The role of micro and small enterprises in reducing unemployment and poverty in Ethiopia

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Key messages

- The micro and small enterprise (MSE) sector has the potential to support the Ethiopian economy in achieving its development goals.
- More support should be focused on female-oriented businesses as this is the most effective strategy for reducing poverty.
- Investments and interventions aimed at reducing unemployment should be focused on high value-added industries.

MSEs focus of economic reform in Ethiopia

Despite the country's success in economic growth and poverty reduction over the past decade, income inequality and unemployment remain formidable challenges in Ethiopia. According to the 2014 Central Statistics Authority report, average urban unemployment was as high as 16.5%. Furthermore, unemployment remains disproportionally higher for women and youth. At 23%, the female unemployment rate is more than double that of men.

Tackling issues of unemployment and poverty through the support and promotion of large-scale manufacturing industries has repeatedly failed to achieve the required results. Some argue that focusing on small businesses, which require relatively less financial and human capital and are able to absorb a significant portion of the labor force, will provide the solution.

In Ethiopia the micro and small enterprise (MSE). sector is under-developed. Furthermore, many MSEs are run by women. Recently, the Ethiopian government designed policies, as part of the first and second five-year Growth and Transformation Plans (GTP I: 2010-2015, GTP II: 2015-2020), to create employment opportunities for three million people through MSEs.

This focus on MSEs is expected to increase income and domestic saving, while reducing unemployment and poverty, particularly among women.

As such, a team of local PEP researchers set out to investigate the potential contributions of the MSE sector to the Ethiopian economy. The study looks particularly at the role of MSEs in reducing unemployment and poverty both generally and specifically among vulnerable groups, such as women. The researchers also consider alternative strategies that could be more effective than current policies as part of the country's plan to develop the MSE sector.

Data and methodology

The research team used a computable general equilibrium (CGE) model based on the 2009-2010 Ethiopian Social Accounting Matrix (SAM) to simulate three scenarios based on the current MSE development plan, but with different implementation strategies:

- o Simulation 1 recreates the government's current strategy, in which MSE development interventions are applied evenly to all MSE activities, to serve as a reference to compare alternative scenarios.
- o Simulation 2 focuses on interventions on a few high value-added manufacturing sector activities.
- o Simulation 3 concentrates interventions on female-oriented MSEs.

The types of intervention and overall budget are the same in the three scenarios but the target sectors differ to allow comparisons.

Key findings

In an effort to reduce unemployment and poverty, the Ethiopian government has prioritized developing the micro and small enterprises (MSE) sector. However, the contribution of MSEs to these objectives has not been hugely successful.

Comparing the results of the three simulation scenarios shows that **the government's current strategy is the most effective for expanding overall production**. In this scenario, real GDP increases by 0.9%, which is 0.2 percentage points more than the alternative strategies. However, total investment in the economy decreases and this strategy does not reduce poverty or unemployment. Female unemployment even increases by 4.1 percentage points under this strategy.

The team's findings indicate that **focusing on high value-added industries** (simulation 2) **is the most effective strategy** of the three **for reducing unemployment**. Average unemployment drops by 3.1 percentage points under this strategy. Furthermore, female unemployment drops by 4.6 percentage points, compared to simulation 1 (and is 3.3 percentage points lower than in simulation 3).

However**, the best strategy** of the three **for reducing poverty is to focus on female-oriented MSEs** (simulation 3). This strategy helps increase household income and reduce the poverty rate both in urban centers (by 0.4 percentage points) and nationally (by 0.1 percentage points). The poverty level in urban centers is reduced by 0.3 percentage points more than in either of the other scenarios.

Implications for policy

The results of this study indicate that the micro and small enterprise (MSE) sector has the potential to support the Ethiopian economy in achieving its development goals. However, the research team recommends some adjustments to the current strategy in order to better and more quickly achieve these targets.

The simulation results indicate that each of the scenarios presents advantages in addressing different concerns. **To reduce unemployment and poverty, the best results will be achieved by focusing efforts on high value-added industries and female-oriented MSEs, respectively**. As such, the government should channel most of the MSE development budget into activities such as wood and metal work, textiles, construction, trade and hotels.

Support for high value-added industries and female-oriented MSEs could be provided through **start-up and working capital, facilitating training opportunities for these key sectors, offering tax waivers and providing business premises.**

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