Economic Growth is not an Option for Ethiopia Economic Development

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1. Introduction

In my recent two articles (Part I and II) entitled the "Sources of Inflation and Economic Growth in Ethiopia," I emphasised the need for higher economic growth in Ethiopia to achieve structural transformation in the county. At the same time, I tried to justify the main sources of inflation in the country: demand pull and cost push sources inflation. The demand pull inflation arises from higher consumption spending in the country. Cost pushes inflation occurred due to an increase in the price of imported materials. Around 95 percent of the spending in Ethiopia is used for consumption spending. The majority of this consumption spending is undertaken by private spending than government spending. This means the higher desire for spending in the country creates excess demand in the economy. The excess demand and increases in the cost of production generates the higher prices of goods and services that cause inflation.

In response to my previous article, Tsegaye Tegenu[2] has tried to comment on the suggestions I made on the sources of inflation and economic growth in Ethiopia. Actually, I appreciate any comments that would provide alternative policies to bring sustainable economic development in Ethiopia. But the idea must be in line with the existing realities in the country. The main issues raised by Tsegaye Tegenu include: how economic growth could be the first choice for Ethiopia's economic development? Is economic growth possible by cutting government spending in Ethiopia? Can excess demand cause inflation in Ethiopia? How does public spending cause economic growth in Ethiopia? These were some of the belief cysted in the comment posed by Tsegaye Tegenu. I think this is a common problem for many people who are not aware or close to the nature and characteristics of Ethiopian economy. Therefore, I would like to elucidate on the main issues mentioned above.

2. Economic growth or inflation: Which must come first

Two of the macroeconomic policy objectives are stable economic growth and price. The nature and the characteristics of economic growth determine the economic development in any country.

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[2] Growth, Inflation, Food Imbalance, Unemployment and Rentseeking: How can best be solved?, September 3,2011

In Ethiopia, we have human and natural resource that could enable us to produce goods and services like any other countries. The current government has been taking a number of measures[3] to achieve economic growth in the country. The priority of the government was to achieve economic growth with stable macroeconomic environment. In its various policy documents, the Government of Ethiopia reiterated that its objective is to reduce poverty through economic growth. Even if the government says that its objective is poverty reduction, such objective can be realised only if the country achieve continues and broad base economic growth.

In 2004, Ethiopian GDP (Gross Domestic Product) was about 63 percent of Kenyan GDP and 4.6 percent of South African GDP. But in 2009, Ethiopia managed to produce 97 percent and 10.1 percent of Kenyan and South African GDP respectively. The fast economic growth in the country between 2004 and 2009 significantly narrowed the gap between Ethiopia and the two countries (Kenya and South Africa). At the same time, it increased the per capita income of the country from $ 138 in 2004 to 344 in 2009. But still Ethiopia's per capita income is around 46.5 percent of Kenya and 6 percent of South Africa in 2009. I do not think anybody wishes Ethiopia to remain with low GDP and per capita income. The country should focus on increasing its national output (GDP) by reducing any supply side constraint.

It would be good to achieve economic growth with stable price, but if not possible due to structural problems of the economy, the priority of any government should be higher economic growth. I may not buy the idea suggested by IMF or other institution to control the demand side of the economy. We must know that higher demand creates supply which increases economic growth. At the same time, continuous economic growth reduces inflation in the long run. All rich countries had to go through economic growth for the last four decades in order to realise their today's economic and social development. Then, nothing makes unique Ethiopia not to record continuous and broad based economic growth. This should be uncompressing stand for the government of Ethiopia to bring structural transformation in the country.

3. Investment and consumption spending in Ethiopia

Investment spending refers to the spending on capital accumulation. On the other side consumption spending refers to the spending by the consumer to get the desired level happiness or

[3] Market deregulation, reducing licence fee, providing various credit schemes, focus on modernization of public sector services, and designing suitable policy environment are the major measure taken to achieve economic growth.

satisfaction. The higher consumption spending will increase aggregate demand which affects economic growth. Unlike consumption spending, investment spending affects economic growth in two ways. First, higher investment spending will increase the demand for goods and service that increase the aggregate demand in the economy. Second the higher investment spending increases infrastructure provision in the country that enhances labour production and productivity which in turn increase economic growth. In countries like Ethiopia, which is known for its poor infrastructure and weak institution, investment spending should be the priority of the economy than consumer spending.

