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Macroeconomic Development and Private Sector Performance in Ethiopia: The 1990's Experience

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1. Introduction

After the downfall of the military government in 1991, the transitional government of Ethiopia committed itself to implement the stabilization and structural adjustment program with the help of the IMF and the World Bank. The objective of the program was to remove cost-price distortions, improve market related incentives, promote private enterprises and exports, and liberalize the economy and to reduce the role of the public sector in the economy. The a private led competitive economy operating under a free market and prudent fiscal and monetary policy environments was optimistically expected to emerge from this.

The practical experience of the last decade of the adjustment program, however, revealed that the expected results could not be obtained. This study tries to explain such failure from theoretical point of view and the practical experience of East Asian countries. To this end the paper is structured as follows: following this introduction is the macroeconomic policies and programs undertaken during 1992/93-2000/01 to encourage the private sector in particular and business activities at large. The third part reviews the performances and problems of the private sector during the same period in the country. Part four is devoted to review the practical experience of successful East Asian countries and the fifth part tries to highlight donor agencies' Private Sector Development (PSD) agenda and the link to poverty reduction. The final part concludes the study and draws a lesson for Ethiopia.

2. Macroeconomic Policies and Programs for Private Sector Development [1992/93-2000/01]

i. Fiscal Policy

With in a disciplined macroeconomic framework, fiscal policy was focused on the provision of basic services and infrastructure while at the same time reducing the overall fiscal deficit. The key objective of the fiscal policy was to strengthen public sector savings, with the twin aim of making available additional domestic and foreign reserves to develop the private sector and of supporting productive public investment (particularly in infrastructure and human capital) to benefit the private sector.

The focus on reducing fiscal deficit for private sector development is for the mere reason that the private sector considers the sustainability of the fiscal adjustment when making investment decisions. If deficits are perceived to be unsustainable, then the private sector will expect future tax increase or money creation (inflation tax), which in turn affects its investment decision.

Therefore, several measures including rationalizing public expenditure, limiting the number of zero-tariff related items and import exemptions, broadening the tax base, introducing rental income tax, reforming interest income and capital gain taxes, reducing the maximum custom tariff rate, and etc have been taken. These measures are believed to improve revenue performances while at the same time raising expenditures only moderately and thus allowing for a reduction in the consolidated overall deficit.

ii. Monetary and Financial Policies

The monetary policy in the period under consideration had been formulated in such away as to ensure the money supply grows at a rate consistent with targets for inflation, economic growth, and the BOP, while allowing reasonable credit growth to meet the needs of the productive sectors, particularly the private sector. To improve the mobilization and allocation of financial resources, monetary policy had also been targeted at ensuring a positive real interest rate for both depositors and lenders. Moreover, to improve the efficiency and soundness of the financial system in creating a conducive environment for private sector development, the policy included institutional and regulatory reforms.

In these lines, several measures had been taken. These include liberalizing the interest rate and allowing them to be market determined, allowing for the establishment of private commercial banks and insurance companies, replacing direct monetary policies with indirect ones and establishing a modern legal and institutional framework for the National Bank of Ethiopia (NBE). In trying to liberalize the interest rate, currently only the minimum deposit rate is set by the NBE. And with regard to the indirect monetary policy instruments, Treasury bill auctions were introduced in January 1995.

iii. External Sector Policies

The external sector policies had been targeted at achieving a viable balance of payments position over the medium term, promoting exports, removing cost-price distortions and integrating the country in to global markets for goods and services. In pursuit of these objectives, import tariffs had been progressively reduced, and the payment and exchange regulations for foreign trade in goods and services have been increasingly liberalized.

With regard to the exchange rate, the Birr value was made to devalue by 58.6 percent in USD terms to Birr 5.0 per USD in 1992. Then after the fortnight foreign exchange retail auction was introduced in 1993. This was again replaced by a weekly retail auction in 1995 and a weekly wholesale auction in 1998, respectively.

