AN ANALYSIS OF THE RELATIONSHIP BETWEEN ETHIOPIA'S FOREIGN TRADE AND GROSS DOMESTIC PRODUCT

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ABSTRACT

The purpose of the study was to establish and analyze the relationship between Ethiopia's foreign trade (exports and imports) and Gross Domestic Product (GDP). A broader review of published sources was made on all aspects of the problem to be investigated. Based on a priori theoretical knowledge and the nature of the scatter diagram, linear regressions of GDP on exports and imports on GDP were formulated. Regression and correlation coefficients were computed and interpreted with allowances given to non-economic variables. The results showed that there is a strong association between GDP and exports, on the one hand, and imports and GDP, on the other. The relationships were then viewed with due considerations given to policy issues such as structural diversification and economic cooperation and integration.

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CHAPTER I

INTRODUCTION

Statement of the Problem

When a portion of a country's income is derived from foreign trade, the country becomes vulnerable to changes in the outside world. This is especially so if exports consist of primary commodities, prices of which undergo wide fluctuations, and imports consist of manufactured goods, whose prices tend to show an upward trend. As a consequence, most primary producing developing countries suffer from a deficit in their balance of trade. It has been estimated that of the 31.8 billion dollar increase in the deficit of non-petroleum developing countries between 1970 and 1975, $11 billion may be attributed to volume changes and $20.8 billion to price changes.[1]

Ethiopia's external trade statistics[2] form a familiar developing country pattern of exports consisting almost entirely of agricultural products and imports largely dominated by manufactures and raw materials. The balance of trade during the period under review, 1970-1978, registered deficits with the exception of the year 1973.[3] The reasons for such a

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[1]United Nations Conference on Trade and Development(UNCTAD), Review of International Trade and Development: Report by the Secretariat of UNCTAD. New York, 1978.

[2]Statistical Abstract of Ethiopia and Quarterly Bulletins of the National Bank of Ethiopia.

[3]Central Statistical Office(CSO), Statistical Abstract. Addis Ababa, 1978, p. 108.

development are to be found in the character of both the export and import trade.

Purpose and Importance of the Study

Ethiopia, like any developing country,[4] being committed to rapid economic development has to have a strategy of development in which the structure and growth of exports and imports play an important role. The export trade which provides the main source of foreign exchange for the importation of goods and capital equipment largely determines the import capacity of the country. A developing country is to be characterized not only by a rising level of imports but also a continual change in the composition of its imports. A general picture of the changing composition of imports of a developing economy is manifested by a larger and growing share of imports of capital and intermediate goods in total imports.

With the appearance of a deficit in the balance of trade, it becomes imperative to have some quantitative estimates of the structure of the foreign sector and the relationship between the foreign sector and Gross Domestic Product(GDP). The main theme of this thesis is to establish some association between Ethiopia's foreign trade(exports and imports) and GDP. Exports contribute to growth because they finance imports. The capacity to import can be attributed to movements in terms of trade, which for primary producing countries(including Ethiopia) have generally worsened and thus depressed the capacity to import. This calls for policies which aim at structural diversification of exports in terms of products and markets

[4]The definition of developing countries in this study follows that used in UNCTAD, Review of International Trade and Development, 1975. Ethiopia is among the least developed countries(lower-income group)with per capital Gross National Product(GNP) below $250 in 1973.

and improving world market terms of trade for Ethiopia's products. In this regard, a brief look at issues of economic cooperation and integration will be made with particular reference to the establishment of the recent Preferential Trade Area(PTA) for Eastern and Southern African States.[5] The study may lead to a better understanding of the development efforts and could help in the formulation of policies. It may also provide points of departure for further studies on related aspects of the problem.

Research Methodology

Data Collection and Analysis

A broader review of published sources will be made on all aspects of the problem to be investigated. Where necessary various concerned individuals will be consulted.

Based on a priori theoretical knowledge and the nature of scatter diagram, linear regressions of GDP on exports and imports on GDP will be formulated. Regression and correlation coefficients will be computed. Such estimates will then be analyzed with due considerations given to policy evaluations and their implications.

Scope and Limitations

The scope of the study is limited to the analysis of the relationship between Ethiopia's foreign trade(exports and imports) and GDP. The sensitivity of the growth of the economy to changes in exports and imports and the interrelationships between import saving and

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[5]Economic Commission for Africa (ECA), Revised Draft Treaty for the Establishment of the Preferential Trade Area for Eastern and Southern African States. Kampala, Uganda, 28 May - 7 June 1980, p. 4.

export expansion will also be incorporated in the study. The period to be covered is 1970-1978.[6]

Even if GDP and GNP are accepted as reasonable indicators, in principle, of economic growth, there remain considerable difficulties in practice in making reliable and consistent estimates of them. Such estimates imply accurate knowledge of economic activity in quantitative terms in all sectors of an economy. Another measurement problem concerns the value of output of the non-monetary sector. Errors in imputing such value could easily distort the recorded overall rate of growth of the economy. The difficulties of statistical measurement are increased when the estimates of GDP or GNP are converted from current to constant prices. The difficultires are most acute in Less Developed Countries(LDCs) which generally have less adequate price information. Despite the limitations stated above, the paper attempts to analyze the association between foreign trade (exports and imports) and GDP with allowance given to such limitations.

A Review of Literature

In this part, I would like to cite various works relating to the problem. A number of studies have shown a strong relation between export expansion and the growth of GNP. It is fairly well established that countries cannot continue to grow rapidly by steadily reducing the share of imports in GNP and that expanding the share of imports and exports in GNP permits more

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[6] The years are chosen so as to cover both pre- and -post revolution periods.

efficient allocation of resources and more rapid growth.[7] In the journal of the Economic Record, Derek T. Healey calculates an association between the growth rates of GDP per capita and exports. He states:

> "For Burma, Ceylon, Phillipines and Thailand the results show that a 1 percent rise in exports will be associated with 0.7 to 0.9 percent rise in GDP. For Malaysia, the elasticity is somewhat greater - a 1.1 percent rise in GDP."

In his book, Exports and Economic Growth of Developing Countries, Alfred Maizels showed that there was a positive correlation between the exports and GDP growth rates of some fifteen developing countries during 1953-62. A linear regression of GDP growth rates on export growth rates for these countries yielded a regression coefficient of 0.55. Furthermore, a linear regression of GDP growth rates on growth rates in the capacity to import (adjusted for capital inflow) showed a regression coefficient of 0.46.

Richard Reimer[8] in "Ethiopia's pattern of demand for imports" specified import demand function in the form: $M = a + bY$, where M is the value of imports and Y is Gross Domestic Product. Separate equations were estimated for each of the five end-use import classifications - raw materials, semi-finished manufactures, fuel, capital goods, and consumer goods. The estimate

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[7] The World Bank, "The Changing Composition of Developing Country Exports," World Bank Staff Working Paper No. 314, January, 1979.

[8] He was a Research Associate at the Institute of Development Research (IDR) of the Haile Selassie I University (now Addis Ababa University). Presently, he is Professor of Economics, the College of Wooster, United States of America.

of the regression coefficient (b) is the marginal propensity to import in value terms. In other words, the estimate derived for the regression coefficient is the amount by which imports vary as income changes. The following table summarizes the findings:

TABLE 1

IMPORT DEMAND FUNCTIONS

	Constant	Reg. Coefficient	R^2
Raw materials	7.6333 (1.6346)	0.0028 (2.1432)	0.3148
Semi-manufactured materials	-23.5733 (2.9106)	0.0248 (10.9996)	0.9237
Fuel	1.4021 (0.2541)	0.0083 (5.3860)	0.7436
Capital goods	82.1937 (2.4163)	0.0178 (1.8141)	0.2476
Consumer goods	28.5479 (2.2896)	0.0271 (7.8099)	0.8591
Total imports	97.1526 (2.2379)	0.0810 (6.7015)	0.8179

Source: Reimer, Richard, "Ethiopia's pattern of demand for imports", Institute of Development Research, Haile Selassie I University (now Addis Ababa University), Addis Ababa.

The coefficient of determination (R^2)[9] for semi-manufactured materials is quite high (0.924), indicating that changes in income explain virtually all the variation in imports of semi-manufactured materials. Similarly, for fuel. In developing countries imports of capital goods would ordinarly not be expected to be particularly responsive to changes in income and that is the case for Ethiopia as indicated in Table 1. One would expect other factors such as the scope of government development projects and the amount of foreign loans and trants, etc., in addition to income to be important determinants of capital goods imports and this appears to be the case for Ethiopia. According to the results of the regression analysis, imports of consumer goods are fairly explained by the equation.

Gerard J. Gill in "Readings on the Ethiopian Economy" summarizes the impact of the instability of export earnings as follows. He states:

> "The consequence of export fluctuations on the domestic economy focusses attention on the impact of such fluctuations on the macroeconomic variables - gross domestic expenditure, private consumption expenditure, investment expenditure and imports."

The results of regression equations and correlation coefficients for changes in government expenditure and changes in exports, changes in gross domestic fixed capital formation(GDFCF) and changes in exports, and changes in imports and changes in exports are given in table 2.

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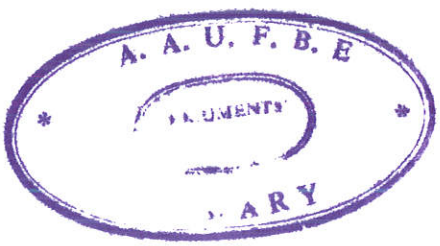
[9] The coefficient of determination is the proportion of total variation in the dependent variable(imports) that has been explained by the independent variable(GDP).