In 2003/04, the growth of consumption spending was 8.3 percent when the growth of capital investment was 40.9 percent. In the same year, the percentage share of consumption spending and investment was 88.1 percent and 26.5 percent respectively. Such high investment in 2003/04, as compared to lower consumption spending, highly reduced the inflation in the year follow. In 2007/08, the annual growth consumption spending reached 49.8 percent when investment spending increased by 45.9 percent. In the years between 2003/04 and 2007/08, the percentage share of consumption spending to GDP increased from 88.1 percent to 94.8 percent while the investment spending declined from 26.5 percent 22.4 percent of GDP. In 2009/10, the growth of rate of consumer spending was 15.4, higher than 12.5 investment spending growth in the same year. The amount of investment spending is lower as compared to the need of the country. That is why saying higher investment, causes inflation in Ethiopia is a wrong conclusion.

Table 1: Growth and percentage share of consumption spending to GDP in Ethiopia

year	Growth of consumption spending			% share of consumption spending to GDP			% share of investment Spen. to GDP	Growth of investment Spending
	Private	Gov.	Total	Private	Gov.	Total		
2003/04	7.2	14.9	8.3	75.0	13.1	88.1	26.5	40.9
2005/06	25.9	21.8	25.4	83.3	12.2	95.4	25.1	31.2
2007/08	51.8	34.8	49.8	85.0	9.8	94.8	22.4	45.9
2008/09	35.7	13.3	33.4	85.4	8.2	93.6	22.7	37.2
2009/10	15.3	15.7	15.4	86.1	8.3	94.5	22.3	12.5
Average	27.18	20.1	26.46	82.96	10.32	93.28	23.8	33.54

Source: MoFED, 2011

In fact in Ethiopia, consumption spending is much higher than the investment spending based on the available data mentioned above. The country needs to focus more on investment spending to increase productivity which directly reduces the supply side constraint of the economy to control inflation. Unless such higher consumption spending is diverted to productive activity, it will increase price of goods and services in the economy. This was my main argument in the previous articles. The higher consumer spending aggravates inflation in the country. Therefore, we must create a favourable situation to divert the higher consumer spending to capital or investment spending to control inflation. This higher spending should not confuse anybody with full employment. Ethiopia has not reached the level of spending that provides full employment opportunity to all citizens. As I have said earlier higher consumer spending cause inflation but this does not indicate the full employment in country. The higher spending in the country was due to the rising per capita income. During higher inflation years, the per capita income in Ethiopia increased from birr 683 in 2005 to birr 992 in 2010. This means, during these years the per capita income increased by 45 percent. The higher per income capita increased the desire for spending which led to inflation.

4. Private and public spending in Ethiopia

In any country, the nature of ownership determines economic growth. The nature of ownership can be seen in terms of private and government/state ownership in the economy. There are areas that both private and government spending can be effective in the economy. When market is efficient for the provision of goods and services, we need the involvement of private sector. At the time when market fails to provide goods and services, the state play an important role in adjusting the market failure. That means, we need both the private and state involvement based on the nature of goods and services. Both must identify their roles in economic development in the country. The state should allocate the resource in designing legal framework, infrastructures' construction and institutions' building. On the other hand, the private sector should involve in the production and distribution of goods and services. The private and public spending in the economy are crucial[4] to achieve structural transformation in the economy.

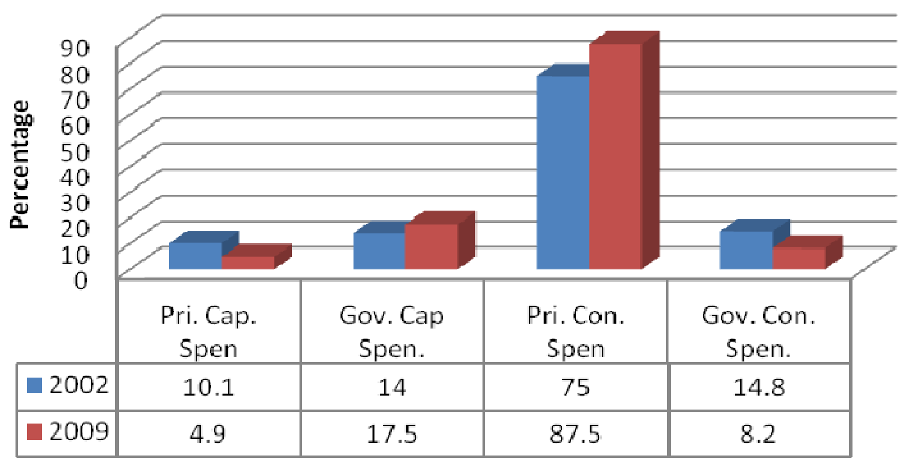
In terms of GDP share, in Ethiopia, private spending is higher than government spending. In 2009, the government and private spending were 25.7 percent and 92.4 percent of GDP respectively. Realising the importance of its involvement in the economy, today the government of Ethiopia

