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POLICY STUDIES INSTITUTE

POLICY BRIEF

Making Growth Work for All Ethiopians - Actionable Insights on Linking Economic Growth to Poverty Reduction

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Executive Summary[2]

Over the past two decades, Ethiopia has achieved remarkable economic growth and has made significant strides in reducing income poverty. However, this progress has been tempered by persistent challenges, including high inflation, low agricultural productivity, and implementation gaps in development programs. Furthermore, a closer look reveals that the benefits of this growth have not been distributed evenly, and poverty, when viewed through a multidimensional lens, remains stubbornly high.

This policy brief synthesizes the findings from the comprehensive report, "Economic Growth and Poverty Reduction in Ethiopia: A CGE – Plus Analysis," which utilizes situational analysis, international benchmarking, and advanced econometric modeling to dissect the complex relationship between economic growth and poverty. The core finding is that the source of economic growth is as important as its rate. Growth originating from the agricultural and agro-processing sectors is demonstrably more effective at reducing poverty than growth in other sectors. This is because these sectors are intensive in unskilled labor, the primary asset of Ethiopia's poorest households.

The report's simulations indicate that a high-growth path tends to concentrate income gains at the top, having a minimal direct impact on poverty. Therefore, to achieve the nation's goal of inclusive prosperity, this brief outline actionable policy recommendations focused on strategically prioritizing investments in pro-poor sectors,

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rebalancing public and private roles in the economy, developing human capital, and vigorously pursuing redistributive policies that have already proven effective.

Introduction: The Paradox of Growth and Poverty

Ethiopia's economic narrative since the turn of the millennium has been one of impressive expansion. Between 2000 and 2021, the nation's GDP grew a remarkable 13.6-fold, from USD 8.16 billion to USD 111.27 billion, with growth rates consistently outpacing the Sub-Saharan African (SSA) average. This was driven by a series of ambitious, state-led development strategies, including the Poverty Reduction Strategy Papers (PRSPs), the Growth and Transformation Plans (GTP I & II), and the current Ten-Years Development Plan. These efforts successfully translated into tangible gains in poverty reduction, with the national income poverty headcount falling from 44.2% in 2000 to 23.5% in 2016.

However, this headline success masks a more complex reality. Key challenges threaten the sustainability and inclusivity of this growth. Inflation has remained persistently high, eroding the purchasing power of the poor. The structural transformation from an agrarian to an industrial economy has not materialized as planned, with the service sector, rather than manufacturing, absorbing the declining share of agriculture in GDP.

Most importantly, despite the progress, poverty remains widespread. In 2020, an estimated 27% of the population still lived below the $1.90 international poverty line, equivalent to 31.8 million people. When measured multidimensionally — accounting for deprivations in health, education, and living standards. The figure is even starker, with 59 million people considered MPI-deprived in 2021. This raises the central questions addressed by the research: What are the key drivers of poverty reduction? Is Ethiopia's growth truly pro-poor? And which policy pathways are most likely to ensure that future prosperity is shared by all?

Key Findings from the Analysis

The report's mixed-methods approach, combining macroeconomic time-series data, household-level panel surveys, and economy-wide CGE modeling, yields several critical findings that should inform future policy.

Finding 1: agriculture and agro-processing are the most potent pro-poor engines

The CGE simulations show that growth originating in the agricultural sector has the largest poverty-reducing effect. The poverty-growth elasticity for agriculture-led growth is -2.29, meaning a 1% increase in GDP driven by agriculture leads to a 2.29% reduction in poverty—a far greater impact than any other sector. This is explained by the fundamental structure of the Ethiopian economy and the nature of poverty:

- Factor endowment: the poorest households' primary asset is their labor, particularly unskilled labor. The agricultural sector is the most intensive user of this factor.
- Consumption patterns: agricultural and food-processing products constitute the largest share of spending for both rural and urban households, meaning that increased agricultural productivity can also lower the cost of living for the poor.
- Linkages: the agro-processing sub-sector also has a high poverty-growth elasticity (-1.81) because it creates jobs for low-skilled workers and has strong backward linkages to the agricultural sector where most of the poor are employed.

Finding 2: high growth alone is not a silver bullet for poverty reduction

A key simulation in the CGE model reveals that under a high-growth scenario, income gains are disproportionately captured by those at the top of the income distribution. This results in only a minimal reduction in poverty, demonstrating that the "trickle-down" effect is weak.

Conversely, the micro-level decomposition analysis shows that redistributive effects have contributed more to the reduction in poverty than the growth component itself. This suggests that Ethiopia's pro-poor policies, such as the Productive Safety Net Program (PSNP), have been crucial and effective. The lesson is that intentional, direct pro-poor action is a necessary complement to any growth strategy.

