

The Relationship between the Ethiopian Economic Growth and the Decrease in Purchasing Power of Consumers

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There is no clear theory which states fixed relationship between inflation and growth. Controversy by quantity and institutional inflation theories also confirm this. According to quantity theorists, there is a long-run trade-off between inflation and economic growth but the supporters of institutional theory of inflation, are less sure about presence of negative relationship about inflation and growth. Thus, the relationship between inflation and economic growth is debatable both in the world and specifically to Ethiopia. Therefore, the objective of this critical review is to determine the relationship between the current status of the Ethiopian economy and the consumer price index by considering the economic development indicators and consumer price index. The nexus of inflation and economic growth is one of the most important macroeconomic policy problems that take the attention of researchers, policy makers and different scholars. Conducting this review will benefit developing countries by discovering what their current status is, as far as a person with a higher level of consumption is regarded as having a higher level of economic wellbeing than someone with a lower level of consumption. This study falls within the ambit of the pragmatism philosophical stance and exploratory in nature. This study applied the inductive method of reasoning and used secondary data. The Study found that there is a negative relationship between the Ethiopian economic growth and the purchasing power of consumer (consumer price index) synonymously measured by the inflation-macroeconomic growth trade-off. The review reveals that Ethiopian economy is highly growing and the consumer price index (purchasing power of consumers) is decreasing. This shows that the purchasing power consumer (consumer price index) in Ethiopia is not solely determined by the macroeconomic development, which in turn requires further investigation. It is recommended therefore that future research works will explore more on the relationship between the Ethiopian economic growth and the purchasing power of consumer or clearly can explore the effect of economic growth on the purchasing power of consumers (consumer price index).

Keywords: macroeconomic growth, inflation, consumer price index, purchasing power of consumer

Introduction

Nowadays, developing countries like Ethiopia have a strong objective to achieve and maintain sustainable economic growth of the country. To realize and maintain continuous economic growth macroeconomic stability is significant. Unemployment, business cycle, output growth and inflation are the major indicators of macroeconomic stability. Macroeconomic stability requires knowing and creating a smooth relationship between these variables in a country. Thus, one of the most relevant debatable issues in macroeconomists is the

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relationship between inflation and economic growth. Policy makers and national banks commonly faced with difficulties to attain simultaneously price stability with sustained economic growth. Before we are going to see the relationship between these variables historically in detail, defining two terms is significant. Economic growth can be defined as an increase in the productive capacity of a nation measured by percentage changes in gross national product (GNP) or gross domestic product (GDP) in some particular period of time. In other words, it is an increase in inflation adjusted market value of goods and services produced by an economy over a time usually measured a percent increase in real Gross domestic product (GDP) while inflation is a sustained decrease in purchasing power of currency over time or a sustained increases on average price of goods and services over time (Christianson, 2008).

Following the failure of Derg regime in Ethiopia, the EPRDF (Ethiopian people's revolutionary democratic front) came into power in May 1991 with the adoption of economic reform effort which supports the structural adjustment programs of World Bank and stabilization programs of IMF. The 1st phase of IMF/WB sponsored structural and economic reform programs was implemented in 1992/93-1994/95.

EPRDF entered to 2nd phase of economic reform program (1994/95-1996/97) whose aim is limiting the role of state in economic activities and promotion of greater private capital participation. In the periods of 1995, 1996 and 1997 economic growth rate shows the positive trend but not progressive this is 6.1 percent, 13.2 percent and 3.5 percent respectively. Inflation for the year 1995, 1996 and 1997 accounts 13.4 percent, 1 percent and negative 6.4 percent respectively (IMF, 2015). In October 1996, a country entered to 3 years enhanced structural adjustment facility (ESAF) arrangement with IMF and start to apply a third phase of reform program that stayed from 1996/97- 1998/99 to achieve broad based economic growth with stable economic environment. In the period of 1998 inflation rate shows 3.6 percent but growth rate shows negative 4 percent as a result of Ethiopia and Eritrean war eruption which degrade economic growth of the country.

After the year 2000, Ethiopia was launching pro-poor growth that contains sustainable development and poverty reduction program (SDPRP) from 2002/03-2004/05 that the government tried to reduce poverty with sustainable macroeconomic environment which set growth as a means to achieve it (MoFED, 2009/10). The 2nd was plan of action for sustainable development and eradication of poverty (PASDEP) from 2005/06-2009/10 and finally growth and transformation plan (GTP) for the period 2010/11-2014/15.

