

Report Submitted

By

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Prime Minister of the Federal Democratic Republic of Ethiopia

To the House of Peoples' Representatives

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Honourable Speaker,
Honourable Members of the House,

As you recall, during the course of the year, I have presented several reports briefing this honourable House on various political and diplomatic matters. My Report today focuses on economic issues.

The Government set two fundamental and clear goals in the economic field for the current budget year. The first was to sustain the fast economic growth which we have recently achieved, and continue to keep economic growth rate of not less than 10%. The other goal was to increase our export trade by not less than 25%. Anchored on the fast growth, and taking advantage of the capacity that we derive from it, another goal was to stabilize the price of commodities and control inflation. In order to fulfil these aims, the Government in the last eight months, has devised strategies and tactics and has worked tirelessly to implement them.

With regard to sustaining fast growth, this year, like the previous several years, I can say we are being successful. On the basis of available evidence, our economy will grow at no less than 10.8% this year. There is no doubt we are set to register over 10% growth for the fifth year running. The other aim for export, to grow at over twice the rate of our economic growth, is satisfactorily on course. The fact that our export trade has grown by 32% in the last eight months, proves that our goal for the year will be achieved successfully.

The aim of eradicating poverty and resolving the economic problems of society can only be sustained by ensuring fast growth. To focus on fast growth, more than anything else, therefore, is correct and necessary. Indeed, the impressive growth that we had achieved in the last four years, and again this

year, proves we are succeeding in this respect. That is, indeed, encouraging. As long as fast growth is achieved, it is a matter of time before we have the capacity to resolve inflation and all other economic problems.

While our current economic development is encouraging, worsening inflation has created a difficult situation for the low income urban dwellers. It has become imperative to address this challenge. The causes of the inflation we are experiencing are varied and complex. We have had to devise various schemes and implement them with care.

One of the main causes for the current rate of inflation is price increases in the global market. The price of oil, which was around 20 USD per barrel five years ago, has now reached around 100 USD per barrel. The prices of food grains, steel, cement and other goods have also risen significantly, if not to the level of oil. Since these changes in the global market are interconnected with the rapid economic growth of China and India as well as other structural changes in the world economy, prices are not expected to decrease to a meaningful degree in the short to the medium term. Since the price of domestically produced goods is inevitably linked to the global market, international price increases not only affect the price of imports, but also domestic production.

As the current inflation is caused by structural changes in the global market, the problem cannot be tackled by Ethiopia alone. It is obvious we do not have the economic capacity to control the global market. Despite this, there are various steps that can be taken to minimize the damage.

Because of the price increases in the global market, we are paying premium prices for goods that we import. The additional costs we incur in transport and other areas compound the problem. The additional cost on most

products is up by 30% or more than the production cost in the countries of origin. Based on this, sufficient local production of some major import items avoids transport and related costs, thus minimizing the impact of global inflation. In fact, efforts are already underway to locally produce in sufficient quantity such items as crops and cement. In this regard, efforts aimed at improving the productivity of farmers and steps taken to encourage investment in cement production are notable examples.

Reducing transport and related costs will help to control inflation but, this will not prevent price increases as long as global prices remain high. Since global price increases are unlikely to change in the short and medium term, the only sustainable solution is to increase people's income. To withstand the impact of global inflation, the country's economy has to grow rapidly and thereby increasing the income of the population. It is with this conviction that the Government has given priority to efforts aimed at realizing rapid economic growth and has taken various measures to increase the income of the population including that of civil servants.

These two measures are significant in ensuring lasting solutions and deserve utmost attention but they also have their limitations. The first problem is the length of time necessary for implementation. For example, a cement factory needs at least three years to come on stream; including the feasibility study. Living conditions can be significantly affected before these fundamental solutions are implemented. The Government will have to take appropriate temporary measures, as far as possible, to minimize the burden on the public. Equally, it is important to ensure that the temporary measures taken to stabilize the situation will not have any adverse effect on the longer-term sustainable solutions or on the economy as a whole.

Accordingly, the Government, along with efforts being made to expedite sustainable solutions, has devised and has been implementing temporary measures. These include the provision of direct and indirect subsidies. Direct subsidies have included Government expenditure to stabilize fuel prices and provide wheat for low-income populations. In the last few years we have spent 3.52 billion birr to subsidize fuel and another 372 million birr on wheat. In addition to direct subsidy, the Government has been providing indirect support to alleviate peoples' burden by fully exempting the duty levied on imported cement at a cost of 387.8 million birr. This allowed the construction sector with its significant work force to continue to flourish.

