



Western Michigan University
ScholarWorks at WMU

International Conference on African
Development Archives

Center for African Development Policy
Research

8-2007

The Political Economy of Poverty Reduction Policies in Ethiopia

Abu Girma Moges
A&A Optimum Solutions, Japan, abugirma@gmail.com

Follow this and additional works at: https://scholarworks.wmich.edu/africancenter_icad_archive



Part of the African Studies Commons, and the Economics Commons

WMU ScholarWorks Citation

Moges, Abu Girma, "The Political Economy of Poverty Reduction Policies in Ethiopia" (2007). *International Conference on African Development Archives*. 122.

https://scholarworks.wmich.edu/africancenter_icad_archive/122

This Paper is brought to you for free and open access by the Center for African Development Policy Research at ScholarWorks at WMU. It has been accepted for inclusion in International Conference on African Development Archives by an authorized administrator of ScholarWorks at WMU. For more information, please contact wmu-scholarworks@wmich.edu.



The Political Economy of Poverty Reduction Policies in Ethiopia

Abu Girma Moges
A&A Optimum Solutions, Japan
abugirma@gmail.com

Abstract: Poverty reduction strategies and policies have gained considerable popularity in recent policy discourse and international economic relations. These policies and strategies are framed in the context of the Millennium Development Goals that set specific quantitative targets to be achieved within a specified time framework. The goals specify the targets and require countries to design national poverty reduction strategies and achieve them with a generous financial assistance from the international community. However, the domestic political economic forces remain to shape the extent and effectiveness of such strategies in addressing and reducing the extent and depth of poverty in the reforming countries. This paper develops a political economy perspective of adopting and pursuing sustainable economic growth and poverty reduction path with particular reference to the Ethiopian situation. It addresses the policies, assesses the experience and identifies the impediments to poverty reduction in Ethiopia and explores the prospects for sustained improvement in standard of living and elimination of chronic poverty.

Key terms: poverty, pro-poor growth, Ethiopia, redistribution, political economy

JEL classification: I32, E65, O11

1. Introduction

Poverty is a multidimensional and dynamic phenomenon. It has multiple causes that exhibit economic, social and political characteristics and poverty reduction requires multi-dimensional approaches and strategies. We have reached an era in which the moral and economic justifications for reducing and even eliminating chronic poverty have received international support. Addressing the problems of poverty has become one of the priority policy targets of governments and yet the task has proved itself as daunting.

The challenges and impediments to reduce poverty are formidable in developing countries where poverty is deep and widespread, income is extremely low, growth rate is weak and income distribution is uneven. These features of the production and distribution of output create systematic tendency for the poverty elasticity of income to be weaker making the growth induced poverty reduction less effective (Besley and Burgess, 2003; Burginon, 2003). In economies where the initial pattern of income distribution is highly unequal and vertical mobility is restricted by economic, social and institutional hurdles, economic growth –if it happens at all- tends to have limited impact on reducing poverty. Whereas redistribution policies, when cautiously implemented, might be used to address immediate crisis situations, they have limited effectiveness in reducing poverty on a sustainable basis. Even economies with remarkable growth rate could not achieve sustainable poverty reduction if the growth process does not generate productive job opportunities, mobility, asset accumulation, and productive engagement of an increasing share of the population. The pattern, characteristics and sector composition and sustainability of growth rate are as important for poverty reduction as the pace of growth performance.

Ethiopia is one of the poorest countries in the world where generalized poverty, low income and productivity, unsustainable growth process, chronic poverty, unemployment, widespread social and economic problems remain to be characteristic features of the economy. When an economy finds itself in such a situation, sustainable reduction in chronic poverty requires comprehensive reform measures and policy

initiatives that can jointly jump-start and move the economy from its impossibility frontier.

The recent growth performance of the Ethiopian economy has been strong. This was largely a broad recovery process from the trough of early 1990s. Nonetheless, real per capita income is barely higher than what it was during the 1970s and growth rate has been rather volatile. Agriculture generates about half of the GDP while employing nearly 85 percent of the labor force and providing livelihood for more than 90 percent of the population. And yet, agriculture in Ethiopia is mainly subsistence in nature making the national economy more or less subsistence oriented. The central challenge of economic growth and poverty reduction in Ethiopia is how to generate sustainable rise in the productivity of labor in agriculture, reduce its vulnerability to shocks, and enable the sector play a leading role in growth of standard of living and income in the country.

The performance of the non-agricultural sector has been modest at best. Examination of the growth rate and its pattern reveals that the recovery and growth process has so far failed to involve the majority of the population in terms of creating employment opportunities, creating space for investment and entrepreneurship for the private sector. This pattern of economic growth has considerably undermined its capacity to reduce poverty in the country. The main impediments to poverty reduction in Ethiopia emerge from a complex interaction of economic, political, social and institutional factors and hence poverty reduction policies should address these underlying forces to develop strategies with lasting effect.

This paper addresses the political economic forces that have impeded sustained poverty reduction in Ethiopia. It examines what factors impede the liberation of the subsistence farmers from earning a decent living and improving their productivity and in the process generate resources for capital accumulation and sustainable economic growth in the country. The rest of the paper is organized as follows. The next section briefly reviews the main issues in the growth and poverty of nations and draws implications for the Ethiopian economy. Section three deals with the features and characteristics of economic growth, poverty and poverty reduction experiences and strategies in Ethiopia. Section four deals with the broad policy issues that exert influence on the growth, equity and poverty situation and explore strategies for addressing the problems of chronic poverty in the country. The final section draws concluding remarks.

2. Poverty: Conceptual and Policy Issues

Poverty is a multi-dimensional concept. It generally refers to inability of households to provide sufficient subsistence and to lead a decent economic and social life. Whereas the currently widely used international poverty line of a dollar a day is appealing to capture popular attention, the national poverty line is more commonly used in the discussion of poverty issues within a nation (World Bank, 2004, Chen and Ravallion, 2001, 2004, 2007; Deaton, 2001; Kanbur, 2001).

The change in the poverty indicators could result from growth of income/consumption expenditure relative to the poverty line, changes in the distribution

of income in favor of or against the poor, the reduction of the number of people living in chronic poverty, and the propensity of vertical mobility in the system where children born into poverty can escape poverty, the capacity of the system to shield the destitute from poverty, shocks to the vulnerable non-poor, increase in population, and the combination of all these factors. It is quite feasible that the absolute number of people living in chronic poverty might be increasing whereas the poverty index is actually falling. A strategy to reduce and eliminate poverty should therefore be undertaken with a clear understanding of what mechanisms influence the dynamics of poverty in the country.

