DOMESTIC PRICE DECONTROLS AND MARKET DEREGULATION IN ETHIOPIA: IMPACT ON PRIVATE FIRMS AND STRUCTURE OF INVESTMENT

Makonnen Abraham

1. INTRODUCTION

Four years have passed since price decontrol and market deregulation measures were introduced for agricultural outputs (cereals, pulses and oilseeds). It is only two years since the Transitional Government of Ethiopia (TGE) introduced an economic policy for the transition period, the basis of which is a shift from a command economy to a market economy. The major thrust of the new economic policy is to solve the structural deficiencies in order to revitalize the economy and create conditions favorable for growth. As a result of this policy directive, price and market liberalization measures have started to apply for industrial products as well.

Price decontrol and market deregulation, together with other macro-economic policies, are expected to encourage the private sector to actively participate in the economy.

The purpose of this short paper is to assess the impact of price decontrol and market deregulation measures on private firms and on the structure of investment. Although it is too early to assess the impacts fully, the policies have created conditions favorable to the private sector. Therefore, in the light of experiences in other African countries, both short and long-term impacts will be assessed.

The paper is organized in six chapters. In the next chapter, the rationale for such policy requirements and the profile of the Ethiopian private sector will be described. This will be followed by a discussion on both short and long-term impacts of the policy measures on private firms and their structure of investment. The fourth chapter assesses experiences in some African countries. The fifth chapter deals with the private sector's response to these and other policy measures in terms of investment in major sectors of the economy. By way of a conclusion the paper tries to highlight some of the obstacles that should be tackled in order to create more favorable conditions for the private sector.

2. PRICE DECONTROL, MARKET DEREGULATION AND THE PRIVATE SECTOR

2.1 Price Decontrol and Market Deregulation

For a couple of decades, the previous Governments had exercised controls over prices and markets of both agricultural and industrial products. The rationale for such controls were three fold:

In addition to supplying agricultural output for local consumption and for export, agriculture also heavily supports the industrial sector: around 70 percent of large and medium-scale industries are agriculturally based. Therefore, growth in the sector is very basic to improving food supply, exports and raw material supply for industrial growth.

Crop production accounts for about two-thirds of agricultural GDP, livestock production for about one-third. In the last five years (1987/88 - 1991/92), food crop production averaged 5.34 million tons a year. The production figures for pulses and oilseeds were 0.68 million and 0.13 million tons, respectively. As a result of this low production level, the country has a structural food deficit in most years.

The country's livestock population is the largest in Africa and plays a key role in enhancing human nutrition. Livestock production is integrated with crop production in many areas and is an important source of farm cash income. It also contributes substantially to exports and the industrial sector.

Although difficult to get adequate and reliable data, there are commercial-scale private firms engaged in agriculture mainly poultry, dairy, fattening, cotton cultivation, flori-culture, etc.

There are a host of problems associated with the slow growth of agricultural production. Had production been increasing more rapidly, food supplies would increase and prices would stabilize or be lower. In addition, more agricultural products would be available for processing and for export. Growth in the agricultural sector would give rise to agricultural surplus, which supports growth in other sectors of the economy. Therefore, the sector requires concerted action by the Government to remove the problems and help develop an "enabling environment" to attract firms into the sector.

2.2.2 Handicraft and Small- scale Industries

i) Handicraft Sector

Although there is a belief that a large number of craftsmen earn a living from the sector providing valuable service, it is still very difficult to determine the number of craftsmen engaged in the sector.

In the past efforts were made by HASIDA to organize craftsmen into cooperatives. Until the end of 1982/83, 824 service and producers' cooperatives were organized with total membership of more than 44,000. The combined fixed capital of these cooperatives was estimated to be about Birr 35 million of which Birr 23 million was the share of weaving and clothmaking cooperatives. Recent data on their performance is not available. However, it is generally assumed that the sector contributes 5 - 7 percent of total production in the manufacturing sector.