Following the implementation of pro-poor growth, Ethiopia experienced a double digit economic growth specially started from 2003/04 to 2010/11 which was 10.4 percent annually on average (NBE, 2010/11). After implementation of millennium development goal (2000-2015) the maximum and minimum inflation rate registered in the year 2008 and 2001 that shows 44.4 percent and negative 8.2 percent respectively. But in those years i.e. 2001 and 2008 the growth rate was 7.5 percent and 11.2 percent (IMF, 2015).

Statement of the Problem

The nexus of inflation and economic growth is one of the most important macroeconomic policy problems that take the attention of researchers, policy makers and different scholars. Initially, inflation-economic growth nexus means dilemma on the relationship between inflation and economic growth. As far as we see in different areas and places of study on the relationship between inflation and economic growth, there are two major problems: First, there is no single clear cut theory which shows fixed relationship between inflation and

economic growth to implement in the country to achieve its objective of sustainable development. 2nd, Even if moderate inflation is an inevitable consequence of economic growth, determining and maintaining inflation on its moderate level is a headache for countries like Ethiopia.

After the coming of EPRDF into power Ethiopia was exercised different strategies under neo-liberalization regime (1991-2000) and pro-poor growth (post 2001). In this period Ethiopian economy showed a mixed performance of both positive and negative real GDP growth rate. In the periods of 1991 and 1992 growth rate of GDP showed negative 7.2 and 9 percent respectively whereas inflation showed more than one digit rate i.e. 20.9 % and 21 % respectively (IMF, 2015). This implies in the initial periods of transitional government, the country had relatively high rates of inflation with not good economic performance. After 1993 to 1997 the growth rate of GDP is positive which range 3.5 % relatively low (in 1994 because of drought) to 13.4 % the highest in 1993 but not sustainable in 1998 because of Ethio- Eritrean war which accounts negative 4 % growth rate. But, inflation from period of 1993-1998 was relatively good which accounted the maximum 13.4 % in 1995 and the minimum of negative 6.4 % in 1997 compared to 1991 and 1992. At the end of neo-liberalization period and at the beginning of implementation of MDGs in the years of 1999-2001 growth and inflation rate on average accounts 6.4 % and 1 % per annum (IMF, 2015).

Following implementation of pro-poor growth, the growth rate of GDP averaged 11.2 percent per annum during 2003/04 and 2008/09 period placing Ethiopia, a double digit growth, among top performing countries in sub-Sahara Africa (NBE, 2013/14). But post 2003/04 high and sustained rise in inflation become a common feature such as in the period of 2008 and 2011 inflation rate accounts 44.4 % and 33.2 % respectively. As it was explained by Alemayehu and Kibrom (2008) before the year 2002/2003 inflation and economic growth have positive relationships. But, starting from the period 2003/2004 the co-movement of these two variables no longer continued rather reversed.

As indicted in Rutaysire (2013), it is now widely accepted by many policy makers, macro economists and central banks the main objective of macroeconomic policy is achieving high economic growth with low inflation rate and believed that higher level of inflation adversely affects economic growth of a country. High inflation causes the economy not to operate at its optimal level. Higher level of inflation have an adverse impact on economic growth by reducing the people's confidence on economy, reduce productive investment in the way that seeking higher interest rate by lenders to protect themselves. Inflation beyond its threshold level will affect welfare negatively, raise current account deficit and reduce investment by lowering saving and consume more since real value of saving erodes over time and inefficient allocation of resources which in turn reduce economic growth of a country (Raj et al., 2007).

To sum up, the statistical data reflect no clear relationship between inflation and economic growth for the periods 1991/92 to 2014/15. Even if some researchers try to see the relationship between these two variables like Kibrom (2008) who got positive relationship between them and Aynalem (2013) by using data from the period of 1974/75 to 2009/10 by using annual data, new research which uses quarter data under post-liberalization period is significant that account other economic variables to see the nexus of these two variables.