The concept of poverty reduction has ambiguous features and imprecise meaning. The poverty index could be reduced without necessarily reducing the absolute number of people struggling in chronic poverty. This is particularly relevant in countries where population growth is very fast, life expectancy is short and more children are born into poverty than those born in non-poor families or escaping the poverty trap. Moreover, the concept has inter-temporal fallacy in that the poverty reduction strategy might become the victim of its own success. If one assumes that public policies reflect the will of the majority, at least in a democratic political setting, decline in the poverty index reduces the incentive for public policies to emphasize on further reduction measures especially when such measures are financed by contributions from the non-poor segments of the population. It therefore becomes important to develop poverty elimination strategies that appeal both to the poor and the non-poor in society and emphasize the idea that eliminating chronic poverty is to the vested economic, social and political interest of the whole population in a nation. The implication of such a perspective is that poverty could

be eliminated only if there is a national consensus and support. It also suggests that a nation cannot consistently reduce, let alone eliminate poverty, by foreign aid.

Poverty reduction policies at the national level also need to have accurate mapping of poverty in the country and across sectors as well as urban-rural manifestation of their strategies. Uneven level of economic development and growth of income across these features requires strategies that incorporate these variables to address chronic poverty.

The issues of poverty reduction could be analyzed from the perspectives of the process of economic growth and distribution of economic opportunities across economic agents and households. The two processes have important effects on the capacity and opportunity to address the scope and depth of poverty in an economy. These two features are also closely interrelated because they are manifestations of the same income distribution.

The level as well as growth of mean income, relative to the absolute poverty line, is an important factor in the dynamics of poverty. An economy might find itself in a situation of generalized poverty where aggregate output is not big enough to provide basic subsistence for all. In such a situation, average income falls short of the poverty line and the economy simply cannot produce enough goods and services sufficient enough to eliminate poverty. This phenomenon emerges where economic agents and resources are underutilized, unemployed, underemployed or economic agents do not have the sufficient

capital or technology to work with for a number of institutional, policy, political, social and economic reasons.

The first order of priority in such a situation is to unburden the population from such constraints and develop strategies to address structural bottlenecks for the realization of the economic potential of the country. This in turn requires thoroughly examining the economic, social, political and behavioral factors and institutions that give rise to such under-capacity utilization of natural and human resources in the economy.

Even when an economy improves its productive capacity and average income is higher than the absolute poverty line output may not or could not be evenly distributed across households. Inequality and its root causes extend beyond economic forces. Observation of cross country patterns of income distribution suggests that even the most egalitarian societies have index of inequality in the range of 0.20 to 0.25 whereas the most unequal economies register about 0.60 to 0.66 (Milanovic 2003; WIDER, 2005). Any society has to maintain some balance between the fairness and justice in the distribution of opportunities and the incentive that encourages economic agents to work hard, invest, and generate more income opportunities that might induce some forms of inequality. However, not all inequality in a system reflects injustice. When the rewards that economic agents receive adjusted relative to their effort, dexterity, and creativity are fairly balanced it maintains the incentives for higher efficiency and growth in national income.

Economic growth is indeed the most powerful instrument to reduce poverty provided that it creates employment opportunities to the poor, increases the demand for factors that the poor owns, and creates the condition in which the poor develop the capability to accumulate productive assets that prepare them for productive and better life. Economic growth has twin effects both of which have important effects on poverty indicators. First, economic growth increases the mean income of all households without necessarily changing their relative income. There is also a distributional effect in which the growth process is accompanied by changes in the relative income with ambiguous effect on the poverty indicators (Ravallion, 2001; Kraay, 2004). Nonetheless, the growth process might exhibit anti-poor elements when economic agents are not positioned to equally participate and benefit from the growth process due to lack of appropriate training and human capital, access to financial services, weak business and investment climate, and restrictive economic policies.

Is economic growth distribution neutral? There are strong tendencies that cast doubt on the distributional neutrality of growth. The growth of income of a national economy does not benefit equally all economic agents for a host of reasons including differences in resource endowment, inputs market imperfections, government policies, institutions, and social relationships. Economic growth benefits first and for most those who have the capability to initiate growth and it eventually reaches those economic agents who get employment opportunities and those who produce factor inputs for the production processes. This process is gradual and its flow does not necessarily involve a significant portion of the population. It is possible that economic growth could be driven

by a sector with very weak linkage with the rest of the economy and with inconsequential effect on employment generation. Such a growth process can give rise to deterioration in the distribution of income and worsens the inequality situation leaving the majority of the population behind.

The theoretical relationship between economic growth and inequality has not been clearly established. Whereas it is quite standard that the growth rate of income and its distribution across economic agents has important implications for poverty reduction efforts, the policy issue stretches beyond these variables. There are underlying forces that influence why some countries manage to achieve sustained economic growth and improve the pattern of income distribution while other countries fail. It is therefore imperative to analyze these factors in the processes of economic growth. The policy issues are related to the availability and effectiveness of public policies that promote shared economic growth patterns for sustainable poverty reduction.

In the context of developing countries, poverty reduction policies are complicated by demographic factors and dynamics. Developing countries are characterized by rapid population growth with high mortality and birth rates and large family size. These features in turn mean relatively young population composition that exerts considerable challenge as well as opportunities to economic policy makers to take into consideration in their effort to address the issue of poverty. In a system where population is growing fast and demographic transition is yet to materialize, most children are born into poor families that compound the problem further not only on current poverty situation but also on how

to provide them with necessary health, educational, and other social services that creates opportunities and capital for productive life. If a system manages to equip its citizens with the necessary human and physical capital, it can sustain economic growth and could have opportunities to even eliminate chronic poverty.

The empirical relationship between economic growth rate and poverty reduction could be framed in the context of “average exit-time” from the ranks of poverty (Morduch 1998). This concept could be used to estimate the time that is needed to achieve the poverty reduction target or the growth rate requirement to achieve poverty elimination or reduction. The average exit time, t , measures the time it will take for a poor household to reach a given poverty line via income growth. If the income of household (i) grows at a constant positive growth rate of g per year, the relationship between current income and the poverty line could be depicted following the Watts poverty index as follows:

$$W = \frac{1}{N} \sum_{i=1}^q [(\ln z) - (\ln y_i)] \quad [1]$$

Where i stands for individuals in the population indexed from 1 to N in an ascending order of income and q of whom have income y_i that falls short of the poverty line z . The average exit time, T_g , is given by W/g provided that it were possible to ensure that income grows at a constant positive rate of g across the population sub-groups.

