

PRIVATIZATION AND DEREGULATION IN ETHIOPIAN INDUSTRY: PROBLEMS, PROSPECTS AND IMPACT ON THE ECONOMY

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1. THE STATE OF INDUSTRIAL PUBLIC ENTERPRISES: A REVIEW

1.1 Role of Industrial Public Enterprises

The majority of the industrial public enterprises (IPEs) in Ethiopia today fall under state ownership as a result of the 1975 nationalizations. Of the rest, a few were state-owned even then; and some were established as state enterprises later on.

IPEs dominate output, value added and employment in the manufacturing sector. The Central Statistical Agency's survey of manufacturing industries for 1988/89 (CSA, 1991), which covered "establishments which engage 10 persons and above and use power-driven machines", provides ample evidence of this. Although an equal number of public (208)¹ and private (206) enterprises was covered by the survey, the dominant role of public enterprises is unmistakable, as the following table demonstrates.

Table 1: Share of the Public Sector in Manufacturing Industry 1987/88 (percentages)

Gross Value of Production	95.3
Value Added at Factor Cost	94.1
Employment	93.2
Indirect Taxes (net)	97.6

Source: CSA, 1991, pp.8, 12, 14, 34, 36, 38.

1.2 Efficiency and Profitability of IPEs

Statements regarding the economic efficiency and financial profitability of Ethiopian IPEs must be placed within specific time periods if they are to be meaningful. With respect to the former, a World Bank study (1985: 116), which calculated domestic resource costs (DRC) for a sample of 19 IPEs, found 13 of them to be "relatively inefficient" (with a DRC higher than one, in some cases considerably so), the average being 1.09 (or 1.39 if Wonji Sugar is excluded). Interestingly, some of the economically inefficient firms were found to be financially profitable, leading the Bank to conclude that "financial profitability of the firms is not a good indicator of their economic efficiency" (p.41). In fact, 10 firms which were characterized as "relatively inefficient" were found to be financially profitable.

The results indicate that the structure of incentives, price controls, and protection is such that, on the average, a firm that is a net contributor to the Treasury is utilizing scarce resources inefficiently, implying that it is not a net saver (or earner) of foreign exchange (p.41).

However, the Bank's verdict on the financial performance of the IPEs was positive. It concluded that they "have been profitable, particularly compared with many African countries" (p.40). One might also add that their performance has been better than that of Ethiopia's state farms, which have been an unmitigated disaster.

A later survey, also conducted by the World Bank (1989), which included 36 firms (accounting for 40% of the gross value of IPEs), was more sanguine about their economic efficiency. It arrived at a domestic resource cost of 0.82, "meaning that, at border prices the firms would be profitable after taking into account the cost of capital" (World Bank, 1990:34). But there were some enterprises that were very inefficient, "with negative value added at border prices" (p.34). In view of such conflicting evidence, it is impossible to arrive at a firm conclusion regarding the economic efficiency of these enterprises.

In terms of financial performance, however, the situation has worsened considerably in the mid-eighties and especially in the last two years. In the first place, the number of losing enterprises has been steadily rising. This number, which was 19 in 1985/86, doubled in 1987/88 and rose to 52 the following year, with the estimate for 1989/90 being 61 (ONCCP, 1991: 9,39). Secondly, IPEs have been registering a steady decline in profits. Thus, total profits before tax, which stood at almost Birr 150 million in 1985/86, had gone down to only slightly more than 37 million in 1989/90, with the estimate for 1990/91 being a loss of almost 68 million. Not surprisingly, the share of profits before tax in net sales has also been declining, from 8% in 1985/86 to -4% in 1990/91 (MOI, 1991).

Again, the return on capital has also been steadily declining. According to one source (Siviter, 1986: 113), the return on capital employed (return defined as net surplus after taxation), declined from 15.4% in 1980 to 10% in 1984, the only exception to the general pattern being the Chemical Corporation, which registered a rise in profitability. Our information for subsequent periods comes from the Ministry of Industry's annual financial plans (1987,1989,1990b,1991). In these sources, return is defined as the sum of net profit before tax, interest on medium- and long-term loans and capital charge. Return on capital employed defined in this manner declined from 14% in 1985/86 to 4% in 1989/90, the figure for 1990/91 having been estimated at 0%.

Yet another indicator of weak financial performance is that the cost of goods sold represents too high a percentage of sales, with a slight tendency to rise in recent years. This figure, which was 82% in 1985/86, had risen to 87% by 1989/90 (MOI, 1987,1989,1990b,1991). While the figure would naturally vary from enterprise to enterprise,

the fact that it has been consistently high for the sector as a whole suggests that most enterprises have either low profitability or are operating at losses. It should also be noted that administrative and general expenses as a proportion of sales have been rising consistently.

