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Private Sector Development in Ethiopia

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PREPARED

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I. INTRODUCTION

Ethiopia is known for its longstanding freedom and civilization that go as back as over three thousand years. Unfortunately the country is now known as backward, least developed and one of the poorest of the poor. This historic plight has its own background and long process that this paper does not intend to get into. The major objective of this paper is to assess private sector that plays a paramount role in the Ethiopian economy.

The importance of private sector in an economy cannot be undermined. History of economic development clearly contends this fact. In the Ethiopian context, the demise of private sector development emanates from various root factors. Government policies, under development of infrastructures; social, political and economic instability and unequal share in the world market are some of the root causes.

The first part of this paper touches on the history of private sector ownership of property in Ethiopia. The contemporary situation of the private sector development is dealt with separately. In this exercise, privatization process of the publicly owned and controlled establishments and new private investments in relation with established policies and guidelines of the country are discussed. All primary information is obtained from direct sources such as Privatization Agency and Investment Authority of Ethiopia. The data, does not include, according to Proclamation Nos. 15/1992, and 37/1996, investments below 250,000 Birr for domestic investors, USD 500,000m, USD 300,000, and USD100,000 for wholly owned, jointly with domestic and investment in engineering/technical consultancy respectively in the case of foreign investors. Furthermore, investments on building development and investment on land transport are not included as investors do not need to get investment permit from the Ethiopian Investment Authority.

Since the subject "Private Sector Development" is wide and cannot be exhaustively discussed in this limited space, only salient and pertinent points are considered in this paper.

II. PRIVATE SECTOR, HISTORICAL BACKGROUND

We can safely say that private sector started in Ethiopia during Emperor Menelek II with acquisition of land. This era was characterized by scramble of principalities more or less waging unsettled war against each other for control of the area and also to defend Ethiopia from foreign aggression. In this process acquisition of private property in the form of land, began and was seen as sign of prestige. However, development of the land by the owners for economic purposes was unknown because of rudimentary market linkages.

Private sector started developing during Emperor Haile Sellassie's time. Even during this period much of the private sector clustered around land and related activities. Land owners developed commercial farms and as a forward linkage agro-processing small scale industries were established by private owners. The constitution clearly supported the right of individuals to possess and develop private property.

Land on which the livelihood of 90% of the Ethiopia populations is based, was privately owned and owners had confidence to develop it until confiscated by the Socialist Military Regime in 1974. In other sectors such as transport and services there were no big private investments. There were very few establishments that involved the private and public jointly owned companies.

Private sector development cannot be discussed much during the socialist military government. The policy was very clear and was to systematically hamper the private sector. Since the beginning of the region, the impact of the policy was total failure. The country experienced chronic food shortages. This resulted from confiscation of private property mainly land. Even after the collapse of the Regime, this situation continued at higher scale. The recent joint World Food Program (WFP) and Food and Agricultural Organization (FAO) report estimated that more than 40% of the agriculturally based population cannot feed itself. Structural food deficit, poor land management and other policy related problems exacerbated the indigent state of food production in the country.

Cognizant of the fact the importance of private sector, the Socialist Government introduced a new period in Ethiopian political and economic history on March 5, 1990 In this economic history the change introduced was far reaching. The proclamation recognized the role of private sector development and stated that private sector could compete with public sector in all the economic sectors. The policy, however, did not last long. Between March 1990 and May 1991 very little implementation of the policy was seen.

When Transitional Government took power, the economic policies were largely based on the preceding policy that focused on deregulation of banned territory and prices control. Privatization of public ownership was clearly pronounced. Sectoral policies were designed and proclamations were pumped and implementing line organizations such as Privatization Agency and Investment Authority were put in place to operate.

III. POLICY IMPLEMENTATION OF THE GOVERNENT

The government took numerous measures as part of the fulfillment of the IMF and World Bank prescriptions. In 1992 the government agreed with IMF, World Bank and other donors to adopt a structural adjustment program. In September 1992 a policy framework paper for 1992/93 - 1994/95 was prepared and agreed upon with the World Bank and the IMF. It is worth noting here that all reform measures taken mainly concerned the non-agricultural sector.

During the first years of the transaction period substantial liberalization of both factor and commodity occurred, price controls were eliminated for all goods except for petroleum and petroleum products, pharmaceuticals and sugar for household consumption. The road transport monopoly was eliminated and a new labor code was introduced.