Table 1
Major Indicators of Private Sector Manufacturing Industry
(Addis Ababa)

Ser. No.	Industrial Branch	No. Of Establishments	No. Of Workers	Capital	Gross Value of Production	Operating Surplus	Gvp/ establishments	Ratio		Analysis	
								GVP/	GVP/	OS/	OS/
					(GVP)			Workers	Capital	Capital	Workers
A	B	C	D	E	F	G	H=F/C	I=F/D	J=F/E	K=G/E	L=G/D
1	Food and Beverages	143	1346	16120	43164	16881	301.85	32.07	2.68	1.04	12.54
2	Textiles	310	1017	17829	41738	21036	134.64	41.04	2.34	1.18	20.68
3	Wearing Apparels	162	1524	11358	28179	15821	173.94	18.49	2.48	1.39	10.38
4	Leather	89	1901	21190	74800	23079	840.45	39.35	3.53	1.09	12.14
5	Wood	10	116	1608	2226	1426	220.60	19.19	1.38	0.89	12.29
6	Paper & Paper Products	12	151	1983	1590	630	135.50	10.53	0.80	0.32	4.17
7	Publishing and Printing	21	354	8561	13463	1291	641.10	38.03	1.57	0.15	3.65
8	Chemicals and Chemical										
	Products	39	523	11362	18450	3425	473.08	35.20	1.62	0.30	6.55
9	Rubber and Plastics	19	396	13893	20469	11434	1077.32	51.69	1.47	0.82	28.87
10	Non-metallic Mineral										
	Products	23	434	8767	7128	2150	309.91	16.42	0.81	8.25	16.42
11	Fabricated Metal Products	50	751	10042	16603	5179	332.06	22.11	1.65	0.52	6.90
12	Machinery and Equipment	32	386	8845	20393	11528	637.28	57.83	2.31	1.30	[illegible]
13	Major Vehicles	5	181	6763	3399	390	679.80	18.79	0.50	0.06	2.15
14	Furniture and Others										
	n.e.c.	61	948	15108	46317	17570	759.38	48.86	3.07	1.16	18.53
	Grand Total	976	10028	153429	337919	131840	346.23	33.70	2.28	0.86	13.15

Source: Ministry of Industry, Annex.

Table 2
Natinnal Estimates of Production of Major Crops (1985/86 - 1991/92)

'000 quintals

Crops	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
Cereals	48199.87	56364.29	61369.68	57335.75	50707.85	53201.71	45671.36
Teff	9687.14	10332.24	10000.30	12177.24	9818.07	18044.65	11750.18
Barely	9138.59	9932.18	12688.73	10181.64	7544.94	7113.79	7043.39
Wheat	7744.07	7753.20	7787.63	7999.36	6229.39	6995.37	7446.64
Maize	10370.70	17153.63	19640.18	16886.86	16086.33	11589.34	12344.76
Sorghum	9045.48	9631.70	9098.96	8492.12	9186.05	6706.15	5479.04
Millet	1898.92	1197.81	1658.54	1121.90	1479.53	2209.63	1278.51
Oats	314.97	363.53	495.34	476.63	363.54	542.78	328.84
Pulses	4822.43	5407.77	5519.43	5637.37	5934.46	9586.30	6241.84
Horse beans	2333.25	2934.69	2500.72	2579.11	2676.91	3665.58	3250.24
Chick Peas	884.02	721.86	1056.03	851.19	915.94	1501.59	761.70
Harricot beans	233.38	332.59	472.39	709.62	655.70	1271.34	387.52
Field Peas							
Lentils	692.59	834.66	732.68	784.06	939.55	1719.45	1042.45
Vetch	258.71	268.88	316.00	278.56	260.38	623.79	256.46
Sayabeans	417.33	308.86	433.55	410.15	485.98	804.55	543.47
	3.15	6.23	8.06	24.68	-	-	-
Oil Crops	1014.27	844.91	808.67	784.75	825.75	3133.22	870.03
Neug	595.42	455.25	423.52	407.72	399.34	2036.25	512.04
Linseed/ Flax	382.71	311.21	230.27	189.20	325.85	804.41	270.65
Fenugreek							
Rapeseed	1.20	24.26	59.63	59.93	60.95	116.89	34.10
Sunflower	19.51	40.99	63.17	74.03	39.61	139.67	53.24
Groundnuts	9.23	6.45	14.92	1.37	-	-	-
Sesame	3.80	6.41	11.63	12.03	-	-	-
	2.40	0.34	5.53	40.47	-	-	-
Total	54036.57	62616.97	67697.78	63757.87	57468.06	65921.33	52783.23

Source: Ministry of Planning and Economic Development.