[4] That why today the country is working on Public and Private Partnership to harmonise the activities of private and public sector in the country.

allocated most of its budget for capital expenditure. In 2009, government consumption spending accounted for 8.2 percent of GDP when the government capital spending was 17.5 percent of the GDP in the same year.

That means much of the government spending was used for capital accumulation than consumption spending. The other evidence that supports this idea is the amount of the government budget allocated for capital expenditure. For instance, in 2009/10, out of the total budget birr 71 billion, the government allocated birr 39 billion for capital spending which is 55 percent of the total spending. These are few of the indicators for proper utilization of government resource for sustainable economic growth in the country. Against of this fact, much of the private spending in Ethiopia has been used for consumption spending than capital spending. As you can see in figure 1, in 2009, the GDP share of private consumption spending was 87.5 percent as compare to 4.9 percent GDP share of capital spending. As compared to 2002, the private consumption spending increased from 75 percent of the GDP to around 87.5 percent in 2009. Private capital spending decreased from 10.1 percent of the GDP in 2002 to 4.9 percent of GDP in 2009.

Figure 1:Government and private spending strcture in 2002 and 2009



	Pri. Cap. Spen	Gov. Cap Spen.	Pri. Con. Spen	Gov. Con. Spen.
2002	10.1	14	75	14.8
2009	4.9	17.5	87.5	8.2

Source: OECD, 2011

Most of the private spending that was used for consumption spending triggered inflation in the country. According to the OECD (2011) report, the government spending on capital spending contributes 3 percent economic growth where as private capital spending contributes only 0.4 percent to economic growth. Without understanding the benefit of government spending in economic growth in Ethiopia, many people suggest that the government should cut spending to curb inflation. As long as the government resources are used for infrastructure's construction and capacity's building, reducing or reviewing government spending is unfair and unjustified by any standard in Ethiopia context.

5. Summary

Ethiopia achieved continuous economic growth for the last six years. Such strong economic growth was characterised by higher consumer spending than investment spending. In other words, the number of people who are paying for consumption is higher than the number of people who are spending for investment. Unfortunately, the private spending in capital investment was less than the government spending. Not only this, the private consumption spending is increasing during the last few years. In this period (during higher inflation period), the percentage share of capital investment declined as compared to the percentage shares of consumption spending. The devaluation of local currency and increase in the price of imported items also contributed to the rise in the prices of goods and services.

During 2004-2009, the country achieved higher economic growth with higher inflation. Here, the question should deal with how to control inflation by maintaining higher economic growth. Not how to control inflation by stopping the higher economic growth. Economic growth is not an option in Ethiopia, because Ethiopia needs more accumulation of capital and wealth to feed its people. Economic growth increases government and private sectors financial capacity. Economic growth facilitates the modernization process of the country. When we think about economic growth, we have to look beyond the change in the real outputs. Hence, economic growth is the only means to reduce poverty in Ethiopia. Therefore, the government and private sectors must work together in investing more on infrastructure and new programs to maintain social and economic growth by increasing the aggregate supply than halting the overheated aggregate demands.

Reference

OECD[5] (2011): African Economic outlook

MoFED[6](2011): Annual report on macroeconomic development, Macro economy policy and management directorate, Addis Ababa, Ethiopia

ADF[7] (2011): Africa Statistical Yearbook

[5] OECD refers to Organization for Economic co-operation and Development
[6] MoFED refers to Ministry of finance and Economic Development
[7] ADF refers to Africa Development Fund