A GLIMPSE OF PRIVATIZATION AND THE PRIVATE SECTOR IN ETHIOPIA

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1. INTRODUCTION

Development theorists, in their attempt to design viable paths of economic development, make the cardinal point that the agents of economic development change with historical developments. Soon after the end of the Second World War, particularly due to the success of socialist industrialization in the former Soviet Union and Eastern Europe, as well as the successful government-led reconstruction programmes of Western Europe, the rhetoric of development policy focused on the need for direct government participation in the development process of the less developed countries(LDCs).

Beginning the early 1950s, development economists and planners prescribed government-led development through long-term and comprehensive national planning. They rationalized this by arguing that the markets of LDCs were sub-optimal to trigger the desired pace of economic development. In fact, entrepreneurship, considered to be the crucial agent of development, was said to be missing in LDCs and, hence, the need for more state participation. Also, equity and development were said to go hand in hand, if states spearhead the development efforts of their countries.

For this and other reasons, the governments of LDCs started to directly participate in the development process of their countries. They invested in large- and medium-scale industries, farming, mining, trade, etc.

The hope that governments will ameliorate economic and social adversities by establishing public enterprises started to lose ground in the late 1970s and 1980s. Public enterprises could not meet their desired objective of achieving sustained development. They were poorly managed and over-manned, as a result of which they started to incur substantial losses. Subsidies to support such enterprises became a drain to government treasury which in turn reduced the investment capabilities of the state. The sum result became slow economic growth.

Other developments also appeared internationally. The fall of socialism in East Europe and the successful privatization programmes carried out in some countries, particularly in Great Britain and in some of the Latin American countries, led to the belief that direct state participation in economic activities has resulted in the recent economic crisis in LDCs. The remedy is then believed to be to encourage the private sector to run the economy, while the role of the state is to be confined to the formulation of development policies and indirect regulation of the operation of the economy.

These days, the issue of privatization is also at the forefront of the debate on the economic development agenda of Ethiopia. The misguided economic policy of the past one and a half decade has left the economy in a mess. State enterprises have become burdens on the economy. In view of these, this paper concerns itself with giving a brief overview of whether the Ethiopian private sector is robust enough to absorb the investment of state- owned industrial enterprises.

There is no adequate data to show the size of private capital in Ethiopia. The reason is fairly obvious. Private businessmen are secretive about the size of their capital and profit for various reasons, for example taxation. Also the policy of the past government has pushed the private sector underground. Concerned government institutions do not have adequate information about the size of capital employed in the different economic sectors. Consequently, it has not been possible to treat the subject matter in detail.

Against this background, the next section of the paper highlights the reasons behind the intended privatization of state industries followed by a section that attempts to roughly indicate the size of public assets in the industrial sector and private savings. The last section tries to raise some policy issues on the privatization programme in the context of Ethiopia by way of a conclusion.

2. WHY PRIVATIZE?

Privatization here is understood as the transfer of all or part of public assets to the private sector directly or indirectly. Here some explanation may be in order. First, direct privatization implies complete transfer of public-owned assets, while the indirect one implies privatization of the management, the assets remaining under the ownership of the public sector. Also, the concept of privatization is linked only to business, implying that policy making and regulatory functions remain in the hands of the government. Moreover, privatization is also different from denationalization in that the former implies new and private ownership while the latter implies giving back nationalized assets to the former owners.

If privatization is a direct or an indirect transfer of public assets to the private sector, it simply implies transfer of one form of ownership to another. The logical question would then be if ownership is ownership regardless of the parties involved, then why is the issue of privatization being talked aloud all over the globe, including in Ethiopia? Since this paper is not meant to treat this question, we shall leave it out. Nevertheless, it is appropriate to highlight the most significant reasons why the industrial sector of Ethiopia needs to be privatized.

Although modern industry was first introduced into the country at the beginning of the century, a conscious effort towards industrial development started after the Second World War. The major policy of the period upto 1974 focused on the creation of an enabling environment for industrial development through encouraging both domestic and foreign private investment.

Thus, the pattern of industrial ownership was mainly private, while the government played a sort of catalyst role to facilitate industrial development.