Conducting this review will benefit developing countries by discovering what their current status is, as far as a person with a higher level of consumption is regarded as having a higher level of economic wellbeing than

someone with a lower level of consumption. Future researchers can assist in identifying research that can be conducted on the case area.

Methodology

The purpose of this section is to discuss the application of theoretical research design and methodology. The philosophical stance, nature of the study, method of reasoning and nature of the data applicable to this study are discussed. This section also covers the systematic review approach and under systematic review a motivation as to the reasons why it is used specifically for this study are provided, together with an explanation of what a systematic review is and how it is generally applicable.

Philosophical Stance

This study falls within the ambit of the pragmatism philosophical stance. Pragmatism does not take on a particular position of the research, however, feels that research on the subjective meanings, objectives and observable phenomena can provide useful knowledge, depending on the research question. This study utilized perspectives, ideas and theories of the currently available literature to help the researcher gain an understanding and more knowledge of the relationship between Ethiopian economy and the purchasing power of consumers.

Nature of the Study

This study is exploratory in nature. Exploratory studies are conducted when much is not known about a particular phenomenon, existing research results are unclear or suffer from serious limitations, the topic is highly complex or there is not enough theory available to guide the development of a theoretical framework. Currently, literature is available on Ethiopian economic development and purchasing power of consumers, however, it is scattered and there is no clear research result. This study seeks to explore and contribute to the body of literature by determining the current status of literature on the relationship between the Ethiopian economy and the purchasing power of consumers.

Method of Reasoning

This study applied the inductive method of reasoning, as the study starts with the observations and end with theories that are proposed towards the completion of the research process as a result of observations. This study aims to generate meanings from literature obtained with regard to the issue in order to identify patterns and relationships with the aim of building a theory. This patterns, resemblances and regularities in literature represent premises that are observed and generated in order to reach conclusions or to formulate a theory on the relationship between Ethiopian economy and the purchasing power of consumers.

Nature of the Data

The nature of this study is secondary data. It is applicable to this study as literature in the form of articles, journals, books and publications are already available on the relationship between the Ethiopian economy and purchasing power of consumers. This literature is referred to as secondary data.

Data Analysis and Presentation of Results

This section records the findings from the literature reviewed and ultimately answers the research question and objectives. The relationship between the Ethiopian economy and purchasing power of consumers is discussed. The effect of economic development on consumer price index also discussed in this section and it

ends with possible solutions identified thus far. First, the Ethiopian economic development was analyzed regarding different key economic indicators, then, secondly, the purchasing power of consumer (consumer price index) was analyzed and then, finally, the relationship between the Ethiopian economic development and consumer consumption power analyzed to determine the current status the issue and also to establish if there are any relationship (positive and negative) between Ethiopian economic development and consumer consumption power. The study arrived at the findings below.

The Ethiopian Economy

The economy of Ethiopia is a mixed and transition economy with a large public sector. The government of Ethiopia is in the process of privatizing many of the state-owned businesses and moving toward a market economy. However, the banking, telecommunication and transportation sectors of the economy are dominated by government-owned companies.

Ethiopia has one of the fastest-growing economies in the world and is Africa's second most populous country. Many properties owned by the government during the previous regime have now been privatized and are in the process of privatization. However, certain sectors such as telecommunications, financial and insurance services, air and land transportation services, and retail, are considered as strategic sectors and are expected to remain under state control for the foreseeable future. Almost 50% of Ethiopia's population is under the age of 18, and even though education enrollment at primary and tertiary level has increased significantly, job creation has not caught up with the increased output from educational institutes. The country must create hundreds of thousands of jobs every year just to keep up with population growth.

Agriculture and Fishing

CIA the World Fact Book shows that as of 2015, agriculture accounts for almost 40.5% of GDP, 81 percent of exports, and 85 percent of the labour force. Many other economic activities depend on agriculture, including marketing, processing, and export of agricultural products. Production is overwhelmingly of a subsistence nature, and a large part of commodity exports are provided by the small agricultural cash-crop sector. Principal crops include coffee, pulses (e.g., beans), oilseeds, cereals, potatoes, sugarcane, and vegetables.