To further promote and diversify exports, a number of measures including the import duty drawback system, establishment of foreign exchange bureaus, etc were also taken.

iv. Other Policies

In addition to the reforms discussed above, the government envisaged several other measures to promote private sector development. These include, inaction of investment and labor codes, eliminating restrictions on renting land, and other measures that tries to simplify the licensing and regulatory frameworks applicable to business and limiting bureaucratic discretions. Moreover, almost all sectors with the exception of military and telecommunication are opened for the private sector to invest.

The government also accelerated the pace of liberalization in domestic markets and replaced administratively fixed price systems with a competitive market based system. It also seeks to develop a flexible-transparent and efficient labor market. Public enterprise reform and privatization were also taken. Up to 1998, about 175 enterprises were privatized.

3. Performances and Problems of the Private Sector in Ethiopia [1992/93-2000/01]

i. Performances

Even though there is no comprehensive information on the participation of the private sector in the country, a glance review based on the information obtained from the Ethiopian Investment Authority, Central Statistical Authority and some other studies is presented below to shed light on the performance of the sector.

Agriculture is remained to be the mainstay of the Ethiopian economy. It covers about 45% of GDP and over 90% of the total export and it provides employment for more than 85% of the total population of the country. Private farm holders are believed to produce more than 95% of the agricultural output and cultivate more than 95% of the agricultural land of the country (Getachew, 2000).

Moreover, about 1,396 agricultural projects, which worth 4,571.8 million Birr domestic private investment capital were approved during 1992/93 - 2000/01. Of these, about 636 projects, which worth 1,704.5 millions of Birr commenced operation during the period [Tables 2 and 3].

As discussed in Getachew (2000), trade mainly domestic, is the second largest economic activity for the private sector in the country. According to the information obtained from the Ministry of Trade and Industry, there were about 4,607 active traders and 3,862 traders, which obtained license, in foreign trade in the year 1998/99. The share of the private sector in the country's export trade, which was 16% of the total export in 1990/91, stood at 74% in the year 1997/98.

The Central Statistical Authority manufacturing survey, 1996 and 1999 revealed that the share of gross value of production of the private manufacturing to total gross value of production of manufacturing increased from 9.5% in 1993/94 to 25.8% in 1997/98. Similarly the share of private sector manufacturing value added at market price increased from 6.1% in 1993/94 to 18.6% in 1997/98 [Table 1].

Table 1: No of establishment, gross value of production and value added at market price of the manufacturing sector.

Period	No. of Establishments			Gross value of production			Value added at market price		
	Private	Total	% Share of Private	Private	Total	% Share of Private	Private	Total	% Share of Private

1993/94	330	499	66	379,091	4,010,703	9.5	126,841	2,070,152	6.1
1997/98	607	762	79.7	1,650,353	6,393,206	25.8	511,119	2,741,798	18.6

Source: Central Statistical Authority

As can be seen in Tables 2&3, industry is the largest sector that the private sector have got investment approval and commenced operation during the period 1992/93 - 2000/01.

Table 2: No and investment capital of domestic private investment projects approved (new and expansion) by sector, 1992/93 - 2000/01.

Sector	**Investment (1992/93-2000/01)**	
	No. of Projects	**Investment Capital In mn. of Birr**
Industry	2,630	16,571.13
Agriculture	1,396	4,571.80
Real Estate Development	448	7,444.19
Hotel and Tourism	374	1,804.57
Education Service	202	1,678.19
Health Service	176	1,381.66
Construction	262	5,660.46
Trade	224	1,127.40
Transport and Storage Services	67	1,339.86
Mining and Quarrying	46	467.94
Electricity Generation	6	113.09
Other Businesses	251	1,806.66
Grand Total	**6,082**	**43,966.95**

Source: Computed from Ethiopian Investment Authority Data

Table 3: No. and investment capital of domestic private investment projects (new and expansion) which have commenced operation by sector, 1992/93 - 2000/01.