Policies for industrial development took a new turn in the mid-1970s. The Military Government that took power in 1974 followed a different approach towards industrial development. The approach was a socialist-oriented industrialization process. Accordingly, large- and medium-scale industries were nationalized. The nationalization drive was so haphazard that, in some cases, factories that could be categorized as small-scale industries under any classification scheme were also nationalized. Private investment was deliberately suppressed, resulting in the loss of the benefits of complementarity between government participation and private sector initiative for industrial development.

The nationalized industries were managed through central planning. Almost all of the factories were grouped along similarities in output and placed under the management of newly established industrial corporations. The first impact of such reorganization measures was that it abolished the legal personalities of the enterprises. Second, the enterprises lost management autonomy. The industries became recipients and executors of targets and quotas as well as different guidelines that emanate from the central authorities. What and how much to produce as well as to whom and how to sell were all decided by the Government. Taxation and finance laws were directed towards generating as much income as possible to the central treasury, to the absolute detriment of the growth and viability of enterprises. This bred inefficiency which resulted in a decline in both output and profitability. Between 1987/88 and 1990/91, for example, gross value of production fell from Birr 2.03 billion to Birr 1.34 billion or by about 44% (see Table 1). In terms of profitability, the performance of all enterprises declined substantially through the years. For example, in 1991 profitability as a percentage of net sales for all industries was -24% (see Table 2).

Table 1: Value of Production by Industrial Branch 1984/85-1990/91 ('000 birr)

Industrial Branch	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Food	444263	472441	454013	448917	474452	392669	347600
Beverage	314051	323461	346913	344720	324048	250352	208101
Tobacco	89356	107843	107292	119399	109694	94564	106684
Textile	353315	371591	407891	424759	354841	374556	251495
leather & Shoe	131372	144407	161377	188140	208173	194602	161893
Wood & Wood Products	11309	11828	12047	12497	12798	7199	4878
Paper Printing & Publishing	92074	97711	103011	97331	95525	82068	77724
Chemical	143318	132092	174626	170872	140438	86623	53499
Non-metallic Mineral Products	56782	69255	74281	89792	94479	66923	71555
Metal Products	127839	122872	132265	133979	105809	87521	59306
Total	1763679	1853501	1973716	2030406	1920257	1637077	1342735

Source: MOI, *Industrial Restructuring in Ethiopia*, Vol. I, August 1992. (Unpublished Report).

Table 2: Profitability as a Percentage of Net Sales by Corporation (in %)

	1984/5	1985/6	1986/7	1987/8	1988/9	1989/90	1990/1	1991/2
1. Ethiopian Food	8	10	12	8	4	4	3	6
2. Ethiopian Sugar	16	8	13	10	8	13	15	-4
3. Ethiopian Beverage	9	7	8	5	3	2	1	-3
4. National Tobacco & Matches	14	15	15	17	20	14	18	32
5. National Textile	4	-1	4	3	0	-7	-7	-29
6. National Leather & Shoe	6	6	5	11	15	10	6	2
7. Ethiopian Printing	31	32	31	32	26	22	24	16
8. National Chemical	18	21	15	20	13	7	4	0
9. Ethiopian Cement	-13	-8	-21	-4	2	-2	-25	-12
10. National Metal Works	18	9	8	8	8	-1	-22	-31
11. Share Companies*	16	21	24	18	20	3	N.A.	-1**
Total	127	120	114	128	119	65	17	-24

* Does not include Ethiopian Pulp and Paper Share Company. The 1990/91 and 1991/92 figures do not include factories in Eritrea.

** Including Pulp and Paper.

Source: MOI, *Industrial Restructuring in Ethiopia*, Vol. I, August 1992. (Unpublished Report).

