	(691)	(931)	(792)		

Source: IEA, 1999

Note: – Numbers in parenthesis show number of projects, otherwise amount of planned capital.

This perhaps indicates that generous investment incentives through investment policy alone in the form of tax holidays and others are not enough to influence the inflow of

private investors to the target regions. Here, though the other main factors supposed to influence investment distribution is beyond this study, factors perceived to be influenced are infrastructure, investment implementation procedures (beaurocracies), capable human resource in respective regions and the certainty of policy environment presumably determining factors, however.

Other thing noteworthy to mention is, the different regional investment regulations are formulated from the Federal Investment Policy in their content. Regions are largely different in their investment opportunity however. These different sectoral compositions and opportunities should be specifically reflected in different regional states investment regulations. The sectoral priority of one region may be different from the other regional priority. For instance, regions with high livestock potential should be able to give more emphasis to promote livestock development. Other region may has tourist potential, this region too, should give due emphasis in promoting this sector.

Regions have developed institutional structures to implement investment policy and have provided some rules regarding the rural and urban land for investment purposes. The following discusses the case of Oromia regional state which is geographically at

the centre of the country and relatively wide in land coverage and natural resource endowed. This regional state has twelve provinces which vary relatively in development level. The region established investment promotion organs in hierarchical order. These are Oromia investment beauru accountable for Investment Board, Zonal and district committee. The Regional Investment Beauru is responsible for the day-to-day activities of investment through Zonal and District Investment Committee in the region.

Among the investment promotion incentives, the provision of rural land is as one the area of investment promotion. The investment proclamation no. 31/ 1995 provides for the use of rural land of investment in the Oromia Region indicates that land will be given on priority bases to projects falling in the category of activities identified to the top priority in the region or those considered having high social return. Those activities which affect the rights of the peasantry and peasant holdings and those that require land which are designated for the development of natural resources, religious sites or public services will not be granted for the investment operation. The size of land holding to be granted for investment depends on the nature of the project and the amount of capital assigned for it. Land is given on a lease contract terms for a period

more than thirty years. The lease rate for the land made to vary from Zone to Zone according to the distance from all Weather roads and the existing development level with in the zones. Hence zones such as East Shoa, West Shoa, and Arsi Which are ranked first as per this criteria have the highest lease rate per hector while zones such as Illubabor, Borena and West Wollega which are ranked least have the lowest lease rate per hectar (see table 4.3). The rate discriminates in favour of remote and under developed zones and which again differ with in the zone. The intention of such policy is to attract investment to less developed areas with in the region. In terms of investment types, those investment which are believed to contribute to the environment protection and public services will be give land free of charge. The proclamation also gives the night of holding upon requested for the above mentioned purpose by full filling the requirement on the side of the private investor, land will be given/transferred/ to the investor within fifteen days from the signing of the contract.

The performance and distribution of investment, however, does not confirm the intention provided by the proclamation. The participation and distribution of the private investors far from intention of the promotion of balanced development among zones.

Table 4.4   Floor Rate for Rural Land Investment (Birr/Hector)

Rank	Zone	Distance from Main all weather road (in Kilometre)				
1st	East Shoa					
	West Shoa	135	129.60	124.42	119.44	114.66
	Arsi					
2nd	Jimma					
	North Shoa	114.75	110.16	105.75	101.52	97.46
	East Hararghe					
3rd	East Wollega					
	West Wollega	97.54	93.64	89.89	86.29	82.83
	Bale					
4th	Illubabor					
	Borena	82.91	79.59	76.41	73.35	70.40
	West Wollega					

Source: – Oromia Regional Government Council (1995) proclamation no. 31/1995

In terms of the performance of investment, during the period of July 1992 to May 9,2000 the number of projects, which have received license to operate in the Oromia region, were 1216 of which only 401 projects (33%) of the total have started production or service. Above 17.5 percent have reported to be under implementation while not much is known about the remaining 350 percent of the projects. This obviously indicates that beyond the regional investment policy or the incentive system there are some factors, which deterred investors to materialize their planned investment. The

reasons as to why low rate of implementation of the projects in the region are; administrative procedures, some ambiguity on the regulation of investment incentive by bottom executing groups and rural land lease rate unclarity, however, are among widely claimed to be problems in the region.

In terms of the distribution of investment in the region there is a clear bias towards the more developed zones of the region (table 4.4). East and west Shoa are the ones with the highest amount of investment projects. Borena and Illubabor are among those, which have small number of projects. East Harerghe with only 2 private investment projects is the one with the lowest number.

Table 4.5 Types of Approved Projects, Operational and Implementation Number, Investment Capital and Employment Creation of Domestic Investment projects, by type in Oromia Region. (July 1992 – July 2000)

Type	No. Of project	Investment)	Employment Creation	
		Capital (Mill.Birr)	Permanent	Temporary
Approved	1,168	5,273.49	47,435	5,827
Operation	394	1,344.99	14435	4,127
Implementation	498	1,122.02	7,395	186
Operation as % Approved	33.73	25.5	30.43	70.82
Implementation as % Approved	16.95	21.28	15.59	3.19

Table 4.6　　　Zonal Distribution of Licensed Private Investment

	Agriculture	Industry	Hotel	Social Service	Construction	Trade	Rural estate	Mining	Transport	Total
East Shoa	117	94	24	6	2	8	3	1	2	259
West Shoa	107	49	7	–	–	1	–	–	2	169
North Shoa	17	5	3	–	–	–	–	–	–	25
West Shoa	13	5	–	–	–	–	–	–	–	18
East Harerghe	2	–	–	–	–	–	–	–	–	2
East Wollega	14	–	–	–	–	2	–	–	–	16
West Wollega	15	22	1	––	–	–	–	1	–	39
Jimma	21	39	2	1	–	–	1	–	–	64
Arsi	48	6	1	1	1	1	–	–	–	57
Bale	9	4	–	–	–	–	–	–	2	13
Borena	3	34	1	–	3	–	–	–	–	38
Illubabor	8	12	–	–	–	–		–	–	23
Different Zones	40	–	–	–	–		–	–	–	40

4.2.2 Performance of Private Investment Post-1992 ERP

Perhaps the least satisfactory aspect of Economic Reform Program Process looks to be

the response of the private sector. In spite of the various measures and gradual amendment of investment proclamation has been undertaken to further encourage private sector, the supply response of the private sector is far from the satisfactory as to be intended in he program. The case is more serious when it comes to materialisation of licensed projects.