Sector	**Investment (1992/93-2000/01)**	
	No. of Projects	**Investment Capital in mn. of Birr**
Industry	902	4,250.60
Agriculture	636	1,704.50
Real Estate Development	20	54.70
Hotel and Tourism	96	251.10
Education Service	22	297.70
Health Service	21	90.90
Construction	37	1,452.90
Trade	36	151.80
Transport and Storage Services	14	955.50

Mining and Quaring	9	167.90
Electricity Generation	0	0.00
Other Businesses	10	89.90
Grand Total	**1,803**	**9,467.50**

Source: Computed from Ethiopian Investment Authority Data

The private sector is also involved in financial institutions like banking, insurance and micro-finances. The information obtained from the National Bank of Ethiopia (as of January, 2003) showed that 6 private commercial banks, 8 insurances and about 21 formal micro-financing institutions have been operating in the country.

ii. Problems

As we have seen in the above section the private sector has shown interest to participate in almost all opened sectors following policy changes. However, despite a bulk of macroeconomic adjustments taken under the umbrella of SAP, the performance of the sector is remained to be poor. As we can see in Table 4 below, only 22% of the approved capital or 1,803 projects out of 6,082 approved projects have been commenced operation in the year 1992/93 - 2000/01. Two reasons can be can be given for this. First, the policies envisaged under stabilization and SAP have mixed impacts on PSD. In other words, some of their policies are pro-private sector development while others tend to discourage it. For instance, deregulation of the domestic market and good macroeconomic policy management would encourage the private sector development through creating competition among firms and business confidence to investors on the macro-economic stance of the country in question. However, the other policies like opening up of doors for imports and banishment of the state from the productive sector of the economy may discourage and curtail private sector involvement.

Secondly, private sector development constraints are more severe at the meso and micro-levels than at macro-level and hence emphasizing at macro level would not be effective without addressing issues at the meso and micro levels. Several studies on problems of private sector in Ethiopia (Dejene and Ibrahim,1998; Addis Ababa Chamber of

Commerce, 1998 and Ethiopia and Addis Ababa Chamber of Commerce, 2002) for instance, revealed that access to land and credit, lack of entrepreneurship skill and infrastructure, market difficulties, tax related problems, etc are the major constraints.

Table 4: Domestic Private Investment Projects, which have commenced operation as percentage of approved projects in the period 1992/93- 2000/01

Sector	**No. of Projects**			**Investment Capital in mn. Birr**		
	Approved	**operation**	**percentage**	**approved**	**operation**	**percentage**
Industry	2,630	902	34	16,571.13	4,250.60	26
Agriculture	1,396	636	46	4,571.80	1,704.50	37
Real Estate Development	448	20	4	7,444.19	54.70	1
Hotel and Tourism	374	96	26	1,804.57	251.10	14
Education Service	202	22	11	1,678.19	297.70	18
Health Service	176	21	12	1,381.66	90.90	7
Construction	262	37	14	5,660.46	1,452.90	26
Trade	224	36	16	1,127.40	151.80	13
Transport and Storage Services	67	14	21	1,339.86	955.50	71
Mining and Quarrying	46	9	20	467.94	167.90	36
Electricity Generation	6	0	0	113.09	0.00	0
Other Businesses	251	10	4	1,806.66	89.90	5
Grand Total	**6,082**	**1,803**	**30**	**43,966.95**	**9,467.50**	**22**

Source: Computed from Ethiopian Investment Authority Data

a) Land Related Problems

The Urban Land Lease Holding Proclamation No.80/1993 confirms that land in the country is owned by the government and it ensures that the government shall provide the right to the private sector to use land on a long-term lease basis, ranging from 50 to 99 years. Different studies like, Dejene and Ibrahim (1998), Addis Ababa Chamber of Commerce (1998) and Ethiopia and Addis Ababa Chamber of Commerce (2002) found out that acquiring land is the prime treat to private investment in the country.