TABLE 2

SUMMARY OF RESULTS OF REGRESSION
OF GOVERNMENT EXPENDITURE, GDFCF & IMPORTS ON EXPORTS

Changes in Y	Changes in X	Regression of Y on X	Corr. Coeff.
Gov't expenditure	exports	26.3487+0.3975x (0.4985)	0.3358
GDFCF	exports	19.3230+1.113x (0.7088)	0.6716
Imports	exports	13.7937+0.9473x (0.9412)	0.4495

Source: Gill, Gerard J. ed., Readings on the Ethiopian Economy, Institute of Development Research, Faculty of Arts, Haile Selassie I University(now Addis Ababa University), Addis Ababa, Ethiopia, Nov., 1974.



CHAPTER II

THEORETICAL FRAMEWORK

Trade and Development

The role of international trade in the development process is a subject of controversy, and is an important issue in the deabte between outward looking and inward-looking strategies of development.[10] A traditional view based on the classical economic theory and the experience of major industrial countries, is that international trade brings gains to a nation and that it can act as an important stiumulus to growth. Some observers, while not contradicting the view, have agreed that such gains are unlikely to be significant among LDCs, because they are less developed and lack the responsiveness to the market oppotunities and dynamic influences of international trade found in developed economies. They point to the slow growth of export earnings from many primary commodities, and the difficulties of obtaining access to overseas markets for a more diversified range of export products. Such arguments do not apply to all LDCs. Nor do they suggest that developing countries should seek to reduce their involvement in international trade in order to further development. They suggest that the choice between an inward-looking or outward-looking development strategy should depend on the market opportunities, production possibilities and prospects of the individual LDC.

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[10] As far as international trade is concerned, outward-looking strategy encourages free trade, while inward-looking strategy stresses self-reliance.

A more radical view suggests that international trade, or more specifically trade between rich and poor countries, is actually harmful to LDCs' development prospects. The view is supported by arguments relating to the adverse social, economic and political repercussions on development which can result from poor countrys' general involvement in the international economic system. The conclusion drawn from these sorts of arguments is that development will be best furthered by a strategy which increases the self-reliance of individual LDCs or groups of LDCs and reduce their economic links, including trade links, with developed countries. We examine some of these arguments beginning with the conventional case for international trade.

The Theory of Comparative Advantage and Its Critiques

The principle of comparative advantage demonstrates that, given certain assumptions, trade leads to high real incomes in the trading countries. The assumptions on which the theory is built and from which the conclusion is reached include, inter alia, the following: perfect competition in both the product and factor markets, perfect mobility of factors within the country and immobility among nations, absence of externalities, unchanging techniques and free trade from tariffs and other obstructions. If these conditions are met, it is possible for the two trading partners to achieve higher levels of production and consumption through more efficient resource allocation. The mechanism can be summarized with the following example.

Assume two trading partners A and B each producting two goods, X and Y, using only two factors of production, capital and labour.

The analytical tool used in this expostition is the transformation curve or the production possibility curve. It shows the largest possible size of the two goods X and Y together, that could be produced with the fixed factors of production, capital and labour. The production possibility curve is concave is shape, showing the marginal opportunity cost of product transformation. In other words, the shape of the transformation curve signifies that production is made under increasing cost conditions. The production of any one of the two commodities can be explained only at the expense of contracting the production of another.

The community's demand or consumption pattern is usually represented by the community indifference curves. The consumption and production point is determined by a point of tangency between the production possibility curve and the community indifference curve. The slope of this tangent also determines the domestic price or exchange ratio between the two goods. Now, assume that the international price ratio, or terms of trade, is anywhere between the two individual countrys' domestic price ratios. The free trade argument, therefore, asserts that if the two countries are allowed to trade, both can gain through trade and specialization. Each country will tend to specialize and produce more of that commodity in which it has a comparative advantage, i.e., the product which it can produce relatively cheaper. The trading opportunities enable the two countries to export their surpluses to each other with export of A being the import of B, and vice versa. In essence, trade produces two beneficial effects. The first is the consumption effect, which is shwon by the

movement from a lower to a higher indifference curve. The second is the production effect which results from specialization. The effect of specialization can either make it possible for more commodities to be produced with the same amount of factors or same quantity produced with less factor input.

In the literature relating to economic development, a variety of arguments have been advanced by the protectionist in support of the policies of protection and import substitution. Some of them argue that the traditional trade theory may not always provide the answer to the development problems of LDCs. Most of the arguments seem to hinge around, and to question the practical applicability of free trade theories in LDCs. The free trade theory is backed by some unrealistic assumptions and strict conditions which can hardly be met in LDCs. The doubts that the protectionists have about the practical reliance of the pure trade theory have induced them to recommend the import substitution policies to the LDCs.

The free trade supporters, on the other hand, think that policies of protection and import-substitution are but second-best policies. Most of the arguments for protection can be summarized under the following:

a) Market imperfection arguments,

b) The infant industry and external economies argument, and

c) The secular - deterioration hypothesis.

a) Market Imperfection Argument

One of the assumptions of the free-trade model is that there are no market imperfections that will lead to the distortions of the price system. If this assumption is true, it follows that all the resources will be optimally allocated. But if there is imperfection in the market, then allocation of resources resulting from free trade may not lead to the highest attainable level of real income. In this case, some economists recommend the use of some form of protection to offset the distortion. The major fear about recommending a policty of protection as means of offsetting domestic price distortion is that an attempt to offset one form of distortion may bring the economy to another.

b) Infant-Industry and External Economies Argument

One of the arguments for protection and import substitution is the infant industry argument. The infant industry argument was forwarded in the 1840s by the German Economist and Politician Friedrick List. The core of the argument is that the young high cost industry should be protected during the early learning period. The protection should be removed when the industry matures, achieves economies of scales and is able to compete in the world market.

In reality this argument is less convincing than it may at first sound. The fear is that such protection may pamper the industry to such an extent that it may remain inefficient

for a long time. Another important argument here is that the fact that the infant industry incurs high initial total cost does not provide a valid reason for the state to step in to support it because naturally the industry will eventually grow up to maturity stage and the maximum profit earned here will be more than enough to pay for the industry's early costs.[11]

Very closely related to the infant industry argument is the case of external economies. It is assumed that the activities of individual industries may either directly or indirectly benefit other industries. There are many ways in which indirect benefits could come to other industries. One of the commonest ways in which external economies can come is through "job training." Some qualified workers previously trained by other employers can in the future be employed by other industries. Such an employee can increase the income of the second industry through an increase in productivity. The ultimate gainer, ofcourse, is the nation whose GDP has increased. In the same way, cost reduction in other industries may result from external economies. It follows, therefore, from welfare considerations that a divergence between private benefits and social benefits has resulted. Some form of protection or subsidy will be needed to compensate for this divergence.

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[11] See Gerald M. Meier, Internationa Trade and Development(1963), p. 125.

c) Secular Deterioration Argument

Another very important but controversial argument for protection and import substitution is the secular deterioration argument. Raul Prebish and a number of other prominant economists argue that less-developed primary producing countries have suffered a secular deterioration in their commodity terms of trade[12] in relation to manufactured goods. Theoretically Prebish accepts international trade theory but asserts that the gains from trade are unequally distributed among partners. He argues that according to the classical economists' theory of the division of labour, international trade should have led to an equal distribution of the gains from technical progress between the trading partners by either price reduction or by an increase in income. This has not been the case becaue the developed countries whom he calls the "centre," have kept all the benefits to themselves and the less-developed countries whom he calls the "periphery" have transferred to them the fruit of their own technical progress.

Because of the power of the trade unions in the centre, any productivity increase was absorbed by wage increases and not shared with the customers in the form of price decreases. In the periphery countries, on the other hand, there is a

[12]Terms of trade is defined as the ratio of a country's average export price to its average import price. A country's terms of trade are said to improve when this ratio increases and to worsen when it decreases.

general lack of trade unions and any tendency for a wage increase is destroyed by a population increase. The fruits of any technical progress are therefore transferred to the customers of the primary products, the majority of whom are in the centre. Many economists do not agree with the secular deterioration theories of Prebish and his collaborators. The critics feel that the terms of trade may not have deteriorated for all products, and where the terms of trade are declining, it may not have come as a result of external causes. As Myint pointed out, most of the time it may have been caused by internal problems.[13]

A similar thesis to that of Prebish has been advanced by Arghiri Emmanuel.[14] His argument proceeds as follows. In the course of transaction between nations, the LDCs exchange their output that requires a relatively large amounts of labour for its production for the output of the developed countries that requires less labour for its production. Based on Marx's theory of value which states that the value of a commodity is determined by the amount of socially necessary labour used in its production, Emmanuel concludes

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[13] See H. Myint, The Economics of the Developing Countries, p. 28.

