

PRIVATIZATION IN ETHIOPIA: ISSUES IN MODALITIES, SEQUENCING AND TIMING

Eshete Taddesse

1. INTRODUCTION

Privatization in Ethiopia appears to be underway. Subsidy to public enterprises (PEs) were officially lifted in 1992 when the Economic Reform and Rehabilitation Programme (ERRP) was launched. Macro-economic stabilization measures of deficit reductions were emphasized. Exchange rate and interest rate adjustments were made to reflect the real exchange rate and the proximate value of investments. In addition, investment and labour laws were revised in line with a market economy to encourage both local and foreign investment. Moreover, with the exception of a few basic commodities, prices were decontrolled. In the transport sector, transport tariff was deregulated and zonal fleet administration abolished. A new law governing PEs' activities and ensuring their autonomy of management has been effected since 1992. As regards the institutional management of the privatization process, a privatization committee has been established. Its main function is to give advice on privatization issues particularly that of modalities. Can these measures alone, important as they are, ensure success in the privatization programme? This paper endeavours to throw light on the necessity of developing a coherent and comprehensive privatization strategy. It emphasizes the reality that "Privatization without policy, procedures, and a competent and committed staff is privatization doomed to failure"(Ghadar et al., 1987, p.81). The basic issues of modalities, sequencing and timing in the privatization process are also indicated. Above all, some of the major policy implications required to ensure a successful privatization programme in Ethiopia are highlighted.

2. PRIVATIZATION IN ETHIOPIA: ISSUES IN MODALITIES, SEQUENCING AND TIMING

2.1 The Objectives of Privatization in General and that of Ethiopia in Particular

Privatization can be defined as the "reassignment of property rights from the public to the private sector"(Berg and Shirley, 1987, p.2). It is thus, generally perceived as the process by which the ownership of an enterprise is transferred from the public sector to the private sector. This process of privatization covers not only the ownership and management transfer of a PE to the private sector through sales, but also other forms of privatization such as lease arrangements, management contracts, cut backs in government activities, denationalization, liquidation, deregulation etc.

The state may also, operate state farms that are strategically important, on a joint venture basis with foreign or domestic investors. PEs in domestic trade will be privatized both in the retail and wholesale trade. However, the state could still engage itself in the wholesale trade of "basic goods of mass consumption based on the principle of profitability, in view of stabilizing prices" (ibid; p.31). PEs in foreign trade will limit their monopoly control over those "areas that cut across sectors. Such areas will be studied and defined by law" (ibid; p.32).

PEs in the transport and communications service sectors, that are difficult for private sector to operate, eg. air, sea, and rail transport services as well as posts and telecommunication services will be retained. However "domestic capital participation in medium sized operations will be studied and legislated" (ibid; p.37).

In mining and energy, PEs will continue operations in the major mining and energy activities that are strategically important for economic growth.

In the construction sector, PEs will be reorganized and continue operations in a competitive environment on the basis of profitability. Similarly, financial institutions such as banks and insurance companies shall be under government control. From the foregoing review of the new economic policy as related to privatization, it becomes evident that in industry and agriculture "only unprofitable public enterprises will be privatized. Those enterprises that the state can run profitably should be retained as a source of revenue" (ibid; p.28). Consequently, the essential goal of privatization will be to reduce losses of PEs and government subsidies to them. Secondly, the privatization of PEs in trade and road transport sectors aims at removing the existing restrictions on the participation of private capital. However, the stipulation in the economic policy that the state will engage itself in the "wholesale trade of basic goods of mass consumption" and restrict its monopoly to "foreign trade areas that cut across sectors" require further clarifications. The existing PEs in the transport and communications mining and energy as well as the financial sectors will continue operations. However, the determination of the domestic private capital participation in these sectors shall be studied and defined by law. In general, the main objective of switching ownership of PEs to the private sector, will be aimed at making the enterprise more efficient, profitable and ultimately stimulate economic growth. In addition, the shift of the TGE from a centrally planned economy to a market oriented economy as well as its commitment to implement the structural adjustment programme, imply that the objectives of privatization goes beyond what is stipulated in the new economic policy. Therefore, the main objective of privatization, in general will be to improve the efficiency and productivity of PEs and ensure adequate revenue for the government. Whatever the objective or combination of objectives, the goals of privatization ought to be clearly specified. Furthermore, a priority list of enterprises to be privatized must be clearly established at the initial stage of the privatization process. To this effect, the privatization objectives of PEs in all sectors of the economy, that require further classifications or specifications ought to be finalized thereby ensuring the governments' commitment to the principle of privatization.