Problems related to land include, high cost of land, very short payment period, interest that should be paid in the payment period, lengthy procedure to acquire land, and etc. According to the result of an unofficial study, the cost of land as percentage of investment capital on average is 25 for industry, 29 for business and 2 for health and education. This, however, excludes different administrative cost in the process of acquiring land and the interest payment. So, if such costs were added, the percentages would have been larger than the reported ones. The price of land in Addis Ababa during 1995/96 – 1998/99 varied from Birr 205 to Birr 4,300 or on average Birr 1,521.35 per Meter Square (Ethiopian Investment Authority, 1999).

Although the new investment code confirms that an approved investment shall get land with in 60 days of the application period, one unofficial survey based study showed that acquiring land is very lengthy, taking on average, 36 months for industry, 24 months for business and 10 months for social sectors. The existence of a chain of organizations and committees to be visited, the requirement of large number of redundant and unrelated documents, lack of transparent procedure, absence of centralized land administration, limited capacity of the responsible organizations and lack of coordination and information flow among the concerned bodies are the major ones, which consume this lengthy time.

b) Finance

Finance is the core element of any investment project. Most investors relay on bank finance for their investment projects. Access to bank finance is not, however, easy for Ethiopian investors. One of the major problems associated with finance is limited and huge collateral requirement. Currently, the only acceptable (by banks) collateral properties are buildings under urban municipalities and vehicles registered by the Road Transport Authority of Ethiopia. So, any investor who wants to get bank loan should own such properties. This problem is more severe for those who would like to invest in the agriculture sector as their buildings or any fixed assets in their farm area are not acceptable. Moreover, it discourages small-scale enterprises, which is again the nature of most private sector enterprises in the country.

The collateral requirement is also very large ranging from 125% to 400% and there is problem of under valuation of collaterals by banks (Ethiopia and Addis Ababa Chamber of Commerce, 2002). Moreover, there is problem of pledging leased land as collateral in spite of the Urban Land Lease Holding Proclamation No.80/1993, which states "... any person who acquires the right to hold urban land on lease may transfer or pledge such right or contribute in the form of a share to the extent of the rent paid".

The findings of the various regional and sectoral consultative forums on private sector development (Ethiopia and Addis Ababa Chamber of Commerce, 2002) and other studies show that the process of getting bank loan is very long and bureaucratic. Thus, the time that takes to get land and bank loans would increase the costs of investment projects considerably.

There is also a problem of extending medium to long-term loans; banks are very reluctant to extend loans for long and medium term development activities and they tend to exclude small borrowers and concentrate on their wealthy clients that are creditworthy (Dejene and Ibrahim, 1998).

c) Infrastructure

Supply of efficient infrastructure facilities such as electricity, telephone, water and road play important role for private sector development. However, those institutions, which are concerned with the provision of physical infrastructure in the country, have weak capacity. On top of that there is no coordination between these institutions and the institutions that are concerned with the provision of land. As a result land allocators provide land irrespective of the presence or absence of infrastructure in the area. This poses several problems on the private sector development. In addition, the costs of telecommunication and electricity are very high and discourage the private sector performance.

Absence of export processing and industrial zones, quality control and marketing and distribution are also the major obstacles to the performance of the private sector.

d) Tax Related Problems

Although the government had taken a remarkable reform on taxes, problems still arise on tax and tax related issues. These include, inefficient tax administration system especially random imposition of taxes in some areas, corruption, with holding taxes very high for most business activities, unpredictability of tax regulations, high rates of capital gain taxes, difficulty in getting duty draw backs and higher taxes on imported inputs (Ethiopia and Addis Ababa Chamber of Commerce, 2002). The business community also complains that most of the tax related incentives by the government are not applicable or bureaucratic if applicable. The higher tax rate (45%) on house rent income and the absence of tax holidays discourages investors from involving in real estate development.