[14] See Arghiri Ammanuel, Unequal Exchange. New York: Monthly Review Press, 1972.

that trade between the developed and under-developed countries diverges from such an exchange. His argument is, therefore, based on the difference in the remuneration to factors of production, especially wages which is the price of labour. In the less developed countries wages are low because of the relative abundance of labour. The low prices of labour in the production of primary products which are labour-intensive means lower costs of production and this results in low international prices. In developed countries, however, as a result of historical development and union pressure, wages are high and this results in high international price for commodities produced by them. This is a case of unequal exchange and as long as there is difference in wages, the LDCs would keep on being exploited. Emmanuel suggests that for an individual LDC, a policy of seeking to reduce its trade by increasing its trade with other low-wage countries or increasing self-reliance, or both, is the only possible way of avoiding unequal exchange and retaining the benefits of low-cost production. We now briefly look at Marxist critique of international trade theory.

The marxist critique of internation trade theory is based on the examination of the assumptions on which the theory is constructed. We will look at some of the assumption and their criticisms. First, the assumption of perfect competition is challenged on the basis that concentration of capital has given rise to the development of monopolies and

and oligopolies. Monopolistic and oligopolistic market control of internationally traded commodities means that large individual corporations are able to manipulate world prices and supplies in their own private interests. Instead of competition, one finds joint producer activities and oligopolistic bargaining among giant buyers and sellers as the most pervasive price and quantity determing force in international economic affairs. Second, the improvement in the level of technology has resulted in the development of increasing returns to scale which results from a change in the scale of production. Third, the mobility of factors of production, especially capital, is increasingly high. The direction and the magnitude of the flow of capital is determined by the rate of profit. As Marx explains, capital withdraws from spheres with low rates of profit and invades others which yield a higher rate.[15]

Socialist Foreign Trade

Foreign trade has brought socialist countries into closer economic cooperation and mutual assistance. The purpose is to pave the way for the expansion of socailism, the growth of socialist industry and the improvement of the living standards of the working people. Foreign trade in socialist countries is characterized by systematic modification of the commodity structure of exports and imports in

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[15] For a mathematical relationship, see Befekadu Degefe, Some Theories of Development and Under-development. Institute of Development Research, Addis Ababa University, January, 1977.

accordance with potentialities and needs among them. Exports are considered not as an end in themselves but as a means to finance the necessary imports.[16]

The rapid and rational development of socialist foreign trade is the result of applying definite principles on planning. Planned development is the most characteristic feature. Plans for exports and imports, an essential component of the national economic plans, are based on long-term trade agreements. In the preparation and implementation of exports and import plans, account is taken of the economic principles of socialism - the law of planned proportionate development. Commodity exchange between socialist countries develops in accordance with the demands of their planned economies and serve as an important means of coordinating their national economic plans. There are no risks of exchange fluctuations in the trade relations between socialist countries. The Council for Mutual Economic Assistance (CMEA) has a role in the organization of economic co-operation. The major function of CMEA is to bring about the co-operation of its members in the coordinated planning of their national economies, the coordination of the various plans, drawn up in the light of the actual characteristic of each country concerned, is designed to promote the rational division of labour between socialist countries.

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[16] Franklyn D. Holzman. Foreign Trade Under Central Planning. Harvard University Press, Cambridge, 1974.

Trade in LDCs

International trade has played a crucial role in the historical development of LDCs. Most LDCs depend on primary exports for their foreign exchange earnings. In addition to their export dependence, many developing countries rely on the importation of raw materials, machinery, capital goods, intermediate goods and consumer products both for industrial expansion and consumption.

The distinction between developing and developed countries is not wholly synonymous with the distinction between primary producers and producers of manufactured goods. The fact remains that the export trade of developing countries is largely dominated by primary products while the share of manufactures is very small. This situation is illustrated in table 3.

TABLE 3

COMMODITY COMPOSITION OF EXPORTS, 1971(%)

Category	LDCs	Developed Countries
PRIMARY COMMODITIES		
- food, food products and raw materials	39	18
- fuels	39	4
MANUFACTURES		
- Chemicals	2	9
- Engineering products	2	36
- Manufactures(non-metallic mineral and others)	17	31
- Unspecified	1	2
TOTAL	100	100

Source: Todaro, Michael P. Economics for a Developing World. London: Longman Group Limited, 1977, p. 296.

Most statistical studies of world demand patterns demonstrate that the demand for foodstuffs and other consumer good is generally much less responsive to income growth than the demand for industrial products. It has been estimated that a one percent increase in the developed country incomes will normally raise their import of foodstuffs from LDCs by 0.6 percent, agricultural raw materials like rubber and vegetable oils by 0.5 percent, petroleum products and

other fuels by 2.4 percent and manufactures by about 1.9 percent.[17] Various explanations have been advanced for the relative worsening of the trade position of LDCs. Most of these arguments have been presented in the preceding discussion on international trade theory and its critiques.[18]

The 1970s have marked a turning point in the trade relations between the rich and the poor countries to bring about a more rational international division of labour and to ensure a more equitable world economic order. There is thus a consensus in the developing world that a New International Economic Order (NIEO) needs to be established in which developing countries can begin to reap the benefits of international trade which they have long been denied. Among LDCs' stated aims in the field of commodities are access to markets in developed countries, price stabilization and improvement in the terms of trade.

It was largely the belief that the inability to import adequate quantities of industrial products was frustrating the attempts of LDCs to achieve an adequate rate of growth that led to the establishment of UNCTAD. In demanding the reform of internation trading arrangements, the LDCs in UNCTAD are seeking price-support and price-stabilization assistance.

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17 Michael P. Todaro. Economics for a Developing World. London: Longman Group Limited, 1977.

18 For detailed arguments against free-trade, see Gerald M. Meier, Leading Issues in Development Economics. New York: Oxford University Press, 1964.

A consensus of opinion is also growing that LDCs should begin to look both outward and inward - outward towards new forms of economic cooperation and integration and inward towards self-reliance through the economic use of their own resources of development. Several groups of countries, most with differences in the development level and some at roughly equal stages of development have entered into arrangements to integrate their economies. While there are potential benefits to be derived from an economic union, especially in the long-run, the immediate gains should not be over-estimated and due attention must be given to the possible undesirable consequences. We will deal with economic integration in the later chapter.

CHAPTER III

ETHIOPIA'S STRUCTURE OF FOREIGN TRADE

Exports

In this and the chapter that follow we attempt to carry the analysis a little more deeply into Ethiopia's foreign trade in the hope of discovering relationships. The classic characteristic of the domination of agricultural primary products in the export structure of LDCs is no exception to Ethiopia. The main export items of agricultural origin comprise coffee, oilseeds, hides and skins, and pulses. The value of most of these commodities are of varying nature from year to year. This situation is illustrated using table 4 and figures 1 and 2.

TABLE 4

VALUE OF MAJOR EXPORTS[19], 1970-78
(IN MILLIONS OF BIRR)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Coffee	181.3	175.2	182.5	189.8	151.9	152.7	324.6	519.3	502.3
Oilseeds	28.4	32.1	48.7	52.0	95.9	84.0	31.2	17.5	12.1
Hides and skins	24.4	25.7	47.6	68.6	47.1	34.4	55.4	48.5	66.3
Pulses	15.8	22.2	26.2	77.2	101.9	64.9	55.9	43.4	17.3
Meat	6.0	8.9	15.1	17.5	14.6	7.1	6.8	4.5	0.7
Fruts and vegetables	5.5	6.2	9.2	7.9	11.8	7.6	7.7	7.6	3.3
Sugar	3.2	4.1	9.1	18.7	4.5	9.5	17.9	2.0	-
Others	40.5	39.6	45.8	71.5	128.6	137.7	81.0	46.0	31.4
Total	305.8	314.1	384.2	503.2	556.2	497.8	580.6	689.0	633.6

Source: National Bank of Ethiopia(NBE), Annual Reports of 1972-78, Addis Ababa, Ethiopia.
_____ Data not available.

[19] Exports are based on free on board(f.o.b)valuation.

