STUDENT'S GUIDE TO THE ECONOMY

Microeconomics VS. Macroeconomics

Global markets instinctively respond to events impacting the economy, such as natural disasters, economic recessions, and pandemics. The rules and principles of two interdependent categories of economics – microeconomics and macroeconomics – govern economies of all sizes.

Microeconomics VS. Macroeconomics: What's the Difference?

Microeconomics and macroeconomics are two distinct categories of economics that complement each other.

KEY TERMS TO KNOW

MICROECONOMICS
The study of individual and business decisions regarding the allocation of resources and prices of goods and services

- Microeconomics also considers taxes, regulations, and government legislation.
- Microeconomics does not try to explain which actions should take place in a market but rather the effects of changes in certain conditions.
- For example, microeconomics can help a company maximize its production and capacity so it could offer lower prices and remain competitive.
- **Microeconomics has applications in:**

Trade | Industrial organization and market structure | Labor economics | Public finance | Welfare economics

MACROECONOMICS
The study of the decisions of countries and governments

- Macroeconomics analyzes entire industries and economies rather than individuals or specific companies.
- Macroeconomics tries to determine the optimal rate of inflation and factors that may stimulate economic growth.
- For example, macroeconomics may analyze how the unemployment rate affects the gross domestic product.
- **Macroeconomics describes relationships among:**

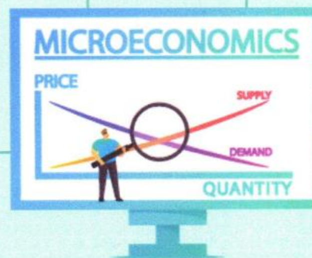
KEY PRINCIPLES OF MICROECONOMICS

DEMAND, SUPPLY, AND EQUILIBRIUM

Supply and demand influence prices. In a perfectly competitive market, suppliers offer the price demanded by consumers.

PRODUCTION THEORY

This theory explores how goods and services are created or manufactured.



COSTS OF PRODUCTION

This principle states that the cost of production determines the price of goods or services.

LABOR ECONOMICS

This principle attempts to explain the relationship between wages, employment, and income.

KEY RESEARCH AREAS IN MACROECONOMICS

ECONOMIC GROWTH

This term refers to an increase in aggregate production in an economy.

- Growth is modeled as a function of physical capital, human capital, labor force, and technology.

BUSINESS CYCLES

This area of macroeconomics considers variables such as employment and national output.

- The Great Depression of the 1930s spurred the development of modern macroeconomic theory.

A Brief History of Economics

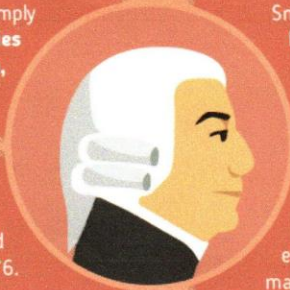
Since its early beginnings in the 1800s, the field of economics has expanded

to try to address the complexity of today's economies and systems.

EARLY ECONOMICS

In the 1800s, economics was simply the study of how **human societies managed the production, distribution, and consumption of goods and services**.

Adam Smith, a Scottish philosopher regarded as the **father of economics**, authored *The Wealth of Nations* in 1776.

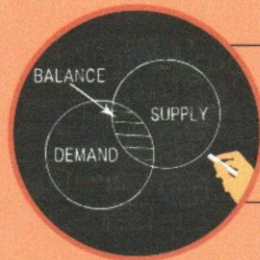


Smith believed that an **invisible hand guides individuals** to maximize their well-being and provide the best overall result to society as a whole.

The Great Depression puzzled economists, as they could offer no plausible explanation for the extreme market collapse of the 1930s.

In the time between the publication of Smith's book and the Great Depression, economists assumed that **the study of individual markets would explain the behavior of variables such as unemployment and output**.

THE BIRTH OF MACROECONOMICS



John Maynard Keynes, considered the **founding father of macroeconomics**, wrote *The General Theory of Employment, Interest and Money* in 1936.

In his book, Keynes introduced the simultaneous consideration of **equilibrium in goods, labor, and finance**.

Keynes also introduced the concept of **disequilibrium economics**, which is the study of departures from general equilibrium.

THE INTERSECTION OF MICROECONOMICS AND MACROECONOMICS

Since the Keynesian revolution, economists have tried to merge microeconomics and macroeconomics by developing microeconomic foundations for macroeconomic models; the reasoning behind these efforts is the belief that individual households and firms act in their best interests.

The Four Building Blocks of International Economics

FOUR AREAS INFLUENCE INTERNATIONAL ECONOMICS:

INTERNATIONAL TRADE

INTERNATIONAL FINANCE

MULTINATIONAL CORPORATIONS

ECONOMIC GLOBALIZATION

INTERNATIONAL TRADE

International trade is defined as the exchange of goods and services between countries.

Global trade allows a country to focus on exporting products or services it can provide more efficiently than other countries.

Specialization reduces opportunity cost and maximizes efficiency in acquiring goods.

The rise of international trade has led to the creation of a global economy in which global events affect supply, demand, and prices.

INTERNATIONAL FINANCE

International finance is defined as the study of monetary interactions between two or more countries.