e) Market Difficulties

Market difficulties are the other obstacles that threaten the private sector development in Ethiopia. Externally, dumping or subsidized cheap imports from Asian countries resulted in cease of most business activities in the country. Domestically, the private sector is said to face unfair competition from party affiliated companies, which are believed to be favored by government, at least by government officials. Of course the government repeatedly denounces this pledge. But these party owned companies are challenging the private sector in almost every sector; trade, construction, transport, publishing, advertising, agriculture input supply and manufacturing. It is clear that, even though the government may not favor them directly, senior government officials and politicians being decision makers and board members of these companies by itself erodes the private sector business confidence. And at the same time service-giving institutions may not treat equally the private sector request and the request of these officials.

Other problems related to market include, rampant contraband activities, poor market information, etc.

f) Absence of Clear Industrial Policy

From a historical perspective of the contemporary world, it is axiomatic that economic development is invariably directly proportional to industrialization. In this high-tech, information and industrialization era, it is the industrial products, which are more profitable and gain more private sector interest. The private sector, to participate, however, needs government leadership and assistance and clear policy that is targeted to develop the sector. In Ethiopia, there is lack of distinctive policy that formulates a strategy for the development of the country's manufacturing industry and hence incentive schemes and priorities that should be given to the sector. This discourages private sector participation in the sector in particular and in the economy at large.

The other problems include lack of information and advisory services, lack of entrepreneurship development programs and absence of public-private partnership.

4. East Asian Experience

A lesson from successful East Asian countries tells us that governments were not only political leaders but also economic and entrepreneurial leaders. Given the low capacity and diminutive nature of their private sector at the early stage of their development, the governments decided to play a leading role in the economic transformation (Kim, 1995; Sakong, 1980 and 1[up] info). The leadership was in such a way that the state guided the business towards the nation's goal of economic development through directing resources and providing the economic conditions in which business could flourish. In short, it is said that the government was considered to be a guide and the private sector as a producer (1[up] info).

This leadership role of the governments led to the emergence and survival of private conglomerates, for instance Chaebol in Korea and Ziabatsu in Japan, which contributed a lot to their fastest economic growth and which still dominated the world market.
Government activities to this end included; participating directly in business activities, designing and implementing favourable and sound industrial and trade policies, planning a chain of selected strategic sectors and allocating resources and designing incentives for them, assisting the private sector in technological and entrepreneurial developments and preparing forums in which the private sector discussed with the government.

Since the private sectors at the early stage of their development were considered to be less experienced and capital-poor that lacked the wherewithal to develop several critical industries, governments established and owned business enterprises (Kim, 1995; 1[up] info; Shim,…). Their enterprises were critical for private sector development through providing forward and backward linkages, introducing new and expensive technological ventures and teaching by doing.

East Asian governments' effort in structurally transforming their economies from backward and subsistence agriculture based to modern industrialization helped their private businesses to strengthen. Because it is evident that the private sector is willing to participate and stay in profitable activities where there is a growing demand for the products both in the international and domestic markets. The World Bank and IMF, however, recommend African countries to specialize in primary agricultural and raw material sectors, as these sectors are the comparative advantage of those nations. Where as the future of exporting these agricultural and raw material products is becoming gloomy as their world demand and prices are persistently declining. In this regard Stein (1999, ----) noted the following:

"Advances in biotechnology and material sciences are leading to synthetic for primary products such as Vanilla and Sugar. Products such as cocoa and palm oil are also being challenged by western firms as they undertake genetic research to develop outright synthetic substitutes or alternative methods of production. On the demand side, the usage of resources like copper is being replaced by optical fibers or microwaves putting downward pressure on prices".