Additionally, the ratio of current assets to current liabilities, which should normally be around 2:1 for industrial enterprises, has fallen consistently below this figure. Between 1985/86 and 1989/90, for example, it never exceeded 1.28:1 (MOI, 1987, 1989, 1990b, 1991). Therefore, the financial picture presented by the IPEs is unhealthy.

1.3 Constraints of IPEs

The poor performance of IPEs suggests that they are operating under serious constraints, of which the major ones are the following:

- a. *Management:* These enterprises have had virtually no autonomy with respect to output levels, prices, employment and all the other matters which are critical to the operation of an enterprise.

In the Ethiopian system, IPE managers have limited authority to manage. Employee remuneration is set outside the enterprises. Managers are not allowed to reward superior performance with material rewards. They do not usually have a choice in procuring inputs. Sometimes corporations purchase selected inputs for all plants ... Plant requirements for skilled manpower are determined in the annual plans, and the manpower is allocated by the Ministry; managers are allowed to select employees only below a certain level (World Bank, 1985: 42).

Moreover, there being no incentives for enterprise managers to reduce costs, by making efficient use of resources, there is little pressure on them to seek optimal results.

- b. *Foreign exchange:* This has also been a critical bottleneck, although IPEs have enjoyed a much more privileged position vis-a-vis private enterprises in terms of access to foreign exchange.
- c. *Weak financial position:* Many IPEs, even those that are financially profitable, have serious cash flow problems.

This is the result of the high level of cash contributions required from IPEs for domestic resource mobilization by the public sector, and of delays in some price adjustments by the authorities. Some IPEs have faced a shortage of working capital, and had to resort to short-term credits, which has added to their financial obligations (World Bank, 1985: 78).

- d. *Availability of raw materials and other inputs:* Especially in the last two or three years, with the escalation of the war and the consequent economic squeeze, industrial enterprises

have been plagued by a severe shortage of raw materials, spare parts and other inputs. This has inevitably had a drastic impact on their operations, capacity utilization in several cases falling to as low as 20%. The impact of such a low level of capacity underutilization on their financial position is obvious.

- e. *Technology*: This has been a perennial problem of the Ethiopian industrial sector. Most of the machinery is old, requiring frequent repairs and maintenance. Consequently, production is often interrupted and the costs of repair and maintenance are a serious constraint, especially in view of limited access to imported spare parts on account of the foreign exchange crunch.

2. THE NEW POLICY FRAMEWORK AND ANTICIPATED REFORMS

The economic policy of the Transitional Government (TGE, 1991) envisages drastically restricting the role of the state and correspondingly expanding that of private enterprise in the economy as a whole.

With respect to industry, however, the state seems to have been accorded quite a significant role. In the first place, there are a number of sub-sectors that have been reserved for the state, those "that are essential for the development of the economy" (p.27). These are described as "large-scale engineering and metallurgical plants, large-scale fertilizer and pharmaceutical plants and industries which supply strategic raw materials to major chemical industries" (p.27), most of which - one notes - are non-existent at the present moment. However, the policy leaves the door open for such enterprises to be run as joint ventures in association with domestic or foreign private capital.

Secondly, with respect to privatization it is stated that the state will privatize only those enterprises which it cannot "operate profitably", and "retain those that it can run profitably as a source of revenue"(p.28).

Thirdly, it is categorically stated that "it will be ensured that privatization is carried out gradually" (p.28). All this means that, even at the level of intent, there does not seem to be much of a commitment to undertake significant privatization of IPEs.

With respect to enterprises that will continue under state ownership, the policy stipulates that they will enjoy "full autonomy with opportunities for operational flexibility and efficiency" and that "decisions will be made at plant levels" (p.28). It is also provided that they will be judged by the criterion of profitability, "without favors and privileges whatsoever" (p.28).

Thus, the main measures envisaged are privatization and deregulation of industry, the subject of this paper.

3. PRIVATIZATION

3.1 Privatization Options: A Review of Experience

a. What to Do with State Enterprises: Hypothetical Options

The options with respect to IPEs are liquidation, reprivatization, decontrol and privatization.