As a result of these policy measures, private traders took over the bulk of distribution activities. Surveys carried by the World Bank revealed that Africa has long traditions of open, competitive marketing at flexible prices that vary with volume of supplies and level of scarcity. In many African countries, almost every family is involved as both buyer and seller in the agricultural trade. Marketing activities involve a large number of transactions dispersed over wide areas. In almost all cases they are self-financing, so that the individual trader survives on his or her judgement, skill and efficiency. Firms in this area are typically small, often involving only one person or family. Therefore, private enterprises are allowed to operate without any hindrance. If state owned marketing boards and distribution outlets are able to compete freely with the private sector, as practiced in the countries mentioned above, there is a possibility of widening the choice for both producers and consumers.

4.2 Price Liberalization

Price control has been in practice in many African countries involving agricultural and industrial products and services. As explained earlier, the rationale for such a policy was mainly to ensure that people with low income can afford to buy basic necessities. However, the benefits of such policies are short-term because they discourage producers from engaging in areas where there is price control and, hence, ultimately leads to shortages and market distortions.

The experience in Ghana was more or less the same as the one here. In Ghana, selected agricultural and industrial products were under control. But government outlets were out of supplies most of the time because such supplies were picked automatically by private traders. The end result was a shift of profits from producers and retail outlets to private outlets. As a result of this bad experience, price controls have been substantially liberalized since 1985. Manufacturers are only required to report price changes, with no prior approval needed.

In order to allow market forces to play a role in the economy, the Zambian Government abolished the control of all wholesale and retail prices in 1982. Following this policy change, producer prices for major agricultural products have increased considerably in real terms. Together with concessionary tax rates for agricultural income and market deregulations, the measures have already led to increases in the area under cultivation and in the marketed output of crops.

For a long time since independence, Malawi maintained a system of formal and informal price controls on a variety of items considered essential either to consumers or producers (inputs). However, the policy was creating serious disincentives for producers, by failing to signal shortages and surpluses, causing inefficiencies and imposing a financial burden on those firms experiencing large increases in their output prices. Aware of this chronic problem, the Government implemented a price liberalization programme, reducing the number of items on the price control list from 56 in 1983 to 9 in 1985. Encouraged by the results of the move, the Government has expressed its commitment to decontrol all prices.

Since SSEs tend to be relatively labour intensive and utilize low levels of technology, price and market deregulation measures alone would not be effective unless accompanied by a strategy conducive to the expansion of the sector is charted out.

As explained earlier, price and market liberalization measures are accompanied hy other macroeconomic measures as part of the Economic Reform Programme, including devaluation and the introduction of foreign exchange auction system. Some of these measures had conflicting implications for entrepreneurs. Adjustment lending gave the private sector access to previously restricted inputs and spare parts. However, the price of imported inputs and the cost of financing them has gone up sharply.

In principle, price liberalization permitted firms to pass over higher costs to consumers in the form of higher prices, but in practice many could not because of demand related problems-either weak demand or too much competition.

3.2 Impact on Structure of Investment

Price decontrol and market deregulation will create a favorable climate for entrepreneurs. Since most local investors so far are traditional investors, capital, level of technology, know-how, entrepreneurial talent, etc. will limit them to engage in known sectors, such as oil extraction, grinding mills, catering, bakeries, small-scale commercial farming and construction. With the policy measures in place, the fierce competition that is going to be created will force them to go for efficiency and better service in order to survive. Those who don't make it will move into sectors that are considered relatively better. Therefore, the impact on the existing structure of investment in the traditional sectors would be very significant. But consumers will he provided with improved goods and services and at the same time be protected from unwarranted price hikes.

Past policies have "spoiled" - so to say-the private sector by forcing it to increasingly move into speculative merchandise trade and rent seeking activities. From the magnitude of conspicuous consumption by the "merchant class", one gets a good indication of the huge profits amassed through arbitrage. It is important, therefore, to remove the distortions by removing price control and market regulation measures that make such activities attractive and thereby give correct economic signals to redirect capital towards productive investment.