Most enterprises are burdened with liabilities. Some firms could not pay taxes and even the necessary contribution to the pension fund. In the absence of profit, firms resorted to short-term bank loans to finance their operations. According to the financial reports available at the Ministry of Industry at the end of 1983 Ethiopian fiscal year, the liquidity balance (current asset liability ratio) of 53 enterprises (or 56% of the total) was less than one, indicating that most firms could not cover their working capital requirements. For the government, this situation implies that either it has to keep on channelling funds to loss-making enterprises or close them down. The first measure is not possible due to budgetary reasons, while the second would have political and social costs. The best option is therefore to privatize the enterprises. Furthermore, the state, rather than being concerned with day-to-day management of enterprises, should involve itself in areas where it has comparative advantage, as in the development of physical and social infrastructures that can facilitate the industrialization of the country.

3. THE SCOPE OF PRIVATIZATION

It is necessary to indicate the size of the industrial assets to be privatized and the size of domestic capital, to have an overview of the circumstances in which a privatization programme can be realized. Similarly, the modest experience of the Ministry of Industry, in the sells of assets will be indicated very briefly.

3.1 The Size of Industrial Assets

To start with, there are a number of alternatives to value public assets. No particular alternative valuation technique, however, seems to be universally acceptable. In the case of Ethiopia, the valuation techniques to be used have not been worked out yet. Thus, in this paper, net fixed asset is taken as a proxy of the market value of industrial enterprises. Even then, since no one knows when the privatization programme will start, it is only possible to know the assets of industrial enterprises when they are to be privatized. Consequently, the net fixed assets of the industrial enterprises under the Ministry of Industry in 1991 have been used in this section.

Currently the Ministry had restructured the management of the enterprises depending on a set of criteria including value added, technological complexity, manpower, export, sales, net profit, fixed assets, product mix, distribution channels, and professional composition. Based on these weighted parameters, industrial enterprises are classified in five categories. Industries having higher grade are categorized in level one, second grade in level two, and so on. In addition, some enterprises are merged while most retain separate management systems. Accordingly, the total number of industrial enterprises currently under the Ministry is 98.

The total net fixed assets of these enterprises in 1991 was about Birr 788.9 million. The largest assets are recorded for the National Textiles Corporation, followed by the National Metal Works and Ethiopian Cement Corporations, in that order. The three corporations accounted for 38.5%, 19% and 14% of the total net fixed assets, respectively. The smallest asset value is recorded for the National Chemicals Corporation amounting to about Birr 9.9 million (see Table 3).

In terms of individual establishments, 29.6% have an asset value of less than one million birr and 97% have assets worth no more than Birr 50 million (for details see Table 4).

This tentative indication suggests that the size of fixed capital in the industrial sector is modest. This may be due to the long period of time the plants have been operational and their small sizes. Whatever the case may be, the value of industrial assets would further decrease during the subsequent years due to depreciation. Consequently, it appears that the size of fixed capital in most of the industrial enterprises may not be beyond the reach of the private sector.

Table 3: Net Fixed Assets of Industrial Corporations under the Ministry of Industry 1991

Corporation	Value ('000 Birr)
	1991
Ethiopian Food	18347
Ethiopian Sugar	53389
Ethiopian Beverage	74413
National Textiles*	303549
National Leather & Shoe	37854
Ethiopian Printing	18342
National Chemical	9933
National Metal Works	151083
Ethiopian Cement	111253
Addis Ababa Cigarette	10728
Total	788862

* Does not include the assets of Arbaminch Textile Mill
Source: Ministry of Industry.

Table 4: Number of Enterprises and Range of Asset Size (1991)

Size of Capital(Birr)	No. of Enterprises	Percentage	Cumulative Percentage
Less than 1 million	29	29.6	29.6
1-5 million	48	49.0	78.6
5-10 million	8	8.2	86.8
10-20 million	8	8.2	95.0
20-50 million	2	2.0	97.0
50-100 million		0	
100 million & above	3	3.0	100.0
Total	98	100.0	

3.2 The Magnitude of Private Capital

The present economic policy of the country gives priority to national investors while the participation of foreign private capital would be allowed, in some selected areas. In fact, the new Investment Code (No. 15/1992) is silent on whether a local private capitalist can engage in a joint-venture undertaking with a foreign partner or not, which appears to be a polite way of discouraging foreign private capital investment in Ethiopia. This situation would thus imply that the bulk of the assets to be privatized would be transferred to Ethiopian nationals.