The following concepts govern the field of international finance:

MUNDELL-FLEMING MODEL
The interaction between the goods market and the money market, based on the assumption that the price levels of goods are fixed

INTERNATIONAL FISHER EFFECT
An international finance theory that assumes nominal interest rates reflect fluctuations in the spot exchange rate between nations

OPTIMUM CURRENCY AREA THEORY
The theory that the adoption of a single currency in a geographical region will maximize economic efficiency

PURCHASING POWER PARITY
The measurement of prices in different areas using a specific good or set of goods to compare the absolute purchasing power between different currencies

INTEREST RATE PARITY
A state of equilibrium in which investors are indifferent to interest rates attached to bank deposits in two separate countries

MULTINATIONAL CORPORATIONS

A MULTINATIONAL CORPORATION:

- Has facilities and other assets located in at least one country other than its home country
- Derives at least a quarter of its revenues from outside its home country

EARLY MULTINATIONAL CORPORATIONS INCLUDE:

- The East India Company, founded in 1660 and based in London
- The Swedish Africa Company, founded in 1649
- The Hudson's Bay Company, founded in 1670

THE BENEFITS OF MULTINATIONAL CORPORATIONS INCLUDE:

- Reducing prices
- Increasing consumers' purchasing power
- Spurring job growth in local economies
- Increasing the variety of goods and services produced

ECONOMIC GLOBALIZATION

Globalization is defined as the spread of products, information, technology, and jobs across national borders.

An advantage of globalization is that it brings jobs and technology to developing economies.

A disadvantage of globalization is that an economic downturn in one country could have global repercussions.

Conclusion

Economics is a complex field with many fixed factors and variables affecting the financial health of individuals, households, companies, and governments. A firm grasp of the principles and theories governing microeconomics and macroeconomics will help professionals make wise decisions concerning nearly all areas of business.

MARYVILLE
UNIVERSITY

STUDENT'S GUIDE TO THE

ECONOMY

Microeconomics VS. Macroeconomics

Global markets instinctively respond to events impacting the economy, such as natural disasters, economic recessions, and pandemics. The rules and principles of two interdependent categories of economics – microeconomics and macroeconomics – govern economies of all sizes.

Microeconomics VS. Macroeconomics: What's the Difference?

Microeconomics and macroeconomics are two distinct categories of economics that complement each other.

KEY TERMS TO KNOW

MICROECONOMICS
The study of individual and business decisions regarding the allocation of resources and prices of goods and services

- Microeconomics also considers taxes, regulations, and government legislation.
- Microeconomics does not try to explain which actions should take place in a market but rather the effects of changes in certain conditions.
- For example, microeconomics can help a company maximize its production and capacity so it could offer lower prices and remain competitive.
- **Microeconomics has applications in:**

Trade | Industrial organization and market | Labor economics | Public finance | Welfare economics

structure

MACROECONOMICS
The study of the decisions of countries and governments

- Macroeconomics analyzes entire industries and economies rather than individuals or specific companies.
- Macroeconomics tries to determine the optimal rate of inflation and factors that may stimulate economic growth.
- For example, macroeconomics may analyze how the unemployment rate affects the gross domestic product.
- **Macroeconomics describes relationships among:**

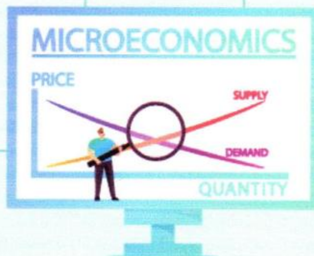
KEY PRINCIPLES OF MICROECONOMICS

DEMAND, SUPPLY, AND EQUILIBRIUM

Supply and demand influence prices. In a perfectly competitive market, suppliers offer the price demanded by consumers.

PRODUCTION THEORY

This theory explores how goods and services are created or manufactured.



COSTS OF PRODUCTION

This principle states that the cost of production determines the price of goods or services.

LABOR ECONOMICS

This principle attempts to explain the relationship between wages, employment, and income.

KEY RESEARCH AREAS IN MACROECONOMICS

ECONOMIC GROWTH

This term refers to an increase in aggregate production in an economy.

- Growth is modeled as a function of physical capital, human capital, labor force, and technology.

BUSINESS CYCLES

This area of macroeconomics considers variables such as employment and national output.

- The Great Depression of the 1930s spurred the development of modern macroeconomic theory.

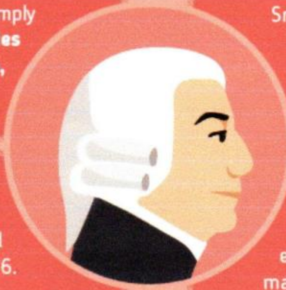
A Brief History of Economics

https://s3-us-east-2.amazonaws.com/maryville/wp-content/upl...-to-the-Economy-MicroeconomicsvsMacroeconomics-final.png 2/5/23, 14:26
Page 2 of 6

Since its early beginnings in the 1800s, the field of economics has expanded to try to address the complexity of today's economies and systems.

EARLY ECONOMICS

In the 1800s, economics was simply the study of how **human societies managed the production, distribution, and consumption of goods and services**.



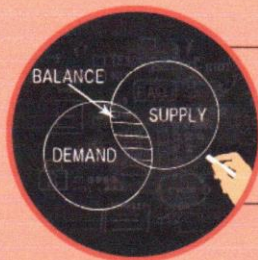
Smith believed that an **invisible hand guides individuals** to maximize their well-being and provide the best overall result to society as a whole.