Exports are almost entirely agricultural commodities, with coffee as the largest foreign exchange earner, and its flower industry becoming a new source of revenue: for 2005/2006 (the latest year available) Ethiopia's coffee exports represented 0.9% of the world exports, and oilseeds and flowers each representing 0.5%. IMF Country Report No. 08/259, pp.35f). As of 2008, some countries that import most of their food, such as Saudi Arabia, have begun planning the purchase and development of large tracts of arable land in developing countries such as Ethiopia (Blas, Javier; Andrew England (20 August 2008). This land grabbing has raised fears of food being exported to more prosperous countries while the local population faces its own shortage.

Ethiopia's fisheries are entirely fresh water, as it has no marine coastline. Although total production has been continuously increasing since 2007, the fishing industry is a very small part of the economy. Fishing is predominantly artisanal. In 2014, nearly 45,000 fishermen were employed in the sector with only 30% of them employed full-time (Fisheries & Aquaculture Country Profile, Ethiopia, 1 October 2015).



Figure 1. Coffee sorting process near Hawassa.



Figure 2. Fishermen at Lake Tana.

Textile Industry

Employees of Ethiopian garment factories, who work for brands such as Guess, H&M or Calvin Klein, receive a monthly salary of 26 dollars per month. These very low wages have led to low productivity, frequent strikes and high turnover. Some factories have replaced all their employees on average every 12 months, according to the 2019 report of the Stern Centre for Business and Human Rights at New York University.

The report states:

Rather than the docile and cheap labour force promoted in Ethiopia, foreign based suppliers have met employees who are unhappy with their pay and living conditions and who want to protest more and more by stopping work or even quitting. In their eagerness to create a "made in Ethiopia" brand, the government, global brands and foreign manufacturers did not anticipate that the base salary was simply too low for workers to make a living from.



Figure 3. Employees in textile factory at Hawassa Industrial Park.

Transport

Ethiopia is building a standard gauge railway network, the National Railway Network of Ethiopia, planned to consist of up to 5,000 km of railways in a number of years. The railway network serves a strategic goal to allow Ethiopia a sustainable and stable economic development. The railway network's primary purpose is then both to connect landlocked Ethiopia to the world market by ensuring a seamless access to one or several sea ports for trade and for transporting most imports and exports. The rail transport of goods appears favorable – if compared to road transport – in terms of volume, costs, safety and speed of transportation for both imports and exports. The primary port for Ethiopia is the Port of Djibouti in Djibouti. More than 95% of Ethiopia's trade passes through Djibouti. The port of Djibouti is served by one international railway, the electrified standard gauge 756 km long Addis Ababa – Djibouti Railway (of which 656 km run in Ethiopia). This railway has officially been opened in October 2016 but it is in trial service with no regular traffic in 2017. Operational by the end of 2017 and it allowed passenger transport and a travel time from Addis Ababa to Djibouti City in less than twelve hours with a designated speed of 120 km/hour.

Another railway, the Awash – Hara Gebeya Railway will go into trial service over its first 270 km in 2018. This second railway links Addis Ababa and the Addis Ababa – Djibouti Railway with the north of Ethiopia. A train ride from Addis Ababa to the twin cities of Kombolcha and Dessie will be possible in around six hours with a designated speed of 120 km/hour.

Road projects now represent around a quarter of the annual infrastructure budget of the Ethiopian federal government. Additionally, through the Road Sector Development Program (RSDP), the government has earmarked \$4 billion to construct, repair and upgrade roads over the next decade. As the first part of a 10-year Road Sector Development Program, between 1997 and 2002 the Ethiopian government began a sustained effort to improve its infrastructure of roads. As a result, as of 2002 Ethiopia has a total (federal and regional) 33,297 km of roads, both paved and gravel. The share of federally managed roads in good quality improved from 14% in 1995 to 31% in 2002 as a result of this program, and to 89% in 2009 the road density increased from 21 km per 1000 km² (in 1995) to 889 km; per 1000 km² (in 2009) however, this is much greater than the average of 50 km per 1000 km² for Africa.