So, what the government of Ethiopian has to learn from this is that creating and generating new capacities, norms, incentives and regulations for industrialization so as to attract private capital and build a private-led competitive economy. The pursuit of industrialization through agriculture policies only cannot structurally transform the economy as the expected saving and foreign exchange earning from agriculture is being difficult to be obtained where the futurity of these products is unpromising. Moreover, industry cannot spontaneously evolve from agriculture without well-designed industrial policy.

Trade policy in East Asia at the early stage of their development was focused on shifting from a strategy of import substitution towards export- oriented policy. This does not, however, mean that they discarded import substitution activities. Indeed, the latter went along with the export-led strategy (Lim, 1995; Kim, 1995; and Brautigam, 1995). It is written in 1[up] info as "The government [Korean] combined a policy of import substitution with the export-led approach". While liberalizing essential imports such as raw materials, energy, capital and intermediate goods, the policies of these countries remained to be highly restrictive on agricultural and manufactured products, which were considered import-substitutable and/or consumer goods (Kim, 1995; Alam, 1989; Okita, 1980). The more rapid export growth in these economies was made possible through protection of domestic industries until they become matured and different incentive structures creating a strong bias towards exports. Such activities would help the private sector to become strong and competitive and further attracts new entrants.

In Ethiopia, however, the existing diminutive and infant enterprises are exposed to external predators under the umbrella of SAP's free trade policy. This resulted in the stagnation of private sector business activities. For instance, in the year 2001 more than 20 shoe factories in Ethiopia were reported to be closed and most others reduced their capacity and labor force due to the cheap Chinese shoes, which crossed the free border of the country.

The main feature of planning in East Asia was to target few sectors of the economy in successive plans that were expected to perform well in international markets and granting special incentives to those who enter the international market (kim, 1995; Okita, 1980; Brautigam, 1995). Saburo Okita, who was involved in the process of Japan’s post-war reconstruction as a planner and as an economist, has put Japan's industrial policy as follows:

> *"The policy was, carefully select industries, prevent ruinous competition at the infancy stage, nurse them up to a competitive stature, and then expose them to outside competition. ... Here western nations frowned up our methods, but we felt it was the right policy for the late-comer to pursue" (Okita, 1980: 96-97).*

The policies of other countries such as Korea, Taiwan and Malaysia more or less resemble that of Japan (Kim, 1995; Brautigam, 1995 and Edwards, 1995).

Mechanisms used by the governments to encourage private sector evolvement in the selected industries included trade protection, tax incentives, subsidies, labor market adjustments, and other industry specific assistances (1[up] info). For instance, as indicated in the planning documents of Korea during the 1970s, the primary goal of planning for industrial priorities was seen as providing incentives to the private sector at a level compatible with resource needs and availabilities. Japanese and Taiwan governments also provided different incentives for their private sectors (Nafziger, 1995, Brautigam, 1995). In Japan, the government imported spindle spinning machines, 1878-79, to sell on lenient credit terms to private enterprises in the textile industry, Japan's leading export sector at the time (Nafziger, 1995:63).

In general, resources were directed to the targeted areas by government institutions that were deliberately built for this purpose. Specialized banks that provide short and long-term credit to the private firms, for example, were deliberately established. Furthermore, the establishment of free trade zones and simplification of customs procedures made East Asian exporters to conduct business smoothly (Korean Ministry of Cultures and Information, 1982: Brautigam, 1995).

The roles of the states in entrepreneurial and technological developments were also impressing. Supports were made through education, research and development, importing technologies for the private sector on credit basis and so on (Jones and Sakong, 1980; Natziger, 1995 and Shim,…). The private sector, on the other hand, gives high value to entrepreneurial skill development. Profits were made to reinvest and/or saving as the governments provides incentives (profit tax exemption) for such activities. Empirical studies on entrepreneurship in Africa indicate, however, that African businessmen, unlike those in East Asia, rarely save their profit to reinvest. They rather tend to value highly consumption and real estate expenditure. Further more, they lack experience in managing and coordinating a production process with specialized work tasks and machinery (Nafziger, 1995:64).