MOVEMENTS OF VALUES OF SOME EXPORT COMMODITIES OF EITHIOPIA, 1970-78

FIGURE 1: Coffee

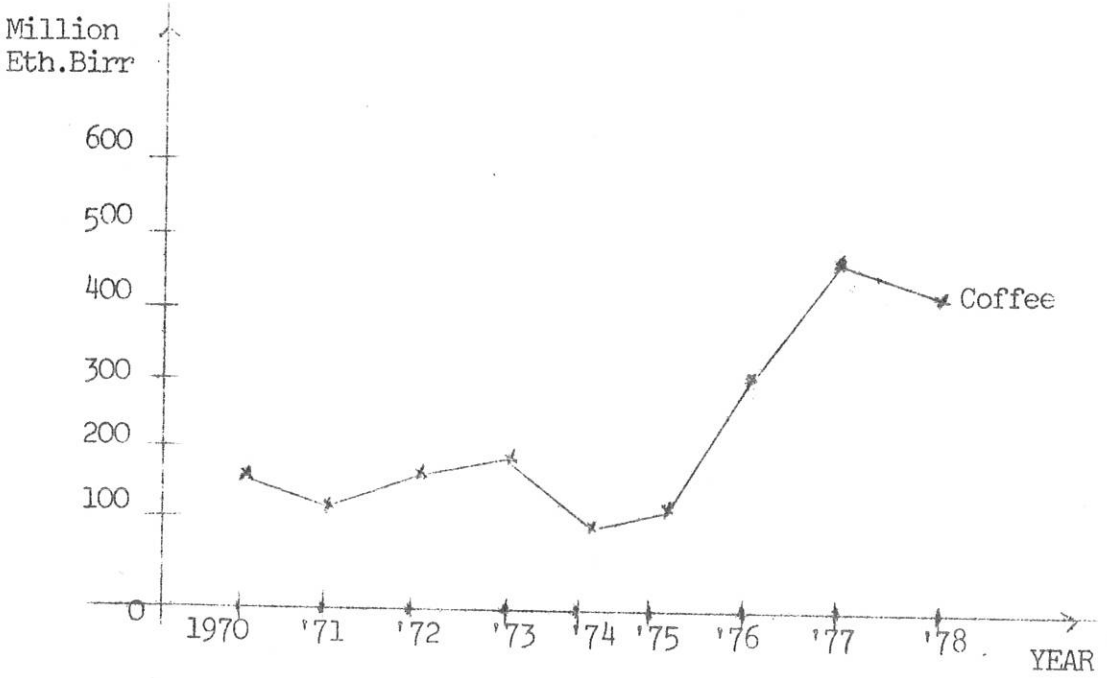
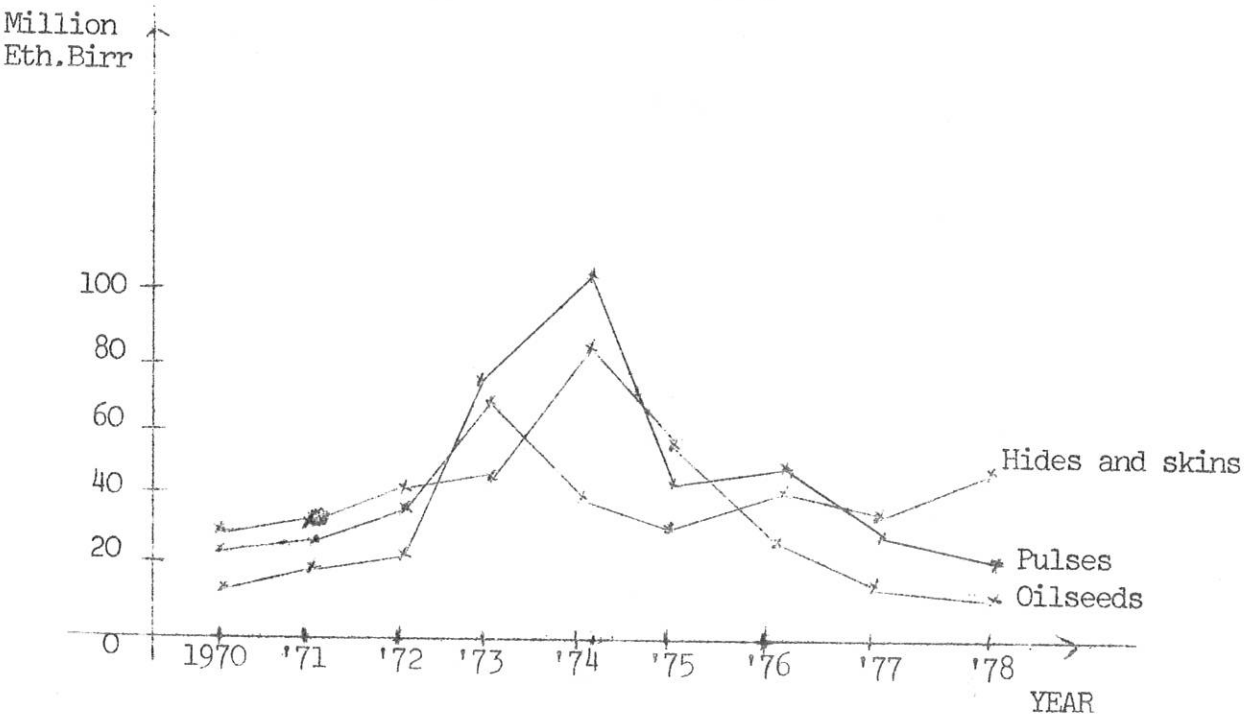


FIGURE 2: OILSEEDS, HIDES AND SKINS AND PULSES



Source: Based on data in table 4.

These trends are mainly determined by the fluctuations in volume and prices. Special mention should be made on coffee export earnings in 1977 and 1978(see table 4). The value of coffee exports in 1977 increased by Birr 194.7 million or about 60.0 percent over the level in 1976. The rise in the value of coffee was reflection of relatively high world prices for the commodity owing to reduced shipment for major coffee producing countries. Adverse weather conditions and political problems combined to create a world shortage of the commodity. An additional factor for the rise in international coffee prices was speculation involving mainly the holding of above-average stocks in expectation of rising prices. The value of coffee export, inspite of volume increase (table 5), declined from Birr 519.3 million in 1977 to Birr 502.3 million in 1978. This was mainly due to the price decline of coffee in the world market. The increase in the volume of coffee was attributed both to improved transportation and government's efforts to increase its production.

In recent years, there has been considerable discussion of the problem posed by fluctuations in export earnings and the impact of these fluctuations on primary-producing countries. The factors for the fluctuations in export earnings from primary commodities are identified with low income elasticity of demand and the supply conditions. Table 5 shows the varying nature of the quantities of Ethiopia's major exports during the period 1970-78.

TABLE 5

QUANTITIES OF MAJOR EXPORTS, 1970-78

(IN METERIC TONS)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Coffee	70,860	80,803	82,522	76,082	55,666	57,780	68,002	48,215	66,325
Oilseeds	56,314	63,336	88,436	96,659	103,280	79,351	32,120	21,624	13,835
Hides & skins	10,644	10.859	16,303	13,984	99,773	6,835	9,219	11,333	8,226
Pulses	51.109	64,105	77,652	141,581	127,160	98,847	90,911	85,541	23,745
Meat	5,046	6,432	10,027	11,364	8,975	3,197	2,928	2,058	339
Fruits & vegetables	17,678	18,465	27,013	23,175	31,018	26,206	21,041	14,978	4,516
Sugar	12,275	14,307	20,519	32,407	10,500	6,431	41,211	3,500	--

Source: NBE, Annual Reports of 1972-78, Addis Ababa, Ethiopia

_____ Data not available.

The slow growth of demand has been attributed partly to the improvement of technology, which has reduced the requirement of raw material inputs and partly due to the development of synthetic substitutes for some primary commodites.[20] The argument for the supply conditions is that the fluctuations in supply reflect unstable volume of exports because of the influences of natural exogeneous factors such as the weather and insect pests that adversely affect production of export commodities.

[20] Association of African Central Banks, African Centre for Monetary Studies. Balance of Payments Problems of African Countries and their Effects on the Development Objectives. Dakar, August 1979.

The structure of Ethiopia's exports shows that no significant change has taken place in the composition of exports and the heavy reliance on coffee has not been reduced. The dominant position of coffee is demonstrated in table 6 which shows percentage contribution of major exports to total export earnings.

TABLE 6

ETHIOPIA'S MAJOR EXPORTS, 1970-78
(PERCENTAGE OF TOTAL VALUE OF EXPORTS)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Coffee	59.3	55.8	47.5	37.7	27.3	30.7	55.9	75.4	79.3
Oilseeds	9.3	10.2	12.7	10.3	17.2	16.9	5.4	2.5	1.9
Hides & skins	8.0	8.2	12.4	13.6	8.5	6.9	9.5	7.0	10.5
Pulses	5.2	7.1	6.8	15.3	18.3	13.0	9.6	6.3	2.7
Meat	2.0	2.8	3.9	3.5	2.6	1.4	1.2	0.7	0.1
Fruits & vegetables	1.8	2.0	2.4	1.6	2.1	1.5	1.3	1.1	0.5
Sugar	1.1	1.3	2.4	3.7	0.8	1.9	3.1	0.3	--
Others	13.2	12.6	11.9	14.3	23.1	27.7	14.0	6.7	5.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Computed from data in table 4.

The proportion of total exports represented by coffee averaged about 52 percent over the period 1970-78. Oilseeds have contributed between 2 and 17 percent of total exports, the average for the period having been 10 percent. The significant decline in the contribution of earnings from oilseeds for the

years 1976-78 is associated with reduced production[21] due to security problems, increased domestic consumption and low international prices for the commodity. Exports of hides and skins and pulses have both averaged 9 percent of total exports in the period under review. Higher domestic consumption and a decline in the production of pulses were responsible for the reduced earnings from the commodity for the years 1976-78. The remaining minor exports of primary commodities have been of little relative importance.

An analysis of the direction of exports[22] by country indicates that the United States of America has been the major market for Ethiopia's exports, largely coffee. Exports to the United States fluctuated between 19 and 49 percent during the period 1970-78 averaging about 32 percent of the total value of exports. The dependence on the United States as an outlet for Ethiopia's exports has been reduced, the share being declined from 49 percent in 1970 to 31 percent in 1978. The significant decline in the share of Ethiopia's exports to the United States for the years 1974 and 1975 is mainly due to the political situation and the consequent expansion of exports to other trading partners like West Germany, Japan and Saudi Arabia.[23] The following table demonstrates Ethiopia's exports by major destinations as percentages of total value of exports.

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[21] See table 5.

[22] For the details of export commodities by country, See CSO, Statistical Abstract, various issues.

[23] See NBE, Twelfth Annual Report, 1976, Annex table 16.