Another set of changes that most people thought would have a positive impact on the functioning of the Ethiopian economy was the up-ward adjustment reform structure of private interest rates, and reformed income tax structure implying that the maximum marginal tax rate has been adjusted down ward.

Furthermore, public enterprises were categorized according to their future states of ownership. The public sector proclamation implied not only privatization of state-owned enterprises, but also reorientation of the organizations of the remaining state owned enterprises to make them more efficient and profitable. The nine state corporations that dominated the industry were dissolved to stimulate domestic and private investments. A new investment code was released and privatization agency was set up. The financial sector (banking and insurance business) was liberalized in order to stimulate investment in the private sector. Thus, we can conclude that the various liberalization measures meant positive changes along all economic system dimensions.

3.1. DEBATE ON PRIVATISATION

One of the most critical and difficult issues in the process of transforming socialist, centrally planned economy to a market economy with greater involvement of the private actors is that of privatization.

Half of all industrial establishments were State-owned. However, these establishments were quite large and employed over 90 per cent of all industrial employees. Thus, in Ethiopia privatization of industrial establishments is a reform that affects nearly everyone in the industrial and agricultural sectors. Employment effects of privatization and the consequences for industrial production should have been given due consideration by the government when deciding upon the strategy of privatization.

The fact that privatization, as a rule, is a complicated issue of reform and thus takes quite a time to implement is noted by Glebe (1993:19) who concludes, from empirical and theoretical evidence, that the process and ownership restructuring is likely to be relatively slow. One reason is that there is still much to be learnt from the experience of countries that have implemented ownership reforms even if it must be remembered that every country and sector has its own characteristics and problems in this respect also.

Stimulating and attracting new private domestic and foreign investments, for instance through the introduction of various market liberalization policies and strengthening of property rights can develop the private sector.

In the implementation of structural adjustment reforms and economic system reform programs the issue of denationalization or privatization is one of the most critical components and also one of the most difficult from the point of view of politics, economics and mal administration. As a rule, too much emphasis seems to be placed on the issue of denationalization in the early stages of reform. Even if, as in the case of Ethiopia, it has been declared clearly that the private sector should increase and come to dominate the economy, and even if a number of changes have been introduced in order to stimulate such a development, a frequent criticism has been that the process of transferring ownership to the private sector moves too slowly. However, even if one objective of privatization is to increase efficiency in production and to improve allocative efficiency, it is important to stress that denationalization or privatization per se does not necessarily lead to an achievement of these objectives. It is as important, to eliminate monopoly power and thus increase competition based on free entry and exit.

The first, and also the most important issue to deal with in the process of increasing the role of the private sector is to introduce changes in the economic system so that markets become competitive. The government of Ethiopia has introduced and begun to complement a number of deregulation proclamations. Thus, the first and perhaps most critical step towards a market economy and a more efficient allocation of resources has already been taken. There is, however, still need for changes in the commercial law to support the economic actors in the deregulated market.

Denationalization process of enterprises has been slower in Ethiopia. In February 1994 the government released the Ethiopian Privatization Agency Establishment Proclamation. The Ethiopian Privatization Agency is accountable to the Prime Minister's office. The objective of this Agency is to carry out the process of privatizing public enterprises in an orderly and efficient manner' (Negarit Gazeta no. 67, 17 February 1994, p.293). To achieve this objective the Agency has been given strong power and duties in addition to handling the privatization of enterprises per se. These are to:

- undertake detailed studies on the economic, technical, financial and price evaluation of public enterprises which the Government has decided to be privatized;

- create conditions which facilitate the successful completion of the privatization process;

- prepare detailed records of manpower, assets, financial and legal affairs of public enterprises that are going to be privatized. ***(Negarit Gazeta no. 67.17 February 1994, p. 293, article 5, points 1, 6, and)***

Privatization is defined by a dictionary of economics and business as sale of public corporations and assets to the private sector. The term denationalization synonymous when referring nationalized industries or corporations that are relating to the private sector, whereas the term "privatization" refers more broadly to a general trend in which the private sector takes over assets and functions from the public sector, thus reducing direct government control". This definition illuminates that transfer of public establishments from public ownership and control to another form of public ownership and control does not fulfill the conditions of denationalization or privatization.