- (i) *Liquidation*: This may be the best way of dealing with sick enterprises that have no prospects at all of being run profitably. The major problem that this raises is one of unemployment.
- (ii) *Denationalization (or reprivatization)*: The major appeal of this option (which involves returning nationalized enterprises to their former owners) is one of justice. It does not, however, address the problem of what to do with enterprises that have been set up by the state itself or of those that have always been state-owned. There is also the problem of potential laying off of workers. Nor is there any guarantee that the denationalized enterprises will not turn out to be inefficient private monopolies.
- (iii) *Decontrol*, i.e., continued state ownership but requiring the enterprises to be run on the basis of efficiency criteria. This would mean privatization of management through leases or management contracts. This may be a preferable alternative in cases where, for some reason or other, private investors cannot or will not buy state enterprises. There is some similarity between this arrangement and that of big corporations, in which there is a delinking between ownership and management. Contrary to the case of socialist public enterprises, it is argued, managers will have a vested interest in making their enterprises succeed. The counter-argument is that hired managers will not have the same degree of motivation as owners.
- (iv) *Privatization*: This could be full (in which case all assets would be transferred from public to private ownership) or partial (in which case only a given percentage of assets would be turned over to private investors, a typical arrangement being joint ventures with domestic and/or foreign private capital). Alternative modalities for privatization include:
 - * Selling to private entrepreneurs: This carries with it the risk that private owners may turn out to be monopolies. As such they would not be subject to pressures to improve efficiency, and there would thus be no net gain to society.
 - * Selling to the general public by floating shares: The crucial question here is

whether the public at large has the capacity to buy shares. Unless this is accompanied by a massive lending program, it is unlikely to be a viable option.

* Selling to the employees of the enterprise, which again raises the question of whether they have the capacity to buy.

In choosing among these alternatives, it must always be kept in mind that the major objectives of privatization are: (a) to increase the competitiveness of enterprises, and, (b) to reduce the financial drain imposed on the treasury by the inefficient operation of public enterprises. It should also be realized, however, that "private enterprise ... is not everywhere synonymous with efficiency" and that public enterprise is not "necessarily synonymous with maladroitness management" (Glade, 1991: 16).

b. Major Issues Pertaining to Privatization

- (i) Governments are seldom willing to sell profitable enterprises while buyers have usually no interest in acquiring losers, especially those that are heavily debt-ridden.
- (ii) Large enterprises may not find any buyers, because the cost of buying them may be prohibitive.
- (iii) Where potential buyers are likely to be few, there is a risk of concentration of ownership, thereby ending up by substituting private for public monopolies. The focus should be on efficiency as the primary goal, not privatization for its own sake.
- (iv) There are complicated problems of valuation involved, which may be taxing on the limited "infrastructure of privatization" (accountants, lawyers, etc.) that is available in poor countries.
- (v) There is need to create institutional mechanism to deal with matters of privatization as well as other issues related to the handling of state enterprises. Especially important in this regard is the need for sequencing strategies. Experiences with privatization in Latin America, for example, suggest "the pivotal role played by the lead institution in a privatization program", since "it is all too easy for the process to be stalled by the interplay of intramural bureaucratic politics and confusion over priorities" (Glade 1991: 128).

c. The Record of Privatization

On the basis of experience, it is possible to make the following generalizations (Berg and Shirley, 1987):

- (i) The practice of privatization has fallen far short of the rhetoric on this subject. We are told that "fewer than 1,000 firms were privatized throughout the world between 1980 and 1987" (Gelb and Gray, 1991:67).
- (ii) In general, privatization has mostly concentrated on enterprises that are small with respect to assets and employment; relatively few large enterprises have been privatized.
- (iii) Cases of privatization of management are few and far between.
- (iv) The performance of economies that have privatized on a large scale is nothing to boast about (e.g., Nigeria, a number of Latin American countries); in other words, privatization is not always the panacea it is often made out to be.
- (v) It should also be pointed out that the private sector in many poor countries is heavily dependent on the state, especially for the provision of essential infrastructure. There is a close nexus between the two, and the mere expedient of privatization will not obviate this. In other words, a strong private sector will require an effective state.

3.2 Problems and Constraints of Privatization in Ethiopia

The foregoing are general considerations that are distilled from the experiences of other countries. They are a useful starting point but hardly an infallible guide. What is required is not "abstract and sometimes evangelistic" statements about the possibilities of privatization (Glade, 1991: 15), but examining such possibilities within the specific realities of a given country. As Glade adds, "context makes all the difference". It is with this in mind that we now turn to the Ethiopian situation.

a. Constraints to Private Enterprise in Ethiopia

- (i) At the present moment there is a great degree of policy ambivalence on the relative roles of the public and private sectors. While a general expression has been made in the economic policy of the Transitional Government with respect to limiting the role of the former and expanding that of the latter, there is no unambiguous commitment to privatization. There are many activities that have been declared the exclusive preserve of the state. In addition, the policy states that only those state enterprises that are not profitable will be sold to private investors.

