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Review of the Pre 2018 Privatization and Lesson for the Current Ethiopian Privatization

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Privatization is the process by which state owned enterprises are transferred to private individuals, has become the most widely discussed subject in economic policy analysis in the last two decades of the 20th century and continues to be a central focus of debate in the 1990s as many countries move toward a market economy (Fekru D 2000). Withdrawing from loss making enterprises in order to minimize the state budget deficit and opening the room for the private sector engagement in the production which leads to greater profit and increase in total production and societal prosperity is the main motives of privatization.

Privatization is an instrument of economic policy. It is the transfer of property or control of assets used to deliver goods or services from the public to the private sector. The narrow definition refers to privatization at the level of the firm or units within it. While there are different forms of privatization, a widely accepted definition of privatization encompasses the privatization of management as well as the privatization of ownership (Kamal S. Shehadi S, 2002).

The privatization movement began in the West in response to mounting budget deficits and growing skepticism about the ability of government to manage and operate enterprises

efficiently. The privatization tide began in Great Britain with Margaret Thatcher's government wholesale transfer of publicly owned entities throughout the 1980s (Fekru D 2000).

Privatization of large state-owned enterprises has been one of the most radical new policies of the last quarter century (*Roland G, n d*). Developing countries are following the initiation of their developed counterparts and are transitioning their economies from state-centered production and allocation of goods and services to a more market oriented approach (Fonseca R, 2009).
Before 1974 the Ethiopian Economic policy was more or less market oriented with an open policy in the sense that no minimum requirement was imposed on the establishment and operation of enterprises. The role of government was mainly to pave the conducive way for smooth functioning of potential investors both from within and outside the country to commit resources in industrial investment (Selvam J , 2007). After the emergence of Marxist Military government in 1974, the political philosophy changed and ownership moved toward the state.

On 7th February 1975, the government released a document outlining socialist Ethiopia's economic policy. The policy identified three manufacturing areas slated for state involvement; basic industries that produced goods serving other industries and that had the capacity to create linkages in the economy; industries that produced essential goods for the general population; and industries that made drugs, medicine, tobacco and beverages. The policy also grouped areas of the public and private sectors into activities reserved for the state, activities where state and private capital could operate jointly, and activities left to the private sector.

In Ethiopia history of privatization back three decades. After the end of Cold war in 1991 Ethiopia experienced state change from Derg to EFDRE with change in ideology and economic policy from command to market economy. It was the Transitional Government that came into power in 1991 which initiated privatization aimed at stopping this hemorrhage. In 1992, there were 211 large and medium sized manufacturing plants under state control, of which 164 were under the management of the Ministry of Industry, while the remaining 47 firms were under other ministries. Altogether the experiment of Derg regime on expanding public ownership proved to be failure, owing to mismanagement and overstaffing, inappropriate investments, poor coverage and quality of services, high debt and fiscal losses and increased corruption.

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Between the period of initiating the process and 2001/2002 (Ethiopian Fiscal Year), around 223 public enterprises were transferred to the private sector. About 60 percent (or 133) of these enterprises were small firms operating in the retail trade sector. Large and medium scale industries constituted around 17% (40). Agricultural enterprises, hotels and tourist attractions sites and mining enterprises held a share of 13 percent, 8 percent and 0.4 percent respectively (Worku G nd).

Giant state enterprises (such as railway, industrial parks, hotels, sugar and manufacturing industries, Ethiopian Airlines, Ethio-Telecom, as well as Ethiopian Shipping & Logistics Services Enterprise.,) are still under the control of the government. With the current wind blow of change in the country, there is a call for domestic and foreign companies to participate on the process of partially or fully privatize in the major public enterprises. This paper briefly review history of privatization in Ethiopia and draw lesson for the current privatization. What is known about prior privatization experience in the country and take lesson in order to draw some lessons for policy and to offer some suggestions on how to assess privatization, at least in countries where there is still scope for it.

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Privatization Trend in Ethiopia

Selvam (2007) undertook a causal analysis to understand what motivated Ethiopia to opt for privatization. The reasons for privatization are as follows (Selvam, 2007, p. 3):

- Higher fiscal pressure on the government due to large public debt and large external debt;
- Dependency on loans from international financial organizations;
- Large share of total investment in SoEs;
- Poor performance of SoEs in terms of production and profitability; and
- Poor prospects for long-term growth.