Adam Smith, a Scottish philosopher regarded as the **father of economics**, authored *The Wealth of Nations* in 1776.

The Great Depression puzzled economists, as they could offer no plausible explanation for the extreme market collapse of the 1930s.

In the time between the publication of Smith's book and the Great Depression, economists assumed that **the study of individual markets would explain the behavior of variables such as unemployment and output**.

THE BIRTH OF MACROECONOMICS



John Maynard Keynes, considered the **founding father of macroeconomics**, wrote *The General Theory of Employment, Interest and Money* in 1936.

In his book, Keynes introduced the simultaneous consideration of **equilibrium in goods, labor, and finance**.

Keynes also introduced the concept of **disequilibrium economics**, which is the study of departures from general equilibrium.

THE INTERSECTION OF MICROECONOMICS AND MACROECONOMICS

Since the Keynesian revolution, economists have tried to merge microeconomics and macroeconomics by developing microeconomic foundations for macroeconomic models; the reasoning behind these efforts is the belief that individual households and firms act in their best interests.

The Four Building Blocks of International Economics

FOUR AREAS INFLUENCE INTERNATIONAL ECONOMICS:

INTERNATIONAL TRADE

INTERNATIONAL FINANCE

MULTINATIONAL CORPORATIONS

ECONOMIC GLOBALIZATION

INTERNATIONAL TRADE

International trade is defined as the exchange of goods and services between countries.

Global trade allows a country to focus on exporting products or services it can provide more efficiently than other countries.

Specialization reduces opportunity cost and maximizes efficiency in acquiring goods.

The rise of international trade has led to the creation of a global economy in which global events affect supply, demand, and prices.

INTERNATIONAL FINANCE

International finance is defined as the study of monetary interactions between two or more countries.

The following concepts govern the field of international finance:

MUNDELL-FLEMING MODEL

The interaction between the goods market and the money market, based on the assumption that the price levels of goods are fixed

INTERNATIONAL FISHER EFFECT

An international finance theory that assumes nominal interest rates reflect fluctuations in the spot exchange rate between nations

OPTIMUM CURRENCY AREA THEORY

The theory that the adoption of a single currency in a geographical region will maximize economic efficiency

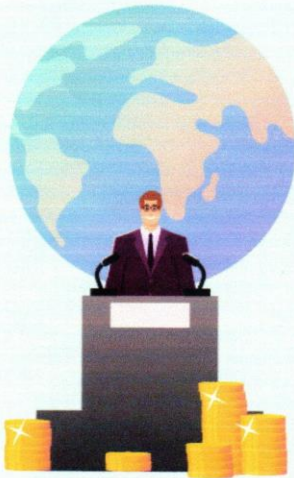
PURCHASING POWER PARITY

The measurement of prices in different areas using a specific good or set of goods to compare the absolute purchasing power between different currencies

INTEREST RATE PARITY

A state of equilibrium in which investors are indifferent to interest rates attached to bank deposits in two separate countries

MULTINATIONAL CORPORATIONS



A MULTINATIONAL CORPORATION:

- Has facilities and other assets located in at least one country other than its home country
- Derives at least a quarter of its revenues from outside its home country

EARLY MULTINATIONAL CORPORATIONS INCLUDE:

- The East India Company, founded in 1660 and based in London
- The Swedish Africa Company, founded in 1649
- The Hudson's Bay Company, founded in 1670

THE BENEFITS OF MULTINATIONAL CORPORATIONS INCLUDE:

- Reducing prices
- Increasing consumers' purchasing power
- Spurring job growth in local economies
- Increasing the variety of goods and services produced

ECONOMIC GLOBALIZATION

Globalization is defined as the spread of products, information, technology, and jobs across national borders.

An advantage of globalization is that it brings jobs and technology to developing economies.

A disadvantage of globalization is that an economic downturn in one country could have global repercussions.

Conclusion

Economics is a complex field with many fixed factors and variables affecting the financial health of individuals, households, companies, and governments. A firm grasp of the principles and theories governing microeconomics and macroeconomics will help professionals make wise decisions concerning nearly all areas of business.

https://s3-us-east-2.amazonaws.com/maryville/wp-content/upl...-to-the-Economy-MicroeconomicsvsMacroeconomics-final.png 2/5/23, 14:26 Page 5 of 6

https://s3-us-east-2.amazonaws.com/maryville/wp-content/upl...-to-the-Economy-MicroeconomicsvsMacroeconomics-final.png 2/5/23, 14:26
Page 6 of 6

relationships among national income, savings, and overall price level.

Key Principles of Microeconomics

One of the microeconomics' core principles involves demand, supply, and equilibrium, as they collectively influence prices. Another principle involves production theory, which explores how goods and services are created or manufactured. A third principle involves the costs of production, which ultimately determine the price of goods and services. Finally, the principle of labor economics attempts to explain the relationship between wages, employment, and income.

Key Research Areas in Macroeconomics

One of macroeconomics' key research areas involves economic growth, which refers to an increase in aggregate production in an economy. This can be modeled as a function of physical capital, human capital, labor force, and technology. Another key research area involves business cycles, an area of macroeconomics that considers variables like employment and national output. The Great Depression of the 1930s spurred the development of modern macroeconomic theory.