The Ethiopian government had begun the second part of the Road Sector Development Program, which was completed in 2007. This had involved the upgrading or construction of over 7,500 km of roads, with the goal of improving the average road density for Ethiopia to 35 km per 1000 km², and reduces the proportion of the country area that is more than 5 km from an all-weather road from 75% to 70%. According to the Government of Ethiopia, it has spent over 600 billion birr (USD \$50 billion, €30 billion) on infrastructure since 1990. The Addis Ababa–Adama Expressway was completed in 2014 as the first expressway in Ethiopia. In December 2015, construction began on a second expressway between Awasa and Mojo, where it will connect to the existing expressway. In addition, the Ethiopian Roads Authority (ERA) has undertaken a three year project to upgrade over 370 km of roads in the country. Contracts have been signed with the Ethiopian Defense Construction, China Railway Engineering, Eney Construction, China Wuyi, Yotek Construction and FAL General Contractor.



Figure 4. Current rail ways in Ethiopia.



Figure 5. Road near Lake Afdera and Erta Ale Volcano, Afar Region, Ethiopia.

The Addis Ababa Airport handles international jet transportation. It is the main hub of Ethiopian Airlines, the national airline that serves destinations in Ethiopia and throughout the African continent, as well as nonstop service to Asia, Europe, North America and South America. The airport is also the base of the Ethiopian Aviation Academy. As of June 2018, nearly 450 flights per day were departing from and arriving at the airport. In 2018, about 12 million passengers were carried on domestic and international flights.

Consumer Price Index

The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

In Ethiopia, the three main components of the consumer price index are: Food and Non-Alcoholic Beverages (54 percent of total weight); Housing and Utilities (16.8 percent) and Clothing & Footwear (5.7 percent). Others include: Restaurants & Hotels (5.3 percent; Alcoholic Beverages & Tobacco (4.6 percent); Furnishings, Household Equipment and Routine Maintenance of the House (4.5 percent); Transport (2.5 percent) and Miscellaneous Goods & Services (2.5 percent). Communication, Health, Recreation & Culture and Education account for the remaining 4.1 percent of total weight (central statistical agency of Ethiopia).

Cost of Food

Cost of food in Ethiopia increased 22.70 percent in December of 2019 over the same month in the previous year.

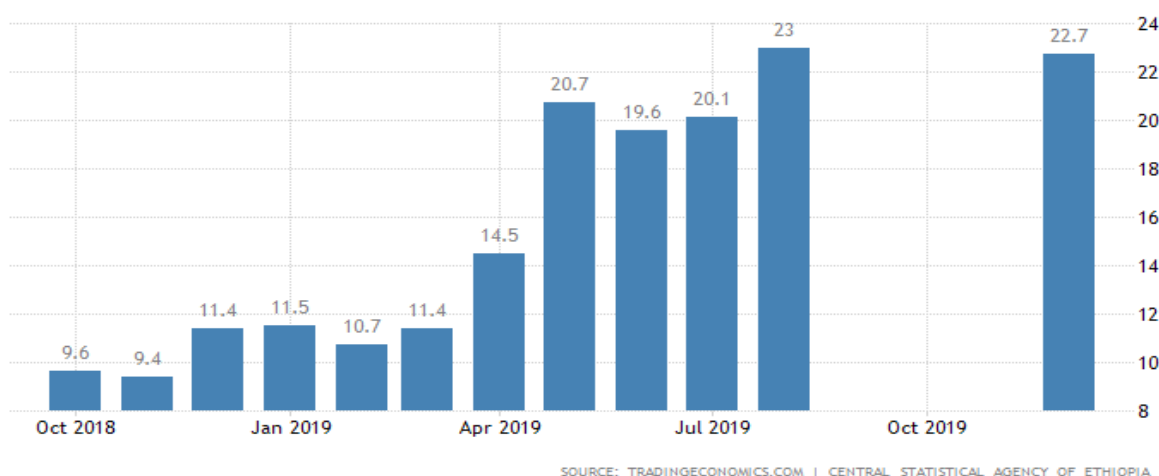


Figure 6. Recent cost of food in Ethiopia.

Housing Utilities

CPI Housing Utilities in Ethiopia decreased to 134.20 Index Points in April from 135.90 Index Points in March of 2019.

Annual Inflation

The annual inflation rate in Ethiopia dropped to 18.7 percent in January 2020 from 19.5 percent in the previous month. On a monthly basis, consumer prices went up 0.8 percent, the most since last September, compared to a 0.6 percent increase in December, pushed up by food prices amid crop devastation caused by the worst invasion of desert locusts in 25 years.