The experiences of other countries indicate that the size of private capital is one of the determining factors for the success of privatization programmes. In the case of Ethiopia, where the large majority of the population is poor, the concern would then be the capacity of private domestic capital to absorb the assets of public industries.

It is not logical to assume that the entire population would participate in the privatization programme. The participants would be from the segment of the population that has got the capital, the will and the knowledge on the costs and benefits of investment. This segment of the population is rather small. Attempts at getting any meaningful information about the size and structure of capital in the hands of this group of would-be participants has however proved virtually impossible.

In the absence of information on the size of private capital in the country, private savings in banks is taken as a rough indicator. According to information obtained from the Commercial Bank of Ethiopia, the size of private savings in 1988/89 was in the order of about Birr 1.5 billion or about 12% of the Gross Domestic Product. The savings of voluntary associations such as credit associations was about Birr 72 million, which brings the total private savings to Birr 1.572 billion. This, is about twice the size of fixed assets in industries. Before arriving at any meaningful conclusion, it would be appropriate to consider other sections of the population that could contribute for the success of the anticipated privatization programme in the industrial sector.

Wage-earners can also have some room to participate in the privatization programme, depending on the modalities to be followed for selling public assets. It is true that all wage-earners may not be in a position to buy shares. But, it is plausible to assume that those earning over Birr 500 per month would most likely be tempted to buy shares, because, they are mostly well educated, well informed and their income is fairly high. In this regard, according to the information obtained from the Ministry of Finance, the number of civil servants earning over Birr 500 at the end of 1984 Ethiopian budget year was about 83,382. It has not been possible to determine the number of people earning more than Birr 500 in the non-public sectors. However, it is plausible to say that the total number of wage-earners under this category would be fairly high.

While the above indications are incomplete and crude, to give any meaningful conclusion about the size of private capital in the country, they can roughly indicate that most of state-owned industrial enterprises, if divested would not be beyond the reach of Ethiopian nationals.

3.3 Recent Experience Observed in the Industrial Sector

The Ministry of Industry has tried to sell machinery and equipment of 27 small-scale enterprises. Initially, the machinery and equipment were imported from India for sale to private investors and the firms to be set up in an industrial estate that was to be developed in Addis Ababa. The plan was, however, aborted by the previous regime, and the Ministry of Industry took the responsibility of installing and operating the firms.

This case may not be a good example of privatization since it is different from privatization as such. All the enterprises have not been operational though the machinery has been here for the last three years and the decision to sell them is simply to reverse and correct the earlier mistakes. However, it can give a glimpse of the willingness and ability of the private sector to participate in privatization. Moreover, the problems encountered can serve as a good lesson to the intended privatization programme.

The Ministry of Industry announced that it wanted to sell the 27 small-scale enterprises to the highest bidder in February 1992. Payment was to be effected in cash. When the tender documents were opened in May, it was found that 13 out of the 27 enterprises had got buyers (see Table 5).

Three observations can be made on the venture carried out by the Ministry. First, the mark-up between the initial bid prices and bid-winner prices for most of the thirteen industries was high. This indicates that the private sector was willing to offer higher prices and in cash, for plants and equipment that were not practically tested. Although auction price may not tell much, it can roughly indicate that operational plants may attract more buyers.

The second is the activities the bidders were involved in. Of the 13 bid winners five (38%) were engaged in some sort of industrial activity such as bread baking and vehicle repair services. The rest were involved in trade. And it is the latter group which offered higher price mark-up. Thus, the trade sector may be the main potential participant in the privatization programme.

The third observation is that there is need for adequate preparation before announcing the sales of assets to the private sector. In this particular case, the construction of buildings where the enterprises were to be set up was not completed. The machinery and equipment were scattered throughout the estate where most of the enterprises were planned to be installed and some were even broken. The need for power supply was not even thought of. In general, the lack of prior preparation to attract potential buyers was the major drawback of this experience of the Ministry to sell state-owned assets. This, coupled with the image people had about technology imported from India, could not attract buyers for all of the enterprises. Even then,

those involved in the programme considered the experience to be fairly encouraging to try once again to sell the remaining enterprises in the near future.