TABLE 7

EXPORTS BY MAJOR DESTINATIONS, 1970-78

(AS PERCENTAGE OF TOTAL VALUE OF EXPORTS)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
U.S.A	48.7	43.9	35.6	29.9	19.5	18.7	32.6	25.8	31.0
W. Germany	7.3	7.9	7.3	8.7	11.4	11.5	6.0	8.6	11.8
Saudi Arabia	5.5	6.4	5.9	6.2	8.9	12.	7.4	8.6	11.2
Japan	5.4	6.0	7.0	5.5	9.1	8.1	6.9	7.0	5.8
Djibouti	5.1	6.3	5.9	7.3	6.9	10.7	8.5	4.8	1.3
Italy	6.2	5.3	8.3	7.8	6.7	4.2	6.9	4.8	5.9
Others	21.8	24.3	30.1	34.5	37.5	34.0	31.6	40.4	33.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Computed from data in Annual Reports of NBE, 1972-78, Addis Ababa, Ethiopia.

West Germay and Saudi Arabia occupy the next positions for Ethiopia's exports. West Germany's share in total exports, mainly coffee and vegetables, increased from 7 percent in 1970 to about 12 percent in 1978, the average being about 9 percent for the period 1970-78. Exports to Saudi Arabia, which largely consist of coffee, averaged 8 percent of total exports during the period under review. The share of Ethiopia's exports to Japan, fluctuated between 5 and 9 percent of total exports. Japan occupied the fourth position, the main export commodities to the country being coffee and oilseeds. Djibouti and Italy both averaged about 6 percent of total exports for the period. Exports to Djibouti largely consisted of vegetables, while exports to Italy were dominated by coffee and hides and skins. Among other countries of destination, which constituted smaller shares of total exports, are France, Netherlands and the United Kingdom.

Imports

In considering the structure and magnitude of imports, the level of economic development of the country in question has to be examined. Thus, during the early stages of development, imports of most LDCs are small and concentrated; while as development proceeds, imports increase in magnitude and will be more diversified due to a higher requirement of importation of development goods. A general picture of the changing composition of imports of a developing economy is thus manifested by a larger and growing share of imports of capital goods and intermediate goods in total imports. The changes in the structure of imports are affected not only by the process of industrialization but also by the country's policy of restriction and control. Arguments for restrictions on the growing import demand stem mainly from two sources: to protect infant industries and to discourage inessential imports. Let us look at each of these arguments.

First, development creates a growing demand for imports of machinery, raw materials and semi-finished goods. A part of these imports has to be supplied from domestic production. Thus the development of domestic industries to reduce potential demand for imports is facilitated by the infant industries protection policy which is to be applied until these industries reach the level of maturity. Nevertheless, attempt at import substitution requires long-term planning and proper administration because what needs to be minimized is the level of imports over time and not just immediately.[24] Another argument for restriction of imports arises from

[24] I.G. Patel, "Trade and Payment Policy for a Developing Economy," in International Trade Theory in a Developing World, ed. Roy Harrod and Douglas Hague, New York, 1965.

the developing country's desire to encourage the importation of items necessary for development and to keep away inessential ones. It is well established that there is a close link between the rate of economic growth and the available supply of investment goods. Thus, a policy of import restriction was used to curtail the demand for luxury imports so as to allow for a larger import of capital goods and semi-finished materials that are essential for development.

Data on the end-use classification of Ethiopia's imports[25] indicate that there has not been much change in the composition of imports during the period 1970-78. Consumer goods(durable and non-durable) and capital goods have a larger percentage share in the total value of imports, averaging about 32 and 31 percent, respectively, for the period under review. Improved personal consumption and the growing requirements of development projects have contributed to the larger share of imports of consumer and capital goods. Tables 8 and 9 demonstrate values of imports by end-use and as percentage of total.

[25] Imports are based on cost, insurance and freight (c.i.f.) valuation.

TABLE 8

VALUE OF IMPORTS BY END-USE, 1970-78
(IN MILLIONS OF BIRR)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Raw materials	14.3	19.7	19.0	20.9	26.8	31.9	24.2	28.7	40.8
Semi-finished products	84.3	88.8	72.1	96.4	132.3	141.8	132.5	117.8	173.4
Fuel	33.7	44.3	36.2	42.0	97.5	107.0	111.1	128.3	145.3
Capital goods	142.3	159.9	167.5	135.2	151.0	153.8	217.7	225.2	360.7
Consumer goods	152.3	152.6	137.7	150.0	174.0	174.9	242.2	271.7	345.0
Miscellaneous	2.0	4.2	3.1	3.7	4.4	3.7	1.2	41.1	15.6
Total	429.1	469.5	435.6	448.2	586.0	613.1	736.6	810.9	1080.8

Source: Central Statistical Office, Statistical Abstracts of 1972-78, Addis Ababa, Ethiopia.

TABLE 9

VALUES OF IMPORTS BY END-USE, 1970-78
(PERCENTAGE OF TOTAL VALUE OF IMPORTS)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Raw materials	3.3	4.2	4.4	4.7	4.6	5.2	3.3	3.5	3.8
semi-finished products	19.6	18.9	16.6	21.5	22.6	23.1	18.0	14.5	16.0
Fuel	7.9	9.4	8.3	9.4	16.6	17.5	15.1	15.8	13.4
Capital goods	33.2	34.1	38.5	30.2	25.8	25.1	29.6	27.8	33.4
Consumer goods	35.5	32.5	31.6	33.5	29.7	28.5	32.9	33.5	31.9
Miscellaneous	0.5	0.9	0.7	0.8	0.8	0.6	1.2	5.1	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Computed from data in table 8.

Semi-finished products and fuel represented about 19 and 13 percent, respectively reflecting increased industrial processing utilizing available capacity and increase in prices. The proportion of raw materials imports to total imports accounted for a smaller share owing to the combined effect of import restriction[26] and improved local supplies. Imports of raw materials fluctuated between 3 and 5 percent, averaging about 4 percent of total imports.

As far as the geographical distribution[27] of imports is concerned, the share of the United States has been less important than the case of exports as shown in table 10.

TABLE 10

VALUE OF IMPORTS BY MAJOR COUNTRIES OF ORIGIN, 1970-78
(AS PERCENTAGE OF TOTAL VALUE OF IMPORTS)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Japan	14.8	14.7	15.2	13.5	12.6	12.4	12.4	15.9	15.0
Italy	16.9	16.1	16.4	14.9	15.0	11.3	8.8	10.0	13.0
W. Germany	13.7	11.1	10.7	11.6	11.8	10.3	8.8	8.1	12.1
U.S.A	8.5	9.2	9.2	8.5	5.5	7.7	10.4	9.1	5.2
U.K.	7.5	9.4	9.5	9.3	7.6	8.0	6.4	5.8	7.9
Others	38.6	39.4	39.1	42.2	47.5	50.4	53.3	51.2	46.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Computed from data in Annual Reports of NBE, 1972-78, Addis Ababa, Ethiopia.

[26] See NBE(Exchange Control), Notice to Importers-List of Goods for which Foreign Exchange will not be Provided, July 21, 1978.

[27] For the details of imported commodities by country of origin, see CSO, Statistical Abstract, Various issues.

Japan and Italy both averaging about 14 percent of total imports have been the main sources of Ethiopia's imports during 1970-78. The major imports from Japan included road motor vehicles and parts and rubber articles; while those from Italy were largely road motor vehicles and parts. West Germany occupied the third position as supplier of imports which mainly consisted of road motor vehicles and parts and machines for industries. Imports from West Germany fluctuated between 8 and 14 percent, the average being 11 percent of total imports. The United States of America and the United Kingdom both represented an average of about 8 percent of total imports during the period under review. Road motor vehicles and parts and machines for industries dominated imports from these countries. The remaining countries of origin for Ethiopia's imports include Saudi Arabia and Iran(largely petroleum and products), and France and Netherlands(mainly road motor vehicles and machines for industries).

Visible Trade Balance

Economic development creates a growing demand for imports, which in most developing countries, are very large to be met by the export sector. The situation is further aggravated because of the fact that developing countries export primary commodities for which world demand has been less favourable relative to manufactured goods. Thus, the growth rate of these countries is retarded by the bottleneck arising from the lag between an insufficient capacity to import, which is limited by inelastic commodity pattern of exports. The export-based capacity to import should be distinguished, of course, from the total capacity to import, which depends

not only on exports but also capital inflow and other invsible exchange receipts.[28]

The balance of trade records the balance of the value of goods exported and the value of goods imported. If the value of goods exported exceeds the value of goods imported, it is termed as a favourable balance, otherwise it is unfavourable. Although both Ethiopia's exports and imports have been increasing in absolute terms, the rate of growth of imports have been greater than that of exports. As a consequence, trade balance based on free on board(f.o.b) valuation for exports and cost insurance and freight (c.i.f) valuation for imports has been unfavourable during 1970-78 with the exception of the year 1973 as shown in table 11.

TABLE 11

TRADE BALANCE, 1970-78
(IN MILLIONS OF BIRR)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Exports (f.o.b)	305.8	314.1	384.2	503.2	556.2	497.8	580.6	689.0	633.6
Imports (c.i.f)	429.1	469.5	435.6	448.2	586.0	613.1	736.6	810.9	1080.8
Trade balance	-123.3	-155.4	-51.4	55.0	-29.8	-115.3	-156.0	-121.9	-447.2

Source: Computed from data in tables 4 and 8.

[28] Meier, G.M. International Trade and Economic Development. New York: Harper and Row, 1963, p. 42.