A Brief History of Economics

Since its beginnings in the 1800s, the field of economics has expanded to try to address the complexity of today's economies and systems.

Early Economics

In the 1800s, economics was simply the study of how human societies managed the production, distribution, and consumption of goods and services. The concept essentially began with Adam Smith, a Scottish philosopher regarded as the father of economics, who authored *The Wealth of Nations* in 1776. Smith believed that an invisible hand guides individuals to maximize their well-being and provide the best overall result to society as a whole.

The Great Depression puzzled economists, as they could offer no plausible explanation for the extreme market collapse of the 1930s. In the time between the publication of Smith's book and the Great Depression, economists assumed that the study of individual markets would explain the behavior of variables like unemployment and output.

The Birth of Macroeconomics

John Maynard Keynes, considered the founding father of macroeconomics, wrote *The General Theory of Employment, Interest and Money* in 1936. In the book, he introduced the simultaneous consideration of equilibrium in goods, labor, and finance. He also introduced the concept of disequilibrium economics, which is the study of departures from general equilibrium.

The Intersection of Microeconomics and Macroeconomics

Since the Keynesian revolution, economists have tried to merge microeconomics and macroeconomics by developing microeconomic foundations for macroeconomic models. The rationale behind these efforts is the belief that individual households and firms act in their best interests.

The Four Building Blocks of International Economics

There are four key areas that influence international economics: International trade, international finance, multinational corporations, and economic globalization.

International Trade

International trade is defined as the exchange of goods and services between countries. Global trade allows a country to focus on exporting products or services it can provide more efficiently than other countries. Specialization reduces opportunity cost and maximizes efficiency in acquiring goods. The rise of international trade has led to the creation of a global economy in which global events affect supply, demand, and prices.

International Finance

International finance is defined as the study of monetary interactions between two or more countries. The concept is governed by multiple concepts. The first concept, the Mundell-Fleming model, is defined as the interaction between the goods market and the money market, based on the assumption that the price levels of goods are fixed.

The second concept, the International Fisher effect, is an international finance theory that assumes nominal interest rates reflecting fluctuations in the spot exchange rate between nations. A third concept is the optimum currency area theory, defined as the adoption of a single currency in a geographical region will maximize economic

efficiency.

Another theory is the purchasing power parity theory, which defines the measurement of prices in different areas using a specific good or set of goods to compare the purchasing power of various currencies. Finally, the interest rate parity theory represents a state of equilibrium where investors are indifferent to interest rates attached to bank deposits in two separate countries.

Multinational Corporations

A multinational corporation has facilities and other assets located in at least one country outside of its home country. It also derives at least a quarter of its revenue from outside its home country. Early examples of these corporations include the East India Company, The Swedish Africa Company, and the Hudson's Bay Company, all of which were founded in the 17th century.

There are numerous benefits associated with multinational corporations, including reduced prices, an increase in consumer purchasing power, spurring job growth in local economies, and increasing the variety of goods and services produced.

Economic Globalization

Globalization is defined as the spread of products, information, technology, and jobs across national borders. On one hand, globalization brings jobs and technology to developing economics. On the other hand, globalization potentially means that an economic downturn in one country could have global repercussions.

Better Understanding, Better Decisions

Economics is a complex field with many fixed factors an[illegible]ables affecting the financial health of individuals, households, companies, a[illegible]vernments. A firm grasp of the principles and theories governing microeconomics a[illegible]acroeconomics will help professionals make wise decisions concerning nearly all[illegible] of business.

Apply

Sources

International Monetary Fund, Micro and Macro: The Ec[illegible]ic Divide

Investopedia, Globalization

am Guide

What Is International Finance, and Why Is It So Important?

Reviewed by MARGARET JAMES

What Is International Finance?

International finance, sometimes known as international macroeconomics, is the study of monetary interactions between two or more countries, focusing on areas such as foreign direct investment and currency exchange rates.

KEY TAKEAWAYS

- International finance is the study of monetary interactions that transpire between two or more countries.
- International finance focuses on areas such as foreign direct investment and currency exchange rates.
- Increased globalization has magnified the importance of international finance.
- An initiative known as the Bretton Woods system emerged from a 1944 conference attended by 40 nations and aims to standardize international monetary exchanges and policies in a broader effort to nurture post World War II economic stability.
- **Understanding International Finance**

International finance deals with the economic interactions between multiple countries, rather than narrowly focusing on individual markets. International finance research is conducted by large institutions such as the International Finance Corp. (IFC), and the National Bureau of Economic Research (NBER). Furthermore, the U.S. Federal Reserve has a division dedicated to analyzing policies germane to U.S. capital flow, external trade, and the development of global markets. **International finance analyzes** the following specific areas of study:

- **The Mundell-Fleming Model**, which studies the interaction between the goods market and the money market, is based on the assumption that price levels of said goods are fixed.
- **International Fisher Effect** is an international finance theory that assumes nominal interest rates mirror fluctuations in the spot exchange rate between nations.
- **The optimum currency area theory** states that certain geographical regions would maximize economic efficiency if the entire area adopted a single currency.
- **Purchasing power parity** is the measurement of prices in different areas using a specific good or a specific set of goods to compare the absolute purchasing power between different currencies.
- **Interest rate parity** describes an equilibrium state in which investors are indifferent to interest rates attached to bank deposits in two separate countries.