Table 5: Comparison of Initial Bid Prices and Bid Winner Prices

Type of Enterprise	Initial Bid Price (Birr)	Bid-winner Price (Birr)	Bidder's Mark-up (%)
Belt Fastener	64,800	91,111.00	41
Flash Light Torches	474,400	500,011.95	5
Spring	148,000	255,200.00	72
Bolts & Nuts	626,800	850,000.00	36
File Fastener	120,300	187,198.99	56
Air & Oil Filter	963,100	1,107,565.00	15
Hand-made Paper	266,000	401,100.00	51
Wire Drawing	375,700	600,000.00	60
Tooth Picks	131,500	150,000.00	14
Rubber Eraser	163,000	253,000.00	55
Wick Stove	649,500	800,007.00	23
Wood Screw & Rivets	251,400	361,000.00	44
Hair Pin & Safety Pin	105,600	252,100.00	139

Source: Ministry of Industry.

4. CONCLUDING REMARKS

In the preceding sections, the potential of the private sector in relation to the value of fixed assets of public enterprises has been roughly indicated. The result seems to be promising. Nevertheless, reality dictates some caution before arriving at hasty conclusions. To start with, the size of fixed capital of the enterprises is rather small, because, most of them are too small. For example, the National Textiles Corporation which recorded the largest fixed asset in 1991 is attributed to two factories, Kombolcha and Awassa Textile Mills, which between them accounted for 87% of the total fixed assets of the enterprises controlled by the Corporation. Secondly, since most of the enterprises are old, their book values are low. These and other

reasons, particularly lack of information about the size of private capital in the country, do not enable to make any meaningful conclusion.

What is more, it becomes too simplistic and crude to compare only the size of fixed assets in public industries to the size of private capital. Privatization cannot be a programme that affects only a sector of the economy. It has to include all sectors of the economy. Otherwise, actual or potential inefficiencies in the state enterprises could spill over to the rest of the economy.

Thus, the task of privatization of the bulk of state assets would be a complex and protracted process. For a successful privatization programme, a number of tasks have to be accomplished. These are many and diverse. The most important ones are indicated below.

The first is how to make the enterprises to be privatized commercially attractive to the private sector. Most of the public enterprises are loss-making. With increased efficiency and improved supply of raw materials and inputs, profitability can be achieved in most enterprises. However, the real problem is the fact that most enterprises are burdened with large amounts of loans which may threaten their existence. In fact, the overall capital injection required to revitalize the enterprises is estimated to be about Birr 340 million. No one wants to buy loss-making factories and be overburdened with liabilities.

Second, to start with the privatization programme, the size of private capital does not seem to have grown that much to absorb the bulk of the state assets in the economy at large, because, the commercialization process would make the enterprises more expensive. It is also impossible to assume that all capital in the hands of the private sector would be used for the purchase of state assets. It could be used to expand the existing activity or to start new business. In view of this, it is prudent to think about the sell of shares in the market. This however poses the problem of creating and developing capital markets. But, since privatization should not wait until capital markets are developed, in the short run, the shares could be sold by the existing financial institutions, as the Agricultural and Industrial Bank used to do during the Imperial era.

In the context of Ethiopia, the most crucial problems that need to be tackled would not be the capacity of the private sector or the financial positions of state enterprises only. The policy of economic centralism pursued during the past one and half decades was characterized by a deliberate discouraging of private sector participation in the process of economic development. The blind nationalization measures implemented and the centralization of economic activities have created lack of trust between the state and the private sector. As a result, the private sector has largely been operating underground. The most important challenge the policy makers of this country face would be how to rebuild the confidence of the business community.

The other important issue is that of foreign capital investment. The need for foreign capital, particularly for the development of the industrial sector, appears to be obvious. But the

competition for foreign capital with Eastern Europe and other developing countries would be strong. In the face of these situations why the country is lukewarm to foreign capital investment is not clear at all. In fact, foreign capital can play an important role in the privatization programme. It can lease the management or buy assets in some industries that require large amount of capital or where the nature of production and the technology employed may necessitate special skill for plant operation and marketing of outputs, especially exportables.

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