

STRATEGIES AND MACROECONOMIC POLICIES FOR THE DEVELOPMENT OF THE PRIVATE SECTOR IN ETHIOPIA

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1. INTRODUCTION

The economic policy of the Transitional Government of Ethiopia (TGE) has redefined responsibilities for economic growth and societal development between the private and the public sectors. The private sector assumed the onus of producing and providing goods and services while the state is by and large, to be the facilitator and regulator of these activities. The general policy framework (TGE, 1991) and the specific measures implemented thereafter envisage and aim to shrink the role of the state in direct participation limited to those activities that are of strategic importance and those considered essential but are beyond the interest and/or capacity of the private sector. The compression of the state and the elevation of the private sector operating within a competitive market economy is a significant departure from the military regime's state-centred and centrally planned development paradigm.

The reshuffling of the burden of growth and development between the public and the private sector and the acknowledgement of the market as the mechanism for resource allocation are moves in the right direction. Lessons from the economic history of nations, including our own recent past have conclusively established that market based private sector anchored economies grow much faster than centrally planned market driven regimes.

While the positive correlation between the private sector and economic performance are undeniable, the qualitative and quantitative effect depend very much on the extent to which the opportunities that are provided by and through the market are exploitable and exploited by private economic agents. The market institution in other words is a necessary but not sufficient to bring about high rates of economic growth. The existence, resilience and dynamism of the private sector is an essential component.

The quality of the private sector determines not only the latitude of the market but also the role of the state in economic activity. Where private economic agents are un or underdeveloped, it would be incumbent upon the state not only to create an enabling and conducive environment for a free enterprise economy, it must in addition nurture and develop the private participants. Among the proven and time honoured private enterprise developing techniques and strategies available to the state are teaching by doing, training and education, support and protection from predators.

This paper seeks to review the conditions and capacity of the private sector in Ethiopia and evaluate the overall macro/micro policy framework from points of view of its compatibility for

government bureaucrats, managers of public enterprises, administrators, regulators at all levels turned into entrepreneurs. Such behaviours are endemic in all countries where attempts are made to supplant the market by administrative fiat (Kruger, 1974, Bhagwatti, 1982).

Secondly a large number of people who traditionally were outside the market were forced into it because of the high cost of living. These included academic staff and other intellectuals, house wives as well as children under age. The purchasing power of income from employment were growing more and more insufficient to support decent life, forcing people to devise and develop their own survival strategies which again invariably turned them into entrepreneurs.

Privately owned manufacturing industries were nationalized and the private sector was limited to small scale enterprises with capital not exceeding half a million birr. Even where daredevils were willing to set up plants legally within the ambit of the regulation, their efforts were frustrated with impossible licensing procedures, shortages of foreign exchange, acquisition of land, etc. But the profitable opportunities created by the economics of shortage were too big to be missed, providing them with sufficiently strong incentive to circumvent the law, usually with the assistance of those who were assigned the responsibility of implementing the repressive legislations. Land, although nationalized was bought and sold and title deeds provided, free foreign exchange markets proliferated, limits on plant size as well as branching restrictions were ignored. Production went underground and industrial entrepreneurs mushroomed in the backyards, garages as well as open spaces.

The condition was no different in agriculture. Despite billions expended to develop state farms and naked attempts at socializing residences through villagization and farms through cooperatives, the peasants maintained their rugged individualism and exercised their creativity in evading and mitigating the impact of government controls and regulations.

The market slated for extinction grew in importance and was performing its classical function of allocating resources on the basis of "right prices" not only domestically but in international trade. Informal foreign trade supplied all goods and services in demand and was paid for by smuggled exports. Despite the huge monetary expansion, inflation was surprisingly low, averaging less than 5% per annum between 1980 and 1989.

The surprisingly low rate of inflation is due neither to the price control (which was ineffective) nor the growth of the formal economy but because of the informal economy. The official GDP and foreign trade figures definitely underestimates the true values. According to my own estimates, the likely size of the GDP is three to four times higher than the official figure while unrecorded imports and exports were about twice the recorded values (Befekadu, 1991).