Different literatures have forwarded different suggestions evidencing more of qualitative reasons with little empirical or quantitative seasonings. Contributing factors among the suggested impediments can be seen in to two aspects. Firstly, from investors aspect; investors in Ethiopia had been marginalized from economic activities for years, so that they have the impression that if the newly changed investment environment is that much credible and to sustain. In addition, the irreversibility of investment behaviour which entails that any investor rationally think that postponding (waiting) investment activities till the uncertainty residuals are removed is the expected behaviour for short period of time. Secondly, the institutional, infrastructures and resource constraints are the outstanding

Obscures that slowed down the pace of real rate of investment in Ethiopia

Table 4.7 Number, Investment Capital and Employment Creation of approved, Terminated and inactive Investment projects by Sector (June, 1992 – January 2000). (Investment Capital in million Birr)

Sector	Total Approved				Terminated projects	Inactive projects
	No. Of Proj.	Investment Capital	Employment Creation			
			Permanent	Temporary		
Primary Sector	1,362	7,464.68	53,943	509,053	38	11
Secondary Sector	2,413	17,817.56	103,510	25,400	32	150
Tertiary Sector	1674	32,481.09	106,652	23,312	20	200
Grand Total	5,369	57,763.33	264,105	557,765	90	361

Source: Ethiopia Investment Authority, January 2000

However, Whatever, the reasons for forwarded for weak response of the private sector, the figures regarding the intended plan investments are impressive, since the number of newly licensed projects have been increased enormously. For instance, since July 1992 up to January, 2000; 5369 projects have got permits (investment licenses), out of which 1,324 projects are in primary sector (Agriculture and Allied activities), with intended

planned capital of 7,094.65 and are expected to create employment both permanent and

temporary 50,007 and 429,152 people respectively. The remaining projects are

categorized as secondary sector (industrial sector) and Tertiary sector (All service

sector) 2,381 and 1.664 projects with planned capital investment of Birr 17,521.28 and

32,166.83 respectively. As to employment creation the two sectors are expected to

generate job opportunity for about 206940 permanent and 486.29 temporary.

Beginning the promulgation of investment proclamation no. 15/1992 projects whose

their licenses were terminated (either cancelled by EIA or returned by investors

themselves) are 90 projects (38 from primary, 32 from secondary. and 20 from territory

sectors). While since 1992/93 those projects approved and did not yet start any

activity and categorized by the authority as in active projects are 361(11 from primary,

150 from secondary and 200 from territory) (See table).

Table 4.8   Number of projects by the ownership.

Description	Total	Domestic				Foreign		
		No.of Proje.	Invest. Capital	Employment permanent	Temporary	No. Of Projects	Investment Capital	Employm
Approved	5369	5144	35,989. 73	227,06 1	432,690	205	10,201. 14	30947
Operation	1517	1470	6330.81	52212	267390	45	3,541.4 6	16,907
Implementati on	1,02 3	954	7264.05	40,044	29,787	63	4,217.6 6	14,040

% To approved								
	28.25	28.58	17.59	22.99	61.80	21.95	34.72	32.07
Operation					6.88			
			20.18	17.64		30.73	41.34	31.48
Implementation	19.05	18.55						

Source: Ethiopia Investment Authority

Among 5368 projects which have got permits since July, 1992 to January, 2000, 5144 projects are owned by domestic investors and the remaining 205 projects are either wholly owned by foreign or joint venture. In terms of planned investment capital, domestic projects amounts 35,989.73 billion Birr while foreign capital on approved projects is 10,201.14 billion Birr. From the same table ---, one interesting figures can be observed. Among the projects that have been given investment certificates, just over 28 percent have been commenced operation and 18 per have started implementation for domestic projects. As to employment creation, the total approved domestic projects are supposed to create job opportunity for about 227,061 permanent job and 432,690 temporary jobs. However, as low the real rate of investment put in to either operation or implementation, it has been possible to create job opportunity only for 52212 and 267,390 people permanently and temporarily respectively. While on the

other hand, projects under implementation have created job opportunity both for permanent and temporary for about 954 and 7,264.05 people respectively.

Secondly, the sectoral and regional distributed of these projects is highly skewed (See Appendix table...). Most t of the projects under implementation is in manufacturing and agriculture, and is mainly located in the capital. Even with in manufacturing, it seems to concentrate around the traditionally dominant sub-sectors such as food and beverages, which does not seem to change the existing structure of the sector. It is also believed that the reform process is in large part in favour of large-scale enterprises, to the determent of the small and medium ones (Taye, 1996). Moreover, the inclination of the planned investment appears to be towards the domestic market rather than export. This situation needs to be given due attention so that the economy would move with a balanced pace in all sectors and in all regions.

According to recent studies made on the impact of Economic Reform Program on the performance of private sector, though licensed projected are very much impressive real investment rates were not as intended. These studies claimed practical policy implementation as obscures than the investment policy itself. Different recent

literatures on post-reform impact analysis on the economy in general, private sector in particular, would agree, if not all, that investment policy has created good investment environment considerably. However, there are instances of inadequacies, the major one being institutional impediments. According to some studies (Abebe, 1996), the existing lack of administrative efficiency, transparency, and accountability at different stages of investment offices with particular emphasis of some regions. The existing capacity differences among regional states would have brought remarkable discrepancy in attracting the investors. The general complain on investment policy and regulations also note worthy to be mentioned. The urban land lease system is vague about the terms of renewal of lease upon expiry. The high Land lease rate, particularly in capital city (Addis Ababa) is also considered to be responsible for low rate of real investment (Berhanu and Seid, 1998). Another missing gap in this regard is access to rural land for agricultural investment. Investors can lease rural land both from regional states that is unoccupied and farmers also can rent their land to investors depending on respective regional states regulations. However, there seems no clear regulatory framework regarding rural land and differential lease rates have been set according to the distance from all weather roads. The higher lease rate for land near to all weather roads and lower rates as one go far away from these roads. The purpose of these

differential rates is intended to discourage concentration of investment in large cities

and relatively developed regions, and to promote investment in remote and

underdeveloped regions with the objective to bring balanced growth and development in

inter-regions and intera-regions.