In the Ethiopian context, 166 state-owned enterprises were ‘privatized’ from 1996 up to December 2000. Out of these enterprises, 130 were bought by private persons and businesses, and the remaining 36 enterprises were bought by government and parastatals. Out of the 130 enterprises sold to the private sector, 45 are sold to Addis Fana, trenched workers. This a commendable move on the part of the government because, the lives of many workers and their family members would have been at stake had the industries been sold to private investors.

Table 1: Privatized Enterprises (from 1996-2000) by sub-sectors

Economic sector	Number of Buyers			Selling Condition		Total Amount
	Private	Govt.	Parastatal	Full	Business	Birr
Hotels						
Ghion Hotels	4	-	4	4	4	12,143,280
Ras Hotels	1	-	1	1	1	8,929,993
Wabi Shebele Hotels	1	-	1	-	2	1,810,155
Ethiopia Hotels	3	-	2	1	4	3,169,181
Filwoha Administration	1	-	-	-	1	210,231
Total	**10**	**-**	**8**	**6**	**12**	**26,26262,840**
ETHOF	10	2	5	7	10	40,763,065
Super Markets						
Tana Super Market	1	-	-	1	-	68,010,020
Food Staff Super Market	8	-	9	6	11	12,442,054
Total	**9**	**-**	**9**	**7**	**11**	**80,462,074**
Leather & Shoes	3	3	10	4	12	5,237,655
Building Material	3	-	6	3	6	15,262,285
Central Food Processing	-	1	-	1	-	8,752,238
Stationary	6	-	6	6	6	20,775,363
Automotive shops	2	2	2	4	2	14,026,180
Kuraz Publishing	-	-	1	1	-	13,031,048
Beverage	3	-	-	3	-	186,007,978
Food Processing	9	-	1	9	1	74,902,980
Wood/Furniture	4	1	-	5	-	56,627,008
Meat Factory	6	-	-	6	-	18,659,536
State Farms	11	3	2	15	1	569,035,440
Leather Tannery	-	-	3	3	-	179,486,850
Metal	-	-	1	1	-	3,100,000
Textile	2	-	2	3	1	171,108,167
Building/Cement	2	-	-	2	-	21,728,705
Chemical	2	-	2	4	-	82,717,290
Agro-Industry	1	-	-	1	-	6,790,600
Tobacco	-	1	-	-	1	285,955,707
Printing	1	-	-	1	-	1,164,000
Mineral	1	-	-	-	1	1,290,796,624
Pharmacy	2	1	1	-	4	4,257,231
GRAND TOTAL	**87**	**14**	**59**	**92**	**68**	**3,232,773,209**

Source: Privatization Agency

Out of the total 166 government-controlled establishments, 16 are bought by foreign investors. There a big debate circulating between those who advocate that preferential margin should have been given to local investor and those who say that foreign investors should also be given equal opportunity. Both sides have their own justifications. Out of the 400 million USD total sales income 358 million USD (89.5%) comes from 16 enterprises sold to foreigners as sales revenue. The following table shows nationalities of the buyers.

Table 2: Number of enterprises sold to foreign investors

Nationality of Buyer	**Number of establishments**	**Amount in US$**	**Status of Amount**	
			Full	**Business/lease**
Saudi	9	293,528,000	8	1
Turkish	3	19,230,000	2	1
Chinese	2	NA	-	2
French	1	10,000,000	1	-
Yemeni	1	35,700,000	-	1
Total	16	358,458,000	11	5

Source: Privatization Agency

Distribution wise, most of the investment capitals were geared to non-productive sectors such as service sectors that do not attract or create much of backward and/or forward linkages in the economy. Most investors seem to seed their capitals for quick harvest of profit. One of the reasons could be loss of confidence in the general prevailing situations that greatly influence the future.

The Privatization Agency has recently announced that 189 enterprises are yet to be sold to the private sector. The agency has planned to put 46 enterprises for sale this fiscal year. The Agency's past experience indicates that the process of privatization was very slow and on average it sold 33 enterprises yearly over the last five years. Most of the important enterprises that had good demand have been already sold and the ones yet to be sold may not have market demand. The Agency's plan seems ambitious and remains to be seen in the near future.