We can depict the relationship between the current income of poor households and the poverty line so as to assess the average exit time from poverty as follows:

$$z = y_i(1 + g)^{t/g} \quad [2]$$

Taking the logarithm and solving for the exit time for poor households, t_g^i , yields:

$$t_g^i = \frac{\ln(z) - \ln(y_i)}{\ln(1+g)} \approx \frac{\ln(z) - \ln(y_i)}{g} \quad [3]$$

The average exit time, T_g , captures the time it takes for the country to bring down poverty to an elimination shore. This could be depicted, noting that exit time for the non-poor is already zero, and making substitution, as:

$$T_g = \frac{1}{N} \sum_{i=1}^n t_g^i = \frac{1}{N} \sum_{i=1}^n \frac{\ln(z) - \ln(y_i)}{g} \quad [4]$$

It is therefore clear that achieving poverty reduction requires ensuring the income/consumption capability of the poor is improving and growth of income among the poor is robust and sustained.

2.1. Political Economy: Issues and Concerns

The discussion about sustainable economic growth and poverty reduction could not be complete without due consideration and analysis of the underlying political economic forces that shape the pace, pattern, and sustainability of economic growth and its capacity to address distributional and poverty reduction objectives. Do political institutions affect the growth and poverty reduction process of national economies? Why should we care about political institutions in the analysis of growth and poverty reduction? The effect of political competition and regime type on the rate and pattern of economic growth has remained a contentious issue in the literature (Wade, 1990; Barro, 1996; Alesina and Perotti, 1994; Przeworski, et al, 2000). The experiences of the East Asian developmental states do not lend an easy conclusion on the subject. East Asian

countries, which are summarily taken to support the non-democratic path to economic growth argument, are not homogeneous in their policies, pattern and pace of economic growth performance. It is more plausible to say that the East Asian economic success was achieved irrespective of, not because of, authoritarian regimes in the respective countries.

The emerging stylized facts indicate that whereas democracies do not necessarily grow faster than non-democratic regimes, the former have a more efficient use of the human and material resources and political competition seem to retard the rate of investment and the supply of labor force. Democratic institutions and practices do not allow the extraction of economic resources from the public by coercive means and redistributive policies could get a backing especially when the poor is politically organized and make their voice influence the political landscape through free and fair elections. Nonetheless, democratic regimes and institutions are distinctively superior in promoting human capital accumulation, the provision of high quality education, health and related social services, and the efficient use of economic resources for their most productive purposes. These two factors make possible economic growth to be sustainable, shared, and more importantly to involve the majority of the population so that the poor would have more opportunities to escape poverty through accumulation of human capital and productive employment.

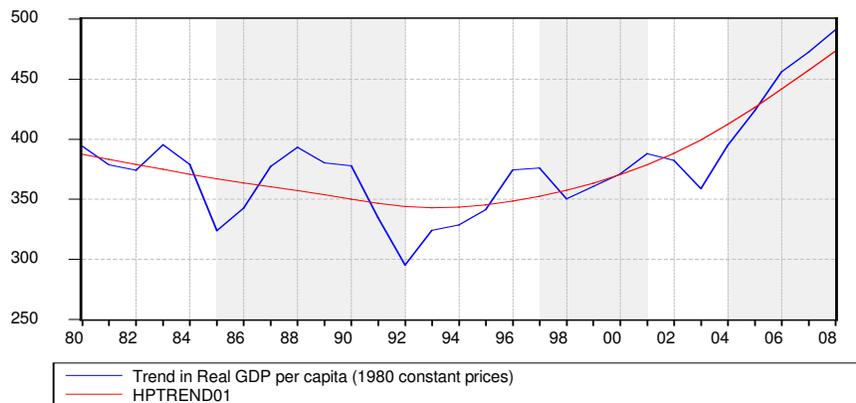
Does regime type affect the propensity of a nation to address its poverty situation? The evidence in cross-country setting suggests that democracies do not necessarily grow faster or accumulate more of physical capital than non-

democratic regimes. However, democracies tend to use factor input more efficiently and promote human capital accumulation. These two factors are crucial in the long-term growth performance of nations and their capacity to address poverty.

3. Ethiopia: poverty challenges and policy responses

Ethiopia is in a situation of generalized poverty. The average level of income and productivity in the economy falls short of the required consumption expenditure necessary to lead a decent life. The real income per capita, according to the revised GDP data series, was just Birr 424 in 2005 in 1980/81 prices (see figure 1). This is a stark indicator in which the national economy finds itself. This level of income per capita was reached after a long and sluggish recovery from the drastic fall in income during early 1990s following political turmoil and regime change.

Ethiopia: Recent Trend in Per capita income



Note: Data from 2006 and up are estimates and projections by Ethiopian authorities.

Source: computed from Ministry of Finance data sources

The national income accounts indicators could be viewed in conjunction with the consumption expenditure data compiled by nationally representative household income and consumption expenditure surveys [HICES] for 1995/6, 1999/2000, and 2004/05. The

surveys indicate that real mean consumption expenditure on food and non-food items was Birr 1256 in 2004/05 as compared to Birr 1057 per capita in 1999/2000 and Birr 1088 in 1995/96, measured in constant 1995/96 prices (FDRE, 2003; MOFAED 2006). These figures, relative to the national poverty line of Birr 1075, reflect the dire situation that the nation finds itself. These consumption expenditure indicators translate into 38.7 percent headcount poverty index for 2004/05 as compared to 44.2 percent in 45.4 percent in 1995/96.