Even more important, however, is the general policy environment within which privatization would be attempted. Unless such an environment is *perceived* to create an atmosphere of competitiveness and a relaxing of the stifling patronage of the state,

whatever measures of privatization are initiated are unlikely to generate the desired benefits. It would be fair to say that such a perception does not exist in Ethiopia now, especially within the business community. This being a matter of confidence-building, it is more of a psychological than an economic factor. Its importance, however, is beyond question.

- (ii) Even with the most unwavering commitment to privatization, there are several real constraints that emanate from the backwardness of the economy. One such constraint, and possibly the most severe, is the availability of foreign exchange. Ethiopian industrial establishments are highly import-intensive, which means that they have considerable need for foreign exchange to import raw materials, spare parts and machinery.

In the past, private entrepreneurs had to labor under the disadvantage of being denied access to foreign exchange. Virtually their sole means of importing has been the *franco valuta* arrangement, i.e., the ability to import goods without being questioned as to how the imports were financed. This system has been recently broadened and the onerous surtaxes removed. But it is not without problems.

While this has helped ease the strain to some degree (bringing down the price of some spare parts, such as tires, as much as 200%), no one is happy with the system. Entrepreneurs point out that in order to secure access to a steady supply of dollars or other hard currency to use in the "franco valuta" system, they are forced to underinvoice exports. Moreover, those businesses which generate foreign exchange are not given the hard currency receipts but rather the equivalent in Birr, effectively imposing a tax on exports (San Martin and Hartland-Peel, 1992:10).

Even if state enterprises are no longer to enjoy differential access to foreign exchange, the supply of hard currency is very limited, which is bound to constrain the activities of private investors as well.

- (iii) Although the highest marginal tax rate on profits of private corporate enterprises has recently been reduced from 89% to 59%, it is still considered extremely unfavorable by private investors. The problem is compounded by the fact that there are no provisions for loss carry forward. Moreover, while the highest marginal tax rate was reduced for incorporated private enterprises, individual entrepreneurs are still subject to the very prohibitive rate of 89%.
- (iv) Past lending practice of the country's financial institutions has been discriminatory towards private investors. The major development lending agency, the Agricultural and Industrial Development Bank, concentrated most of its loans on the state sector, the share of the private sector being negligible. Thus, private entrepreneurs have had

to rely on their own resources or on non-bank sources of finance for both their start-up and working capital needs.

Moreover, private investors have to pay an interest rate of 9%, compared to a rate of 8% for state enterprises. But even this is far from the entire story:

The actual cost of credit to private borrowers is in fact much higher, because banks require that these investors insure their assets; insurance fees range from 1 to 2 per cent of the loan amount. In addition to discriminatory interest rates, borrowers openly complain that they would have to pay other (unspecified) up-front charges demanded of them by unscrupulous loan officers. From discussions with borrowers, especially smaller ones which appear to be at a particular disadvantage, it is understood that such costs may be as high as 10 per cent of the loan amount (World Bank, 1991, Annex IV: 1).

On top of this, private investors have to negotiate numerous bureaucratic hurdles to obtain credit; put up excessive collateral; and present personal guarantors in addition to the collateral. And the loan obtained at the end is usually a small fraction of that requested (World Bank, 1991, Annex IV).

- (v) Although licensing procedures have been considerably simplified recently, they are still prohibitive.

It currently takes MOI less than 48 hours to issue a temporary business license, and over 4,000 of these licenses have been issued over the last 12 months. Nevertheless, this license is only a temporary one. The entrepreneur can use it to apply for a loan, and obtain additional permits, but cannot begin operating until he/she has the permanent license. The applicant must take the temporary license and obtain additional permits and inspection certificates from a host of other regulatory bodies before it [sic] can go back to MOI and get the permanent license. There are no figures on how long this process takes. Apparently the most cumbersome of the other regulatory bodies, in ... terms of the length of time it takes to obtain the necessary permits and certificates, is the Municipality of Addis Ababa; it has been called "the Bermuda Triangle", since correspondence and applications left there often disappear without a trace (San Martin and Hartland-Peel, 1992: 12).

It is also known that customs procedures are cumbersome and time-consuming.