3.2. Strengths and Constraints of Privatization

Privatization process is quite intricate. It was a new idea to the Government and was not simple to get acquainted themselves with the process. First and for most market economy was a complete turn around from state controlled economic system. The market and book values of the enterprises were not known. Implications of privatization on workers that would follow from selling the enterprises were also unknown. International multilateral and bilateral institutions were pressing on the Government to liberalize the economy with out proper detailed study before acting. The Government was unable to buy time to take breath and think because the treasury was empty and needed donation and loan to fill it.

Privatization in Ethiopia has gained both opponents and proponents. Proponents go to the extent of saying that state owned enterprises should be privatized at any cost. This comes from the hatred they developed for the preceding system. On the other hand, opponents express their views that errors do not correct errors. Privatization for the sake of privatizing does not help unless it brings socio economic change in the society. At the same time they admit that privatization cannot be carried out flawlessly. However, its contribution to development could have been maximized if genuinely done. Major points of departure are the following:-

3.2.1. Most of the action plans and guidelines of privatization were not discussed by the public at large. They were designed and implemented behind closed doors. In this exercise, many express their fears that interests of certain individuals might have been served rather than the benefit of the stake holders in general.

3.2.2. Detailed study and broad participation should have been conducted to determine the exact mode of selling publicly owned enterprises. Most of the enterprises were old and above all, they were operating in distorted market environment. On top of this essential information was not disseminated to the public on time.

3.2.3. Many employees were made jobless by the investors due to the fact that they did not want to employ the services of 'inefficient workers'. Furthermore, the new owners wanted to restructure the enterprises they purchased. Profit being their motive, the social aspect of the workers was neglected. In fact some of the enterprises are temporarily closed down for innovation purposes. Development efforts in a given economy aim at achieving two major economic objectives: employment creation and income generation.

Privatization efforts in Ethiopia, many people contend, did not achieve much on these lines.

3.2.4. Privatization failed to take into consideration tough competition between domestic production and imports of consumable goods such as leather, textile, food, beverages, tobacco, steel, chemicals, furniture, stationeries etc. On the other hand smuggling of consumable goods and services seem to be taking tall from time to time. There is a high resentment by most investors on privatized enterprises for what they say that there is no equal plying field for both domestic and imported goods to compete in the domestic market.

IV. NEW PRIVATE INVESTMENT

While discussing private sector development the correlation between saving and investment as well as the capacity of the people to save must be looked into. Low saving tends to result in low accumulation of capital and adequate capital formation making the rate of investment very low. Domestic out put can be enhanced through investment and to be able to invest more, requires a sacrifice of current consumption so that increase in saving rate could come forth. However, this situation was not in place in Ethiopia. As a result, dependence on foreign resources becomes eminent. Major determinant factors affecting saving and investment are:

1. Low disposable income

2. Absence of conducive environment
3. Low level of out put
4. Unequal levels of market competition
5. Shortage and high cost of foreign exchange
6. Unclear land policies
7. Mal implementation of policies accompanied by fear of political instability

Too much dependence largely on foreign capital in flow leads itself to unhealthy long run effects due to the following major reasons:

1. Sources are out of control (exogenous of the government). Any disturbances can jeopardize the flow.
2. It is sensitive to international economic and political conditions and cannot be considered as a stable economic variable.
3. Large foreign financing is often associated with foreign debt services ration and puts heavy pressure on the balance of payment.

Even though foreign capital sources play a vital role in the investment sector, it should be noted here that from the point view of the national interest, they are required to augment domestic savings and not to replace them.

While domestic investment, on the one hand, is hampered by scarcity of both domestic capital and foreign exchange as well as upward price fluctuation of capital goods in world capital market, investment on the other hand is limited by the investors who wish to get maximum guarantee for their capital and property. Under such circumstances satisfying these two opposite scenarios often become practically impossible.

In Ethiopia, private sector investment after the economic liberalization can be seen as major indicator of investment response to policies and other conditions in the economy. In general, the response of private investment to policies of the government seems to demonstrate positive sign.

During the period from July 1992 to July 2000, 5,411 domestic private investment projects, 120 foreign private investment projects and 110 private domestic and foreign joint venture investment projects were approved by the Investment Authority with planned investment capital of 38,629.85, 5'425.18 and 5'547.70 million Birr respectively. As per the plan indicated in the approved projects, it was envisaged that these projects would create a total permanent job opportunities of 289,495 and temporary jobs of 501,888.