Finally, an essential component of East Asian private sector development was the public-private partnership forums. Deliberate councils were established to organize forums for exchange of ideas between the two.

In Japan, the government and the private sector have engaged in policy dialogue through two types of councils: functional or thematic councils and industrial councils. These councils provide a forum for government officials and representatives from the business labor consumer, and academic communities as well as the press, to discuss policy and marketing issues (African Development Bank,1997: 97).

In Korea and Singapore also, governments and the private sector relations have been close and cooperative. The most important channels of communication in Korea, for instance, are through monthly export-promotion meetings of economic ministers and top business leaders (African Development Bank, 1997:97).

Most importantly, the views and comments of the private sector about markets, policies and plans are considered critical components of policies. The governments usually invite the business community and professional associations to submit their views on policy documents and plans before going in to implementation stages (African Development Bank, 1997 and Kim, 1995).

In general, East Asian economic take-off in the 1960s and 1970s was undertaken under the government interventions and their leading roles. Such intervention is not, however, to be taken as indicative of either blindness or anti-private sector business bias. Interventions were structured so as to promote private sector development, in supportive of entrepreneurial endeavor and with a bias towards expansion of projects (Jones and Sakong, 1980).

5. Donor Agencies, Poverty Reduction and the PSD Agenda

The failure of most of the 1960s and 1970s state-led development and import substitution policies resulted in shift of developmental thinking of multilateral donor agencies, the World Bank and IMF. Hence, in the 1980s these institutions followed adjustment lending with conditions on general policy reforms (World Bank: 2002). These policies were macroeconomic stabilization and opening up of economies to trade and foreign investment.

The focus was on shifting the role of the government from business activities in to macroeconomic management and leaving the former to the private sector. Hence, the World Bank tended to emphasize on PSD in addition to stabilization and openness. The need for stabilization and trade liberalization arised to create economic incentives for PSD.

Later on the bank understood that the response of the private sector to these macroeconomic trade policy measures could not be as expected and tried to expand the PSD agenda to emphasizing on microeconomic and institutional reforms (World Bank, 2002:25). Particularly, when the World Bank and IMF shifted their agenda from structural adjustment program and stabilization to poverty reduction strategy PSD has been considered as critical. This is because first, private markets are the engine for productivity growth and thus create more productive jobs and higher incomes. Secondly, complementary to government roles in regulation, funding and provision, private initiative can help provide basic services that empower the poor by improving infrastructure, health and education – the conditions for sustainable improvements of livelihood (World Bank, 2002: i).

Hence, the recommendations for extending the reach of markets include – enhancing the investment climate, and direct support to firms in the form of finance and advisory services, which should be aligned with market forces and not to be subsidized. The components of enhancing the investment climate include sensible government system, infrastructure, competition, sound financial system, stable macroeconomic environment and open to trade.

Improving basic service delivery by the private sector can also be achieved through allowing the private sector participation in infrastructure and provision of social services.

All in all, the Bank focuses on four PSD related interventions

- improving the investment climate
- privatizational and concessional type arrangements
- direct assistance to enterprises
- social funds

These PSD interventions are also shared among other bilateral and multilateral donors (Gibbon and Schalpen, 2002; OECD, 1990; AFDB, 1997).

Despite their claim that they are emphasizing on PSD and poverty reduction in developing countries, their policies and strategies do not seem to address the real problems of PSD in these countries. First and foremost, they still insist on macroeconomic management and trade openness for PSD. However, the response of the private sector in these countries to such policies could not be positive. For instance, Magarinos (2001:2) argued that '… the private sector is not responding positively to macroeconomic stability, and structural adjustment policies and programs". The African Development Bank 1997 annual report also agrees with this, even though its justification shows that it still insists on the importance of such policies on PSD[1]. The reasons for such failure are, however, as discussed before the mixed impacts of the SAP policies and the less attention given to problems at the meso- and micro-levels, which are infact, the major problems for PSD.