- (vi) It is widely reported that the labor law, which has been a disincentive to private investors in the past, is in the process of being revised. One will have to wait for the new law before any categorical statements can be made as to whether or not it is a change for the better. As it stands, however, it is unduly restrictive on management.
- (vii) Another problem has to do with access to land and premises and with having services.

such as electricity and telephone installed. In view of continued public ownership of land, access to land is bound to be a significant constraint on the development of private enterprise. The time-consuming and extremely frustrating red-tape involved in acquiring land is very prohibitive. Much the same is true with regard to renting premises and having indispensable services installed.

b. Issues of Privatization in the Ethiopian Context

It is unlikely that there will be speedy and comprehensive privatization in the Ethiopian industrial sector in the immediate future. This is partly because the government is lukewarm to the whole exercise. As one review pointed out, it seems the government is "far more interested in restructuring than in any massive privatization" (San Martin and Hartland-Peel, 1992: 15). As the same review (p.14) concluded,

interviews [with government officials] suggest that the commitment to some sort of reform of the state enterprise sector is real. What has yet to be articulated clearly, perhaps because TGE [Transitional Government of Ethiopia] officials themselves have limited knowledge of the options available, is what, aside from political capital in the international community, they hope to get from the privatization process. ... The question remains: What do TGE officials wish to achieve through "privatization"?

This is not an idle question because the answer to it will determine the magnitude and pace of privatization. Related to this is the wider policy environment within which the privatization exercise will be attempted. The issue is not merely one of privatizing this or that particular IPE but one of dismantling the entire edifice of regulation within which private enterprise has been forced to operate in the past. A positive supply response on the part of the private sector cannot be anticipated if the environment of rigid regulation is permitted to continue with only marginal modifications.

The pace of privatization is also bound to be slowed by a range of intractable technical problems involved, quite apart from the question of commitment. Some of the problems are identified below:

- (i) At the moment of writing there is no special unit to handle the problem of state industrial enterprises. In the absence of such a unit, whatever privatization takes place is bound to be characterized by confusion.

At the present time, each ministry is setting its own privatization agenda, and the pace of its divestiture process. It is not yet clear whether the final word on a particular privatization proposal will come from the ministry with direct operational responsibility for the SOEs [state-owned enterprises], from the Ministry of Finance as the official owner of the enterprises, or from another body.

Nor is it clear whether "asset sales" and other privatization actions will be coordinated by one central body or by each individual ministry. When an investor wishes to obtain information on a privatization candidate, to whom will he refer?; and is the operating ministry the best body to put in charge of direct negotiations with the investor? (San Martin and Hartland-Peel, 1992: 18).

Given the immensity and complexity of the task involved, this unit must be staffed with highly qualified professionals, and this would compete for already very limited talent within the public sector.

- (ii) Once such a unit is set up, it has to determine which IPEs are to continue under state ownership, which to be liquidated, which to remain under public ownership but subject to private management, and which to be privatized. This is by no means an easy exercise, since it will require detailed examination of each enterprise by taking a variety of factors into account.
- (iii) Once the enterprises to be privatized have been identified, decisions must be made regarding the modalities of privatization and the time frame involved. This would require working out a timetable for privatization based on priorities. Since not everything can be done at once, sequencing is of the essence. In other words, what is required is nothing less than a "privatization plan", but there is none as yet.

The TGE seems to lack concrete plans for moving to the divestiture stage. The Minister of Industry acknowledged that the government lacks technical expertise in setting priorities for divestiture: how to establish which companies are viable privatization candidates; how to identify which SOEs should/could be privatized without much restructuring and which would require more extensive rehabilitation; how to determine how much the state should be willing to invest in rehabilitation before it divests; how to evaluate the likely employment and other social impacts of divestiture in a particular sector; how to arrive at a reasonable price (the difference between the book value and the business value of a company) (San Martin and Hartland-Peel, 1992: 16).

- (iv) A particularly complicated problem with respect to privatization is that of valuation of enterprises. Some options are book value of assets, current market price, original purchase value, etc., each one of which has its own formidable problems. There is need for consistency and for avoiding arbitrariness of any kind. And transparency is of the utmost importance.
- (v) It must be recognized that the private sector in Ethiopia, which has never been particularly robust, has been further weakened by the policies of the military regime. Although undeniably large fortunes have been made by exploiting the pervasive scarcities that have characterized the economy, the private sector is still essentially weak. Therefore, one must be wary of the assumption that there is a strong private sector waiting to buy up IPEs once they are offered for sale.

In this connection it is worthwhile to take a close look at the size of IPEs, both in terms of assets and employment. Ministry of Industry data (1990a) reveal that in 1988/89, for example, more than 48% of all IPEs employed 200 or less permanent workers. More than 32% employed between 201 and 600, and these are sizable enterprises by Ethiopian standards. Perhaps a more useful indicator would be size of assets. Unfortunately, data on assets are not disaggregated by categories. Still, one can obtain a general idea by looking at average figures. In 1988/89 the net book value of fixed assets in the 164 IPEs amounted to more than Birr 676 million, giving an average of more than Birr 4 million per establishment, a figure which many Ethiopian investors will find prohibitive. Thus, while there may be buyers for the smaller enterprises, one cannot be too sanguine about the prospects for the larger ones.