Finding 3: a trade-off exists between growth-maximizing and welfare-maximizing investments

The report's public investment simulations rank economic sub-sectors based on their impact on both GDP and household consumption (a proxy for welfare). The results highlight a clear policy trade-off:

- Highest GDP impact: investments in export-oriented sectors like coffee, pulses, flowers, and textiles generate the largest increases in overall GDP.
- Highest welfare impact: investments in staple food crops like wheat, teff, and maize, and in essential manufacturing like clothing and food processing, generate the largest increases in household consumption and have a greater direct impact on reducing poverty.

While some sectors, like wheat and textiles, perform well on both metrics, many do not. This finding implies that a growth strategy focused solely on maximizing GDP may not be the most effective strategy for poverty reduction. A balanced portfolio of investments is required.

Finding 4: structural hurdles inhibit inclusive growth

Several underlying challenges continue to constrain Ethiopia's ability to make growth more pro-poor:

- Public vs. private investment: macro-level analysis indicates a potential "crowding out" effect, where heavy government-led investment may be hindering private capital formation, which is critical for long-term, efficient growth.
- Stagnating agricultural productivity: despite its importance, gains in agricultural productivity, particularly for cereal crops, have become harder to realize, limiting the sector's potential.
- Implementation capacity: the management and execution of large-scale public development projects have been inefficient, leading to delays and reducing their impact.
- Skills mismatch: The transition to an industrialized economy is hampered by a shortage of technically skilled labor that meets industry demands.

Actionable Policy Recommendations

Based on these findings, the following policy actions are recommended to accelerate poverty reduction and ensure the benefits of economic growth are shared more broadly.

Recommendation 1: adopt a dual-focus public investment strategy

To simultaneously drive economic growth and improve welfare, the government should strategically balance its investment portfolio.

- For growth and foreign exchange: continue to support high-potential, export-oriented sub-sectors such as coffee, pulses, textiles, and leather/footwear to generate revenue and drive overall GDP.
- For poverty reduction and food security: Prioritize and increase investment in staple food sectors like wheat, teff, and maize, which have the most significant direct impact on household consumption and welfare. The recent success in expanding irrigated wheat production is a promising model that should be scaled and replicated for other key staples.

Recommendation 2: turbocharge agro-processing as the engine of structural transformation

The agro-processing sector is the critical link between Ethiopia's pro-poor agricultural base and its industrialization goals.

- Provide targeted incentives for investment in sub-sectors with high poverty-reduction elasticities, such as grain milling, meat processing, dairy, and fruit/vegetable processing.
- Develop policies that strengthen backward linkages, ensuring that processing industries source their raw materials from local smallholder farmers, thereby distributing income into rural areas.

Recommendation 3: rebalance the roles of the public and private sectors

To foster more efficient and sustainable growth, policies should actively encourage and facilitate private investment.

- Address the potential crowding-out effect by improving the ease of doing business. This includes continuing efforts to automate business license applications and renewals and streamlining regulations.
- Launch and expand schemes to identify and promote entrepreneurship, with a specific focus on creating an enabling environment for small and medium enterprises (SMEs), which are crucial for job creation.

Recommendation 4: invest in people and places to harness the demographic dividend

Ethiopia's young and growing population is a potential economic advantage that must be cultivated.

- Create jobs: Pursue all avenues to create jobs that can absorb the "youth bulge" and turn the large population into a productive asset rather than a liability.
- Build relevant skills: Invest heavily in technical and vocational training that is reflexive and adaptive to the evolving needs of the industrial and service labor markets45.
- Promote urbanization: Encourage the expansion of urban centers, particularly small towns near rural settlements. The micro-analysis confirms that living in small towns has a significant positive effect on household welfare.

Recommendation 5: reinforce and deepen redistributive and social protection policies

Given that redistribution has been a powerful driver of poverty reduction, these efforts should be strengthened, not seen as secondary to growth.

- Strengthen safety nets: vigorously pursue and expand successful schemes like the Productive Safety Net Program (PSNP) and Community-Based Health Insurance (CBHI).
- Adopt a multidimensional lens: shift the focus of poverty reduction strategies beyond just income. Design interventions that explicitly target improvements in health, education, and basic living conditions like housing, energy sources, and WASH services.

Concluding Remarks

The path to a prosperous and equitable Ethiopia requires more than just high GDP growth. The findings of this comprehensive analysis demonstrate that the pattern and composition of that growth are paramount. By strategically prioritizing investments in agriculture and labor-intensive agro-processing, rebalancing the roles of the state and the private sector, investing in its human capital, and doubling down on proven redistributive policies, Ethiopia can build a more resilient and inclusive economy. Such a strategy will not only accelerate progress towards its development goals but will ensure that prosperity is a reality shared by all its citizens.