Example of International Institutions of International Finance The Bretton Woods System The Bretton Woods system was created at the Bretton Woods conference in 1944, where the 40 participating countries agreed to establish a fixed exchange rate system. The collective goal of this initiative was to standardize international monetary exchanges and policies in a broader effort to create post World War II stability.

The Bretton Woods conference catalyzed the development of international institutions that play a foundational role in the global economy. These include the International Monetary Fund (IMF), a consortium of 189 countries dedicated to creating global monetary cooperation, and the International Bank for Reconstruction and Development, which later became known as the World Bank.

Special Considerations

International trade is arguably the most important influencer of global prosperity and growth. But there are worries related to the fact the United States has shifted from being the largest international creditor, to becoming the world's largest international debtor, absorbing excess amounts of funding from organizations and countries on a global basis. This may affect international finance in unforeseen ways.

International finance involves measuring the political and foreign exchange risk associated with managing multinational corporations.

SPONSORED

Get Tax Relief Today!

Facing the IRS alone can be a stressful experience. If you owe $10,000 or more let Anthem Tax Services help. Free consultation to check which IRS tax reduction programs you are eligible for 100% Money Back Guarantee - If we don't save you money or rework your payments, you get your money back – guaranteed! A+ Rated with the Better Business Bureau.

What Is the World Bank, and What Does It Do?

The World Bank is an international organization dedicated to providing financing, advice, and research to developing nations to aid economic advancement.

Macroeconomics Definition, History, and Schools of Thought

Macroeconomics studies an overall economy or market system, its behaviors, the factors that drive it, and how to improve its performance.

Bank for International Settlements (BIS)

The Bank for International Settlements is an international financial institution that serves as a bank and forum for national central banks.

more

Gross Domestic Product (GDP): Formula and How to Use It

Gross domestic product is the monetary value of all finished goods and services made within a country during a specific period.

Bretton Woods Agreement and the Institutions It Created Explained

The Bretton Woods Agreement and System created a collective international currency exchange regime based on the U.S. dollar and gold.

more

Gold Standard: Definition, How It Works, and Example

The gold standard is a system in which a country's government allows its currency to be freely converted into fixed amounts of gold.

THE Reporter

Interview › What's Ethiopia's economy lacking?

What's Ethiopia's economy lacking?

By: Ashenafi Endale

February 4, 2023

The economist explains

Ayele Gelan is a senior research economist with the Economic Public Policy Program of the Kuwait Institute for Scientific Research (KISR). He has widely published in peer-reviewed international journals covering a range of economic policy issues, including macroeconomic, energy, trade, regional, agricultural, and tourism policies. He has authored "Chronicles on the Political Economy of Plunder in Ethiopia, 1991–2018" (2018, Amazon and AAU Press).

Aside from academic writing, he is a regular contributor of economic commentary to most English-language weeklies published in Ethiopia. His research and teaching experiences encompass contexts in developed and developing countries. His previous affiliations include Research Economist with the International Livestock Research Institute (ILRI), Kenya; Research Fellow at the Hutton Institute in Aberdeen, UK; and Director of the Tayside Economic Research Centre at the University of Abertay, UK. He holds a PhD in Economics from the University of Strathclyde in Glasgow, UK. The Reporter's Ashenafi Endale was granted Ayele's audience.

EXCERPTS:

The Reporter: From its practices and direction, what kind of political ideology and economic model is the incumbent applying? How do you diagnose the current state of Ethiopia's political economy?

Ayele Gelan: When the popular uprising ended in 2018 and Prime Minister Abiy Ahmed's (PhD) administration took over, I expected major departures from the two pillars of the Ethiopian Peoples' Revolutionary Democratic Front's (EPRDF) ideologies.

The first was the politics of democratic centralism, copied from the principles of proletarian dictatorship in the socialist era. I am not sure if the current administration has made any substantive departures in this regard; perhaps it is still practicing a variant of democratic centralism, stripping it of its socialist flavor.

The second pillar was in the economic policy domain: the developmental state model! From the very outset, it was clear that the new administration was not in any mood to abandon the developmental state model. I noticed some inconsistencies in the rhetoric of the new regime during the first few months after Abiy assumed power in April 2018.

On the one hand, there was a huge curse of EPRDF politics, which manifested to the point of ditching its name and forming a new party. On the other hand, there was the mantra that "we will continue with the achievements of the economic successes of the previous decades."

I realized the regime was heading down the wrong path because I have never believed miraculous economic growth has ever occurred in Ethiopia, except for the illusions created by high-rise buildings and industrial parks owned and operated by party-affiliated crony businesses.

While expressing commitment to the continuation of the development strategy of the EPRDF era, the authorities were also engaged in a massive campaign discrediting the same economic policies, e.g., the non-achievement of most targets of the Growth and Transformation Program (GTP), the bankruptcies of the giant sugar corporations, the METEC scandal, etc.

I have proposed to the authorities that the sooner they disown the so-called miraculous success story, the better. My concern was that there were backlogs of policy blunders whose effects were just simmering underneath and waiting to burst out for everyone to witness. Even if the civil war had not happened, Ethiopia would still be struggling to deal with numerous macroeconomic and structural imbalances; now they are hidden under the rubble.