Poverty in Ethiopia is persistent, widespread and dominantly structural. The poverty rate, with sector growth rate projection, has shown no or little decline from 1989 to 2004 (World Bank, 2005b). The headcount poverty index hovers around 38 percent. This is despite a robust economic recovery process since the mid 1990s. It suggests a very low poverty elasticity of economic growth in Ethiopia. Furthermore, about 20 percent are barely non-poor and so vulnerable that a single major shock would lead them into the ranks of poverty (World Bank, 2005a). More broadly, nearly 61 percent of the total population has a 50 chance of falling into poverty in the future reflecting the degree of vulnerability and lack of protection against such risks (World Bank, 2005a, 2005b). The implication of such disturbing economic statistics, despite its limitations, is that chronic poverty is widespread and requires major and comprehensive policy measures. It sounds oxymoron but it might be appropriate to inquire who are the non-poor and how did they manage to escape poverty rather than pondering on a rather national phenomenon.

The first order of priority in such a situation is enabling the economy and economic agents improve productivity so that average income is sufficiently higher than the poverty line. The poverty situation in Ethiopia exhibits a number of unique features and characteristics that reflect the performance of the national economy, the dynamics of population growth, the distribution of opportunities, and subsistence dominated agricultural sector, and the policy environment that hampered the realization of the economic potentials of the nation. These features resulted in low productivity of labor. Not only is productivity very low but also it has been stagnant over time. The harsh initial economic conditions, low educational and health indicators of human capital, weak and prohibitive institutional factors have all exerted adverse influence on economic growth performance.

Addressing the problems of poverty in Ethiopia requires setting the priorities in order and undertaking appropriate measures to improve the capacity of the economy to move out of the impossibility frontier it finds itself.

The macroeconomic indicators have similar signals as the national survey results. The predominant share of the Ethiopian population lives and works in the rural sector with family or self-based employment. A recent national survey of labor force in Ethiopia revealed that paid employees altogether constitute only 8 percent of the total working population (CSA 2007). Whereas open unemployment rate in the rural sector seems largely marginal, the rate in urban areas hovers around 20.6 percent during the same survey period of 2005. The key element in addressing the problems of underemployment,

unemployment and the growth in productivity of labor hence has to deal with the huge labor force largely within the ranks of unpaid family workers and providing them the opportunities to engage in new and more rewarding activities.

The overall hostile investment climate sets a hurdle for sustained improvement in the productivity of labor. This problem is widespread and leaves its mark both in agricultural and industrial activities. An average industrial worker in Ethiopia, for instance, is twice less productive than their counterpart in China and 80 percent less productive than workers in Bangladesh. This stark difference in productivity of workers is largely attributable to total factor productivity differences (77 percent) whereas the remaining could be accounted for by differences in intensity of physical and human capital per worker [World Bank, 2003]. Addressing the overall business climate and removing the burden of uncertainty, unpredictability, favoritism, and poor infrastructure for local entrepreneurs remains a critical problem calling for comprehensive policy reforms.

These observations call for examination of the prospects for sustainable growth in productivity and income in Ethiopia. Despite the occasional recoveries, the economy is still beset by stagnation and volatility in growth performance with excessive dependency on the vagaries of nature. It is not therefore surprising that the poverty situation in the country could not register sustainable improvement over time.

Economic growth in Ethiopia is conditioned on the capacity of the country to realize the productive potentials of its citizens and creating the opportunities to technological progress and adaptation. These conditions in turn require the accumulation of human and physical capital that improves the capacity of the labor force to engage in activities with higher productivity potentials and building coping mechanisms against shocks to the economy. Besides eliminating bureaucratic hurdles to investment and radically changing the hostile investment environment, it is necessary to create institutional arrangements that proactively promote the accumulation and productive utilization of all economic resources.

In the context of Ethiopia, it is imperative to emphasize the crucial importance of capital accumulation accompanied by judicious and efficient allocation to establish firm foundation for economic growth and development. The low level of productivity and income pose considerable constraint on the capacity of the economy to save and invest. However, it is important to note that the under capacity utilization of economic resources in the economy coupled with appropriate incentive for economic agents could generate persistent improvement in exploiting investment opportunities and subsequently improving the capacity to save and invest in the economy.

It is evident that economic growth alone could not accomplish the task of reducing chronic poverty. Whereas fast and sustainable economic growth is a necessary condition, it is not sufficient to achieve poverty reduction. Egalitarian distribution of income and ensuring sufficient subsistence to the poor are critical elements in shaping the

poverty landscape of a country in the short to medium term. In the long-term context, it is necessary to reform the institutions, encourage vertical social mobility, address the underlying forces that shape the economic opportunities available for poor people through educational and asset accumulation efforts, and developing strategies in which the non-poor recognizes its vested interest in the elimination of poverty.

Unlike the conventional belief, poor countries do not necessarily have more egalitarian income distribution (Milanovic, 2003; UN-WIDER, 2004). There is also emerging evidence that indicates deterioration in the distribution of income and rising inequality in such economies. This situation can make economic growth to benefit a relatively small portion of the population and leave the majority in chronic poverty.

The distribution of income relative to the average when the average level of income is increasing is therefore an important factor that would affect how economic growth could translate into poverty reduction. Improving the pattern of income distribution is a slow process that could be addressed in a long-term context and involves crucial economic and political innovations and compromises (Lipton and Ravallion, 1995; Bourguignon and Morrison, 2002). This is particularly challenging when the initial level of poverty is severe, per capita income is low and growth rate is volatile and income distribution is uneven and/or deteriorating. Whereas redistributive policies are feasible and affordable in countries where growth is fast and widespread in scope, such policies might hamper growth initiatives and generate little effect on poverty reduction efforts in stagnant economies.

How serious a concern is the problem of uneven distribution of income in Ethiopia? Reliable and comprehensive data is not available to make firm judgment about the level and trends in the distribution of income in the country. The recent information on the distribution of income and index of inequality indicates that the Gini-Coefficient was 28.0 percent in 1999/2000 as compared to 29.0 percent in 1995/96 and 32.42 in 1981(FDRE, 2002; MOFAED, 2006; UN-WIDER, 2004). If these figures are reliable enough, then the country has somewhat maintained the distribution of income stable at relatively low level. The share of national income (consumption expenditure) that accrues to the bottom 20 percent of the population was just about 9.1 percent whereas the bottom 40 percent of the population manages to receive about 22.3 percent of income (World Bank, 2005; FDRE, 2002). These indicators could be compared with index of inequality in other developing countries such as Kenya (42.5 percent), Namibia (70.7 percent), and Japan (24.9 percent). These figures highlight the limitations of assuming poor countries have equitable distribution of income and the conventional trade-off argument between economic development and inequality.