The government seems to be cautious on the land policy, particularly the rural land,

given the traditional historical context of the country, for fear that peasants might be

flocking to the towns by selling their farm land and cause social unrest. The fear that

farmers may sell their land in time of serious problems is looks plausible anticipation

given that famine following drought in Ethiopia is becoming chronic condition rather

than an occasional phenomena. The government strong commitment to land policy (i.e.

land is under the government and society), made dissatisfied on the donor side, since

they always try to impose a much faster pace of reform and liberalization what ever the

cost is.

In general contributing factors for weak response of private sector, though major macro
economic variables empirically analysed using econometric model in the next section, it
is possible to argue in general on some qualitative perception, given their difficulty to
weak domestic markets (effective demand, credit availability), lack of information and
weak financial and entrepreneur capacity of domestic private sector are hypothesized to
be contributing for weak response of the private sector. Another major bottleneck to

private sector is particularly; regarding regional distribution is poor infrastructure in the country in general and uneven distribution among the regions in particular. Partly the reason can be explained that in the past regimes, many regions had been marginalized from fair share of development fruits and hence the current decentralization of political flower to the regional states believed to enhance the development of regional infrastructures. Obviously, some evidences and changes have been witnessed that the government capital budget on infrastructure has been remarkably increasing after post-reform.

V. Econometric Estimation of Investment model

5.1 Model specification

The model of private investment applied to Ethiopia is an eclectic version of flexible accelerator model designed to capture some of the key determinants in developing countries. Empirical studies on private investment determinants have done to capture some of the specific features of private investment in developing countries; here too, the basic accelerator model is modified to support the view that the effects of resource constraints are significantly determining private investment behaviour in Ethiopia.

There is a growing perception that such constraints in respect of credit and foreign exchange reserves affect both the direction and speed of adjustment of actual stock of capital accumulation to desired capital stock.

4.1.2 Model specification

In the long-rum steady state, private sector desired capital stock (kt*) is assumed to be proportional to expected out put (Yt^e)

(1) $Kt* = a (Yt^e)$

Because of difficultly in identifying theoretically correct specification and obtaining the necessary and reliable data in Ethiopia, this paper does not attempt to build and

estimate a full – scale structural model of private investment in Ethiopia. Due to this fact, rather it is more of exploratory data analysis. Nevertheless the findings of this analysis may give supportive idea for those who tries to build a full – scale fundamental relation ship between private investment and macroeconomic variables in this county, which can then be used to develop appropriate model of investment behaviour.

Macroeconomic variables assumed influence the gap between actual investment to desired investment included in the empirical analysis are: – (1) real per capita GDP growth rate (2) public investment (3) real credit availability to private sector (4) real foreign exchange reserve availability to private sector (5) real exchange rate (5) consumer price index (6) government budget deficit and Dummy variable to capture structural change

There fore, private investment is a function of the following macroeconomic variables.

PI/ GDP = f (RPGR, PB/ GDP, CR/GDP, FRA /GDP, RER CPI, (BDT / GDP)-1, D).

Where

PI/GDP = the ratio of private sector investment to GDP

RPGR = real per capital GDP growth rate

Pub/GDP = public investment to GDP ratio

Cr /GDP = real credit available to private sector to real GDP ratio .

FRA/GDP = the percentage change of foreign reserve availability to private sector to

GDP,

RER = the percentage change of real exchange rate.

CPI = the percentage change in consumer price index.

BDI/ GDP (-1) = lagged ratio of government budget deficit to GDP.

D = Dummy variable to capture structural change (D= 0 for the period 1975 – 1991, and

D= 1 for the remaining period).

5.1.3 Data Exploration

To avoid non-stationary and spurious results, analysing the nature of each variable

about their distribution (normal or skewed) and its trend (stationary or non-stationary)

is the first task in econometric regression. To this affect, first, the ratio rather than the

level is preferred for each variable. Believing that this does not avoid the spurious

result particularly due to serial correlation of macroeconomic variables, for most of the

variables that are expected to suffer from non-stationary, real ratios or growth rates

have been used. These variables are real per capita GDP growth rate, real foreign

reserve and real exchange rates real credit availability. All the variables were tested

for normal distribution. It was found that all variables were almost normally distributed

results.

5.1.3 Estimation Result and Evaluation

To examine more rigorously the various hypothesis out lined above, four equations for

private investment rate were estimated for the country, using a time series data for the

period 1975- 1998. Because of the violation of the assumption of orthogonal between

the private investment ratio to GDP and real GDP growth rate, a preliminary test found

that the two are highly correlated. One of the resolutions to such problem is either to

drop or to transform the variable. Here what was made is that real per capital GDP

growth rate was used instead. For government budget deficit, because, the information

on the variable is always available at the end of the year one year lagged value was

used. To avoid the non-stationary of credit available to private sector, real rate was

employed instead of nominal rate. Every possible alternative was tried to avoid the

problem of serial correlation. To capture the policy change since early 1990s, dummy

variable was included in the specification coded zero for the period 1975 – 1991 and

one for the remaining period. This tests the difference in intercepts between the two

periods. This does not mean the inclusion of dummy variable can explain the effects and

magnitudes on private sector since the policy change. The result of the estimated four

equations using OLS were presented in table 5.1

The result of equation (1) suggest that real per capital GDP growth rate and foreign

exchange availability have exhibited expected positive sign and significant at 5% and

1% level respectively. Public investment, real exchange rate, consumer price index and

budget deficit have exhibited negative sign and except budget deficit. The three

variables are significant at 1% for public investment, 5% for real exchange rate and 10%

for consumer price index. The remaining variable that is credit availability to private

sector is positive in sign but insignificant magnitude. The equation was tested for

multicollinarity using a tolerance value, i.e. (1-(R-squared). A tolerance value of less

than 0.2 is observed for some of the variables: real exchange rate, CPI, and budget

deficit. Hence there is a need to avoid some of the variables step by step depending on

the regression result. The basis for estimating the remaining equation is: (1) the

presence of multicollinarity between some of the variables. (2) Some of the variables

such as real exchange rate, CPI, and budget deficit, are proxy the same Condition

(macroeconomic instability / uncertainty) (3) estimating each variables separately in

different equation enables us to identity its effect on the goodness of fit of the equation.