Aside from the rhetoric, there are numerous indicators that the current regime is actively pursuing the developmental state model. These may include the proliferation of megaprojects mostly concentrated in Addis Ababa, aggravating imbalances in center-periphery relationships, worsening inequalities between places and people, etc.

In its post-war recovery plans, the government has prepared a three-year roadmap for Homegrown Economic Reform 2.0 and also a reconstruction roadmap. Do you think the reform plans of the past few years are on track?

I have three major concerns regarding the Home Grown Economic Reform (HGER). First, why has the government suddenly begun to label its economic policies as *"homegrown"*?

Two things happened soon after the regime change in 2018. The new regime did not take the time to collect and organize evidence, as well as to develop sound economic policy to address existing macro- and structural imbalances.

For instance, the agricultural sector was stagnant, and there were dire food security challenges. Similarly, youth unemployment was alarmingly high. So the government was expected to start by addressing these fundamental challenges. It would not have puzzled me if the government went along this path and then labeled its policies as "homegrown." However, what happened was quite different.

The government surprised everyone by unexpectedly announcing a series of privatization initiatives, including even Ethiopian Airlines, in an attempt to fix something that is not broken. This caused widespread uproar among the public, who rightly felt the government was misled by the

pressure applied by external

Reporter

Therefore, "homegrown" was

However, signs of external influence are still sprinkled all over the major pillars of both HGERs. For instance, devaluation or exchange rate floating have been major elements of both rounds of HGER.

It is well known that the International Monetary Fund (IMF) used it as one of the conditions for granting assistance. There is nothing wrong with selectively accepting proposals from multilateral agencies, but labeling such policies "homegrown" was untenable.

My second concern was that both versions of the HGER have not been introduced through coherently prepared policy documents. The realistic nature of targets in any development plan is heavily dependent on the quality of the baseline economic statistics used in their formulation. Ethiopia's official economic statistics are progressively moving away from the reality on the ground.

For instance, in a PowerPoint slide I read on HGER 2.0, there is a claim that Ethiopia's agriculture has experienced steady upward growth during the last five years, starting from 3.5 percent in 2010 and reaching a whopping 6.1 percent in 2014 (both in Ethiopian calendar).

The 2014 growth rate provides the baseline for setting targets for the HGER 2.0 three-year plan. It seems the foundation is set to project steady upward growth in the agricultural sector.

However, I find it difficult to accept the fact that Ethiopia's agriculture has grown by that much during 2014. After all, the growth rate during 2010 was low for obvious reasons, instabilities, and popular uprisings! The situation was much worse during the subsequent years, with a shift from ad hoc protests at a few locations to widespread civil war covering many districts and regions of Ethiopia.

The third concern is related to the manner in which targets were described for HGER 2.0. Development plans are supposed to be devised in terms of "inputs" and "outputs." Target accomplishments are outputs, but there should be commitments in terms of setting input provision targets to enable businesses to perform better and progress toward anticipated targets. Policy documents related to both HGERs do not provide information on the relationship between supports (or inputs) and achievements (targets).

In these circumstances, distinguishing between normal baseline projections and policy-induced additional growth performance is impossible. For instance, referring back to the questionable 6.1 percent, the authorities were expected to provide evidence of support to farmers to claim the above-normal growth rate—that is, if we accept that the reported growth rate was real in the first place. Otherwise, the growth rate figure could be explained by exogenous factors, such as good rain.

What are your recommendations regarding taming inflation, external debt, fiscal deficits, and the forex shortage?

At first glance, these questions may sound disparate and unrelated, but they are interrelated in many ways. The art of economic policymaking is in identifying synergies, or policy instruments, that can address and tackle multiple economic challenges concurrently. For instance, at the most fundamental level, the economic problems listed in your question can be explained by supply-side constraints.

A huge chunk of Ethiopia's productive agricultural land is lying idle. Tens of millions of Ethiopia's labor force are unemployed or underemployed. These problems can be jointly solved by utilizing human and natural resources to produce goods and services. The rest is detail. I will dwell on ways to deal with inflation; policy synergy means solutions for the rest will immediately follow.

I often debate with my fellow economists about inflation, which many blame on money printing. I am not surprised that many fellow economists associate the money supply with inflation. After all, that is what we are taught at universities, and that is what we learn from economics textbooks, such as the so-called "quantity theory of money," in which the amount of money in circulation is directly related to the amount of goods and services produced and marketed.

However, there are two implicit assumptions behind that relationship. First, full employment of human and natural resources and/or full capacity utilization by existing businesses Second, the direction of causation is such that the quantity of goods and services in circulation can affect the quantity of money in circulation but not the other way around. But what if the first assumption does not apply?

For instance, resources are not fully employed in Ethiopia. There are millions of people in the labor force who are unemployed. A huge chunk of productive agricultural land is yet to be cultivated. A good proportion of Ethiopia's industries operate at less than full capacity. In that case, additional money supply is required to expand credit, finance investment projects, create jobs, utilize land, and ultimately produce goods and services.

This means the direction of causation is reversed, and the authorities can start by expanding the money supply to finance productive investment. Since the new money would ultimately be matched with new products and services on the market, there is no reason whatsoever why additional money would necessarily lead to inflation in the conditions of an economy with sizable idle resources.

But it is legitimate to raise a question: why has printing more money evidently been fueling inflation in Ethiopia in recent decades? The answer is simple: the authorities have not utilized the new money to finance productive investments. For instance, the Ethiopian government is the country's largest borrower from Ethiopia's banking system.