Subsidies at such a high cost, even temporary, are very difficult to bear for a poor country such as ours. Obviously the 4.2 billion birr spent on subsidies could have been used to implement other development projects. Hence, the policy of subsidies implemented by the Government could have a negative impact, though limited, on sustainable development. This means balancing the burden of the high cost of living borne by the public, particularly by poor urban dwellers against the long term damage the subsidy might cause. This policy has to be implemented because we have no option. Since inflation is not yet stabilized as much as expected, we will have to continue this policy and even have to expand it in some areas.

Indeed, we have made a decision to continue provision of subsidized wheat to low income urban dwellers. A decision has been made to continue the policy of step-by-step alignment of the local fuel prices to the world market, rather than transferring the global increase immediately to the local consumer. I can also say, we have decided effective from tomorrow, to lift Value Added Tax and Turn-Over Tax on grains.

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The increase in commodity prices on the international market is one of the basic reasons for the inflation we have witnessed. It is not, however, the only reason. We believe there are at least two additional domestic reasons, unconnected to the international market, that exacerbate the problem. The significant increase in circulation of money and the deficiencies in the marketing system require particular attention. If the inflation caused by these two factors can be overcome, it will be easier to alleviate the consequences of continued shocks in the international market. The Government has, thus, been addressing the root causes of inflation.

As the economy grows, it is inevitable and appropriate that the amount of money in circulation needs to increase correspondingly. However, as economists state if the money in circulation increases by a larger margin than the rate of economic growth, more money chases fewer goods. The result is price increase. It may not be possible to state with certainty the extent to which greater increases in monetary circulation than economic growth can be ascribed to inflation. There is an ongoing debate among economists in this regard. Nevertheless, whatever the impact, the Government has taken strong corrective measures.

In this regard, the measure taken by the National Bank last year can be cited as a major effort. The amount of money that banks are required to hold in reserve from money they have collected has doubled from 5% to 10%. This means a drop in money available for loans by banks and consequently a reduction in the rate of growth of money circulating in the economy. Similarly, Government borrowing to cover budgetary deficits has been maintained at a minimal level,

only 2.7% of the national income. This rate is even lower than the upper limit of 3% used by developed European countries. It shows the extent to which the Government has gone to curb increases in circulation of money.

Despite Government borrowing being carried out as planned, the overall increase in money circulation has still not fallen to the desired level. Indeed, at a time when interest rates, in real terms, are below zero, deposits have increased sharply. The amount of money repaid to banks by borrowers has increased.

Owing to the fact that excessive amounts of money have been deposited at banks, efforts to curb the amount of lending by banks through increased reserve requirement has not been as successful as planned. The National Bank, which has been monitoring this trend, will take further measures to restrict the growth of money supply. Additional measures will be taken by the Ministry of Finance and Economic Development with a view to strengthening this measure by the National Bank. We are confident that, as a result of the coordinated effort exerted by these bodies, the rate of monetary circulation will fall to the planned level and, its negative impact on inflation will be nullified.

One of the main factors behind the creation and worsening of the phenomenon of price increase is rooted in our own agricultural marketing system. Our marketing system is backward and cumbersome. Convinced that this is a deep-rooted problem, the Government has been trying to implement a basic solution. Special attention is being devoted to the immediate establishment of a modern commodities exchange centre. It will be strengthened in due course. With the centre successfully established, it will commence its activities in the current budget year.

Along with this, there have been efforts to streamline the cumbersome marketing system, and to enable consumers to organize themselves to buy basic goods at reasonable prices. Attempts have been made to encourage people to establish consumer associations. These associations should belong to the people. Unless the people establish, strengthen and control them with a spirit of ownership, they will only rely on the Government and have no life of their own. As demonstrated by our experience so far, when the Government intervenes in such circumstances, these associations are doomed to fail. For example, while community-based establishments such as traditional credit associations (Equb) and self-help organizations (Edir) by and large are successful, Kebele (local government) shops have not delivered.