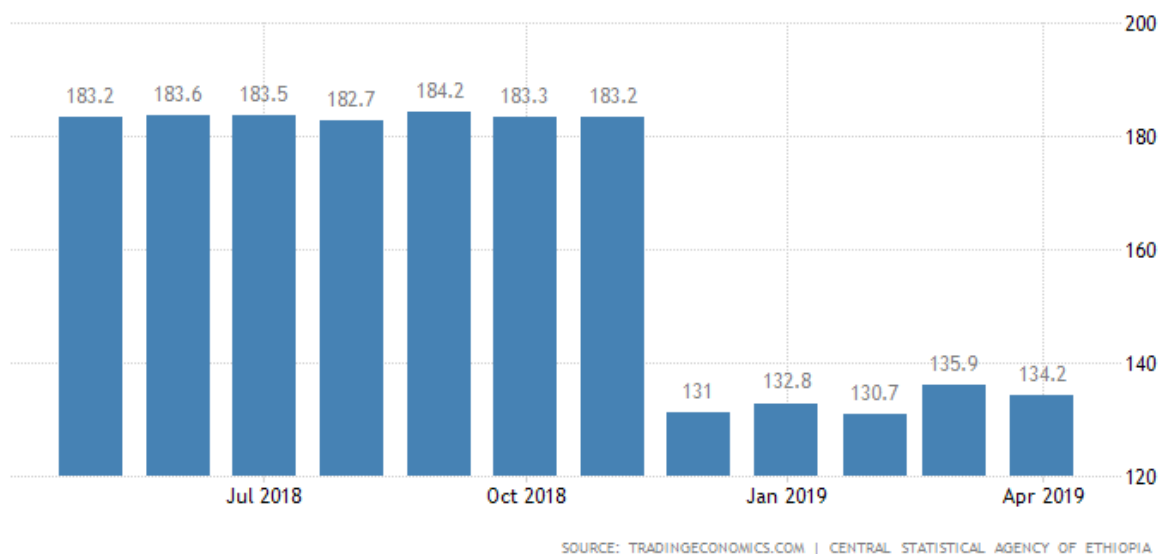


Figure 7. Recent housing utilities in Ethiopia.

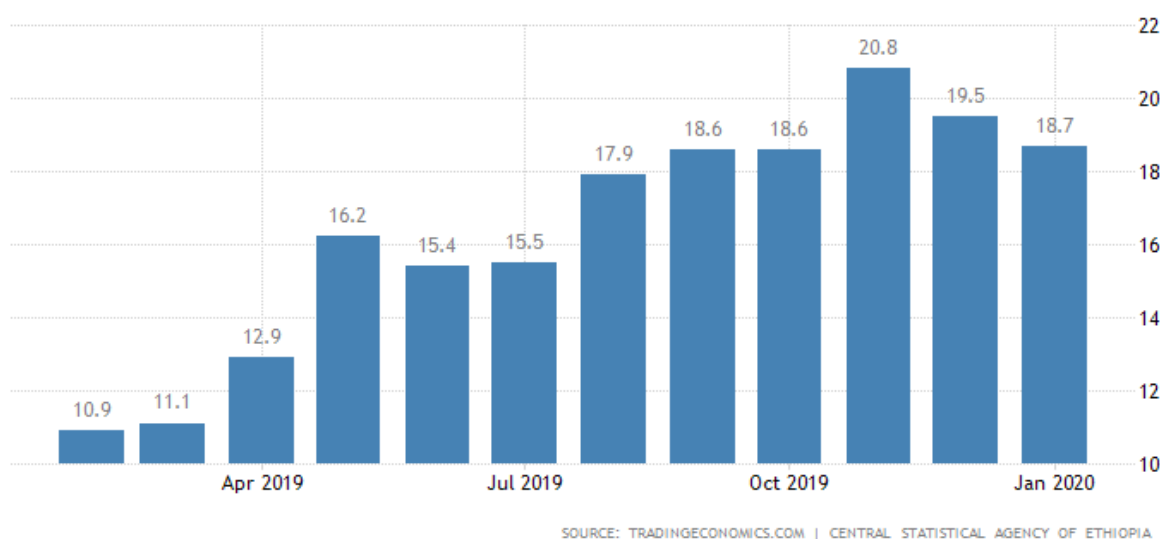


Figure 8. Annual inflation rate in Ethiopia.