The Commercial Bank of Ethiopia (CBE) is by far the largest lender, and more than three-quarters of its loans go to the government. The funds borrowed by the government are either poured into megaprojects that have no or extremely poor linkages to the production of goods and services. Funds are also used to finance totally unproductive activities such as military expenditure or paying the salaries of the large army of civil servants, who do not directly contribute to the production of any tangible goods and services that would ultimately appear on supermarket shelves.

In summary, inflation can be tackled by producing more goods and services. In that process, inevitably more money will need to be printed; therefore, we need to refrain from the temptation to associate inflation with the money supply. A related issue is that government borrowing has effectively crowded out private sector borrowing. This needs to be stopped.

If the logic of tackling inflation is clear, then policy synergy means that the solution for inflation would ultimately contribute to each of the other problems. Enhancing productive capacity is a common denominator for the problems raised by many. We fight against inflation by increasing the production and supply of goods and services for the domestic market. Similarly, by enhancing production of exportable goods, export revenues will finance and reduce foreign debt. Investment and the formation of new businesses would result in an expansion of the tax base. Incidentally, currently, tax base expansion has been somewhat misconstrued; the authorities often interpret it as meaning squeezing existing businesses and collecting more taxes.

As far as the forex crisis is concerned, export promotion is the ultimate solution in the medium-to-long run. In the short run, however, the government should employ innovative policy interventions, such as applying dual exchange rates. In short, it means using two exchange rates at the same time. One comes into existence by accepting the existing black market rate for remittances, government intervention, and buying at the same rate as black marketeers.

Billions of dollars are sucked into the foreign bank accounts of individuals. Some proportion of that is used by private traders to import goods, taking into account private profits. The country would have additional billions of dollars desperately needed to finance imports according to national priorities, such as medicine, tractors, etc. The other black marketeers are corrupt politicians who may have large sums of birr on hand and are keen to pay any amount of birr per dollar so that they can siphon off the funds and deposit the dollars in foreign banks.

If the government bought hard currency at the same rate as on the black market, then dollars would be diverted to official channels and end up in Ethiopian banks.

The other component of the dual exchange rate would be the existing official exchange rate, which I propose to keep in place to finance any transaction other than remittance inflows. In any case, the dual exchange rate is a temporary solution that will need to be replaced by a flexible or floating exchange rate when the country's ability to make exportable goods grows.

What is your take on the opening up of the financial sector, devaluation, and gradual floatation?

Most countries in the world have opened their banking sectors to competition with foreign banks, and Ethiopia should not be an exception. However, entering any competition requires prior "training." No country sends its national football team to a match without the coach taking them through rigorous training sessions over a certain period.

Ethiopian banking is an infant industry in many ways. Besides, we cannot say there has been competition between existing banks, which have evolved through extreme imbalance. There is one giant, the CBE, in the middle, and numerous private banks dotted around. Government policy has a serious bias in favor of its own banks. There is no level playing field.

Private banks charge exorbitantly high interest rates on loans while paying as little as possible for deposits. They retain big margins, make colossal profits, and have continuously declared 30 to 40 percent dividends to their shareholders for three decades. They are partly affiliated with government officials who turn a blind eye to the abnormal banking practices, avoiding desperately needed regulation of the sector.

Ethiopian banks will need to learn competition by competing among themselves before they are exposed to competition with foreign banks. The government should reform the domestic banking sector and remove existing imbalances, particularly government giant banks, which should be broken into smaller banks that can compete with the rest of the banking sector, or private banks will need to be consolidated to relatively larger banks, each nearly comparable to the CBE.

The performance of the banking sector in any country depends largely on the structure of the sector. The government should undertake reforms that will improve the structure and then the performance of the sector. It is only after undertaking these pre-requisites that the government should contemplate inviting foreign banks to enter and compete with domestic banks.

The birr has been devalued umpteen times before, but the only thing Ethiopians got was chronic inflation. It is straightforward why devaluation will wash straight through and translate to inflation. Devaluation is essentially a mechanism that deliberately lowers the value of domestic currency in order to entice foreigners to buy exported goods and services at a lower price.

This works only if there is enough to export so that what is lost in *value* by reducing export prices will be more than compensated by large export *quantities*. Ethiopia has never been able to produce enough exports. Therefore, in these circumstances, devaluation means loss of export revenue, making an already bad situation worse.

On the other hand, devaluation means making imports expensive, with the idea of discouraging imports and saving foreign exchange. However, Ethiopia's imports are mostly necessities that cannot be avoided: medicine, fertilizer, raw materials for factories, etc. If importing these items is unavoidable, that is, if the imports cannot be discouraged, then what is the point of purposefully making items that must be purchased more expensive for oneself? In other words, for the same quantity of goods, import bills will become larger than before the devaluation.

It would amount to shooting oneself in the foot to go ahead with the devaluation of the birr in the immediate future. When the circumstances are right, it is inevitable that the Birr will gradually float.

The PM launched an anticorruption taskforce and is also undertaking major reshuffle. Is the government really cleaning house or preparing for grand corruption?