Table 5.1 OLS estimation Results for Private Investment Function

Explanatory variables	Equation			
	1	2	3	4
RPGR	0.046	0.054	0.007	0.063
	(2.22)**	(2.03)**	(0.56)	(2.40)**
PUB/GDP	−0.297	−0.254	−0.199	0.207
	(−3.35)***	(−2.26)**	(−3.96)***	(−1.90)*
CR/GDP	3.775	17.717	3.714	13.71
	(0.45)	(2.45)**	(0.76)	(1.88)*

FRA/GDP	0.197	0.131	0.077	0.158
	(6.27)***	(4.27)***	(3.43)***	(5.13)***
RER	−0.048	------------	−0.030	------------
	(−2.55)**		(−0.96)	
CPI	−0.71	−0.048	−0.059	−0.048
	(−1.80)	(−1.11)	(−3.11)***	(−0.96)
(BDT/GDP)−1	−0.071	-----------	------------	−0.048
	(−0.66)			(4.83)***
D	----------	----------	---------------	2.411
			−	(4.83)***
C	6.844	5.366	4.296	4.787
	(3.37)***	(3.030)***	(5.49)***	(2.90)**
ADJUSTED − R^2	0.91	0.84	0.87	0.97
DW − statistic	1.81	1.57	1.87	1.89

The symbols ***, **, and * denote statistical significance at the 0.01, 0.05, and 0.10

levels.

Variables which improve the predication power (R- square) of the equation will be added to the equation, where as those which resulted in the equation weak prediction power will be dropped from the equation (Hamilton, pp, 72). With this background four equations were estimated. In equation (1) all variables were included. As it has been shown in table 4, except credit availability and budget deficit, the rest variables are significant at different levels. Real per capital GDP growth rate and foreign exchange availability were positively and significantly affected private investment while public investment, real exchange rate and CPI were significantly influenced private investment in opposite direction over the regression period. In equation (2) two variables were excluded from the equation RER and (BDT/ GDP)-1. In this estimation except CPI all variables' coefficient included in estimation are significant at 5% for RPGR, PUB/GDP, CR/GDP and FRA/GDP at 1% level and except public investment, the remaining variables were positively influenced private investment. When predication power was seen, it was less than the prediction power of equation (1) i.e. it dropped from 0.91 (1) to 0.84 (2). But there was no problem of multicollinarity between variables as the analysis residuals indicated, there is no serial correlation, the error terms are normally distributed. However, Durbin –Watson statistics that shows the existence of auto correlation exhibited a reduction from equation (1) that is 1.81 to 1.57.

Nevertheless, it does not tell us a series problem of autocorrelation. In order to see the effect of omitting RER from equation (2), equation (3) was estimated by including RER. As it seen from table 5.1, in equation (3) estimation, the coefficient of RPGR, CR/GDP are insignificant, with expected sign however (i.e. positive sign). While the remaining variables are highly significant with opposite direction of influence on private investment, all are significant at 1% level. The other observation from estimation of equation on (3) is (1) predication power (as indication by adjusted $-$ R^2) has been improved as well for Durbin $-$ wanton. To see if there is structural change over the period under study, equation four was estimated. In this equation RER was excluded and (BDT/GDP) -1 was used to see the effect of its omitting in equation (3), the coefficient of all variables included in the estimation are significant at different significant level except (BDT/GDP) -1 and their sign is consistent as the preceding equations. Dummy Variable included in the equations to capture the structural change confirmed that there was structural change (policy change) over the period, which has been substantiated by high significance level at 1 %. In this equation both the prediction power (adjusted $-$R2) and Durbin $-$ Waston statistics have shown an improvement over the preceding equations (see tables 5.1, equation (4)).

From the estimations made through equation (1) to (4) public investment over the estimation period showed that in Ethiopia, it had been substituted private investment rather to complement it. The estimation results on public investment in all four equations were against most of the argument for complementarily between public investment and private investment in developing countries. It is not surprising to get such results in Ethiopia case, the country where the government capital budget had been used to establish prastatals and the government used to participate in the economy to the extent of production and distribution of consumer goods those could have been purely produced and distributed by private sector for most of the period under study (1975-1991). Out of 23 years, 17 years have fallen in the situation explained above. The remaining years have been the period of a dramatic change in economic policy in general and the role and magnitude of government in the economy in particular. Since it was found to be difficult, if not impossible, to estimate separately for the post – 1992 effect of policy change due to short period and difficulty to get quarterly or six month data on all macroeconomic variables included in the regression in the country. Thus the seventeen years negative effect of public investment out weighed the possible impact of the remaining years.

Fearing such result, because, the regression analysis comprised of two distinct periods, I tried to review exhaustively the recent economic performance with particular emphasis on private investment to show the post-1992 performance of macroeconomic variables using comparative analysis with that of the pre-1992 performance. Therefore, the estimation results using OLS over 23 years period of the impact of macroeconomic variables on private investment may be used as indicative but not conclusive. Another observation from the analysis is real exchange rate, which has been negatively influenced private sector. This result can be explained in two ways by looking at the real exchange position in two periods. The pre – 1992 period was known by over valuation, which was made deliberately to promote import substitution, which had negative affected the profitability of tradable goods. When it comes to the post –1992 devaluation, in the short period of time, devaluation has negative influence on returns to investment by increasing cost of imported capital goods. However, it is argued that devaluation has a positive effect on the profitability of tradable goods in medium and long-term. Therefore the regression results on RER have reflected the real existing situation in Ethiopia in both periods.