4. Policy Issues and Strategies

The issue of poverty could be seen from the perspectives of the process of production of national output, the distribution of national income, and the demographic features of a nation. The impediments to poverty reduction are closely related to these factors and the underlying variables operating within a setting of a national economy. The

underlying forces of poverty and its dynamics in Ethiopia have both production inefficiency and distributional inequity characteristics. Addressing the problems of poverty in the country therefore require efforts to improve production allocation efficiency, productivity, investment in human and physical capital, improving the distribution of resources and opportunities, and undertaking sound institutional reforms.

A realistic assessment of the growth prospects of the economy and the factors that have hampered and might continue to hamper the realization of fast and sustained economic growth is very imperative. The main factors for economic stagnation are harsh initial conditions, hostile investment policy environment, weak human and physical capital accumulation, political instability, conflicts, weak institutional capacity and infrastructure, rampant corruption, frequent external shocks and the demographic factors (Easterly and Levine, 1997; Moges, 2004; Geda and Degefe, 2002).

The recent trend in poverty reduction in Ethiopia strongly suggests that the pace of poverty reduction is weak and has no momentum. At the current pace, Ethiopia could hardly be able to achieve the core target of the Millennium Development Goals by 2015. Despite these facts and absence of a coherent policy of promoting sustained and shared economic growth in the economy, policy makers in the country have repeatedly declared that the country would achieve the millennium development goals (MDGs). This is rather irresponsible position and it diverts policy priorities and realism in the policy decision-making processes. Even the unlikely scenario of doubling foreign aid inflow could not accomplish the task given the human capital constraint, the policy environment and the

failure to undertake bold and credible policy reform measures. The denial exercise also puts into question the credibility of decision makers and the issue of public accountability in economic policy making. Unfortunately, sustained poverty reduction could not be achieved without a meaningful and leading role of domestic private sector involvement in all aspects of production and support for radical policy and institutional reforms.

Ethiopia formally embarked on anti-poverty reduction strategy, with the sponsorship of the IMF and the World Bank, in 2002 and the government put its objectives and policies in its poverty reduction strategy paper –Ethiopia: Sustainable Development and Poverty Reduction Program- which assesses the poverty situation in the country, the sources and constraints to economic growth, and outlines measures to address them (FDRE, 2002). The document boldly claims that the country can achieve all the development targets by 2015 which critics and supporters alike find it somewhat unrealistic (IMF, 2004; World Bank, 2004; EEA, 2003). This was followed by a revised policy plan to accelerate and sustainable development to end poverty (MOFAED, 2006). The revised policy stance recognizes the importance of non-agricultural sector in promoting overall growth and in addressing pressing poverty problems.

The core of the strategy of the policy is to achieve an average annual real GDP growth rate of 5.7 percent from 2002/3 to 2015/16 to reduce the rate of poverty by half during this period (FDRE, 2002). The strategy suggests that, with further improvements in institutional, efficiency of public services and policy environment, the required growth rate would be about 4.7 percent per annum. The strategy emphasizes agricultural

development led industrialization even if its revised version of PASDEP recognizes the need for industrial and service sectors for growth and employment generation efforts (MOFAED 2006). Moreover, the expectation for doubling of foreign aid inflow has tempted policy makers to revise their targeted growth rate to 7 percent hence ensuring the achievement of the income poverty target (FDRE, 2004).

What does it take to achieve such a growth rate of income? There are a number of issues that must be critically assessed to get a plausible picture of the growth prospects of the country. First, whereas growth rate in real GDP exhibited remarkable improvement since the 1990s as compared to the 1980s, it is largely explainable by a recovery process instead of sustained expansion of the productive capacity of the economy. The relative peace and higher capacity utilization enabled recovery from the trough. Moreover, the volatile growth rate and its excessive dependency on the vagaries of nature make the growth performance erratic and closely tied to weather conditions. For instance, the level of labor productivity managed to recover to its 1983 peak only by the year 2000 which indicate a long and sluggish recovery process. Generating further growth requires not only the full utilization of the capacity of the economy but also fast expansion of the capacity of the economy. These in turn require sustained accumulation of human and physical capital as well as the creation of institutions and policies that render the most efficient utilization of these resources possible. It requires the involvement of the domestic economic agents in the generation, employment and efficiency improvement of capital in the economy and enjoying the benefits of their effort.

Agriculture remains to be dominant for a foreseeable future in the economy and it is here that the most pressing challenges to poverty reduction concentrate. Ethiopian agriculture is burdened by lack of strategic policies that could transform the sector and assume an important role in the economic take off effort. The sector and farmers have little security in one of the core means of production, farmland. The current Constitution is and remains to be a central source of insecurity in denying peasants the right to ownership of their productive asset. It is necessary to remove the monopoly of land ownership from the grips of the state. Moreover, population concentration and demographic dynamics, without accompanying dynamism in absorbing labor force in industrial and service sectors, has necessitated fragmentation of land. The average holding size has declined over decades from 0.5 ha per person in 1960s to merely 0.11 ha per person by 1999. Given the current state of applied technology in Ethiopia, such plot size could not ensure subsistence let alone to produce marketable surplus. Farmers with “hunger plots” are increasing in number and land inequality has already become a serious problem (with an estimated Gini Coefficient of 0.47).

There is a concerted need to reduce the dependence of farmers on rainfall by expanding support services for small-scale irrigation systems and water management practices. It is also time to promote support services for adaptation of appropriate farming equipment that fit smallholder farming. The supply of modern farm inputs and the integration of agricultural marketing networks with suitable infrastructure and services with the participation of private sector delivery of such services on efficient and competitive basis need to be promoted.

The county has low inequality as expressed in its Gini-coefficient of income (consumption expenditure). This is somewhat consistent with the low level of income and the widespread nature of poverty in the country. When economic growth gathers momentum, it also generates tendencies to distribute benefits in such a way that reflects the productive capacity and effort of economic agents. When economic agents do not have equitable access to productive capital accumulation and training opportunities, the growth process might generate tendencies that weaken the egalitarian nature of income distribution. It is therefore important to address in time the underlying differences across economic agents in terms of access to opportunities and training that would enable them to productively participate in the growth process. On the other hand, a relatively low degree of income inequality indicates that there is little room for improving the poverty situation in the system through re-distributive policies.

