Export-led or Domestic Demand-led Growth Policy for Ethiopia: Getting Choice and Sequence Right

Tsegaye Tegenu, June 25, 2011- This piece of writing is a reflection to the news about Ethiopia’s power export to Djibouti and Sudan. The news heralds the shift of the export concentration from the predominance of primary products to a new energy market which may lead to development of an energy industry. Until now the major export products of the country are traditional products and these includes coffee, oil seeds, fruits, livestock and textiles. The government attempt to increase and diversify the country's export is necessary for various reasons: to assist external debt servicing, increase reserves of foreign currency, to pay for imported capital and consumer goods, etc. But given the low level of power consumption in the country and the urgent need for rural electrification, I think it is too early to venture into energy trade with neighbouring countries. The question is why the government gave priority to energy export in the face of growing domestic power shortage in the country. My observation is that in its development strategy the government has given strong emphasis to the promotion of exports in order to increase the growth performance of the economy. If one looks at the reform policies of the government over the past two decades, the economic growth policy is guided by the idea of export-led growth. The view of export-led growth conceives growth of exports as having a favourable impact on economic growth (Beckerman 1965, Vernon1966). According to this view export expansion to foreign markets improves resource allocation and production efficiency (using core market concept). Export is claimed as the 'engine of growth'.

Since the 1992 open economy policy, the EPRDF government has undertaken various measures to address the specific bottlenecks of the export sector. These includes: devaluation of the Birr and step-by-step liberalization of the foreign exchange market, streamlining import and export licensing system, tariff reduction, and provision of incentives to exporters, abolishing taxes on exports, encouraging export-oriented investment, promulgating an export development strategy, establishing export support institutions, instituted export specific incentive schemes, etc. (for further details see Kagnew Wolde, 2008).

In contrast to the export-led growth hypothesis, there is a development strategy which emphasis growth based on deep internal market development. This paradigm is commonly known as domestic demand-led growth. The fundamental idea of demand-led growth is that growth in output is determined by the growth in aggregate demand. The focus of this development strategy is on domestic development and identification of policies which influence the level and growth of aggregate demand. In the Ethiopian context this may include surplus creation in the agricultural sector and generation of demand linkages with the rest of the economy (I will return to my idea of green revolution and manufacturing decentralization at the later part of the discussion).

The demand-led growth strategy focuses increasing the capacity to produce more to
meet effective demands. In the context of least developing countries, the paradigm emphasis internally generated economic growth, i.e., shift in demand and an increase in domestic investment and technological improvement. Once a certain level of domestic industrialization is achieved through demand-led growth strategy, the country enhances its international competitiveness of tradeable goods (hence, exports are promoted). The history of the industrialized economies shows such sequences along the path of development. In this note my intention is not to initiate a theoretical debate on supply or demand driven side of growth. Neither is my intention to undermine the role of foreign trade. I am trying to point out the order of importance and sequences between the two alternative paradigm choices taking into account of the Ethiopian condition. My view is that at the current stage of the country’s structural transformation requires policy agenda of domestic demand-led growth. I will try to base my arguments by reference to some of the well argued shortcomings of export-led growth and through reviewing the domestic development of the country.

**Limits of Export-led Growth**

The idea of export-led growth is partly anchored on the Washington consensus which emphasizes policies of trade liberalization, privatization, market flexibility, capital mobility and fiscal austerity programs. In the context of least developing countries these policies have been severely criticized. As pointed out in the literature, the export-led growth paradigm shifted the focus away from domestic market growth and placed emphasis on international market in which developing countries are found in “race-to-the-bottom” competition with each other. In countries where structural transformation has not yet realized shifting ever more output onto global markets can distort development.

Another criticism refers to the instability and fluctuation of the country’s export earnings as a result of the rivalry between countries and downward price pressure. Rivalry between countries at global markets often crowd out exports of another country. If there are more countries competing each other export-led development can have a zero-sum game effect (one is gaining at the expense of the other). Under such rivalry circumstance increasing exports certainly distorts internal development. Other identified problem of the strategy is its weak linkages into the rest of the economy. Export led growth is considered by some as a means of extracting surplus to the extent of negatively affecting local people interest. Export-led growth is viewed to have similar exploitative characteristics of earlier “plantation” model of development (for detailed criticisms see Palley 2002).

**Paradigm of domestic demand-led growth**

My main argument is that instead of focusing to grow on the back of demand expansion in other countries, at this stage of our development it is much better to produce for the domestic market since this creates rapid employment and provides sustained household income. I am of the opinion that the country should follow a paradigm of domestic demand-led growth. Theoretically speaking, under demand-led growth the capacity of the economy to supply output expands in response to an increase in the level of effective demand. In this respect the question is does domestic demand expanding currently in Ethiopia or not. If it does is it an effective
In the Ethiopian context to increase effective domestic demand it is necessary at first to bring about a shift in the household demand. As household expenditure survey shows, Ethiopian households, particularly in the rural areas, spend more of their income on food consumption than on manufactured goods. To bring about a shift in demand, it is necessary to increase household income. I suggested green revolution to increasing household income in rural areas and industrial decentralization to create rapid employment in rural towns (see previous postings). My policy suggestion of green revolution and industrial decentralization emphasizes development of domestic capacities for domestic use purposes. These alternative policy suggestions increase the level of effective domestic demand (function of income increase) and the capacity to produce more to meet effective demands. Implementation of green revolution and manufacturing requires power generation in addition to other infrastructure such as transport, communications and water supply facilities.

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References