The year 1973 was marked by an exceptionally high increase in world trade expansion estimated to have been 36 percent in value and 12 percent in real terms over the level in 1972.[29] Exports increased from Eth.Birr 384.2 million in 1972 to Eth.Birr 503.2 million in 1973 (see table 4), which was an increase of about 31 percent. Imports, on the other hand rose sluggishly from Eth.Birr 435.6 million in 1972 to Eth.Birr 448.2 million in 1973 (see table 8), which was about a 3 percent increase. The country therefore registered a surplus of Eth.Birr 55.0 million in 1973. Coffee, the most important export item, registered a rise in foreign earnings of Eth.Birr 7.3 million or 4 percent from Eth.Birr 182.5 million in 1972 to Eth.Birr 189.8 million in 1973. World coffee prices remained high throughout 1973 as a result of world supply shortages and low stocks brought about by the severe frost in Brazil in July 1972.

The trends in the geographical distribution of exports and imports illustrate the problem of disequilibrium in Ethiopia's trade with most of her trading partners. This situation can be demonstrated in table 12 which shows Ethiopia's trade balances with major trading partners.

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[29] See NBE, Tenth Annual Report, 1973, p. 18.

TABLE 12

TRADE BALANCES WITH MAJOR TRADING PARTNERS

(IN MILLIONS OF BIRR)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
U.S.A	112.5	94.5	96.9	112.5	75.9	45.8	113.1	104.0	140.6
Djibouti	14.6	19.2	22.1	35.8	37.4	52.6	48.0	31.7	5.7
Saudi Arabia	-	18.0	22.1	30.5	20.0	-13.4	-51.7	-27.5	69.0
W. Germany	-36.6	-27.1	-18.2	-8.1	-5.2	-6.1	-29.8	-6.1	-55.5
U.Kingdom	-26.2	-37.1	-30.4	-26.6	-26.4	-35.2	-29.1	-29.1	-71.0
Italy	-53.6	-59.2	-39.4	-27.6	-51.0	-48.2	-24.5	-47.9	-103.2
Japan	-47.0	-50.5	-42.4	-32.5	-23.2	-35.5	-51.1	-80.7	-125.5

Source: NBE, Annual Reports, Various issues.

_____ Data not available.

As shown in the table, Ethiopia has always had a favourable trade balance with the United States and Djibouti, to which most of its exports of coffee and vegetables, respectively, have been directed. Saudi Arabia maintained favourable balances during the period 1971-74 and in 1978, while the balances for the years 1975-77 were unfavourable. Trade balances with the remaining major trading partners have consistently registered deficits during the period 1970-78.

CHAPTER IV

ETHIOPIA'S GROSS DOMESTIC PRODUCT

The present chapter is a discussion on Ethiopia's Gross Domestic Product(GDP) followed by the establishment of an association between GDP and exports and GDP and imports. The relationship will then be analyzed and interpreted with due considerations given to policy evaluations and their implications.

The reference period for the government budget and governmental plan in general is the Ethiopian Fiscal Year(E.F.Y) in order to facilitate the monitoring and evaluation of plan implementation. Thus, national accounts data have been compiled in the E.F.Y. According to the available data,[30] GDP by sector at constant 1960/61 prices is classified into agricultural sector, other commodity sectors, distribution services, and other services. Agricultural sector includes forestry, hunting and fishing. Other commodity sectors comprise mining and quarrying, manufacturing, handicraft and small scale industry, building and construction, and electricity and water. Distribution services are, wholesale and retail trade, and transport and communication. Other services include banking, insurance, public administration and defense, educational services, medical and health services and other domestic services. Tables 13 and 14 show GDP by sector at constant 1960/61 prices and the relative contribution of different sectors to GDP, respectively, during the years 1970/71-1978/79. GDP at

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[30] See NBE, Annual Report, Various Issues.

constant 1960/61 prices have been considered to take an account of the inflationary situation which could lead to overstimation of the values.

TABLE 13

GDP BY SECTOR AT CONSTANT 1960/61
FACTOR COST(E.F.Y. 1953), 1970/71-1978/79
(IN MILLIONS OF BIRR)

	1970/71	71/72	72/73	73/74	74/75	75/76	76/77	77/78	78/79
Agricultural sector	1870.3	1936.8	1950.8	1940.1	1902.6	1953.7	1952.8	1922.2	1968.4
Other commodity sectors	593.8	620.6	637.2	633.7	624.3	597.7	605.5	583.1	653.0
Distribution services	527.1	560.7	585.5	612.7	611.6	647.5	624.6	569.3	638.0
Other services	614.9	659.7	706.1	749.5	801.0	832.5	872.4	934.7	958.1
GDP at constant Factor cost	3606.1	3777.8	3879.6	3936.0	3939.5	4031.4	4055.3	4009.3	4217.5

Source: NBE, Annual Reports of 1977-79, Addis Ababa, Ethiopia.

TABLE 14

CONTRIBUTION OF MAJOR SECTORS TO GDP, 1970/71-1978/79
(PERCENTAGE OF GDP)

	1970/71	71/72	72/73	73/74	74/75	75/76	76/77	77/78	78/79
Agricultural sector	51.9	51.3	50.3	49.3	48.3	48.5	48.2	48.0	46.7
Other commodity sectors	16.5	16.4	16.4	16.1	15.8	14.8	14.9	14.5	15.5
Distribution services	14.6	14.8	15.1	15.6	15.5	16.1	15.4	14.2	15.1
Other services	17.1	17.5	18.2	19.0	20.3	20.7	21.5	23.3	22.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Computed from data in table 13.

As seen from table 14, the most important sector is agriculture, which during the period 1970/71-1978/79 accounted on the average for about 49 percent of GDP. The agricultural sector fluctuated between 52 percent in 1970/71 and 47 percent in 1978/79 owing mainly to variations in climatic conditions. Other commodity sectors represented on the average about 16 percent of GDP during the period under review. Distribution services averaged about 15 percent of GDP. Other services such as banking, insurance, education, medical and health contributed the remaining balance to GDP.

According to the available statistics, the annual rate of grown of GDP in constant 1960/61 prices has fluctuated between 4.7 percent in 1970/71 and 5.2 percent in 1978/79, averaging about 2.3 percent over the nine years period. Table 15 illustrates the situation.

TABLE 15

ORIGIN AND GROWTH OF GDP, 1970/71-1978/79
(IN PERCENT)

	1970/71	71/72	72/73	73/74	74/75	75/76	76/77	77/78	78/79
Agricultural sector	2.0	3.6	0.7	-0.5	-1.9	2.7	-0.04	-1.6	2.4
Other commodity sectors	10.0	4.5	2.6	-0.5	1.5	-4.3	1.3	3.7	12.0
Distribution services	8.4	6.4	4.4	4.6	-0.2	5.9	-3.5	-8.9	12.1
Other services	5.2	7.3	7.0	6.1	6.9	3.9	4.8	7.1	2.5
GDP at constant factor cost	4.7	4.8	2.7	1.5	0.1	2.3	0.6	1.1	5.2

Source: Computed from data in table 13.

The fluctuation in GDP may be explained by the fact that the economy is basically agricultural and variations in weather have a big impact on the economy. The growth in GDP was thus adversely affected by the performance of the agricultural sector, where the annual rate of growth averaged about 0.8 percent. The average annual growth rates for other commodity sectors, distribution services, and other services are, respectively 3.4, 3.2 and 5.6 percent.

Gross Domestic Product and Exports

In chapter three we have attempted to look at Ethiopia's structure of foreign trade - exports, imports and the balance of trade. It is generally accepted from the analysis that earnings from primary products fluctuate from year to year owing to low income elasticity of demand and the supply conditions of these commodities. The fluctuations will tend to have internal repercussions. The argument is that national product is generated largely in agriculture and ancilary activities while industry is minute and elementary with the corollary that manufactures of capital equipment must be imported from aborad and paid for mainly by exports. This study is an attempt to establish an association between Ethiopia's GDP and exports, analyze and interpret the results.

Similar studies have been made for some developing countries. In the journal of the Economic Record, Derek T. Healey calculated an association between the growth rates of GDP per capita and exports. He states: "for Burma, Ceylon, Philippines and Thailand the results show that a 1 percent rise in exports will be associated with 0.7 to 0.9 percent rise in GDP. For Malaysia, the elasticity is some what greater - a 1.1 percent rise in

GDP." In his book, Exports and Economic Growth of Developing Countries, Alfred Maizels showed that there was a positive correlation between the exports and GDP growth rates of some fifteen developing countries during 1953-62. A linear regression of GDP growth rates on export growth rates for these countries yielded a regression coefficient of 0.55.[31] A similar work has been done by Alasdain I. Macbean,[32] who established an association between Uganda's exports and GDP. It was found out that the annual percentage changes in export proceeds and domestic product for 1950-60 are highly correlated (r = 0.95).

The present study is therefore an attempt to fill-in the gap by establishing some association between GDP and exports for Ethiopia. The GDP values that have been considered in the relationship are in current prices so that they correspond to export prices of the same valuation. The following table provides GDP and export values upon which the relationship is based.

TABLE 16

GDP AND EXPORTS AT CURRENT PRICES 1970/71-1978/79
(IN MILLIONS OF BIRR)

	1970/71	71/72	72/73	73/74	74/75	75/76	76/77	77/78	78/79
GDP	4408.9	4416.6	4629.2	5140.8	5103.2	5530.0	6146.3	6487.0	7086.5
Exports	305.8	314.1	384.2	503.2	556.2	497.8	580.6	689.0	633.6

Source: NBE, Annual Report, Various issues.
CSO, Statistical Abstract, Various issues.