Although the private sector is large and vibrant, two of its essential characteristics must be brought out for their possible influence and impact on policy.

2.2.2 Local Administration

Early in its tenure, the TGE introduced a new administrative framework, based mainly on ethnic criteria with considerable autonomy (TGE, 1991b). The administrative units so created have departed markedly from the traditional arrangements in many ways, particularly in the definition of the working language and ownership of natural resources. The lingua franca in each of the administrative regions are the local languages with latin script in many. The administration of natural resources, particularly land seems to have devolved to local administration.

3. ASSESSMENT OF POLICIES AND PRIVATE SECTOR DEVELOPMENT

How conducive and supportive are these political, administrative and macro-economic policies, given the nature of the private sector and the responsibility it is expected to assume. What should be done to build-up the confidence of the private sector and help them move into more interesting and particularly productive activities in industry and agriculture?

3.1 Political Framework

A primary prerequisite for an investor of domestic or foreign origin is the perceived political stability as well as credible and sustainable government policy. This is of special relevance in Ethiopia because of the unfortunate experience over the last two decades.

The current Ethiopian political landscape does not seem to be as encouraging as investors would want it to be. The uncertainty mainly emanates from its transitional and fluid nature of both policy and political arrangement. There are sensitive and contentious issues and the rivalry among interest groups moving in different directions casts strong cloud of uncertainty. What are important here are how the issues are to be settled , how long a time it takes and the likely outcome.

Investors have so far been very cautious and hedging. A large number have expressed interest, particularly in industry and agriculture and have acquired the necessary licenses. But much of these interests have yet to be backed by actual commitment. Most of the private sector remain in trade and services basically because such activities carry minimum risk in that the investors are in the possession of their assets either in the form of goods or in money at all times.

3.2 Administrative Framework

While the overall political uncertainty is a major inhibitive factor, it is nevertheless not the only constraint on private sector investment. Closely linked to political stability and heavily influencing investors perception about the future are the new administrative framework. The ethnic based, heavily decentralized internal administration with ill-defined or undefined division

Unfortunately these positive trends are overwhelmed by the constraints emerging from the overall economic policy, the most significant of which are pointed out below.

3.3.1 Economic Stability

The economic policy pursued by the government has the cardinal objective of stabilizing prices at home, and the balance of payments by decreasing domestic demand. It was in line with this objective that the government decreased its expenditure, reduced the volume of credit to be extended by the financial institutions, increased interest rates, and devalued the Birr.

While the targeting of macro-economic stability is correct, the cardinal error of SAP type models lies in their demand suppressing policy. The more appropriate and rewarding strategy should have sought to achieve the goal of macro-economic stability by focusing on the supply side of the equation. The advantages of stability through growth are obvious.

The first is humanitarian. In a country where more than 50% of the population are poor, (World Bank 1992:23) and the national average daily calorie intake is 73% of the requirement (UNDP 1993:139), stabilizing the economy by suppressing demand and increasing prices borders on the inhuman policy of clearing off the excess population. Attempts at mitigating the impact of structural adjustment through the social dimension is likely to be overwhelmed by the stagflationary nature of SAP. The best solution and the most effective remedy for poverty is growth and this requires supply enhancing policies rather than demand restricting strategies.

Secondly, there is no better engine for private sector development and economic growth than excess demand, provided the right policies are in place. The higher prices would serve as an incentive to increase production of goods and services. The same policy is being pursued in the developed countries. The current recession and weak recovery in the developed countries are due to low demand and efforts are being taken to encourage consumers to increase their purchases (IMF, 1993). Interest rates in the US for example is at record low and Japan is being pressured to increase public expenditure to help energize the World economy. In other words lack of demand is a constraint on economic growth.

In Ethiopia where the potential to alleviate poverty and improve the standard of living lies idle, supply enhancing private sector developing policies are definitely superior and more rewarding than demand suppressing approaches.