Budget deficit has confirmed the negative influence on private investment but with insignificant level. The estimated coefficient on CPI has confirmed the negative

correlation with private investment with less significance. This is the expected result in Ethiopia case, where we have historically moderate inflation rate as compared to the developing and transitional economic. Even though, it is difficult to tell the relative importance of each variable as a determinant of private investement, it is possible to explain the relevant elasticity from the estimated coefficient listed table 5.1. In this aspect, foreign macroeconomic variables with positive impact on private investment are foreign exchange reserve with greatest impact, followed by real per capital GDP growth rate and credit availability proxy demand and resource constraints respectively.

VI. Conclusion Remarks

The analysis of this paper has demonstrated the economic performance in general and the participation of private sector in particular over two distinctive periods. This is to mean the two periods included in the analysis are apparently different both in ideology and policy orientation of economic development. The poor performance of the economy has stemmed basically from differences in policy pursued by two governments over the period under study.

Behind the poor performance of the Socialist (Derg) regime primarily lies the poor performance agricultural sector. Agricultural out had grown on average at about 1%, while the sector accounted for about 65% of GDP, 85% of employment, 85% export earnings and provides raw materials for 70% of the country's large and medium sized agro- industries. Moreover, more than 90% of land under cultivation is operated by small – scale landholders. Therefore, a poor performance of the economy during Derg regime came from the decline and stagnation of agricultural sector. Given the above-mentioned contribution of agriculture to the economy as a whole, the success of any policy measure depends on the extent to which it address the problems of this sector.

In general the growth rate of GDP over the Derg regime was on average around 2%, while, on the other hand population had been growing at an average of rate of 2.6 percent. Obviously, this implies that GDP per capita had been declining significantly over this period (1981-1991). The centrally planned economy the country had employed, the ever intensified civil war and external sector shocks and the restrictive policy on the economy in general, the private sector in particular had led the economy to dual nature with low prices for agricultural and industrial goods in the official market, while in parallel market, the prices were significantly higher. The other indicator of relative price was the foreign exchange rate, which was more than double in parallel market than the official rate led to low, or no incentive for export sector. These restrictive policies led to excessive smuggling and severe fiscal imbalances and balance of payment problems, widened saving gap, low capacity utilization in manufacturing, severe food deficit and massive dislocation.

It was against such a distorted economic background that the current government took the power over the Derg regime. The new government has launched comprehensive economic reforms, new political and administrative system with the objective of creating market-oriented economy, democratic political and decentralized

administrative systems, respectively.   The central with this is the emphasis it has given the recovery of private sector to help enable to play the leading role in the economy.

The out come of policy change could be seen by macroeconomic variables indicators. GDP grew in real term at an average rate of 5.5% mainly with the profound up surge of industrial and service sectors, which have grown on average 7.3% and 7.7 respectively over the period 1992 to 1998.   The other instance to look at the economy is the domestic aggregate demand.   All the three (components consumption, investment and government expenditure) have shown on increasing trend.   However, the structure of the components both in volume and trend has not been changed.   This is to mean consumption expenditure constitutes still the lion's share of aggregate demand, which has led the total expenditure to exceed significantly gross domestic product.   By the year 1998, the gap stood at 13%.   This implied that the gap was financed by external financial sources.   Along this, though gross domestic savings grew at doubling rate after the introduction of economic reform program, yet it was able to finance one-third of the gross domestic fixed capital formation.   This again implied how much the county depended on external source, which may have its own implication on the economy in debt servicing in the future.

In general, since the launching of economic reform program, the macroeconomic variables have shown improvement over the period. Foreign exchange has been improved which can be seen by number of weeks import financing. At the very beginning of the ERP, it was able to finance only 1.3 weeks while it reached peak in 1996 (33.1 weeks), which then recorded deceleration trend for the remaining two years. The other significant change is inflation rate was contained at single digit from peak of about 22% one year before the reform program.

Another progress that has been seen during the post reform period is a significant recovery in private sector. This could be revealed based on the number of projects approved by the Ethiopia investment Authority and Regional investment Bureaus. Following the issuance of proclamation No. 15/1992, beginning from July 1992 up to January, 2000, 5369 projects have got permit (investment licences), with planned investment capital of 56,782,72 billion Birr and these projects when put in to operation they are supposed to create job opportunity for about 256, 947 and 477,781 permanent and temporary respectively. Out of which 5,144 projects are domestic investment licensed and con thought to create for about 227,061 permanent and 432,690 temporary

employment opportunities. In spite of the enormous number of projects licensed, the real investment rate is by far less than satisfactory. For instance, out of the licensed project stated above only 28,25 percent have been put into operational and 19.05 have started implementation process. The remaining more than 50% project did not yet start any process of realization of the projects. Obviously, these show that there is some other problems behind to be investigated despite the various measures and gradual amendment of investment proclamation to further encourage and promote private sector. Thus the evidence that during the past seven years the ratio of actual (real) investment to planned investment over seven years period was very low. This low achievement rate is despite considerable effort to remove macroeconomic imbalances, the introduction and gradual amendment of investment legislation with generous incentives and an attempt to remove the restrictions imposed on private investment in the past legislations. The hindering factor to examined is only on the macroeconomic variables and investment policy; more serious problem is putting the existing policy realization as per the intention and desire of the policy objectives.

The other main analysis of this paper is the estimation results using OLS method of the determinants of macroeconomic variables on private investment.   The results of

this study provide some support for the hypothesis that private investment rates in developing countries are affected by important macroeconomic variables. The econometric tests under taken support the view that real per capita GDP, public investment, credit availability, foreign exchange reserve availability, real exchange rate and to a lesser extent government budget deficit and consumer price index have all been significant determinants of private investment rates in Ethiopia during the period 1975-1998. Of these variables, the real per capita GDP, foreign exchange reserve availability and credit availability appear to have had a significant positive impact on private investment rates while the public investment, real exchange rate and to a lesser magnitude consumer price index have had a negative effect. These results suggest that public sector investment has been substituting the private sector in Ethiopia as opposed to most of the empirical findings on public sector investment in other developing countries, due to the fact that the majority of the years included in the regression have fallen in the period where public sector investment was used to establish state-owned enterprises. Hence, the seventeen years period, which featured by the above, mentioned situation out weighed the possible positive impact of the public sector investment there after.