[31] Alfred Maizels, Exports and Economic Growth of Developing Countries. Cambridge University Press, 1971, pp. 43-45

[32] Alasdain I. Macbean. Export Instability and Economic Development. Harvard University Press, Cambridge 1966, p. 133.

Description of the Model and Analysis

Based on a priori reasoning, nature of scatter diagram, and published results of others, a linear regression of GDP on exports is formulated. This takes the form:

$Q_t = a + bX_t$, where

Q = GDP, and

X = Exports.

The regression equation resulted:

$$Q = 2307.6628 + \underset{(1.1420)}{6.3120X} \qquad R^2 = 0.8136$$

According to the results of regression analysis GDP and exports are highly correlated ($r = 0.9020$). The coefficient of determination (R^2) is quite high (0.8136), indicating that about 81 percent of the variation in GDP is explained by variation in exports. The estimate of the regression coefficient (b) is the amount by which GDP varies as exports change. Over the period, the results show that a 1 birr increase in the value of exports is associated with about 6 birr increase in GDP. It has to be noted, however, that the causal effect of exports is only one element in the process. There are government policy instruments and other non-economic variables that could influence the relationship. The parenthetical figure is the standard error for the regression coefficient. The regression coefficient is highly significant at the 0.01 level.

Gross Domestic Product and Imports

The foregoing trends in exports naturally entail changes of similar intensity in the quantum and value of imports. It must be noted, however, that other factors will also affect imports. Richard Reimer[33] in "Ethiopia's pattern of demand for imports" specified import demand function in the form: $M = a+bY$, where M is the value of imports and Y is GDP. Separate equations were estimated for each of the five end-use import classifications - raw materials, semi-finished manufactures, fuel, capital goods, and consumer goods. The results showed that the coefficient of determination (R^2)[34] for semi-finished manufactures (0.9237), fuel (0.7436) and consumer goods (0.8591) was quite high, indicating that changes in income explain most of the variations in imports of these commodities. Imports of raw materials and capital goods, however, showed coefficients of determination of 0.3148 and 0.2476, respectively. The relatively low response of imports of raw materials and capital goods to changes in income indicates the influence of other factors such as the scope of development projects, amount of foreign loans and grants, and other non-economic variables that operate through government instrumental policies.

This part of the work, on Ethiopia's GDP and imports, is similar to the study done by Richard Reimer. But, instead of estimating separate equations for each of the five end-use classifications of imports as in the case of Reimer, the analysis is based on a linear regression of total

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[33] See footnote 8.

[34] See footnote 9.

imports on GDP. Import and GDP values for the regression equation are obtained, respectively, from tables 8 and 16.

Description of the Model and Analysis

This is based on a linear regression of the form:

$M_t = a_1 + b_1 Z_t$, where

M = Imports, and

Z = GDP.

The results obtained are as follows:

$$M_t = -573.79196 + \underset{(0.0255)}{0.2201Z} \qquad R^2 = 0.9142$$

The coefficient of correlation is quite high ($r = 0.9561$), indicating a strong association between imports and GDP. The coefficient of determination ($R^2 = 0.9142$) shows that about 91 percent of the variation in imports is explained by changes in GDP. It has to be noted that the relationship we have already established between GDP and exports could have an effect on the association between imports and GDP. The regression coefficient ($b_1 = 0.2201$) is highly significant at the 0.01 level. Standard error of estimate of the regression coefficient is enclosed in parenthesis.

CHAPTER V

POLICY ISSUES

In the foregoing, we have attempted to look at LDCs' structure of foreign trade in general and of Ethiopia in particular in view of establishing relationships. The purpose of the present study is to explore some of the ingredients of policy issues as important factors affecting foreign trade. An analysis of such effects will enable us to make an overall assessment and implications on economic development.

A convenient way to approach the complex issue of appropriate trade policies is to set the specific policies in the content of a broader LDC strategy of looking outward or looking inward. Outward-looking policies encourage free movement of capital, workers, and enterprises a welcome to the multi-national corporations and an open system of communications.[35] Inward-looking policies are those that stress economic self-reliance including the development of indigenous technologies appropriate to a country's resources endowment. Based on outward and inward-looking policies for development, we will now examine the specific trade strategies that fall under these two broad approaches. Among the specific trade strategies that have been considered in this study are structural diversification and economic integration.

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[35] For a detailed discussion on these issues, see Streeten, Paul. ed. Trade Strategies for Development. Macmillan, 1973, pp. 1-10.

Structural Diversification

The majority of LDCs are still heavily dependent on one or two principal commodities in their export trade, and relatively few countries have yet achieved any substantial progress in the diversification of their export structures. The narrow commodity specialization, for which the world market is sluggish, affects LDC's development unless appropriate remedial policy changes are made. Primary export promotion[36] has long been considered as a major ingredient in long-run development strategy of these countries. But, despite the efforts made to promote primary exports, experience has shown large fluctuations in earnings from the commodities. The factors that work against the rapid expansion of primary export promotion include instability in supply conditions, low demand and supply elasticities(affecting the price), and cyclical variations in world demand. On the other hand, past experience has shown that a number of developing countries like Korea, Taiwan, and Mexico have been able to increase their exports of manufactures quite substantially. A device to modify the tendency for primary product prices to decline relative to manufactures is the establishment of international commodity agreements. International commodity agreements, in which both producing and consuming countries participate, have generally aimed at price stabilization. It is for this reason that UNCTAD advocated, at its fourth international conference in May 1976, the establishment of an 11 billion dollar fund to support the prices of some 18 primary commodities.[37] A successful promotion of primary

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[36] Primary export promotion is defined as the encouragement of agricultural and raw material exports.

[37] Todaro, op.cit., p. 323.

product exports necessitates a reorganization of rural social and economic structure. The primary objective must be to provide sufficient food to feed the nation first and then be concerned about export expansion. Export promotion can then be achieved through cooperation, access to markets in developed countries, and by price stabilization programmes.

Associated with export promotion is export diversification. The problem of export diversification is the most important issue from the long-term view-point. Development planning in LDCs needs to allow for the expansion and structural change of the export sector as an integral part of general economic growth. The process assumes that the planners make careful and objective assessment of the probable future trends in world demand for both present and potential export commodities, so that a rationally based programme of diversification into relatively expanding export lines can be drawn up, taking into account the country's available resources.

In a dynamic sense, export diversification also implies industrialization. The early stages of industrialization consist of the development of import-saving industries, which entail an attempt to replace imported commodities with domestic sources of production and supply. Though the initial costs of production may lead to a higher retail prices than those of former imports, the economic rationale for the establishment of import-substituting manufacturing is either that the industry will eventually be able to reap the benefits of large-scale production and lower costs[38] or that the balance

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[38] This is the so-called infant industry argument where a newly established industry is set-up behind the protection of a tariff barrier as part of a policy of import substitution. Once the industry is no longer an infant, the protective tariffs are supposed to disappear but they often do not.

of payments will be improved as fewer consumer goods are imported. Some argue that the protection afforded to certain industries leads to distortions in the price system of other industries which are not protected. In fact, by protecting only import-substituting industries, a bias is created against export industries. Advocates of this view argue for better forms of protectionist policies which do not discourage exports. This presentation of arguments and counter-arguments is only meant to illustrate the controversial character of the strategy of import substitution. In reality, import substitution is the product of a natural growth process, in which domestic industries emerge as the economy grows.

Economic Cooperation and Integration

Some Basic Concepts

The continuing concern with economic growth and economic development in LDCs has resulted in the emergence of new forms of economic cooperation and integration. Several groups of countries in Latin America, the Caribbean and Africa, most at different states of development and some with relatively homogeneous structure, have entered into arrangements to integrate their economies.

Economic integration is defined as a process and as a state of affairs. As a process, it includes all measures which aim at abolishing discrimination between economic units from different countries, and as a state of affairs it is characterized by the absence of various forms of discrimination between countries.[39]

[39] See L.B.M. Mennes. Planning Economic Integration Among Developing Countries. Rotterdam University Press, Rotterdam, 1973, p. 1.

Economic integration can take several forms, each form representing a different stage of integration. One first stage is the free-trade area, in which member countries remove trade-barriers such as tariffs and quantitative restrictions among themselves, while each country is allowed to set its own tariffs against non-members. A second stage is the custom union which, besides removing trade barriers within the union, requires the establishment of a tariff at common rates on imports from non-member countries. A third stage is the common market which allows not only for the removal of trade barriers, but also for the abolition of restrictions on factor movements. A higher stage may be reached in an economic union which, in addition to the removal of restrictions on commodity and factor movements, may also involve agreement on other matters of international economic relations, such as the coordination of national policies in order to remove discrimination that was due to disparities in these policies.