The experiment of Derg regime on expanding public ownership proved to be failure, owing to mismanagement and overstaffing, inappropriate investments, poor coverage and quality of services, high debt and fiscal losses and increased corruption. Following the overthrow of the Derg regime the transitional government of Ethiopia adopts privatization of loss making public enterprises. According to Selvan (2007) "The first and foremost reason that expedited the

privatization programme in Ethiopia in 1991 was the poor performance of SoEs particularly production and utilization of plant capacity. During this period around 33%of SoEs could not cover their working capital requirement and making a loss.

The country experienced two phases of privatization since 1991: the first wave occurred from 1991 to 1994 and the second wave lasted from 1999 to 2004 (Ismail Z, 2018). Weak functioning of SOE were the major causes of privatization. The main beneficiaries of the privatization programme were two large business conglomerates: the Endowment Fund for Rehabilitation of Tigray (EFFORT), which is an endowment fund owned by the EPDRF and the MIDROC Ethiopia Investment Group, owned by Sheik Mohamed al-Amoudi (Ismail Z, 2018). These two business empires benefit from preferential treatment from the government and operate as a duopoly that undermines competiveness (Wondwosen, 2009). In dollar terms, nearly 60 percent of enterprises have been awarded to Al Amoudi-related companies. Failures of privatization arose when monopolies (especially natural monopolies) were privatized before regulatory and antitrust systems were put into place. The private sector was better at exploiting monopoly power than the government: overall economic efficiency was not enhanced.

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The privatization process has been marked by enormous abuses: in many countries a few individuals managed to grab hold of previously state- owned resources for a pittance and become millionaires or billionaires. Unmanaged privatization concentrates the public resources in the hands of few individuals which broaden income inequality and degrade the sense of ownership among the citizens. Employment in former SoE's declined by 12%. After privatization the production level declined by 14.21% during 1995 to 2004. The 1991 privatization in the country has drawbacks; there was a lack of transparency regarding the may account for the absence of detail names of the entities that were privatized (Kikeri S and Nellis J, 2002).

The literature is divided with regard to the impact of privatization on firms and the economy as a whole, more specially:

- The production level declined by 14.21% in the post-privatization period (1995-2004) (Selvam, 2008).
- There was no improvement in productivity in the manufacturing sector from 1994 to 2010 (Wodajo & Senbet, 2017).

- There were modest gains in after tax profit from 1995 to 2004 (Selvam, 2008).
- No positive shifts in management philosophy or training were found (Selvam, 2008).
  The 2018 privitization

The sale of public firms is one of the most important venues of entry for foreign direct investment (FDI). Most state owned enterprises, which have been ready for privatization, are found in accessible areas, with relatively developed infrastructural facilities. Albeit other attributes of these firms, privatization provides leverage over investments on the establishment of new enterprises and thus possibly attract FDI in countries such as Ethiopia where access to infrastructural services is a painstaking undertaking in terms of time and cost. Nonetheless, privatization has failed to attract meaningful FDI in Ethiopia and thus contributed little to create dynamic private sector. Ethiopian investors have held about 80% of all the privatized firms, albeit their share from the total commitment has been about 70%, or 2338 million birr.

Curbing budget deficit either through avoiding loss making enterprises or generating revenue from the sales of public enterprises is one of the rationales for privatization. As a policy, government avoided incentives to public firms in the form of financial subsidy. There is no gain that the country could anticipate by curtailing resource drain towards loss making public firms through privatization. In terms of generating revenue, privatization proceeds accounted about 10-21% of non-tax revenue and about 4 – 8% of the overall government revenue, excluding grants. Nonetheless, against greater expectations, the budget deficit has been increasing particularly since 1997/98. Although it is difficult to segregate the amount of revenue that government got from privatized firms through taxes, one could safely argue that the privatization process has contributed little to shape the fiscal structure of the country.

The 2018 privatization

According to Ismail Z,(2018) SoEs are still prominent in some sectors. In 2006 the manufacturing sector was still dominated by public enterprises which accounted for 72% of total

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manufacturing value added and 62% of gross value of production. SoEs also employed 57% of the manufacturing workforce.

The recent resolution of the Executive Committee of the ruling party in Ethiopia to transfer some enterprises to the private sector heralded a wave of privatization which is momentous not only in the number of enterprises to be privatized but also their size, sector and prominence. It is reported that the decision includes partially or fully transferring the shares of companies such as railway, industrial parks, hotels, sugar and manufacturing industries and also to sell lesser portions of stakes of companies including the Ethiopian Airlines, Ethio-Telecom, as well as Ethiopian Shipping & Logistics Services Enterprise.