However, the data from the Authority indicates that out of the total 5,641 domestic and foreign private investment projects approved only 1,800 or 31.77 percent have been operational in eight years. The rest 68.23 percent have been either terminated or lagging behind their schedule of implementation time due to many reasons that have to be further studied. The gap between approved and implemented projects is a vantage point clearly illuminating the fact that implementation aspect of the private investment is difficult in

Ethiopia when it comes to practice. These difficulties are more so to domestic investors. Out of the total 5,411 domestic private projects approved only 1,742 (32 percent) were completed with investment capital of 9'004.78 million Birr out of the planned 38,629.85 million investment capital. Only 67,001 or 28 percent jobs were achieved out of the 238,390 planned. In totality, the acceleration effects of both intended investment capitals and job creation opportunities were far from achieving any objectives.

Foreign investors also seem to either encounter a lot of difficulties even though they are at a better advantage in manipulating things than the domestic investors to implement projects at any cost as scarcity of resources may not be likely as much as it is with domestic investors. Out of the total 230 approved foreign projects only 50, or 22 % were completed and made operational. Out of the total Birr 10972.68 million planned foreign investment, only Birr 4340.65 million was invested. The country has forgone Birr 6632.03 (60.4) of the total planned investment due to many reasons. Furthermore, out of 108421 both permanent and temporary job opportunities planned in the approved foreign projects, 18042 (16.6 percent) were realized while 83.4 percent is again forgone by the country where unemployment problem is very high.

Out of the total 5,411 approved domestic investment projects 1,740 (32.2 percent) were undertaken in Addis Ababa. Oromia Region stands second with 1,168, or 21.6 percent SNNP, Amhara and Tigrai stand third, forth and fifth with respective 649, 408 and 391 projects. Other regions receive very much insignificant projects. This tends to clearly show that apart from economic factors, projects are undertaken through other irrational investment choices of both government and, to some extent, investors themselves.

SNNP, Amhara, Gambella, and Afar regions have enough potential of raw materials that could attract investments. However, their share of the approved project are very low. It becomes unrealistic to say that equitable private sector development have been undertaken in all the regions that takes into account population magnitude. Amhara Region with almost one third of the 62.8 million total population of the country and having enormous raw materials and skilled man power potentials got 7.5 percent of the approved projects. At the opposite end, we find Tigrai Region with about 3.3 million population receiving share of 7.2 percent projects and yet has no much raw materials potentials. This is an eyebrows raising issue that invites further academic study.

In view of the two most important economic planning objectives mentioned above, i.e. achieving employment and generating incomes, while in Amhara Region only 49,732 permanent and temporary jobs were planned to be created, employment opportunities for 242,499 permanent and temporary employees were planned for Tigrai Region in the approved projects.

Eight years have now gone by since these private investment projects were approved. Most of these projects are in Addis Ababa and surrounding areas where infrastructures are relatively better. Furthermore, 1'820 projects were in tertiary sector such as real estate, coffee cleaning, hotels and tourism, health services etc. and 529 projects were expansion of existed establishments. These projects do not require more than 2 years on average to be operational.

V. CONCLUSIONS

Projects are planned and implemented to achieve given economic objectives and goals. During the past eight years investment projects were planned, approved and executed by the private sector in Ethiopia. Like in any developing countries, two major development objectives in economic planning are considered as important indicators in this paper for discussing the private sector development issues in Ethiopia. These are: creation of job opportunities and increase of incomes. Along with this, private sector investment on new projects and privatization of publicly owned and controlled enterprises in view of the benefits obtained in terms of up ward increase in incomes and job creation is critically assessed.

Both empirical data obtained from Investment Authority and Privatization Agency and short interviews conducted with sample investors suggest that the process of investment starting from preparation up to implementation of projects passes through a long and cumbersome bureaucratic hassle. This is well manifested by the big gap between approved and operational projects. Policies that directly or indirectly influence private sector development are far from being transparent and are not disseminated to the public for participation. This opens loopholes for under carpet operation.

Response of private sector investment to government policies has been positive. However, unclear land policy compounded by fear of political instability on the part of investors has impeded private sector development.

ANNEX