Ethiopia has formidable challenges to address the problems of poverty and hunger over medium-to-long term horizon. The poverty level, relative to the national poverty line, indicates that about 44.2 percent of the population lives in poverty in 1999/2000 as compared to 45.5 percent of the population in 1995/96 (FDRE, 2002). This was equivalent to about 29.6 million Ethiopians in 1999/2000. The HICES 2005 indicates the headcount poverty index at 38.7 percent (MOFAED 2006). If the population projection for the country is accurate enough, the median variant of Ethiopia's population projection indicates about 97.2 million by 2015 and 170.2 million by 2050 (United Nations, 2004). The population expands on average with about 2 million people every year for about five

decades. Most, if not all, will join poor families and reside in rural areas. This implies that even if the country were to manage reducing the poverty index by half from its current level, about 21.5 million Ethiopians will be living in chronic poverty by 2015. It will not be possible to consider such poverty reduction achievement as successful by any standard or perspective. Consideration of vulnerability of the barely non-poor to join the ranks of the poor with one major shock to their income or consumption suggests that about 20 percent of the population faces the risk of such shocks and their after effects.

These projections on the poverty trend, as grim as they indeed are, may not necessarily become reality provided that appropriate and comprehensive measures are taken in time. The capacity of the economy to assess its opportunities and act upon them so that an increasing share of the population could be engaged in productive activities could shape the poverty trend and its prospects to achieve economic, social and political development goals.

The situation of generalized poverty limits not only our capacity to eliminate poverty but also exerts its influence on our institutions and behavior in economic decision making. It has affected our political behavior as well. One of the typical features of the Ethiopian economy is that about half of the national output is produced in a subsistence dominated agricultural sector that employs more than 80 percent of the labor force. This reflects both the dominance and weakness of the agricultural sector. Poverty is widespread in the sector so much so that life is brut, short, and subjected to the daily tragedy of deprivation and hunger. Farmers are not physically fit to engage in labor-

intensive activities for long and with dexterity. This limits the amount and quality of their labor input in the production process. Even if hardship and the threat of hunger condition the body for exerting effort, there are limits that the body could not absorb. The labor force hence would generate a disproportionately lower amount of effective labor input to the production of goods and services.

This situation calls for new initiatives and mechanisms under which farmers with food deficiency could be provided food credit and health support for a certain period of time so that they could improve their productivity as well as escape from the cycle of hunger and low productivity traps. This is a prudent social investment that could be assisted by private sector intervention for the realization of the minimum threshold of producing sufficient output for subsistence as well as accumulation. Such a transitional intervention measure could be adopted in gradual phases starting with areas with high potential and lagging behind in terms of productivity and the mechanism could be operated on private sector led, government sector assisted, and socially supported manner.

The physical, health, and cultural handicaps continue to hamper the full dexterity of the labor force in the production process. In such a situation, there are deficits that the economy must bridge before realizing its potentials. As to the economically active population engaged in agriculture, there is deficiency in the amount and quality of nutrition for them to fully engage in production and the scarcity of land or mismatch between labor force distribution and arable land distribution. This problem might worsen with the population pressure. One of the priority issues in this respect is to identify

unused arable land and make appropriate investment so that it would be ready for cultivation as well as free from diseases that make it inhospitable for farmers to live and work. Once such measures are taken, farmers should be invited on a voluntary basis to take advantage of the opportunities. The failed experiences of the past should serve as a lesson not to taint the economic opportunities as political maneuver to control and subjugate farmers. Moreover, it is a prudent social investment to provide food credit to farmers who remain in their old settlements to cover their nutritional deficiency that hampers their productivity. This could improve the length and intensity of work of the labor force besides its direct effect to reduce the suffering from hunger.

To ensure the sustainability of such an approach, it is necessary to invest in the provision of food and basic health services to children so that they could grow physically and mentally capable of engaging in productive activities. Comprehensive social education programs that could enrich our food culture, basic health care, and work ethics could complement such endeavors. Adaptation of social services to the local circumstances in Ethiopia such as the design of village level basic literary education system with flexible schedule and jointly supported by local and national resources, village library system, the promotion of mobile clinic to basic health check system, and similar initiatives that could improve the length and intensity of labor input in the production system are necessary. These initiatives could improve the capacity of the labor force to improve its productivity significantly with minimum inputs outside the system and in the process enable the economy escape from the situation of impossibility frontier.

Once the economy starts to improve labor productivity and real income is sufficient to provide basic subsistence, further economic growth requires accumulation of both human and physical capital. The accumulation of physical capital and its availability for the labor force to work with requires setting the investment environment attractive enough for economic agents to respond to. The real return to saving and investment could be eroded by lack of property rights, the rule of law, instability, corruption, and implicit and explicit tax burdens on returns to earned income. In this respect, Ethiopia has a wide area to cover to reverse the current crisis in the saving rate especially by the private sector. Without a domestically driven saving and capital accumulation efforts, it would be unlikely for an economy to sustain its economic growth performance and maintain macroeconomic stability.

The accumulation of human capital is a more challenging and perhaps more critical in the process of rapid and sustained economic growth. The challenge is formidable and yet progress could be made provided that new initiatives are undertaken on a broadly collaborative ways. Currently, about two-third of the Ethiopian population is illiterate and only half of the children at the primary school age have access to educational service. This indicates that at the current rate of primary school enrollment and taking into account the rapid population growth rate, improving access to basic education would be a slow process. Whereas formal education requires long duration and investment in infrastructure and operating costs, it is possible to initiate new approaches that could equip children with basic literary skills. Expanding access to basic education for all school age children is very important. In this respect, the Japanese *terakoya* system

where individual houses were used to serve as classrooms during the Tokugawa period of the 19th century to train ordinary people was successful and cost effective. Similar approach to achieve fast and flexible access to basic education is adaptable in our current context. It could be possible to provide basic literary education within a reasonably short period of time by sponsoring literate individuals, such as high school graduates, priests, and the like, in villages to train children in private houses, community hall, and other suitable places with flexible schedule.

This approach is cost effective and could be sponsored by parents, local administration, private sector companies, colleges and universities and the government to cover the basic costs of running such programs. The flexibility of the system and its possible adaptability to local preferences and time allocation would mean coverage to basic education could be achieved within a couple of years. The sponsorship could also involve using local resources and rotation labor service of parents. The ultimate objective of such measures is enabling children get basic literary skills, balanced nutrition, health guidance, and the like so as to prepare them for productive life and enabling the country to improve its stock of human capital for sustainable economic growth.