The other interesting results from the estimation are the significant negative effect of real exchange rate in Ethiopia. The period 1975-1991 used to be the period of multiple and over valued exchange rates, while the remaining period 1992-1998 has been the period of devaluation and gradual adjustment the official rate to parallel market rate.

Both periods tell us most likely possible negative influence of exchange rate, which again confirmed by the regression results. This is because, over valuation act as tax on exports which reduces the return on investment, on the other hand devaluation in short-term have a negative impact on tradable goods through increasing the cost of imported capital goods as the county highly depends on import for raw materials, as well as intermediate goods.

The impact of consumer price index rate on private investment is moderate in Ethiopia as can be seen from the estimation results. These results have confirmed that the argument for historically moderate inflation rate in Ethiopia in comparison to other Sub-Sahara African Countries and transitional economies. Lastly, certainly not the least, the estimation results has confirmed that resource constraints which

captured by real per capita GDP, credit availability and foreign exchange reserve availability to private sector highly and significantly influence private investment rate in Ethiopia.

Therefore, developing more effective policy measures that can affect these macro economic variables will help promote and strengthen private sector investment activity, and there by raise the long-term rate of economic growth.

In line with this, the Economic Policy of Socialist Ethiopia was declared in February 197, which was severely restricting the role of private sector and the government controlling over all economy (NGE, 1975). To this end, the government declared subsequent proclamations.

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APPENDIX A

Trends in monetary Aggregates

Table 1.1

Item	1991	1992	1993	1994	1995	1996	1997	1998	1980–1990	1991–1998
Domestic credit	8937	10106	12167	12744	13873	15411	17146	18931	12.0	9.8
. Claims on Gov.	6022	7032	7825	9616	9024	7888	8797	9372	15.7	3.2
. Claims on other	2915	3072	4342	3128	4849	7523	8349	9559	7.6	20
Foreign Assets (net)	288	403	810	3765	4659	6236	5551	5724	–4.1	48
. National Bank	138	108	159	2143	2345	4901	2874	1963	––	––
. Commercial bank	150	295	651	1622	2314	1335	2677	3761	––	––
Brother items (Net)	1263	1498	2455	4910	4529	5991	6185	6034	––	––
Broad money	7962	9011	10522	11599	14003	15655	16511	18621	11.6	12.1
Money (M1)	6135	6845	7712	8373	9909	9917	9980	10970	12.2	7.5
. DD	2314	2529	2827	3214	4066	4261	4803	6220	13	14.4
. Cur. In circulation	3821	4316	4885	5159	5843	5657	5178	4750	11.6	1.8
Quasi Money	1827	2166	2810	3226	4094	5737	6531	7651	9.7	21.6
. Saving deposit	167	200	245	284	3649	4984	5699	6485	13.1	20.6

	9	2	9	5						
. Time deposits	148	164	351	38	445	753	832	1166	−6.1	29.6

Source: - National Bank Of Ethiopia (NBE)

Government Performance Indicators

Table 1.2

Year	Domestic Revenue	Total Expenditure	Deficit	GDP	Ratio to GDP			Percentage charge over the previous year			
					Revenue	Expenditure	Deficit	Exp	Rev	Def.	GDP
1981	1757.1	2296.5	−539.4	10721.3	16.4	21.4	−5.0	−−	−−	−−	−−
1982	1876.6	2649.8	−773.2	11280.9	16.6	23.5	−6.9	15.4	6.8	15.4	5.2
1983	2174.5	3807.6	−1633.1	12540.0	17.3	30.4	−13.0	43.7	15.9	43.7	11.2
1984	2293.8	3198.1	−904.3	11849.3	19.4	27.0	−7.6	16.0	5.5	16.0	5.5
1985	2323.2	3924.5	−1601.3	13876.2	16.7	28.3	−11.5	22.7	1.3	22.7	17.1
1986	2806.1	4131.1	−1325.0	14493.3	19.4	28.5	−9.1	5.3	20.8	5.3	4.4
1987	2925.8	4136.3	−1210.5	15501.2	18.9	26.7	−7.8	0.1	4.3	0.1	7.0
1988	3467.1	5058.1	−1591.0	15996.9	21.7	31.6	−9.9	22.3	18.5	22.3	3.2
1989	3899.2	5912.4	−2013.2	16873.4	23.1	35.0	−11.9	16.9	12.5	16.9	5.5
1990	3142.8	5369.2	−2226.4	17821.7	17.6	30.1	−12.5	9.2	19.4	9.2	5.6
1991	2706.7	4852.4	−2145.7	19815.6	13.7	24.5	−10.8	9.6	13.9	9.6	11.2
1992	2207.9	4205.3	−1997.4	20793.0	10.6	20.2	−9.6	13.3	18.4	13.3	4.9
1993	3191.2	5219.4	−2028.2	26552.0	12.0	19.7	−7.6	24.1	44.5	24.1	27.7
1994	3938.8	7093.8	−3155.0	28355.0	13.9	25.0	−11.1	35.9	23.4	35.9	6.8
1995	5912.7	8372.0	−	34063.0	17.4	24.6	−7.2	18.	50.	18.0	20.

