Policy brief

ETH-19064 | February 2020

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Making privatisation work for Ethiopia

In brief

- Ethiopia has embarked on a major programme to privatise some of its key state-owned enterprises (SOEs) as part of a broader effort to reform the economy and expand the role of the private sector. The country is attracting large volumes of foreign direct investment, being one of the top 10 recipients in the African continent (UNCTAD, 2019).
- This brief is based on a review of the international and regional experience of privatisation in Ethiopia and highlights some of the key policy lessons.
- A prudent approach to privatisation usually starts with setting clear, measurable, transparent, and predictable criteria to select SOEs for privatisation at the beginning of the process.
- Recommendations also include carefully managing the pace of privatisation to allow enough space for experimentation without dampening investor confidence and interest by trying to retain too much control.
- Privatisation should be used as an instrument to catalyse broader private sector development that can generate jobs and reduce poverty instead of helping create foreign-owned enclaves with little linkages to the rest of the economy.
- Large-scale privatisation might have adverse political economy consequences by shifting the distribution of wealth and power.

This project was funded by IGC Ethiopia.

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FUNDED BY
UKaid
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Overview of the project

The Government of Ethiopia has initiated a major programme to privatise some of the key state-owned enterprises (SOEs) as part of a broader effort to reform the economy and expand the role of the private sector. This round of privatisation is likely to be more consequential than the early efforts in the 1990s because it aims to move some key public assets in sectors such as telecom, power, logistics and transport to private hands. Even if the country is a late starter, the current wave of privatisation will be the largest exercise in the country's economic history.

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As expected, it is attracting the attention of stakeholders such as aspiring domestic investor as well as major international companies that may be competing to have a stake in various sectors of the economy to serve and benefit from one of the biggest markets on the African continent. It has been well-established over the last few decades that the international track-record on privatisation is mixed. Moreover, economic theory provides little guidance on privatisation adding to the dilemma policymakers in developing countries face. Therefore, it is important to critically review the existing evidence on past privatisation experiences to inform the discourse on privatisation in Ethiopia.

This brief is based on a synthesis report which reviewed the international and regional experience on privatisation from the point of view of Ethiopia's effort to divest the government of selected public assets. In addition to discussion of the rationale for privatisation at some length, the review highlighted the potential macroeconomic, microeconomic, social welfare and political economy implications of privatisation with reference to a trove of empirical evidence from around the developing world. In the following sections, we highlight some of the key policy lessons that might be relevant for the privatisation process in Ethiopia.

Policy motivation

Ethiopia is one of the numerous African countries that embarked on privatisation over the years. Table 1 below shows the list of African countries engaged in privatisation over the years. The revenue raised via privatisation can be significant and it is on a par with Europe when expressed as proportion of GDP. Estrin and Pelletier (2018) provide Africa-wide evidence for a 20-year period window from 1988 to 2008. The recent wave of privatisation in Ethiopia is one of the most comprehensive initiatives by scope and sectors covered.

Table 1: Privatisation in Africa

Period	Privatising countries
1960's - early 1980	Cote d'Ivoire, Benin, Guinea, Niger, Senegal (mainly Francophone Africa)
Late 1980's	Ghana, Nigeria, Cote d'Ivoire, Mali, Kenya, Malawi, Mozambique, Madagascar and Uganda
1990's - present	Cameroon, Ethiopia, Sierra Leone, Tanzania, Burkina Faso and Zambia

Source: Compiled based on Estrin and Pelletier (2018).

This project is set against the backdrop of the mixed record and controversial reputation of privatisation around the world. In the absence of a clear theory of change working in most contexts, policy makers need to study the experiences of past privatisation initiatives very closely. Moreover, privatisation does not always lend itself easily to the kinds of experimental approaches policy makers can employ to test the impacts of a policy in a pilot setting before it is rolled out at scale. The task of understanding the potential implications of privatisation is rendered rather complicated when one considers the multiplicity of economic and social outcomes that may be affected by the process. Therefore, there is much value, from the point of view of informing policy making and implementation, in scrutinising existing empirical evidence on privatisation.

Policy recommendations

Adopting pragmatism as a key principle

Despite the temptation to resort to normative and ideological premises when justifying or criticising privatisation, the past experiences of various countries show that the privatisation process should be guided by genuine pragmatism. The advice of international financial institutions, the accumulation of public debts, growing dissatisfaction with the performances of SOEs (e.g., electricity provision) as well as changes in the political dynamics in the country play an important role for the privatisation initiative the country has embarked on. Nevertheless, the government should adopt clear and measurable criteria to select SOEs for privatisation. There are numerous possible performance indicators such as contribution to employment growth and productivity, but financial viability is often considered the most relevant selection criterion. If SOEs are financially sound and operationally efficient, there needs to be a very compelling reason to justify the privatisation of operating arms of such companies. It could be the case that financial viability is a relative notion which may depend on the accounting practices of the entity in question. As such, some SOEs that are deemed financially sound may no longer be viable when stricter accounting practices (e.g., best practice international accounting standards) are applied.

Therefore, the government should employ uniform and standard yardsticks in evaluating financial viability. On top of financial performance at the firm level, the government should also be cognisant of the full extent of the macro-fiscal implications of privatisation. In this regard, it is prudent to have a robust assessment of the short term as well as the long-term trade-offs. For instance, Mauritius used privatisation not for short-term fiscal gains but to diversify its economy as a long-term objective and encourage private sector development successfully (Stiglitz, 2011).