15-20 percent of the outstanding shares at concessional prices. According to this scheme, employees may be allowed to acquire individual shares on credit and pay for their shares through increased productivity. The employees receive their shares upon retirement, but from the first year they are entitled to obtain dividends on their share if the company shows a profit. This financing technique has been extensively used in the USA and Bangladesh. Employees become motivated to work harder and to make fellow employees do the same to cut waste and increase production and profitability. On the other hand, its economic drawbacks may be great due to its inability to generate any cash. It can be considered as an indirect form of subsidy.

iii) Cut backs in PE activities

Cut backs in PE activities is another approach to privatization. The centrally planned economy, as experienced in Ethiopia, had allowed the PEs to engage in too many economic activities that could be done more efficiently by the private sector. As a result, PEs experienced a poor record of efficient resource utilization and financial performance. The encouragement of private capital to participate in the economy as well as the restriction of PEs' activities, will enhance competition and ensure the efficient use of resources.

iv) Deregulation

Deregulation refers to the removal of specific monopoly rights and other protective privileges given to PEs. In order to influence the stability of prices or other regulatory purposes the government had given special powers and privileges to PEs such as EDDC, AMC, CMC, etc. The restriction as well as the removal of their special privileges will enhance the free entry and exit of enterprises in the market and ultimately ensure competition.

v) Liquidation and Withdrawal

In cases where PEs or Financial Agencies (FAs) are chronic money losers, and their financial investigation reveal that their long-term viability are at stake and the loss not written off equals 50% or more of the state capital, the law stipulates dissolution or liquidation (Negarit Gazeta, No. 163/1979). Formal liquidation involves the winding up of an enterprise as a legal entity and the sale of its assets. Thus, by liquidation and withdrawal, the state will create a vacuum which can thereafter be filled by the private sector.

vi) Other forms of privatization

The other forms of privatization mechanisms include joint ventures, management contract for a fee, lease arrangements, restitution of property to former owners, debt-equity swaps, franchising etc. Each of these mechanisms of privatization has its own advantages and disadvantages.

service status, which makes it difficult for management to compress the labour force. PEs tend to be overstaffed with unproductive labour, because of the employment creation objective pursued by the government. In many instances, many PEs were subsidized in order to protect jobs. In the pursuit of privatization, however, the new owners and managers of the privatized company must be allowed to operate freely. This would allow enterprise managers to reduce the labour force based on the standard of labour productivity which will be consistent with the profit motive. Consequently, the prospects of massive redundancy become a serious problem that require urgent solutions (Susungi, 1988, p.38). Furthermore, the transferability of the various social benefits such as social insurance, pension benefits, and disability insurance has to be studied carefully, in order to protect the rights and privileges of workers. In this respect, the new economic policy of TGE has stated that in order to minimize the problems of unemployment, privatization will be a gradual process based on appropriate studies in all sectors of the economy. A final pitfall may be the danger of too much focus on privatization. Privatization for privatization's sake may not yield many efficiency gains. The policy environment or government policy that encourages competition, innovation, efficiency pricing, etc., are the crucial factors that contribute to PEs efficiency and productivity.

3. THE NEED FOR A COHERENT AND COMPREHENSIVE PRIVATIZATION STRATEGY

The most critical question in privatization is to design and work out an appropriate privatization strategy that could minimize or overcome the above mentioned obstacles and pitfalls of privatization (ibid p. 10). Although there is no "perfect model" of privatization strategy which is applicable to all countries, the privatization process in general may proceed along two main phases, i.e., the preparation phase and the execution phase.