Arguments for Integration

There are economic as well as political factors underlying the derive towards integration. The traditional customs union theory, pioneered by Jacob Viner, attempts to determine the static effects of a customs union. Professor Viner introduces the concepts of trade creation and trade diversion. The former represents a shift from high-cost domestic production to low-cost partner production, while the latter indicates a shift from low-cost foreign production to high-cost partner production. The concern here is with the efficiency of resource allocation. Viner's argument is entirely in

terms of production effects. Trade creation has positive production effects of saving in cost resulting from a shift of purchases from higher-cost to lower-cost sources of supply. Trade diversion, on the other hand, has negative production effects as the result of the extra cost of producing a commodity in the partner than in the foreign country. The conclusion is that trade diversion is considered undesirable since both the world and member states are perceived to be worse off as a result of the diversion of production from more efficient foreign suppliers to the less efficient domestic industries of member states.[40]

It may be argued that economic integration for LDCs should be sought not for its static but for its dynamic effects, irrespective of the initial economic cost. Dynamic effects are long-run effects and are expected to be induced through expanding the size of the market. Larger economic units with their larger markets permit economies of scale in production and justify the establishment of enterprises previously considered too costly. Resources may move freely to the most productive areas of these larger markets and add to the growth of output. The other dynamic rationale for economic integration is that, by removing barriers to trade among member states, it provides the possibility of coordinated industrial planning. This presumes both political and technical judgements on the feasibility and desirability of priorities and locations for the industries.

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[40] Todaro, op.cit., p. 333.

Apart from the static and dynamic economic arguments, there is a political motive for establishing regional economic groupings. This is to strengthen collective self-reliance and thereby reinforce the political independence of the developing countries, enhance their power vis- a -vis the developed world, and enlarge their economic and political role in international relations.

Main Obstacles Hindering Integration and Possible Ways to Overcome

Despite the general arguments for integration and the urgent need for accelerating economic development, economic integration in LDCs has not yet gone very far. The major problems relate to the differences in levels of development among prospective members and the consequent expectation among smaller members that a uniform trade liberalization will benefit the more developed members at their expense. Experience with economic integration illustrates the possibility of the concentration of benefits on the side of the relatively developed because of the availability of infrastructure, supply of ancillary goods and services, and proximity to markets. A good example in the East African Community(EAC). Among the factors that contributed to the breakdown of the EAC is the dissimilarities among the partners in the level of development. The economic characteristics of the EAC were such that the benefits were not distributed evenly among them. If there are imbalances among member countries, as in the case of Kenya vis- a -vis Uganda and Tanzaniz, there will be a tendency for the widening of income between

rich and poor members. This is why many LDCs feel reluctant to consider integration between themselves without making the necessary institutional arrangements beforehand so as to warrant equity in the distribution of benefits.[41]

Secondly, an effective economic integration presupposes to a certain degree a cooperative atomosphere. Unless the political condition is ripe for a regional integration, any attempt at economic integration will probably raise more issues than it settles. The effects of the different ideological orientations of the partner states affect trade relations and the general scheme of investments and industrial policies - the situation in Tanzania contrasting with a clear emphasis in Kenya on private, largely foreign, investments. Ideological differences influence the foreign policies of the countries and, in turn, their relations among themselves.

It would be erroneous to assume that any cooperative scheme would automatically cause the distribution of benefits to flow in the right direction and in the right proportions. The problem of differences in the level of development and the consequent unequal gains could be tackled by the application of different schedule of trade liberalization, with the more advanced countries lowering their barriers at a faster rate. As to problems of cooperation, the appropriate approach at the initial atage will be to increase contact among neighboring countries.

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[41] Girma Zawdie. Economic Integration and Industrialization: Reflections on the Proposed Access of Ethiopia to the East African Common Market. Occasional Economic Paper No. 7, Department of Economics, Haile Selassie I University(now Addis Ababa University), April 1975.

In the area of economic policy, this could assume the form of joint irrigation projects, joint mining or railroad ventures and the like. A cautious, go slow intial approach will probably prove beneficial in the long run.

Aaron Segal[42] suggests three preconditions which must be met if integration between developing countries is to be successful:

1) Substantial tangible benefits must be offered to each member of the proposed union - requiring advance agreement concerning distribution of any benefits;
2) The present sources of external assistance must not be threatened or must be substituted for; and
3) The carrying out of nation - building policies must not be jeopardized.

The Preferential Trade Area(PTA for Eastern and Southern African States

A declaration on the establishment of the PTA for Eastern and Southern African States was adopted by the first Conference of Ministers of Trade, Finance and planning held in Lusaka, Republic of Zambia, from the 3oth to the 31st March 1978. The PTA for Eastern and Southern African States is a step towards the establishment of a common market and eventually of an economic community.[43]

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[42] Aaron Segal, "The Integration of Developing Countries: Some Thoughts on East Africa and Central Africa", Journal of Common Market Studies, Quoted by S.E. Reynolds in Customs Union Among Developing Countries, 1967.

[43] ECA. Revised Draft Treaty for the Establishment of the Preferential Trade Area for Eastern and Southern African States. Kampala, Uganda, 28 May - 7 June 1980, p. 4.

The aim of the PTA is to promote cooperation and development in all fields of economic activity. These include trade, customs, industry, transport, communications, agriculture, natural resources, and monetary affairs. The member states agree to the eventual establishment of a common market among themselves. The Council of Ministers - Minister for Trade or Finance or Economic planning designated by each member state are responsible to review and ensure the proper functioning and development of the PTA. The member states[44] recognize the unique situation of Botswana, Losotho and Swaziland(BLS) states as members of the Southern African Customs Union and thus grant the BLS states of temporary exemption from the full applications of certain provisions in the Treaty. The member states also agree to exempt Comoros and Djibouti from the full application of some of the provisions.

As to trade matters, the member states agree to the establishment of a list of commodities to be traded among themselves. Goods shall be accepted as originating in a member state if they have been produced by eneterprises in the member states which are subject to majority indigenous management and to at least 51 percent equity holding by nationals of the member states.[45] Customs duties and

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[44]The member states of the PTA are: Angola, Botswana, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Madagascar, Maritius, Mozambique, Seychelles, Somalia, Swaziland, Tanzania, Uganda, Zambia and Zimbawe.

[45]ECA, op.cit., Annex III, p. 2

non-tariff barriers are reduced or eliminated with respect to these goods. Ethiopia's list of export commodities to be traded within the PTA for Eastern and Southern African States include: poultry, beef, fresh eggs, lentiles, pulses, gum, incense, sugar, molasses, mineral water, wine, common salt, leather shoes, etc. On the other hand, among the imports are: milk and cream, butter, tea, tobacco, paper pulp, cotton, jutes, etc.

The economic structure of Ethiopia and the PTA member countries are observed to be competitive rather than complementary. The commodity pattern is such that primary commodities account for the bulk of exports and imports consist of products of light industry for the consumer market. While economies of LDCs may be competitive in the sense that they produce similar products, they cannot be complementary without a dynamic economic transformation. Therefore, economic integration for LDCs should be sought for its dynamic effects, irrespective of the initial economic cost. This view may be unwarranted, however, since dynamic effects can be fully exploited only after a union has overcome the difficulties caused by the initial, unfavourable static effects.[46]

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[46] Yu-Min Chou. "Economic Integration in Less Developed Countries, the Case of Small Countries", Journal of Development Studies, Vol. 4.4., 1967, p. 354.

CHAPTER VI

SUMMARY AND CONCLUSIONS

In recent years, a great deal of attention has been devoted to the problemsof LDCs. While economic growth is by no means the exclusive concern of any particular group of countries, there can be little doubt that the task of developing the poorer societies is particularly urgent and difficult. In analyzing the problems that LDCs are faced with, one has to learn their economic and social history. In other words, the problems must be viewed within the context of a country's general political, economic, social and cultural objectives.

All LDCs are committeed to accelerating their economic development. Development is a complex process, and the form it takes differes from country to country. We have seen that there is always an external trade element to every development strategy that has been devised. One of the important aspect of the role of foreign trade in the process of economic development, is its influence on internal conditions. Trade, by making imports available, and by providing export markets, helps industrialization in several ways. On the import side, it affords a country access to sources of essential commodities which would otherwise be unobtainable. On the other side, exports earn the foreign exchange required to finance the imports of essential commodities.

Inspite of the increased needs of developing countries for a widening of their trade opportunities, their relative position has worsened and they have been unable to maintain their share of total world trade. The majority of LDCs are still heavily dependent on one or two principal

primary commodities in their export trade, and relatively few countries have yet achieved any substantial progress in the diversification of their export structures. In a world that is becoming more rapidly interdependent, the real issue is how to increase a country's effective participation by strengthening its economic international bargaining position. The answer lies in a process of appropriate policy formulation where the engines of structural change are sought in and around the domain of domestic resources.

The objective of this study was to analyze the relationship between Ethiopia's GDP and exports, on the one hand, and imports and GDP, on the other. As already has been outlined, Ethiopia is dependent largely on a few export commodities whose prices fluctuate from year to year. The overall instability in the export earnings of the country has been caused by the fluctuation in the prices and volumes of exports, high specialization in a few commodities, the unstable demand for exports, and by increased volume and values of imports. These fluctuations will tend to have internal repercussion on macro-economic variables. This calls for policies that aim at structural diversification and economic cooperation and integration.

The problem of export diversification is the most important from the long-run view point. Development planning needs to allow for the expansion and structural change of the export sector as an integral part of general economic growth. The process assumes that the planners make careful and objective assessment of the probable future trends in world demand for both present and potential commodities, so that a rationally based programme

of diversification into relatively expanding export lines can be drawn up, taking into account the country's available resources. The issue of economic integration and cooperation is to establish collaboration between LDCs to stimulate their mutual trade as one means of promoting their rate of economic growth.

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D E C L A R A T I O N

I, the undersigned, declare that this thesis is my work and that all sources of material used for the thesis have been duly acknowledged.

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