The 1991 privatizations objective was to reduce the budget deficit of the government which was raised as the result of majority of SoE were operating in loss and being subsidized by the state budget. But for the current privatization there is no clear objectives declared by the state. Especially the call for partial privatization of Ethiopian Airline is confusing because this airline is the most successful aviation in Africa. Ethiopian Air line is property and figure of identity for the citizens.

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Challenge of privatization in Ethiopia.

In Ethiopia privatization is not an easy task. Major consideration has been taken in order to terminate the huge participation of the state from the economy through the process of privatization. The major bottlenecks of privatization are; absence of a developed capital market, problem of valuation, social equity issues, problem of unemployment and purchasing power of the public.

The transfer of shares from the public to the private sector requires the presence of a developed capital market. The transfer generally takes place through the mechanism of the stock exchange. The process also requires the intervention of the investment banks and securities brokerage firms. Their role is to undertake the valuation of a company and eventually act as underwriters to buy the shares from the government and retail the shares through the stock exchange at market

price. However, in underdeveloped countries such as Ethiopia, the required capital market and the institutional infrastructures necessary for the privatization process are nonexistent.

Before the share of a PE can be sold to private individuals, it is necessary to determine the price of each share by implication, the value of the company concerned. However, it is generally difficult to determine the value of a company where accounts were not kept regularly or systematically, or whose accounts were not regularly audited. Nevertheless, proper valuation remains of critical importance, because the government has a public responsibility of ensuring that the property of the society is not undersold to private individuals. At the time, the government has the social responsibility of ensuring that it is not selling a fictitious asset of no value.

The privatization process involves the transfer of assets that belong to the entire public, to a small and exclusive class of individuals that possess wealth. There could be a danger therefore, where key sectors of the economy on which the lives of the majority depend, would come under the control of the small class of wealthy individuals who are primarily motivated by profit, at the possible expense of social equity.

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PEs in Ethiopia, are generally unprofitable due to the fact that their employees enjoy a semi-civil service status which makes it difficult for management to compress the labour force. Moreover, PEs tends 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. Therefore, in the pursuit of privatization, the new owners and managers of the privatized company must be allowed to operate freely. They must be allowed to reduce the labour force based on the standard of labour productivity which will be consistent with the profit motive. As a result, the prospects of massive redundancy cannot be underestimated. The social and political repercussions of massive redundancies are a serious problem that requires urgent solutions.

It might be politically expedient to exclude foreigners from participating in the process of privatization of public companies. However, because of the low saving rate, the question to be

addressed is whether there are indigenous investors that possess the financial resources, the purchasing power and the willingness to buy the shares thereby offered. Will the commercial banks be willing to extend loans to individuals so that they acquire shares in privatized companies? Will the government be prepared to allow workers to acquire shares on privatized companies on credit? What kind of guarantees and incentives are necessary to attract the purchasing of shares in privatized companies? These are some of the various questions that must be addressed if privatization is to become a reality in Ethiopia.

Remark way forwarded

The paper highlights the conditions for successful privatization: strong political commitment combined with wider public understanding and support for the process; creation of competitive markets—removal of entry and exit barriers, financial sector reforms that create commercially oriented banking systems, effective regulatory framework—to reinforce the benefits of private ownership; transparency in the privatization process; and measures to mitigate the social and environmental impact.

History reveals sudden jump to privatization processes in Russia had led to significant wastage of public resources as corrupt officials colluded with emerging entrepreneurs to grab entire industries at a significantly undervalued price. Non-transparent and corrupt privatization procedures have led to the loss of substantial public wealth in countries such as Madagascar. The objectives should be clearly spelt out and it should not only best price but also capital investment program, management control, employment guarantee and technology transfer be given due attention. The government should privatize large companies, if only it identifies operational inefficiencies, to have a better management, technology transfer and transparency. Even then, it could privatize a portion of these public firms only to add value, and not to be sold to single investor, but to the general public.

To fully take advantage of the benefits of privatization, however, the process will have to be transparent and carefully managed. For instance, a clear case for privatization needs to be made

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for each enterprise rather than making a political decision to privatize every public-owned business entity.

Ethiopian Airlines appears to be doing very well, and it is not clear why it should be privatized. The company has a very ambitious expansion plan which has made it the largest African airliner while also being one of the most profitable. Privatizing such a successful enterprise rather than strengthening its management and governance structures sounds like fixing something that is not broken, and in fact, works fabulously.

The transfer of ownership should likewise focus not only on attracting capital and technology but also creating a sense of collective ownership. While the Prime Minister's proposal to sell about five percent of the shares to individuals of Ethiopian origins is encouraging, this number might not be revised upwards in order to succeed in creating a genuine sense of ownership (*ADDISU A.* 2018).

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