For all these reasons, therefore, the prospects for a speedy and comprehensive privatization of Ethiopian IPEs must be contemplated soberly.

3.3 The Impact of Privatization

Thus, since no large-scale privatization is likely to take place in the near future, its impact on the economy is unlikely to be significant. Moreover, the mere fact of privatization alone will not make any significant difference, unless it takes place in a wider environment that enables private economic activity to take place in a less regimented and constrained manner. One should also not lose sight of the constraints which were mentioned earlier on, which are largely structural and will not vanish on the morrow of privatization.

However, whatever degree of privatization takes place is likely to have some effect, especially on government revenue and employment, and possibly on output and prices. Unfortunately, most of what can be said in this regard runs the risk of being speculative, given the large number of assumptions that have to be made with respect to what will happen after privatization.

a. Impact on Government Revenue

The major contribution that IPEs make to government revenue is in the form of:

- (i) a capital charge of 5% on the sum total of their capital and general reserve fund;
- (ii) a 50% tax on profits;
- (iii) a residual surplus (what is left over from profits after deducting (i) and (ii) above and a contribution to their reserve fund of 10% of net surplus after taxation, which is

transferable to the general reserve fund only for so long as the latter amounts to less than 30% of state capital);

(iv) sales and transaction taxes; and

(v) excise taxes.

Of these, those from (i) to (iii) apply only to IPEs, while (iv) and (v) apply to all industrial enterprises.

However, these payments do not represent a net contribution to the Treasury. In the first place, the IPEs get yearly allocations from the budget, which must be deducted to arrive at a figure for their net contribution. Then there is the untidy problem of how to treat money borrowed from local banks. Strictly speaking, this does not represent government contribution. However, since the IPEs get these loans by virtue of being public enterprises and since a portion of the loans never gets paid back, there is some legitimacy in considering them as public funds. Much the same consideration applies to foreign loans. There is, therefore, justification for considering the IPEs' net contribution to government revenue as the difference between the sum of what they get through budgetary allocations and loans (domestic and foreign) on the one hand, and the various payments that they make to the budget, on the other.

Unfortunately, the only year for which we have full information is 1988/89 (see Table 2). In that year, IPEs acquired a total of Birr 242 million from the budget, loans and grants; their revenue contribution, however, was Birr 757 million, which means they made a net contribution of Birr 523 million to the budget.

On the basis of this (possibly misleading) information, what can be said about the likely impact of privatization on government revenue? To begin with, there will be no reason to assume that the figures for the indirect taxes will change (unless production levels change), since these have to be paid by all industrial enterprises, public or otherwise. But the capital charge and residual surplus will not be paid by private investors. These, especially the latter, will therefore represent a clear loss for the government. And what will be forthcoming from the profits tax is likely to be less, because it is unlikely that the average rate will be as high as 50%. Therefore, it seems reasonable to expect a decline in the revenue contribution of IPEs.

This, however, is only part of the story. More important, perhaps, is the expenditure side of the picture. Privatization would mean that the government will not be supplying funds to industrial enterprises either from the budget or through loans. In other words, there will be no government expenditure involved. It would therefore be fair to conclude that privatization would lead to a relaxing of the drain on public resources. It is important to stress, however, that this is assuming wholesale privatization of the industrial sector, a patently unrealistic assumption.

Table 2: IPEs' Sources of Funds and Contribution to Government Revenue 1988/89 (million birr)

Sources of Funds:	
Budget	48.6
Own Funds	46.2
Bank Loans (Local)	70.4
Bank Loans (Foreign)	119.1
Foreign Grants	4.1
Contribution to Government Revenue:	
Sales + Transactions Taxes	117.6
Excise Taxes	457.1
Capital Charge	27.4
Profits Tax	82.9
Residual Surplus	72.2

Source: ONCCP, 1991.

b. Impact on Employment

Any statement on the possible impact of privatization on employment must necessarily be speculative, and quantification is obviously out of the question. In general, one would expect privatization to result in the laying-off of workers, given the labor redundancy that characterizes IPEs and the rationalization measures that are likely to be introduced by private investors.