3.1 The Preparation Phase

One of the ways to overcome the obstacles and avoid the pitfalls of privatization for a government might be to design and develop an appropriate sequencing and timing of the privatization strategy. In general, these efforts as proposed by Berg and Shirley (1987) include:

- i) preparing the ground for privatization;
- ii) developing systematic privatization strategies and classifying PEs;
- iii) making PEs ready for sale or liquidation; and,
- iv) creating special units responsible for privatization.

- ii) Concrete proposals to solve major legal, administrative, fiscal, organization policy and other obstacles standing in the way of privatization,
- iii) Classification of PEs into different groups according to their prospects for privatization,
- iv) Establishment of a broad privatization action plan with PEs ranked in order of priority. The action plan would define which PEs:
 - could be sold immediately;
 - would need rehabilitation before sale;
 - should be considered for leasing and management contracts;
 - should be considered for closure; and,
 - should remain as a PE.

In the Ethiopian case, a tentative classification of PEs that should be privatized and those that should be retained as a PE have been prepared in each sector of the economy. The new economic policy of the TGE in general and the governments commitment to the structural adjustment program in particular, imply the establishment of the following criteria, for PEs that could be candidates for privatization.

- i) PEs that are generally difficult for the government to manage or administer, due to their particular nature or small size, such as retail trade, hotel services, etc.
- ii) PEs with large financial losses, to maximize economic benefits by minimizing fiscal and credit pressures.
- iii) PEs with minimum need for short-term employment reduction to ensure minimum negative social effects.
- iv) PEs with minimum need for majority foreign ownership to minimize possible political opposition.

Once an agreement on the candidates of PEs to be privatized has been reached, the next critical issue in the process of privatization programme becomes its sequencing and timing. PEs do not have identical prospects for privatization. A few number of PEs may be privatized in the short-term (1-2 years); a few in the medium-term (2-3 years); and the rest in the long-run (3-5 years). Some of the major determinant factors affecting sequencing may include the following:

- The past trends of PEs' financial results and their prospects of profitability,
- The relative convenience and the prospects of PEs' realistic valuation,

time of labour retrenchment in Ethiopia. The restitution of PEs to their former rightful owners may involve, at the initial stage, administrative problems in identifying and locating the former owners. In addition, appropriate valuation of the enterprise at the time of nationalization and at the present time may present serious practical problems. However, the returning of the nationalized enterprises to their former rightful owners has the main advantage of inspiring domestic investor confidence in the private sector. As of today, the promised "fair compensation" for already nationalized enterprises have not been paid for Ethiopian nationals.

3.1.3 Making PEs Ready for Sale or Liquidation

In order to make PEs ready for sale or liquidation, the assets of PEs will have to be valued and the net claims on those assets have to be determined. One of the most difficult and essential issues facing the government is the valuation of PEs' assets. "An over-valuation entails the risk of chasing away potential private investors while an under-valuation would invite criticisms for having given away the nations assets"(Ghadar, et al., 1987, p.136-137). The latter might be even more serious, if the sale is to foreigners. The second major problem is concerned with the delay caused in closing the books of accounts and in finalizing the audits of PEs that are selected for privatization. If recent balance sheets or profit and loss statements are not available, additional financial audits may be required. In addition, claims of employees as well as their severance pay will have to be assessed and determined. Finally, unrecorded arrears will have to be investigated and uncovered. Therefore, in order to carry out proper valuation and audits of PEs would require the technical expertise and skills of such professions as financial analysts, accountants, engineers, economists, lawyers, etc.

3.1.4 The necessity of Creating a Central Privatization Unit

The establishment of a central privatization unit, in the management process of a privatization programme, remains necessary and desirable. As indicated earlier, "Privatization is a long, slow and often frustrating activity" (ibid, p. 487). At the initial stage, the performance as well as the assets of PEs to be privatized have to be properly evaluated based on diagnostic studies. For those PEs to be sold, buyers must be found and financing sought from domestic or external sources. At the same time the ground work and the prerequisites of privatization such as the development of capital markets, the provision of credit facilities and reform measures of macro-economic policies that could enable the growth and expansion of the private sector ought to be ensured. In addition, the choice of modalities and sequencing must be made on a case by case basis so as to make them better suited to the political atmosphere and tailored to country circumstances.