Secondly, they argue that markets alone will do the job of facilitating the private sector to contribute to poverty reduction. And thus, the government should not intervene in business activities and its role should be limited to governance, macroeconomic management, and domestic security and ensure that markets are operating freely. The practical experience of East Asian countries, however, tell us that governments play a leading role in promoting private sector development and economic development at large through its direct intervention to business activities. It is difficult to attain economic development by putting the burden of all the business activities on the back of the low experienced and capital poor private sector.

Thirdly, they recommend avoiding subsidy, which was found to be very important in the successful private sector development process of East Asia. Finally, they focus on encouraging private sector involvement in infrastructure and social service provision and view this as the final goal of PSD. And hence they recommend privatization of public enterprises involved in these activities. The argument is that, the poor will have access to

[1] The justification for such poor response of the private sector is given to be the uncertainty over the sustainability of the reforms.

these services and hence contribute to poverty reduction. However, there is a more dynamic gain from PSD if infrastructures can be viewed as a means to encourage private sector activities in other profitable sectors such as industry and other service sectors. This is because the private sector needs have access to infrastructure to engage in profitable business activities and productions for export, which may perhaps be the best route for growth and poverty reduction. Moreover, private firms are mostly reluctant to engage in sectors with large sunk costs and high-risk markets such as infrastructure.

6. Concluding Remarks and Drawing Lessons for Ethiopia

This study tries to review the macroeconomic policy measures taken in Ethiopia and their respective impacts on private sector development in the 1990s. Upon reviewing, the study concludes that the bulk of macroeconomic adjustments taken under the umbrella of SAP have not encouraged the private sector performance. In trying to find out the reasons from theoretical literatures, survey based studies, and practical experiences, the study argues that; first, the policies envisaged under SAP have mixed impacts on PSD. In other words, some of the policies have positive impacts while the others have pervasive negative impacts. Secondly, the constraints for PSD are severe at the meso and micro levels and hence emphasizing at macro level would not be effective without addressing issues at the meso and micro levels.

Thus, the study calls for government intervention in business activities in a way that promotes private sector development, in supportive of entrepreneurial endeavor and with a bias towards expansion of business activities. On the other hand, putting all the business activities or the role of coordinating and running the productive sector of the economy on the back of infant, less experienced and capital-poor private sector that lacks the wherewithal to undertake such activities has not proven to be effective practically.

In particular, the government has roles to play at different levels of the economy to encourage the private sector and to attain sustainable development. At the international level the government has a role to play in finding markets for exports, making trade negotiations, negotiating with donors about the attached preconditions and attracting foreign capital.

At the macro-level the state has to make the financial, fiscal, exchange rate and trade polices favourable and in supportive of domestic business activities. In addition, efforts have to be made by the government to build infrastructure and good governance.

At the meso and micro level the government has a role to play, perhaps very important for PSD, in building institutional infrastructure such as intermediate financial institutions, R & D institutions and training institutions, and in supporting the private sector for access to technology, entrepreneurship development programs, market information, etc.

There is also a need to have public-private partnership forums for exchange of views and ideas on plans, policies and marketing issues. The recent document on poverty reduction and strategy paper of the government acknowledged the need for such forums. It, however, seems to limit the role of the forums to be a means to mutual understanding (as a partner) and trust. But, there is a more important gain if the government considers the concerns of the private sector as critical policy components. There is nothing to be gained from giving a hearing after the government already decides on the implementation of the policies and plans.

Finally, from the private sector's side there is a need to give emphasis on entrepreneurship development, striving for technology and reusing profits for business expansion rather than using for high-valued consumption expenditure and real estate developments. It is also important for PSD if the business community develops a business discipline i.e. complying with the fiscal, legal and regulatory requirements of commercial activity.

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