It is now planned to enable consumer associations, like traditional credit associations (Equb) and self-help organizations (Edir), hold elections to provide for control by the members. Government intervention will be limited to creating conducive environment and ensuring the distribution of goods to the associations at reasonable prices through state enterprises. I, therefore, wish to call upon the people once again to establish consumer associations voluntarily. I would also like to urge Government authorities at various levels to give legal recognition to organized consumer associations and provide them with full cooperation.

Although disentangling our marketing system from cumbersome and backward procedures will be instrumental in alleviating inflation and other related problems, it is inevitable that it would take its own time like any other structural economic change. Until then, in addition to direct negative implications, this system serves as a cover for the few business people who may wish to enrich themselves illegally. Therefore, it is imperative to devise and implement temporary solutions to mitigate the problem, in tandem with the

implementation of fundamental measures that will bring about structural change.

The Government, as far as possible, has attempted to create a situation whereby basic goods reach the consumer directly. One example is wheat being sold at an affordable price. Another is the effort to sell edible oil in a similar manner. As the results are encouraging, the Government, in line with capacity, has decided to expand this scheme. The current distribution of wheat will be maintained and edible oil will also be offered in a similar manner until the price of goods has been satisfactorily stabilized. We will also attempt to distribute products such as soap if deemed appropriate depending on the circumstances.

The Government is aware that there are business people who try to benefit inappropriately from the prevailing situation. The public has raised the issue. However, the Government wanted to deal with this issue patiently and carefully rather than get into the business of chasing them down. The Government had many reasons for this. First of all, as the great majority of business persons are law-abiding citizens, pursuing few illegal business persons would have an adverse effect on the good reputation and the interest of the law-abiding majority. After weighing the pros and cons, patience was chosen as a preferred option. Furthermore, it was hoped that punishing a few individuals engaged in blatantly illegal activities would lead others refrain from such behaviour. Measures were taken against few individuals, who hoarded grain with the aim of causing price increases. This was made also known to the public. Similarly, few people who were selling agricultural products on the international market at a lower price than domestically were punished. This was also made known to the public. However, this approach has not produced the desired result.

Some greedy and illegal business persons taking the Government's patience as weakness or negligence, continue to exploit the unstable market situation exposing the public to great abuse. Displaying complete disdain for the measures that the Government intended as a warning, they intensified their persistent illegal exploitative activities. The recent crime committed in the salt market clearly indicates the level to which this illegal activity can reach.

As you well know, we produce more than enough salt for our consumption. Indeed, salt producing public enterprises do not have sufficient market for their produce. They are thus operating below half capacity. There cannot be, now or in the future, any shortages of salt but only the lack of a market. There can be no justification for any increase in the price of salt. Despite this, some business people and their accomplices, by spreading disinformation and creating fear among the public, succeeded in causing a five to ten fold increase in the price of salt in a single day. Although the price of salt returned to its previous level a day later, and although law-abiding business people continue to sell salt at the normal price throughout, the speculators proved they had the ability to make salt prices skyrocket whenever they wanted to. These criminals have made it clear they will leave no stone unturned to cause economic havoc for their own illegal ends.

The effect of this type of coordinated economic crime means the harm outweighs the benefit in our exiting policy of patience. As a result of these crimes, the confidence between the people and the great majority of law-abiding business persons has been severely tested. It is clear that in order to maintain the good name and reputation of the majority of business persons and to re-build the relations of confidence between them and the public, the criminal elements must be identified and all legal measures taken against them. The Government's expectation that punishing a few individuals as a warning would deter others

has been proved wrong. The recent events in the salt market prove that this approach only emboldened greedy business persons and did not deter them. Obviously, such greedy and illegal business persons will only respond when each has been identified and punished. As a result, the Government has decided to completely change its approach towards those committing economic crimes.

A taskforce comprising members from the Ministry of Trade and Industry, the Federal Police and the National Security and Intelligence Service has been set up to permanently monitor illicit activities and take prompt legal measures as necessary. A clear working directive has been issued to the taskforce to work collectively working with other government agencies as necessary and bring suspects to court. The taskforce will identify unlawful practices, and take the necessary administrative measures in line with the law to deal and prosecute all serious offenders. Similar structures in regional states and major cities will be put in place. The success of the taskforce depends on the support and cooperation of the general public and particularly the law-abiding business people to provide tip-offs and refrain from illicit practices. I urge everybody to cooperate.