Transportation

The transportation sub-index of the CPI basket in Ethiopia decreased to 129.80 points in April of 2019 from 131.50 points in March of 2019.

InflationRateMovement

Inflation rate movement in Ethiopia averaged 0.64 percent from 1966 until 2020, reaching an all-time high of 12.75 percent in June of 2008 and a record low of -34.65 percent in December of 2011.

The Relationship between Ethiopian Economy and Consumer Price Index

From the above separate analysis of the Ethiopian economic development and consumer price index (purchasing power of consumer), we can understand that there is a negative relationship between the Ethiopian economic growth and the purchasing power of consumer (consumer price index) synonymously measured by

the inflation-macroeconomic growth trade-off. This shows that the purchasing power consumer (consumer price index) in Ethiopia is not solely determined by the macroeconomic development, which in turn requires further investigation.

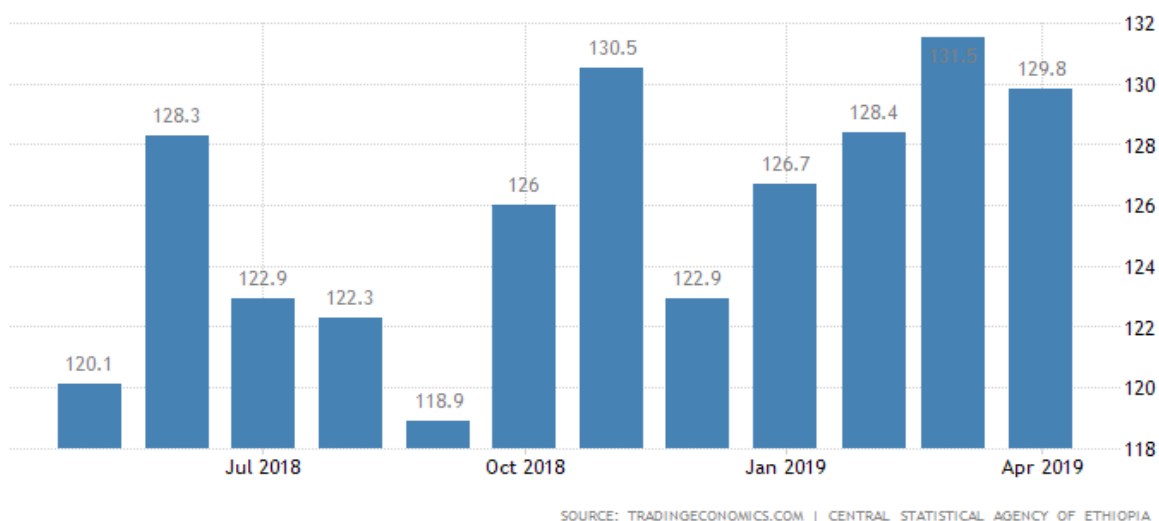


Figure 9. Transportation price index in Ethiopia.