Managing the speed and sequence of privatisation

There is wisdom in controlling the speed and sequencing of privatisation. The sequence of firms to be privatised may have far-reaching consequences in terms of shaping the market structure, sectoral linkages and political power dynamics. The Ethiopian government should consider partial privatisation as a viable option whenever conditions permit due to the absence of capital market and the lack of capacity of the domestic market to absorb a major sale via privatisation. The agreed percentage of equity between the parties varies from case to case but as the experience of Chile and Venezuela in the early 1990's show, mixed ownership is a good starting point. However, despite the technology transfer and financial flow advantage, partial privatisation might create a management problem (Enderwick, 1994). Nevertheless, where this issue can be mitigated, partial privatisation can allow the government to test the initial impact of privatisation while maintaining reasonable policy space.

By adopting partial privatisation, governments can prevent potentially exploitative foreign partners keen on shipping away profits abroad and find ways of taxing capital inflows. In addition, the sequencing issue is not only a matter of deciding the sequence of firms to be privatised but also the timing of the privatisation which often takes longer than anticipated.

Decisions with regards to the timing of completion of deals with potential investors and the timing of relevant policies are critical. These decisions should be made cautiously and transparently without exposing the economy to private actors to exploit policy loopholes. For this to happen, strong regulatory frameworks (e.g., overseeing the legality of contracts) backed by enforcement mechanisms should be in place to ring-fence the contracts against potential rent-seeking by public officials and predatory and exploitative foreign investors. The experiences of other countries in telecom privatisation, for instance, shows that care in timing, management, and governance of the process of privatisation will spare Ethiopia from a web of damaging probes, and corruption charges, which may risk cancelling out the gains from privatisation. The case of Macedonia is a good example here (Arifi, 2017).

Sequencing and partial privatisations can go hand in hand. For instance, in the case of privatising the energy and power generation sector, the most importance decision to be made is who does what in terms of generation (hydropower, thermal, etc.), transmission, and distribution. Evidence and good practice elsewhere indicate that generation and transmission are better left to state control while distribution and supply can be handled by private actors.

Building regulatory capabilities

Both the efficiency and equity implications of privatisation are moderated by the strength of regulatory institutions. The best practice is to have independent watchdogs that can monitor and put appropriate checks and balances in place for each of the targeted firms. For instance, regulating and promoting competition in the telecom, logistics, and utilities sectors should be undertaken by three different authorities that oversee their respective sectors. In the absence of a robust regulatory framework, allocative efficiency and social welfare may suffer. Therefore, building a reliable regulatory framework is often considered one of the centrepieces of a successful privatisation process.

Much of the social and economic pain that was caused by privatisation in the developing world in the past can be linked to the weakness of regulatory institutions (see the example of Argentina examined by Baer and Montes-Rohas, 2008). It might seem expedient to create a façade of regulatory institutions by transplanting rules from elsewhere without necessarily creating the functional capability to enforce those rules. This is usually the case when the state lacks basic institutional and personnel capabilities.

Ethiopian authorities should pay extra attention to the challenge of building effective regulatory institutions concurrently with privatisation given the lack of proper incentives and low motivation of the civil service. Providing wages commensurate with education and labour market experience and other non-monetary benefits (e.g., subsidised housing) for civil servants is one potential solution to reduce rent-seeking behaviour. In addition, punitive measures should be enforced on those engaged in malpractices to deter similar behaviour and prevent institutional regulations from being undermined.

Passing effective laws governing the privatisation of public enterprises is an essential component of the regulatory framework. Even if Ethiopia has a tradition of putting in place strong legislation, the need to revise and make amendments to existing and new proclamations should not be underestimated. Given the complexity of the process, policy makers should work on maintaining the robustness, sanctity and consistency of the various proclamations that guide the process of divestiture in the country for decades to come.

An Africa-based study of the telecoms sector and its regulation in terms of price cap, competition, and cost of service showed that Ghana, Cote d'Ivoire and Uganda did well compared to relatively poor performance by Malawi and Tanzania (Noll and Shirley, undated).

Putting privatisation in the broader context of private sector development

There is a strong case for treating privatisation as one component in the overall effort to improve private sector development in Ethiopia. As such, it is important to ensure that while the current reforms and privatisation initiatives are focused on privatising large SOEs, the necessary support should be provided to a large number of small and medium enterprises (SMEs) to have a handle on the growing unemployment problem and to promote avenues for self-employment and entrepreneurship especially for youth and women. This means the potential implications of privatisation for the development of the rest of the private sector including the linkages of privatized SOEs to other firms should be considered carefully. In addition to the real sector, privatisation can have implications for the development of the financial sector and capital markets. Therefore, the government should consider ways of capitalising on the privatisation process to spur private sector and capital market development as done in Mauritius (Stiglitz, 2011).

Managing the political economy consequences of privatisation

Large-scale privatisation can affect the distribution of wealth and power in society considerably. The benefits of privatisation (partial or not) should be visible in terms of the welfare of the general population and the service delivered by the firms under the new ownership arrangements. Depending on initial conditions with respect to the strength of democratic and fiscal institutions, the transfer of wealth through divestiture can worsen rent-seeking behaviour. This could be particularly the case if state monopolies are transferred to private hands without the necessary reform to foster competition and regulation of the process as we emphasised earlier. Hence, strengthening regulatory institutions with the aim of promoting competition does not only improve social welfare but also help to ward off the emergence of rent-seeking interests. Failing to monitor effective execution and oversight of this mega privatisation initiative and the subsequence conduct and performance of each of the firms within the regulatory framework undermines the process and can lead to re-nationalisation and derailment of the process and direction of sustainable economic development.

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