I recall Dergue's anti-corruption taskforce, called the Central Commission for Discipline Inspection (*Yequtitir Komite)*. The joke was that in a short while, members of that commission became among the most affluent folks in town! In Ethiopia, it is customary to form a committee to address any issue that arises. Establishing an anti-corruption taskforce amounts to beating around the bush.

A simple two-step procedure of scrutiny would suffice to know whether an official is corrupt or not. First, there are documents that confirm their monthly salary and related benefits. HR units in each department can provide the required information. Second, most officials do not even

make any attempt to hide th
Reporter
These two facts are more th
another institution that requires large sums of money to operate.

How long do you think it will take for Ethiopia to recover from the two-year war?

It will really depend on the authorities' ability to raise the necessary funds from domestic and international sources, on the one hand, and their commitment to use funds in the least expensive combination of activities, on the other. By the way, I wish HGER 2.0 was more focused and committed to the reconstruction of the war-torn economy.

Do you see real fiscal decentralization in Ethiopia's federal structure? Some argue that the government should resolve the conflict in Oromia peacefully, as it did in Tigray. Why do you think the international community is not vocal about the conflict in Oromia, unlike the Tigray war?

Fiscal decentralization goes hand-in-hand with decentralization of politics and governance. Ethiopia has experimented with federalism, but it is untenable to say that the country has so far transformed to a genuinely federalist style of governance. It is just a matter of time, though, and progress towards genuine federalism is inevitable. That is the only way to loosen the simmering tensions.

Resolving the war in Tigray alone would not make Ethiopia a peaceful country. For the country to progress toward peace and stability, guns should be silenced in all corners of Ethiopia. The call for peaceful resolution in Oromia is getting louder by the day. I hope and pray that peace talks to end the conflict in Oromia will take place soon.

There are two factors that explain why the international community has been vocal about the war in Tigray and less so about the conflict in Oromia. First, the war in Tigray was conventional and intensive, causing massive damage in a relatively short span of time and place. Similarly, the Tigray People's Liberation Front (TPLF) has built a solid diplomatic capital during its 30-year stay in power.

On the other hand, the conflict in Oromia is relatively less visible because it is extensive in its geographical scope; remember, Oromia is about seven times the size of Tigray. Importantly, the nature of the conflict in Oromia is more guerilla-type, and the damages are scattered in many zones and districts. Besides, the conflict in Oromia started long before Tigray, meaning that it slowly built up, as opposed to the sudden flare-up of the war in Tigray.

Finally, even after accounting for all these differences, the international community has a tendency to wait until devastations happen on a grand scale.

How do you see the role of the World Bank (WB), IMF, United Nations Development Program (UNDP), and western liberals in Ethiopia's policymaking?

Let me begin with the role of multilaterals in Ethiopia. First, many of the multi-lateral institutions were established to serve a specific purpose, particularly to protest the interests of advanced western nations. For instance, not many people recognize that the WB and the IMF are banks owned by a group of powerful countries and governed by boards created by the shareholders. Both act and behave pretty much like any other bank, except that they are given a façade as if they are institutions that were established to serve the interests of all countries to the same extent.

The fact is, developing countries are just clients or customers of those banks. The IMF is often labeled as an extension or subsidiary of the US Treasury.

The most important thing for Ethiopia's policymakers and the public is to get rid of the illusion that the multilateral institutions stand for the interests of all countries in the world. It follows that the Ethiopian authorities should bear this in mind and deal with the IMF or WB the same way they deal with any other government institution in the US or Europe. Diplomacy has a big place in this process.

It is counter-productive to complain about or curse the conditionalities imposed by the multilateral agencies. It is the job of Ethiopia's policymakers to articulate issues in the best interest of the country and seek assistance with a clear purpose. The multilateral institutions have a tendency to prescribe more or less similar policy recommendations to all countries.

For instance, in all forex crises, it is common for the IMF to recommend devaluation or a floating exchange rate. Countries that have competent policy practitioners can engage IMF staff and convince them of alternative policies. The Ethiopian authorities should be able to convince the IMF that several rounds of devaluation episodes have already crippled the Ethiopian economy, it is premature to float the birr as well, and we choose to pursue the dual exchange option to deal with the country's forex crisis. The IMF would listen and accept such options.

The trouble has been that the authorities have sat around a round table with the IMF without offering any well-thought-out alternatives. In that case, the IMF will get a chance to dictate the terms and the policy options. If that is the case, then it is not the IMF's fault but that of the Ethiopian authorities.

What are the underlying problems in Ethiopia?

Ethiopia has multiple chronic imbalances. In "*Putting a Spotlight on Ethiopia's Economic Idiosyncrasies,*" in my paper presented at Ethiopia 2050: Grand Challenges and Opportunities, I have outlined a series of peculiar features of economic imbalances in Ethiopia. By "Ethiopia's economic idiosyncrasies," I meant the type of economic imbalances that one can rarely find anywhere in the world or development challenges unique to Ethiopia.

Among some, one is Ethiopia's low wage curse. A fresh MSc graduate in Kenya starts with a salary level about five times that of an Addis Ababa University (AAU) professor with a PhD and 30 years of teaching and research experience. An elementary school teacher in Nairobi earns, on average, about seven times more than her counterpart in Addis Ababa. This would not have mattered if the cost of living in Ethiopia were lower than that in Kenya. Data related to cost of living indices for major cities in the world indicate that the cost of living in Addis Ababa is higher than that of Nairobi.