3.3.2 The Role of the State

The macro-economic policy framework is driven by the need to ostracize the state from active participation in the economy and relegating it to regulatory and facilitating role. The argument against the state essentially source from and are based upon three central tenets. The first is inefficiency, the second crowding - out of the private sector and the third ideology. These

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- i) those with capacity to purchase the enterprises to be privatized should be given the opportunity and incentive to use their resources to build new plants and thus increase the productive capacity of the nation. One of the problems in Ethiopia is the dearth of the modern sector - both in transport and manufacturing industries, and policy should target their expansion. Consequently selling existent plants and enterprises to investors with capacity and vision to install new plants tends to suppress the growth and development possibility. The better policy lies in encouraging these people to initiate new ventures.
- ii) the emergence of new productive enterprises not only increases capacity but also intensifies competition. It should be remembered that a non-competitive market is likely to be as inefficient as the condemned state and more harmful to social welfare compared to state monopoly. Expansion of private sector productive capacity enhances the efficiency of the public enterprises, intensifies competition, reduces prices and increases welfare and effectively stabilizes the economy.
- iii) the sale of the public enterprises to small economic agents distributes benefits widely and creates "popular capitalism" and serves as a means of equitable income distribution. As the burden of production shifts from labour to machines, because of technical and technological development, the share of income collected by owners of capital is liable to increase. Under such circumstances it would only be fair to turn labour into owners of capital by selling shares to them.
- iv) such divestiture process extends and expands the resource mobilization capacity to members of society that could be difficult to reach otherwise.

The public enterprises could be used to motivate and invigorate the private sector through the disequilibrium they are to create in the economy (Hirschman, 1958). The backward and forward linkage that emerges could be strengthened through formal arrangements such as sub-contracting the private sector.

3.3.3 Trade Liberalization

The current policy liberalizes both domestic and external trade. Domestic liberalization is a necessary condition for private sector development. However, exposing the domestic economy to external competition tends to suppress it. Of these two forces with opposite effect on the private sector, the negative external impact is definitely more aggressive and stifling to the development of the private sector.

In countries pursuing the SAP model, domestic producers are invariably disadvantaged by trade liberalization in a number of ways . First, devaluation and high interest rate increase the cost of production. Second, SAP induced depression tends to decrease the volume of sales. Consequently, effect of these policies decrease profitability.

utilization and new investment were locked into the availability of foreign exchange derived from external credit and export earnings, a very unhealthy development approach, indeed.

Protection and incentives must, therefore, be marshalled to encourage the domestic production of these vital yet neglected sources of growth and development. But, the structure of protection must be selective to speed up development and make the economy more competitive.

3.3.4 Monetary Policy

The restrictive monetary policy is not conducive to the development of the private sector mainly due to the decreased volume but increased cost of credit as well.

In countries such as Ethiopia, where domestic saving is low on account of low income, credit is the major means of increasing investment. But to increase the productive use of domestic credit, the interest rate should also be rendered attractive to investments. The tight monetary policy and the high interest rate are in breach of this principle.

The right policy in the use of credit is to make sure that it is utilized to increase the productive sectors of the economy, mainly agriculture, industry and transport. Consequently, the instrument of selective credit control is the more appropriate means of ensuring not only the development of the private sector but the employment of resources in ways beneficial to society. The use of targeted credit need not compromise efficiency since the allocation would be based on the viability of the projects presented for funding.

4. PRIVATE SECTOR CAPACITY BUILDING POLICIES

This paper dwelt at length on the need to create an enabling environment, because it is the most important condition for the development of the private sector. While a conducive and enabling environment is necessary it is not, in and by itself, sufficient condition for an emergence of a private sector capable of serving as an engine of economic growth and social transformation. It must be supported to develop its vision and entrepreneurial capacity and provided with assistance and supplied with collaborative factors of production to help them translate their dreams into reality.

The private sector in Ethiopia is extremely diminutive and socially inefficient. Its greatest asset is the desire to survive and eventually get rich. The second advantage is its creativity and ingeniousness. The urban based private sector firms are in trade and service while the rural based ones and particularly the agriculturally occupied suffer from their alienation from modern technology. An estimated 80% of the labour force cannot feed the balance. Converting urban

The training should focus on a) achievement motivation development; b) opportunities counselling; c) market survey and project plan guidance; d) information on organizations, procedures and sources of assistance; and e) confidence and competence development strategies.