Among other things, the unit could perform the following duties and responsibilities:

- i) to value PE assets and recommend selling prices;

phase focused on structural reforms, which included such measures as the revision of investment and labour laws in order to complement the stabilization objective and at the same time provide an enabling environment for the private sector (ibid, p.8). The revised investment law was expected to encourage both local and foreign investments. The revised labour law was said to be in line with a market economy. Furthermore, prices except that of sugar, yarn, corrugated iron sheets, nails and cement were decontrolled. Transport tariff was deregulated and zonal fleet administration abolished. In the third phase, the above mentioned structural reform measures will be strengthened by subsequent structural reform measures that will focus on the financial sector, public enterprises and civil reforms.

The impact of these measures have both positive and negative effects on PEs. Some of the measures that directly assist PEs include the following:

- i) The availability of foreign exchange through the ERRP and governments' direct allocation so that PEs are enabled to secure the required inputs and spare parts.
- ii) The devaluation of Birr has changed the relative prices of imported goods and those domestically produced.
- iii) The revised labour law removed the bias in favour of labour. It enabled PE management to enforce strict labour discipline and ensure labour productivity.
- iv) Except for few essential commodities, prices for products and inputs were generally liberalized.

Some of the measures that may have adversely affected PEs, at least initially, include the following:

- i) The upward adjustment of interest rates became a burden on PEs as most of them operate on over-draft and term loans.
- ii) The government's commitment to reduce its deficit has adverse effect on PEs that mainly produced for the previous military.
- iii) The direct and indirect restriction of the private sector has been lifted. This removes, the market protection that PEs used to enjoy, such as foreign exchange allocation and the directive to government organs to buy from PEs.

Having implemented and monitored the process of privatization, the next stage will be performance evaluation. The process of performance evaluation is basically static in nature.

laws, extend guarantees, adjudicate contracts, define property rights and liberalize prices in the labour and financial markets. Thus, macro-economic stabilization and structural adjustment measures will create inflationary effects that might have a profoundly destabilizing social and political consequences. As a result, appropriate sequencing and timing will minimize the unavoidable negative economic effects and political risk.

- 4.5 A successful privatization programme will require substantial structural adjustments and changes in institutional management, such as the development of a capital market, the existence of a stock exchange and the availability of credit facilities for share transactions. In this regard, there is an urgent need to revive or create a stock market that will be responsible for the valuation and the transfer of PEs shares. Domestic investors should have access to the necessary credits and financing facilities to enable the purchase and sell of PEs shares in the stock-market. At the same time, widespread popular knowledge of share investment and the operation of a stock market could make privatization quicker and easier. In addition, the creation and establishment of a central privatization unit to manage the privatization becomes crucial to the privatization programme.
- 4.6 Finally, transparency should be a major element in all privatization related programmes. This means more and better studies of the particular problems of each PE selected for privatization and disseminate their findings widely to the public. In this respect, prospectus preparation for each of the PEs to be privatized will be desirable. This will ultimately help in the decision whether to liquidate or rehabilitate the PE in question in terms of its cost implications to the private investor or the society at large.

5. CONCLUSION

In the process of a privatization programme, the issues of modalities, sequencing and timing deserve particular attention, because they are critical elements. The appropriate speed of the privatization programme may vary greatly with the circumstances of each country. In the Ethiopian setting, in order to carry out a successful privatization programme, the preparation phase ought to be completed before the execution phase begins. That is to say, privatization objectives and policies should be clearly established. Secondly, the priority list of enterprises to be privatized as well as the practicable mode of privatization ought to be carefully selected on the basis of a diagnostic study of PEs. Thirdly, systematic privatization strategies must be developed and PEs made ready for sale or liquidation. In other words, decisions on what type of PEs to sell, for whom to sell and at what prices to sell ought to be determined before embarking on the execution of privatization. To this effect, there is an urgent need for a coherent and comprehensive privatization strategy that encourages efficient operations of both the private and public sectors of the economy in Ethiopia.