			2459.3					0	1		1
1996	6966.1	10194.0	−3227.9	38771.0	18.0	26.3	−8.3	21.0	17.8	21.8	13.8
1997	7877.4	10017.2	−2139.8	41465.0	19.0	24.2	−5.2	1.7	13.1	1.7	6.9
1998	8400.1	11460.0	−3059.9	45188.8	18.6	25.4	−6.8	14.4	6.6	14.4	9.0

Source: -Revenue and Expenditure accounts – Ministry of Finance

- Data on GDP are from MEDac

Percentage

Share of Capital Expenditure by Sector

Table 1.3

	Sector /Year	Average over the period 1986 – 1991 (Derg)	1992	1993	1994	1995
1	Economic Development	91	88.4	84.4	73.3	77.5
	1.1 Agriculture	23	25.4	18.2	13.9	9.3
	1.2 Mining & Every	20	14.7	8.3	9.3	8.5
	1.3 Natural Resource of Settlement	16	16.0	17.8	12.9	14.7
	1.4 Industry	14	15.4	17.3	9.8	10.4
	1.5 Road construction	6	6.4	11.1	15.4	23.7
	1.6 Transport and Communication	8	7.1	7.9	9.6	5.9
	Financial agencies	2	3.4	3.4	2.2	5.0
2	Social Development	7	9.6	14.0	23.0	16.1
	2.1 Education	3	4.0	7.5	9.5	8.5
	2.2 Health	2	3.9	3.8	2.6	3.8
	2.3 Urban Dev't & Housing	1	10.2	1.4	5.9	3.5
3	General Services	2	1.6	1.3	3.0	5.3
4	Compensation payment	n.a	0.4	0.2	0.7	0.5

Source: – Calculated from appendix _____ table

– N.a – data not available

Deposit by Mobilizing Banks

Table   1.4

(In Million Birr)

Item	1991	1992	1993	1994	1995	1996	1997	19
All Banks	5121	5672	6750	7992	10111	11976	13878	17
CBE	4415	5022	6228	7436	9598	11194	12702	155
DD	26.03	2870	3461	4211	5504	6038	7065	919
SD	1677	1999	2451	2844	3649	4585	5090	56
TD	135	153	316	391	445	571	547	69
CBB	521	485	359	386	393	409	557	56
DD	–	–	–	–	11	38	37	2
SD	76	87	126	161	201	219	261	2
TD	445	398	233	215	181	152	259	28
DBE	185	165	163	170	86	10	38	6
DD						9.4	36	29
SD							2.1	
TD	185	165	163	170	86	0.3	0.1	60
Private Banks					34	363	581	98
DD					15.1	174.7	205.5	29
SD					18.5	180.7	334.3	60
TD					–	7.8	40.9	9

Source: – NBE

Note – Average growth rates shown have been computed by OLS

Deposit Mobilization by Banks and types of Deposits

Table   1.5

In Million Birr

A. Growth rate 1992 – 98	Average growth th rare 1981 – 1991	Item	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
17.6	9.8	All bank	1829.3	2011.1	2314.5	2572.6	2956.5	3261.5	3716	4082	4355	4854	5121
18.7	10.2	Demand Deposit	892	984	1148	1258	1531	2029	2029	2251	2255	2496	2603
17.5	11.9	Saving Deposit	504.3	568.1	684.5	7996	849.5	1085	1085	1267	1433	1639	1753
12.9	5.4	To me Deposit	433	459	482	515	576	602	602	564	667	719	765

Source:-National Bank of Ethiopia

Note: -All growth rates were computed by OLS method.

Credit disbursement by Clients and source

Table   1.6

(In Million Birr)

Client/ Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Public enterprise	547.5	1052	877.8	694.2	478.9	454.4	482.4	517.4	454	387.5	207.5
Cooperatives	23.4	58.9	53	76.3	35	60.2	94.2	169	178	139.7	119.8
Private	227.5	386.5	362.8	284.9	230.3	211.1	172.4	205.4	187.6	204.3	216.5
Total	798.4	1497.4	1293.6	1055.4	744.2	725.7	749	891.8	819.6	731.5	543.8
Share of Total (%)											
• Public enterprise	68.6	70.3	67.9	65.8	64.4	62.6	64.4	58.0	55.4	53.0	38.2
• Cooperative	2.9	3.9	4.1	7.2	4.7	8.3	12.6	19.0	21.7	19.1	22.0
• Private	28.5	25.8	28.0	27.0	30.9	29.1	23.0	23.0	22.9	27.9	39.8

Source: National Bank of Ethiopia

Gross Domestic Product by Industrial Origin at Constant Factor Cost

Table   1.7

(In Million Birr)

	Activity/Year	1991	1992	1993	1994	1995	1996	1997
1.	**Agriculture & Allied Activities**	6114.89	5947.60	6308.32	6078.00	6284.0	7206.2	745
	Agriculture	5330.71	5147.39	5488.27	5271.85	5450.03	6519.76	6879.
	Forest	779.48	795.20	814.77	800.57	828.60	856.80	887.
	Fishing	4.70	5.01	5.28	5.58	5.90	6.10	6.
2.	**Industry**	1024.14	951.41	1222.33	1307.21	1412.5	1492.1	160
	Mining & Quarrying	52.10	38.98	57.10	45.00	49.0	55.74	6
	Large & Medium Manufacturing	336.40	306.90	456.39	514.15	562.4	606.2	64
	Small Scale industry &Handicrafts	200.76	201.33	234.25	237.48	256.5	274.8	29
	Electricity & Water	179.90	186.86	197.80	207.90	219.3	206.4	23
	Construction	254.97	218.15	276.78	302.67	325.3	349.3	37
3.	**All Services**	3729.1	3572.5	4193.7	4525.2	4834.2	5292	570
3.1	Distributive Services	1304.92	1272.14	1555.13	1650.98	1757.3	1914.7	209
	Trade, Hotels & Restaurants	760.82	648.51	887.40	945.22	1027.7	1115.5	120
	Transport & Communication	544.09	623.63	667.73	705.76	729.6	799.2	88
3.2	Other services	2424.22	2300.42	2638.64	2874.15	3190.5	3377.3	361
	Banking & Insurance Real Estate & Owner	656.56	623.19	681.06	747.42	810.3	879.7	95

ship Dwellings							
Public Administration & Defence	913.45	776.64	1017.84	1125.04	1327.8	1391.5	148
Education	271.30	278.50	271.10	278.20	287.94	298.0	31
Health	90.80	100.00	114.70	136.80	146.51	154	16
Domestic & Other Services	492.11	522.09	553.94	585.68	618.0	654.1	69
GDP at 1980/8 constant Factor cost	10868.16	10471.56	11724.42	11910.33	12644.3	13990.3	1476