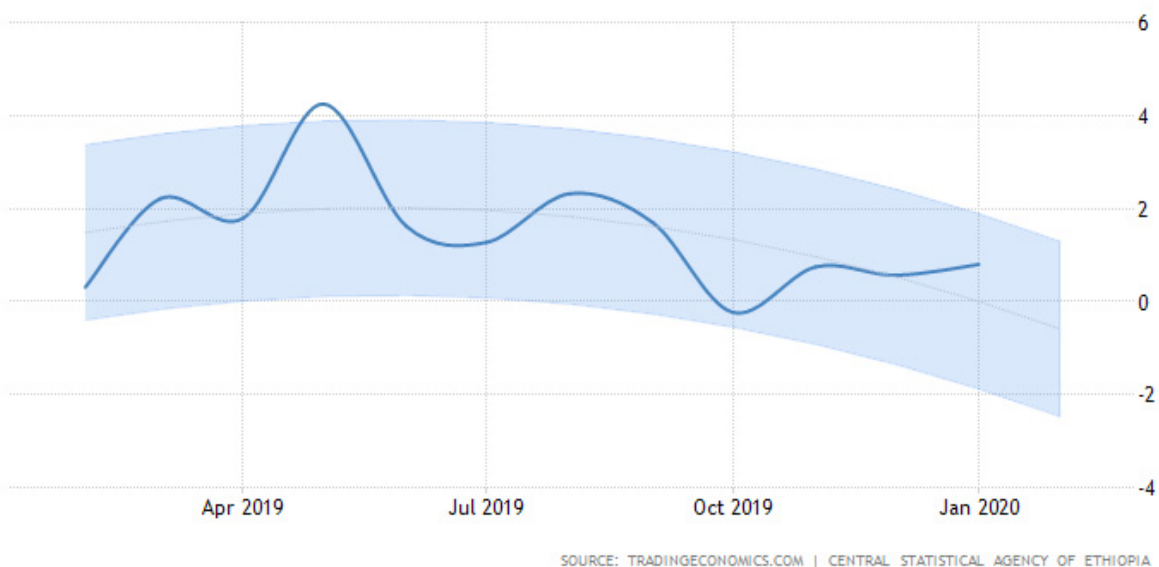


Figure 10. Inflation rate movement in Ethiopia.

Summary of Findings and Recommendation

The purpose of this section is to reflect on the journey that was taken throughout the study in addressing the research question and make recommendations for future study.

Summary of Findings

Ethiopia's location gives it strategic dominance as a jumping off point in the Horn of Africa, close to the Middle East and its markets. Bordering Eritrea, Somalia, Kenya, South Sudan, and Sudan, Ethiopia is landlocked, and has been using neighboring Djibouti's main port for the last two decades. However, with the

recent peace with Eritrea, Ethiopia is set to resume accessing the Eritrean ports of Assab and Massawa for its international trade.

Ethiopia's economy experienced strong, broad-based growth averaging 9.9% a year from 2007/08 to 2017/18, compared to a regional average of 5.4%. Ethiopia's real gross domestic product (GDP) growth decelerated to 7.7% in 2017/18. Industry, mainly construction, and services accounted for most of the growth. Agriculture and manufacturing made lower contribution to growth in 2017/18 compared to the previous year. Private consumption and public investment explain demand-side growth, the latter assuming an increasingly important role. Higher economic growth brought with it positive trends in poverty reduction in both urban and rural areas. The share of the population living below the national poverty line decreased from 30% in 2011 to 24% in 2016. The government is implementing the second phase of its Growth and Transformation Plan (GTP II) which will run to 2019/20. GTP II aims to continue expanding physical infrastructure through public investments and to transform the country into a manufacturing hub. GTP II targets an average of 11% GDP growth annually, and in line with the manufacturing strategy, the industrial sector is set to expand by 20% on average, creating more jobs.

Ethiopia's main challenges are sustaining its positive economic growth with moderate inflation and accelerating poverty reduction, which both require significant progress in job creation as well as improved governance. The government is devoting a high share of its budget to pro-poor programs and investments. Large scale donor support will continue to provide a vital contribution in the near-term to finance the cost of pro-poor programs. Key challenges are related to:

- Limited competitiveness, which constrains the development of manufacturing, the creation of jobs, and the increase of exports.
- An underdeveloped private sector, which would limit the country's trade competitiveness and resilience to shocks. The government aims to expand the role of the private sector through foreign investment and industrial parks to make Ethiopia's growth momentum more sustainable.
- Political disruption, associated with social unrest, could negatively impact growth through lower foreign direct investment, tourism, and exports.

In conclusion, the review revealed that the purchasing power of the consumer (consumer price index) is negatively related to the Ethiopian economic growth, however the economic growth alone cannot be the best measure for the purchasing power of consumers, there may be other indicators that can determine the purchasing power of consumers.

Recommendations and Future Research

The review on the Ethiopian economic growth reveals that Ethiopian economy is highly growing and the review on the consumer price index (purchasing power of consumers) shows that there is decreasing in the purchasing power of consumer, which is conflicting with the first literature. This study systematically identified literature on the topic of interest and suggests that there is negative relationship between the Ethiopian economic growth and the consumer price index (the purchasing power of consumer). This implies that the Ethiopian government should work to maintain moderate inflation to achieve the increasing economic growth with increasing purchasing power of consumers. It also is recommended that future research works will explore more on the relationship between the Ethiopian economic growth and the purchasing power of consumer or clearly can explore the effect of economic growth on the purchasing power of consumers (consumer price index).

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