The accumulation of capital and the efforts to improve the amount and quality of labor input by the labor force are important elements in generating and sustaining economic growth. However, this should be complemented by a host of other factors that affect, in a way or another, the efficiency of factor inputs in the production process. This is somewhat the software of the production system in which the society manages to create

cooperative and competitive spirit among economic agents, cultivates work culture and ethics, builds social consensus, and weakens perpetual conflicts. A society should not deplete its energy in resolving conflicts instead of mobilizing its collective energy to achieve its priority objectives. Whereas the adoption of the rule of law, clear property rights, accountability, and transparent rules of economic interaction helps to resolve possible conflicts, a society needs to minimize such leakage in its energy and refocus it for collective prosperity.

The rural based agricultural sector is the most dominant and is likely to remain as such in the Ethiopian economy. However, a successful transformation of the subsistence agrarian sector requires additional measures to tame the pressure on the sector by improving the employment creating capacity of the industrial and services sectors in the economy. Pursuing effective industrialization policy is not only necessary but also the only way to ensure the burden of population pressure in rural areas and allowing an increasing share of the labor force earn its livelihood from industrial and services sectors. In this respect, the development of basic industries with extensive backward and forward linkage coupled with the establishment of small-scale labor- intensive industries becomes critical and feasible. The industrial sector is weak and yet with considerable potential not only to improve overall productivity but also generate employment opportunities for the poor with sufficient human capital and training to take advantage of the opportunities. It is not possible to reduce poverty on a sustained manner by exclusively focusing on the agricultural sector.

Distributional issues are important and will become even more so once the economy overcomes the problem of generalized poverty. The current poverty problem is such that Ethiopia could not use redistribution policies alone to fully address the poverty situation. The issues should be addressed instead by identifying the underlying problems that give rise of differences in capabilities in the population. In this regard, policies that open fairly equal opportunities for all and equip our children with the necessary health, nutrition, care and education should be promoted to address long term income distribution concerns.

There are feasible mechanisms that could be used to establish a national social fund to provide basic financing for alleviating the barriers for poor economic agents to engage in productive activities and human capital investment. The resources for such a social cum economic fund could be generated from the private sector with some tax incentives and from the local, regional and federal government annual budget allocation. This should be accompanied by clearing all the social, economic and cultural hurdles for children from poor families so that they will be ready and capable to engage in productive activities and escape the poverty trap. This would also serve as the mechanism to create equal opportunities for all citizens and generate shared and sustainable economic growth.

5. Concluding Remarks

Poverty is a pressing public policy concern in Ethiopia. It has multiple features and causes related to production, distribution, institutional and policy factors in the system. Sustained poverty reduction could be achieved by addressing these causes through fast and shared economic growth that benefits an increasing share of the population. Impediments to poverty reduction emerge from forces that limit the capacity of the economy to achieve sustained and shared economic growth. These forces limit the accumulation and efficient allocation of physical and human capital, the expansion of the productive base of the economy, the innovation and adaptation of new technologies in production.

Ethiopia is in a situation of generalized poverty. This situation calls for measures to improve labor productivity and expand aggregate output so that average income reaches beyond the threshold level of absolute poverty line. The recent rate of economic growth and the pattern of income distribution in the country suggest that significant poverty reduction, let alone elimination of chronic poverty, would be unlikely. The problem could get even worse given the fact that population is growing rapidly and most children are born into poor families. It is therefore necessary to take timely action to accelerate the accumulation of physical and human capital, undertake comprehensive policy reform measures that promote market forces and private sector development, pursue institutional reforms to reduce hurdles to full utilization of the potentials of the economy. These measures coupled with prudent social policies that cultivate the environment for collective prosperity could enable the system to reduce chronic poverty and put the economy on a sustainable development path.

References

- Addison, Tony and Giovanni Andrea Cornia (2001). "Income Distribution Policies for faster poverty reduction," WIDER discussion paper 2001/93.
- Alesina, A. and Perotti, R. (1994). *The Political Economy of growth: A critical survey of the recent literature*, World Bank Economic Review, 8, 351-371.
- Barro, R.J. (1996). "Democracy and Economic Growth," *Journal of Economic Growth*, 1, 1-27.
- Baier, Scott, Gerald Dwyer Jr. and Robert Tamura (2002). "How Important Are Capital and Total Factor Productivity for Economic Growth?" *Federal Reserve Bank of Atlanta*, Working Paper 2002.
- Besley, Timothy and Robin Burgess (2003). "Halving Global Poverty" *The Journal of Economic Perspectives*, 17(3): 3-22.
- Besley, Timothy and Robin Burgess (2002). "The Political Economy of Government Responsiveness: Theory and Evidence." *Quarterly Journal of Economics*. 117(4):1415-1451.
- Bigsten, Arne and Abebe Shimeles (2004). "Dynamics of Poverty in Ethiopia," UN-WIDER Discussion Paper No 2004/39.
- Blis, Mark and Peter Klenow (2000). "Does Schooling Cause Growth?" *American Economic Review*, 90(5):1160-1183.
- Bosworth, Barry and Susan Collins (2003). "Empirics of Growth: An Update," the Brookings Institution program on Economic Studies.
- Bourguignon, Francois. (2003). "The Growth Elasticity of Poverty Reduction: Explaining Heterogeneity across Countries and Time Periods," World Bank research paper memo.
- Bourguignon, Francois and Christian Morrison (2002). "Inequality Among World Citizens: 1829-1992." *American Economic Review*. 92(4): 727-744.
- Brown, Lester, Gary Gardner, and Brian Halwell (1998). *Beyond Malthus: Sixteen Dimensions of Population Problems*, World Watch Institute.
- Central Statistical Agency (CSA-GOE). 2007. Ethiopia: The 2005 National Labor Force Survey (NLFS), summary results at national level, available at www.csa.gov.et.
- Chen, Shaohua and Martin Ravallion (2001). "How did the World's Poor Fare in the 1990s?" *Review of Income and Wealth*. 47(3): 283-300.
- Chen, Shaohua and Martin Ravallion (2004). "How have the World's Poorest fared since the early 1980s?" World Bank Research paper, memo.
- Chen, Shaohua and Martin Ravallion (2007). "Absolute Poverty Measures for the Developing World, 1981-2004," World Bank Research Group, research memo, World Bank.
- Collier, Paul and David Dollar (2001). "Can the World Cut Poverty in Half? How Policy Reform and Effective Aid Can Meet International Development Goals." *World Development*. 29(11): 1787-1802.
- Deaton, Angus (2002). "Is World Poverty Falling?" *Finance and Development*. 39(2): 4-7.
- Deaton, Angus (2001). "Counting the World's Poor: Problems and Possible Solutions," *World Bank Research Observer*, Vol. 16 no. 2Pp:125-147.