Source: Ministry of Economic Development and Cooperation

*Average Growth Rate for the Period 1992 – 1998 were Computed by OLS method

Expenditure on GDP at Current Market Price

Table   1.8

(In Million Birr)

Expenditure Components	1991	1992	1993	1994	1995	1996	19
Gross domestic Expenditure	20531.32	22077.90	28969.40	31196.40	37186.20	42694.90	4
Consumption Expenditure	18534.94	20166.80	25177.30	26902.70	31617.20	35448.80	3
Government	3165.79	2107.80	2818.80	3155.20	3675.30	4158.10	4
Private	15369.15	18059.00	22358.50	23747.50	27941.90	31290.70	3
Goss Capital formation	1996.38	1911.10	3792.10	4293.70	5569.00	7246.10	7
Resource Balance	−1335.99	−1285.90	−2298.00	−2867.50	−3301.20	−4757.30	4
Export of G&NFS	1062.21	937.50	2222.50	3223.00	4852.30	4961.70	6
Import of G&NFS	2398.20	2223.40	4520.50	6090.50	8153.50	9719.00	1
GDP at Current Market Prices	19195.34	20792.00	26671.40	28328.90	33885.00	37937.60	4
Domestic Saving	660.40	625.20	1494.10	1426.20	2267.80	2488.80	3
Net Factor Income from ROW	−142.31	178.80	14.10	−459.60	−377.50	−275.40	−
Net Current Transfers from ROW	557.11	1011.10	1930.40	2275.80	3651.90	3701.80	2
Gross National Savings	1075.20	1457.50	3010.40	3242.50	5542.20	5915.20	6
Gross National Product at Current Market Price	19053.03	20613.20	26257.30	27869.30	33507.50	37662.20	4

Gross National Disposable	19610.14	21624.30	28187.70	30145.20	37159.30	41364.00	4
Income							

Source Ministry of Economic Development and Cooperation

N.B. Growth Rates refer to the period 1993 to 1998. All Growth Rates have been computed by using OLS Method except that of the Resource Balance

Resource Balance & its financing

Table1.9

(In Million Birr)

Resource Balance & Financing Sources	1991	1992	1993	1994	1995	1996	1997
Resource Balance	–1336	–1285.9	–2298	–2867.5	–3301.2	–4757.3	–4479
Gross Domestic Saving	660.4	625.2	1494.1	1426.2	2267.8	2488.8	3440.4
Net Factor Income from Abroad	–142.3	–178.8	14.1	–459.6	–377.5	–275.4	–107.7
Net Unrequited current transfer	557.1	1011.1	1930.4	2275.8	3651.9	3701.8	2877.7
Gross National Savings	1075.2	1457.5	3438.6	3242.4	5542.2	5915.2	6210.4
Official Transfer (net)	604.3	893.5	1709.7	1647.9	2671.9	2483.4	1471.9
Total financing sources	1679.5	2351	5148.3	4890.3	8214.1	8398.6	7682.3
Gross Domestic Capital Formation	1996.4	1911.1	3792.1	4293.7	5569	7246.1	7919.8

Source: Macroeconomic planning and economic policy analysis Department (MEDaC)

Financing Sources as a Share of Gross domestic Capital Formation (%)

Table 1.10

Resource Balance & Financing		1991	1992	1993	1994	1995	1996	199

sources							
Resource Balance		−66.9	−67.3	−60.6	−66.8	−59.3	−65.7	−56.6
Gross Domestic Saving		33.1	32.7	39.4	33.2	40.7	34.3	43.4
Net Factor Income from Abroad		−7.1	−9.4	0.4	−10.7	−6.8	−3.8	−1.4
Net Unrequited current transfer		27.9	52.9	50.9	54.0	65.6	51.1	36.3
Gross National Savings		53.9	76.3	90.7	75.5	99.5	81.6	78.4
Official Transfer (net)		30.3	46.8	45.1	38.4	48.0	34.3	18.6
Total Financing Sources		84.1	123.0	135.8	113.9	1475	115.9	97.0
Gross Domestic Capital formation		100	100	100	100	100	100	100

Source: Computed Based on Data From Table

NB: Growth Rates Refer to Annual Average Growth Rates encompassing the period 1992 to 1998.

Recurrent Expenditure by Economic classification

(1986 – 1997)

Table 1.11

	Item No.							
1	Wages and Operating Expenditure	2333.1	1799.4	2208.7	2811.5	3290.0	3652.3	3
	Wages and Salaries	1394.3	1176.8	1477.0	1762.2	1893.0	2101.3	21
	Materials & equipment	938.7	622.6	731.7	1049.4	1397.0	1551.0	
	% Share	69.4	55.3	64.3	62.4	63.9	70.0	
2	Grants and contributions	174.5	485.6	328.6	217.8	385.0	387.5	
	% Share	5.2	14.9	9.6	5.0	6.8	7.4	
3	Price Subsidies	74.7	59.8	6.0	85.1	149.8	174.5	
	% Share	2.2	1.8	0.2	1.9	3.7	3.1	
4	Pension	132.6	194.3	228.2	274.9	274.4	290.6	
	% Share	4.0	5.9	6.6	6.2	5.3	5.2	
5	Interest & Charges	349.4	307.3	530.5	956.9	838.6	922.5	
	– Internal Debt	196.1	246.0	408.9	809.9	596.8	609.9	
	– External Debt	152.4	61.3	121.6	147.0	241.8	312.9	
	% Share	10.4	9.4	15.4	21.7	16.1	16.5	
6	Safety Net	–	–	–	–	64.1	12.2	
	% Share		0.0	0.0	0.0	1.2	0.2	
7	External Assistance	295.6	407.1	132.5	53.3	213.5	142.7	
	% Share	8.8	12.5	3.8	1.2	4.1	2.5	
	Total	3359.9	3253.5	3434.5	4399.6	5215.5	5582.2	5

Source: Compiled from MOF Revenue and expenditure Accounts.