The measures are also expected to have significant impacts on entrepreneurs in their choice of technology. The right choice of technology would enable investors to enjoy larger benefits. In cases where the technology involved is dynamic, the investor would be extracting maximum benefits during the early years of the investment period. It provides the investor with competitive edge over competitors. With stable technology, however, the level of benefits would be reasonable but for a longer period of time. But the choice of such a technology would put the investor in a vulnerable position as the structure of investment changes in the sector.

investment certificates were issued for only 59 projects with a total capital outlay of only Birr 79.4 million.

Unlike projects in the industrial sector, agricultural projects are highly dependent on domestic raw materials. But investors' response to the sectoral priority envisaged in the Economic Policy and the Investment Code will not be realized if the sector continues to lag behind other sectors. This could be attributed to several factors including security of land tenure and prevalence of peace, which are considered high in the investors' assessment of risk.

Another striking factor regarding location is that 84.6 percent of the total projects are envisaged to be set up in Addis Ababa. Therefore, despite the additional incentive provisions in the investment code, choice of location has followed the traditional pattern. Factors influencing such decisions include easy access to market, availability of infrastructural facilities and, most of all, stability.

With regard to investments below Birr 250,000, it was stated earlier that licenses for such projects are planned to be issued by sector ministries. However, it was found difficult to get data from the ministries other than Ministries of Industry and Transport and Communication. HASIDA of the Ministry of Industry has issued 645 licenses to small-and medium-scale industrial projects in 1991/92. The breakdown of these projects together with the investment magnitude and employment generation is shown below:

Table 5
Summary of Small and Medium-Scale Industrial Projects Licensed by HASIDA (1991/92)

Sub-sector	No. of Projects	Capital Cost ('000 Birr)	Employment Creation	Capital Labour ratios 000 Birr
Food	249	23003	1605	14.3
Beverages	1	521	34	15.3
Textiles	190	17140	2196	7.8
Leather	55	9350	587	15.9
Wood Work	9	1156	90	12.8
Pulp and Printing	13	6410	273	23.5
Chemical	19	13317	265	50.3
Metal Works	64	10770	766	14.1
Non-Metal Works	43	5736	597	9.6
Others	2	813	24	33.9
Total	645	88216	6437	13.7

Source: HASIDA, Ministry of Industry.

As stipulated in the Economic Policy of TGE, foreign capital participation in the economy will be encouraged. However, priority will be given to local investors whereas foreign investors will be allowed in selected sectors. Proclamation No. 15/1992 does not provide investment opportunities for a joint-venture undertaking between a foreign partner and a local investor. Unless revised on time, it would become a constraint in attracting foreign investments in general with a significant impact on the structure of investment.

6. CONCLUDING REMARKS

In the 1960s and 1970s, local entrepreneurs were very active in small-scale industries, artisan and trading activities. However, the past regime stressed the role of government in directing the development process, consequently, private entrepreneurship was down played over the past seventeen years.

The Economic Policy of TGE and other macro-economic polices have addressed the major issues hampering the growth of the private sector. Entrepreneurship needs a positive environment to flourish and time to gain confidence. Therefore, there are still some obstacles that need to be removed in order to promote private enterprise. These include:

- Lack of active equity markets. A financial institution with a special lending policy needs to be created or the existing financial institutions must open a special window to provide services for those who have the skill and potential to do business but no start-up capital.

- Apart from the recently introduced auction system, the country is still working on a centralized system of foreign exchange budgeting and allocation. Therefore, in order to make more foreign exchange available to private entrepreneurs, the auction system should be gradually applied to all the amount of foreign exchange available.

- Aid donors can help to create a better environment for entrepreneurs in many ways. Their existing programmes are expected to make significant contributions. They should be reinforced by placing greater stress on the development of competitive markets, the easing of regulatory controls and closer collaboration with the private sector at all stages of foreign aid financed activities.

Private entrepreneurship will flourish most as long as the supportive policy regimes allow free markets to operate. And if financial institutions provide seed capital to potential investors with skill and entrepreneurial talent, many individuals just out of school or even in the public service would join the entrepreneurial sector. As witnessed in other countries, an encouraged private