There are, however, a number of factors that suggest that the impact will not be pronounced. First, employment in IPEs is only slightly higher than 90,000, which comes to less than one-half of one per cent of the country's labor force. Second, as pointed out earlier, the degree of privatization that will take place is bound to be minimal. Therefore, the nightmare of massive unemployment on account of privatization is difficult to envisage. It must also be recognized that, over the long haul, privatization may even lead to expanded employment if it leads to an increase in output.

c. Impact on Output

It is possible that privatization may lead to an increase in output on account of greater efficiency, but there is nothing automatic about this. In any case, the decisive factor is the larger policy framework and the extent to which some of the basic constraints, especially those of foreign exchange and raw materials, will be relaxed.

d. Impact on Prices

It is most likely that privatization will give rise to an increase in prices, essentially because prices will be decontrolled and private enterprises will not benefit from government subsidies or other forms of state patronage.

All in all, however, it is difficult to make categorical statements about the impact of privatization. The safest thing to say would seem to be that large-scale privatization being unlikely in the short run would have minimal possible effects.

4. DEREGULATION OF INDUSTRIAL ACTIVITY

4.1 Deregulation Measures

We use the word deregulation to refer to two distinct - albeit related - phenomena: liberalizing the general economic policy framework on the one hand, and restructuring of public enterprises on the other.

The first concerns unshackling the economy from a wide variety of state controls and interventions, its major components being the following:

- a) reducing the role of the state and increasing that of private enterprise in the economy, with special emphasis on creating an "enabling environment" for new enterprises;
- b) reducing government interventions in the economy; more specifically,
 - (i) allowing a larger role for the market in the determination of the prices of goods and services (i.e., departing from the practice of administrative prices);
 - (ii) reducing state intervention in the transport sector (e.g., determination of routes, tariff rates, etc.) and confining the role of the government to essential regulatory functions;
 - (iii) minimizing regulations and procedures for licensing of enterprises, customs clearance, credit and foreign exchange allocation, etc.;
 - (iv) granting autonomy to banks and other financial institutions so that they can be run free of unnecessary government interventions, and creating conditions for the setting up of private banks;
 - (v) abolishing restrictions on the mobility of labor and goods; and

- (vi) withdrawing the special privileges enjoyed by public enterprises vis-a-vis the private sector.

Liberalization can thus be seen as relaxing the constraints within which enterprises, whether public or private, operate. More specifically, the real significance of liberalization lies in providing the opportunity for new private investment to be forthcoming and participating in the development of the economy, in an atmosphere of relative freedom and without being stifled by excessive government intervention.

The second aspect of deregulation - the restructuring of public enterprises - is basically concerned with the problem of how to handle those enterprises that, for some reason or other, will not be privatized.

As should be evident from the discussion in Section 3 above, it seems likely that many IPEs will continue under state ownership for some time to come. The question of the context within which they will continue their operations is therefore of paramount importance. As mentioned earlier, one option is outright liquidation of those without a future. A second option is for the state to retain ownership and transfer management to the private sector on the basis of leases or management contracts (what Glade calls "simulated privatization"). This means that, although the concerned establishments will be owned by the state, they will continue to be operated as private entities, i.e., on the basis of efficiency principles. A third option is for the state to retain both ownership and management, but ensure that the enterprises are run on the basis of efficiency criteria, without having any access to special privileges that are denied to private enterprise. This will naturally mean removing the various policy and administrative constraints within which private enterprise is condemned to operate and, in general, creating conditions propitious for competition among and between state and private enterprises.

With respect to surviving state enterprises, some of the measures that need to be introduced are the following:

- a) Broad management autonomy at the enterprise level, with minimal interference in the workings of enterprises, apart from the state performing general regulatory functions. This will mean, among other things, that management will have the final say with respect to output level and mix, sources of input supply, pricing, hiring and firing labor, reinvestment, markets (including export markets), etc.
- b) The major criterion by which an enterprise will be judged would be profitability, except in special cases where an enterprise is assigned specifically non-economic goals, which may have a social or political content deemed to be in the larger national interest. There should be no attempt to mix such diverse goals, as any attempt to do so would merely cause confusion.

- c) State enterprises should compete with private ones on an equal footing, i.e., without being given differential access to foreign exchange, credit, inputs, etc. or without enjoying special privileges with respect to taxation, for example.

Other measures of restructuring would include reorganization of state enterprises (not only internally but also with respect to the possible dismantling or reorganization of larger structures), cancelling the debt of enterprises or working out other modalities for easing their financial burden, and opening them up for joint state-private ownership and management.