This means that the Government has changed its approach. This is not because it believed inflation was caused solely by the illicit activities of a few business people. What they did certainly exacerbated the already complex problem. But the multiple causes of inflation cannot be curbed by steps taken against them alone. Without prompt and convincing measures against illegal business people, one cannot stabilize the rate of inflation. It must be underlined that our change in approach should be integrated and implemented alongside other measures aimed at regulating price increases.

The Government did not introduce these changes because it believed many businesspersons were engaged in unlawful practices. The Government believes the majority of business people are law-abiding and their role in development is something to be proud of, indeed irreplaceable. I must mention the stance taken by a number of salt traders who stood their ground and refused to engage in inflated sales during the unprecedented day-long price rise. They stuck to the normal price proving a majority of merchants could resist challenges and temptations, and respect the law.

The need for change is seen as necessary to identify unlawful business activity along with the obligation to protect the reputation and honour of the majority of business people.

The Government was forced to make a change in approach not because it thinks forceful measures are the better options. It believes the fundamental solution is to effect a structural transformation of the economy, a transformation that would not accommodate fraudsters. It is determined to make this the core of its activity. Until then, in order not to allow similar incidents, the Government underlines the need to give greater attention to ensure the rule of law is respected. Of course, as even the rights of the unlawful business people have to be respected, all steps taken by Government will be in accordance with the law.

Honourable Speaker

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As indicated in this Report, even though our main economic objective is being achieved successfully, our endeavour to control inflation has not yielded the desired result. Inflation is a complex problem with different causes. It is,

therefore, imperative that all its root causes are carefully examined, tactics and strategy designed to address them, including tackling the root causes at source. This should be the focus of the struggle. While the main emphasis must be aimed primarily at redoubling efforts towards long-term solutions, our strategy should also be to design and implement temporary responses to mitigate the immediate difficulties, without undermining the long-term solution. Our country is faced with this problem at a time of high global inflation, which inevitably makes the problem more complex and challenging. Hence, it is imperative that all measures must be based on an in-depth study and should be carefully selected. We should closely monitor the process and strengthen successful measures and review and adjust those that have not attained the desired results. The Government has been guided by these principles and directions in order to address the problem. Accordingly, the Government will strengthen successful solutions, correct those requiring revision and implement additional measures.

In this regard, we are making efforts to increase people's income by expanding the domestic production of basic goods and ensuring rapid economic growth. Besides these efforts, we are also removing taxes and duties on selected products and increasing direct subsidies as much as possible to temporarily mitigate the inflation problem. In addition, we will lift value added tax and turnover tax imposed on grains. The Government will closely monitor the implementation and effectiveness of these measures and correct them where necessary.

The National Bank and the Ministry of Finance and Economic Development will take coordinated monetary and fiscal policy measures in order to further strengthen and ensure the effectiveness of action taken to alleviate problems associated with the fast increasing circulation of money in the economy.

Efforts to address inflation arising from the backward and cumbersome agricultural marketing system will include modernizing the system, and transforming it structurally through speedy implementation of the commodity exchange centre. The centre's capacity will be strengthened in due course. Efforts to encourage the establishment of consumer associations will be intensified. The Government will also expand and strengthen measures to make available additional basic consumer goods at affordable prices. Similarly, the Government will take strong legal measures to tackle problems being created by illegal business people, in close cooperation with the public and the law abiding majority of business people. It will also periodically evaluate and undertake the necessary rectifications.

Our economy is essentially healthy. As planned, our general economic growth as well as our export trade growth is achieving satisfactory results. With this, we can withstand inflation. While setting an exact date is not possible, we can certainly say controlling inflation will not take too long. Equally, it remains of a paramount importance to mobilize the general public and the business community to help alleviate the problem with patience, wisdom and in a spirit of shared interest. The Government will continue to implement well-studied and carefully selected measures. It will evaluate the effectiveness of these measures and take corrective actions as necessary. I would like to take this opportunity to affirm that the Government is determined to control inflation and will continue to take appropriate measures. At present, inflation in Ethiopia is public enemy number one. I would like to reaffirm to this House that the Government would take decisive and effective measures in order to crush this enemy. I am firmly convinced that we will succeed.

Thank you!