Training is provided over a period of three months to one year and are conducted in the evening. After graduation the entrepreneurs are provided with post-training support involving setting up business, follow-up on loan applications for finance, facilitating acquisition of infrastructure, such as land and factory shed, etc.

The performance of the graduates have been impressive. As Patel says the trained entrepreneurs had less than 10% closure rates and 80% were making profit at the end of the second year of graduation.

The Indian experience has been replicated elsewhere with similar results. The Ethiopian government could launch such a program with the assistance of the Chamber of Commerces and the international donor community.

4.1.2 Finance

Finance is a major constraint for the realization of entrepreneurial capacity. The problems come from lack of collateral, red tape and the high standard of the formal financial institutions that renders them inaccessible to the upcoming entrepreneurs. As a result daring entrepreneurs depend on personal and family savings and the informal credit market.

The development of entrepreneurs dictates easing such constraints. The financial system should device ways in and through which upcoming entrepreneurs should be provided with seed money on the merit of the project. The seed money could either be a loan or better still equity participation by the financial institutions. The provision of venture capital is an important contribution that the financial institutions could make to the entrepreneurial development. In addition, the financial institutions should have research and project identification departments to develop bankable projects.

In addition to the formal financial institutions, the government should set up credit institutions targeted to the development of small scale operators. Such an institution should be multi-purpose including helping entrepreneurs to identify and initiate viable projects and providing with financial assistance at concessionary rates.

In the longer run, the better source of venture capital is the share (stock) market; to which the government should pay special attention. As suggested earlier, the government can offer shares of public enterprises for sale to selected and targeted members of the public.

- ii) grades 7 - 8 for those with highest potential for vocational and skill development training supplemented by academic oriented courses;
- iii) grade 9 - 12 different types of training based on the interest and capacity of the individuals and aiming at producing lower middle level manpower; and,
- iv) post grade 12.
 - a. The most brilliant and capable should join the University on degree track.
 - b. The rest should joint advanced vocational and skill developing diploma track training to produce middle level manpower.

The virtue of such arrangements are that

- i) drop out at all levels acquire skill and could be productively employed or self-employed.
- ii) the educational system produces manpower with marketable skills from the top scientist down to the lowest support staff.

Skill based training is the best source of entrepreneurs and provides a most viable avenue for private sector development.

5. EXTERNAL SUPPORT AND ASSISTANCE

While the major responsibility for national development should reside with the people and the government of the country, their efforts should be assisted by the international community. The support could take different forms with variable impact on private sector development. Two general areas are identified for support - the one aiming at developing a more viable environment and the other to assist private sector development.

The most pressing development problems confronting the Ethiopian government are high rate of population growth and extensive environmental degradation and desertification. International organizations particularly UNICEF and WHO have done an admirable job of saving lives while the World Bank financed and supported projects aimed at rehabilitating the environment. But much needs to be done to bring about a quick demographic transition and environmental rehabilitation. Given the enormity of the two interrelated problems, external assistance and support are essential input to stem the tide of population growth as well as to reverse the process of environmental degradation.

5 billion are licensed, these have yet to be implemented partly because of doubts on political stability and problems related to acquisition of necessary infrastructure, particularly land.

The macro-economic policy emphasizing stability before growth do not augur well for private sector development. The better approach should focus on stability through growth and implement supply enhancing rather than the demand depressing current policy. In particular the tight fiscal and monetary policies as well as trade liberalization are policies with strong negative consequences on private sector development.

Specific policies targeting the development of private sector include training in the short run and human capacity building, by restructuring the content and system of education, in the medium to the long run. The entrepreneurial class must be supported by easy access to credit and marketing among others.

Although the major thrust for private sector development must be anchored nationally, external assistance is necessary. In particular, the donor community could be of assistance in population control and environmental rehabilitation, research to increase agricultural productivity as well as the development of alternative employment in the rural areas.

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