4.2 Prospects and Problems of Deregulation in Ethiopia

The prospects and problems of deregulation as it affects Ethiopian IPEs must be considered in two parts, following the distinction made in 4.1 above. With respect to liberalizing the general policy framework, the economic policy of the Transitional Government indicates certain departures from the past. It is envisaged that the role of the state in the economy will be reduced; that it will "create enabling conditions that will encourage private capital participation" (TGE 1991:17); that it will "remove all existing bureaucratic procedures and red-tape" (p.18); that financial institutions (which will continue under state ownership) will "enjoy broad operational autonomy" and that "private capital will be encouraged to participate in banking and insurance activities" (p.34).

While these are important departures in the direction of liberalizing the economy, they must be viewed in conjunction with two qualifications. First, these are intentions, and the speed and determination with which they will be implemented remain to be seen. Second, even at the level of intentions, there are several areas in which government policy is at best ambivalent.

Even at this level, however, the degree of reorientation should not be exaggerated, because the economic agenda envisaged for the state during the transition period is still substantial. Thus, land - both rural and urban - would continue to be public property. It is also envisaged that state ownership will continue, in one degree or another, in commercial agriculture; big engineering and metal works industries; major enterprises producing pharmaceuticals and fertilizers; "strategic" raw materials for the chemical industry; some wholesale trade enterprises; major financial institutions; air, rail and sea transport; telephone and postal services; some road transport establishments; mining and energy; and some construction enterprises. And the state is also expected to continue playing important regulatory functions in the economy. There is therefore no basis to expect the emergence of a full-blown market economy (Eshetu, 1992: 15).

With respect to the restructuring of IPEs, the policy envisages broad autonomy at the enterprise level:

Industrial enterprises under state ownership or those run in partnership with private capital would have full autonomy with opportunities for operational flexibility and efficiency. To prevent delays in decision making through a chain of organizational layers, decisions will be made at plant levels (p.28).

It is also stipulated that IPEs should operate on the principle of profitability "in a competitive environment" and that "they should be treated like any private enterprise without favors and privileges whatsoever"(p.28).

There is one jarring note, however. The policy stipulates that "in order to eliminate rampant bribery, theft and inefficiency as well as to provide incentives to workers and promote management-worker relations, labor should have a third of the voting right through representation on enterprise management boards"(p.28). This provision is difficult to reconcile with management autonomy; as it withdraws the hand of the state from management, it introduces the hand of labor, thereby severely limiting the latitude of management in making decisions.

All told, however, it seems likely that the thrust of reform will tilt towards restructuring IPEs rather than towards privatizing them.

It is obvious that the stipulations made above are rather stiff conditions for state enterprises to meet. Their fulfillment represents both an opportunity and a challenge. The opportunity is that all economic enterprises will have to operate in a competitive framework, with the expected result that this will enhance the efficiency of the economy and contribute to faster economic growth.

The challenges and problems involved, however, are legion. First, it will not be easy for enterprises that have for years operated under the benevolent protection of the state and with all manner of privileges to adopt overnight a modus operandi that is totally alien to the one that they are used to. The costs of learning by doing are formidable.

Should they fail, the logical conclusion is for such enterprises to be liquidated, a prospect with far-reaching social implications, especially in the field of employment.

What makes this prospect even less attractive is that, in the absence of a weak private sector to take over from the state, liquidation itself becomes a questionable alternative, even if the choice is maintaining unprofitable enterprises.

But, as pointed out earlier, the heart of the matter lies not so much in improving the efficiency of IPEs - although this is very important - but in creating an environment that would enable all actors in the economy to make their fullest contributions.

It should be pointed out in this connection that deregulation should not be taken to mean negating the important role of the state in an economy of the Ethiopian type. There will still be a lot the state has to do, if not as a matter of principle, at least by default. One can go even further and state, only apparently paradoxically, that deregulation may have to proceed parallel to "re-regulating". "New regulations may be required to strengthen the operation of the capital

market, to forestall the emergence of undue concentrations of economic power in the private sector, and to install an appropriate operating framework for public utility industries" (Glade, 1991: 5-6).

5. CONCLUDING REMARKS

It seems that deregulation - rather than privatization - will represent the major focus of government reform policy in the industrial sector. While this is a matter of conscious policy preference, one must also recognize the serious obstacles standing in the way of massive privatization in Ethiopia today.

It must be stressed, however, that if they are to be effective at all, both privatization and deregulation need to be carefully planned and sequenced. For this to happen, the requisite institutional mechanisms must be put in place without delay. Above all, there must be an unwavering commitment to creating a policy framework that will enable all actors in the economy to contribute, as fully as possible, to the rehabilitation and development of an economy that is in a very sorry state indeed.

NOTES

1. It should be noted that of these 208 establishments, 48 were in Eritrea.

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