Dollar, David and Aart Kraay (2001). "Growth is Good for the Poor," *Journal of Economic Growth*. 7(3): 195-225.

Diao, Xinshen, Alejandro Nin Pratt et al. 2004. Growth Options and Poverty Reduction in Ethiopia-An Economic Wide Model Analysis 2004-2015. International Food Policy Research Institute: Washington, D.C.

Easterly, William (2002). "Growth in Ethiopia: Retrospect and Prospect," memo, Institute for International Economics.

Easterly, William (2001). "The Lost Decades: Developing Countries' Stagnation in Spite of Policy Reform 1980-1998," World Bank, memo.

Easterly, William and Ross Levine (1997). "Africa's Growth Tragedy: Policies and Ethnic Divisions," *Quarterly Journal of Economics*, November, 1203-1250.

Federal Democratic Republic of Ethiopia(FDRE) (2002). *Ethiopia: Sustainable Development and Poverty Reduction Program*. July, Addis Ababa, Ethiopia.

Foster, J., Greer, J., Thorbecke, E. 1984. "A class of decomposable poverty measures," *Econometrica* 52(3): 761-766.

Geda, Alemayehu and Befekadu Degefe (2002). "Explaining African Growth Performance: The Case of Ethiopia,"

Hall, Robert and Chad Jones (1999). "Why Do Some Countries Produce So Much More Output Per Worker than Others?" *Quarterly Journal of Economics*. 114(1): 83-116.

Kanbur, Ravi (2001). "Economic Policy, Distribution, and Poverty: The Nature of the Disagreements." *World Development*. 29(6): 1083-1094.

Kanbur, Ravi (1987). "Measurement and Alleviation of Poverty," *IMF Staff Papers*, 34(1): 60-85.

Kraay, Aart. 2004. "When is Growth Pro-Poor? Cross Country Evidence" IMF Working Paper, WP/04/47.

Krueger, Alan and Mikael Lindhal (2001). "Education for Growth: Why and For Whom?" *Journal of Economic Literature*. 39(4): 1101-1136.

Li, Hongyi, Lyn Squire and Heng-fu Zou (1998). "Explaining International and Inter-temporal Variations in Income Inequality." *Economic Journal*. 108(1): 26-43.

Lipton, Michael and Martin Ravallion (1995). "Poverty and Policy," in Jere Behrman and T. N. Srinivasan (eds.) *Handbook of Development Economics*, Amsterdam: North-Holland, pp. 2551-2657.

Mauro, Paul (1995). "Corruption and Growth." *Quarterly Journal of Economics*. 110, November: 681-712.

Milanovic, Branko (2003). "Is Inequality in Africa really different?" draft document, (World Bank website: <http://www.worldbank.org>)

Ministry of Finance and Economic Development (MOFED) (2003). *Ethiopia: Sustainable Development and Poverty Reduction Program-Annual Progress Report (2002/2003)*, December, Addis Ababa, Ethiopia.

Ministry of Finance and Economic Development (MOFED) (2006). *Ethiopia: Building on Progress- A Plan for Accelerated and Sustained Development to End Poverty (PASDEP) 2005/06-2009/10*, Volume I, September, Addis Ababa, Ethiopia.

Moges, Abu G. (2004). "Impediments to Poverty Reduction: Economic Growth, Distribution and Policy Issues," paper presented on the Annual Conference of the Japanese Economic Association, Okayama University, Japan.

Morduch, Jonathan (1998). "Poverty, Economic Growth, and Average Exit Time," *Economics Letters* 59, 385-390.

Przeworski, A., Alvarez, M.E., Cheibub, J.A. and Limongi, F. (2000). *Democracy and Development: Political regimes and well-being in the world, 1950-1990*. New York: Cambridge University Press.

Ravallion, Martin (2001). "Growth, Inequality and Poverty: Looking Beyond the Averages," *World Development*. 29(11): 1803-1815.

United Nations Conference on Trade and Development (UNCTAD). (2002). *The Least Developed Countries 2002 Report – Escaping the Poverty Trap*, United Nations, Geneva.

United Nations (UN) (2004). *World Population Prospects: The 2004 Revision Population Database* (<http://esa.un.org/unpp/p2k0data.asp>).

UN-WIDER. (2004). "World Income Inequality Database WIID2 Beta" (www.wider.unu.edu)

Wade, Robert. (1990). *Governing the market: Economic Theory and the role of the government in East Asian Industrialization*, Princeton, N.J.: Princeton University Press.

World Bank. (1990). *World Development Report 1990: Poverty*. New York: Oxford University Press.

World Bank. (2001). *World Development Report 2000/2001: Attacking Poverty*. New York: Oxford University Press.

World Bank. (2003). *Determinants of Private Sector Growth in Ethiopia's Urban Industry: The Role of Investment Climate*, May, World Bank, Washington, D.C.

World Bank. (2004). *Ethiopia: A Strategy to Balance and Stimulate Growth- A Country Economic Memorandum, Poverty Reduction and Economic Management 2, (AFTP2)*, Africa Region, World Bank, Washington, D.C.

World Bank. (2005a). *Ethiopia: Risk and Vulnerability Assessment*, August, Report No. 26275-ET, Washington, D.C.

World Bank. (2005b). *Ethiopia: Well-Being and Poverty in Ethiopia- The Role of Agriculture and Agency*, Report No. 29468-ET, Washington, D.C.

World Bank. (2005c). *Global Economic Prospects 2005: Trade, Regionalism and Development*, World Bank: Washington, D.C.

World Bank. (2007). *Ethiopia: Urban Labor Markets in Ethiopia: Challenges and Prospects*, Volume I, March, Synthesis Report, No. 38665-ET, Washington, D.C.

World Bank. (2007). *Ethiopia: Accelerating Equitable Growth – Country Economic Memorandum, Part I, Overview*, Poverty Reduction and Economic Management Unit, Africa Region, World Bank, Washington, D.C.