

3-D System Approach to Private Sector Development in Ethiopia

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Over the last two decades the role of the private sector in Ethiopian economy has been a bone of contention among government officials, business people, experts and the general public. While government officials stress that the private sector is the engine of the economy and there is enough room for businesses to strive and grow, businesses and experts argue that the public led investment growth is crowding out the private sector, making it almost irrelevant in the economy. In order to understand the exact role and level of the private sector development (PSD) and government support policies, I use the idea of an economic system and a methodology of economic taxonomy to measure and account the overall national economy of the country.

I have the assumption that the nature of the national economy of Ethiopia is composed of three types of independent economic systems that coexist side-by-side: the market economy, state economy and population economy. The value and composition of output produced in the country over a period of time (growth patterns), and the relative changes in the size and productivity of the various components of the macro aggregates (economic activities and structure) can be measured and accounted using three dimensional economic system models (see figure one for 3D economic systems). My assumption is based on three theoretical pillars: comparative economics, political economy and demographic economics.

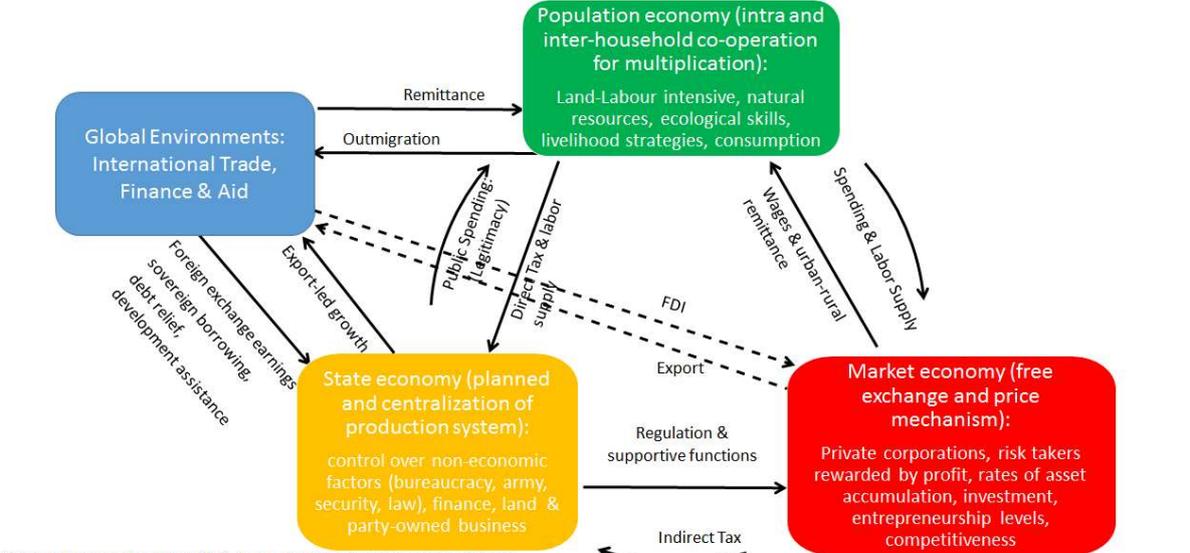
Theoretical Pillars

Comparative economics, a methodology of classifying economic systems based on criteria of property ownership and incentives, identifies two different process of decision making in resource use and allocation. It compares the goals of market economies (capitalism) and planned economies (socialism) to understand institutional efficiency for the purpose of planning and implementation. Private ownership of the means of production (market economy or capitalism) and public ownership of the means of production (socialism or communism or "planning") can be neatly distinguished. Comparative economic system is a one dimension approach that compares two systems that have similar structure. Both forms of economic system share common characteristics, namely division of labour, specialization, economies of scale, and a given level of technological development. Without such structural similarities there is no ground for comparison.

I used the assumption and approaches of comparative economics to define the market system economy in Ethiopia. A market economy is defined as an economy where nodal points of exchange (location) are dominated by value principles, exchange principles; demand principles; and principles of monetary transaction. In the case of Ethiopia, it is only the private corporations sector (both financial and non-financial) which have developed these market principles as mechanism for allocating factor resources among alternative outputs.

The second theoretical pillar of the 3D system approach is based on the concept of political economy, a study of the interaction of politics and economics. Political economy combines the ability to exercise power and the knowledge of optimal use of scarce resources. According to this theory the problem of policy choice is not simply a technical or computational one as in the case of production possibilities curves. The process of deciding technically what policy to adopt is dependent on political constraints and exercise of power. I used the perspective of political economy to define the economy controlled by the state. State economy is that part of a nation’s economy which is controlled by the political power elite. It is a planned economy in which the power elite decides how the factors of production are used and distributed. State economy is not subject to the sovereignty of the market; production, distribution and exchange market is controlled by the government, not by individuals or privately owned corporations. The definition of state economy includes party-owned business.

Figure 1: Inputs, Processes, Purposes and Environments of Economic Systems Independently Coexisting Side by Side



Source: Tsegaye Tegenu (2017), *One Country, Three Economic Systems: Institutional Attributes, Performance Curves and Policy Challenges*.

The third theoretical pillar of the 3D system approach is the concept of demographic economics which is used to explain the link between population and development. Demographic economics is the application of economic analysis to population growth and demographic transition. It is used to fill the theoretical gap and discusses aspects of the economy that are not captured by micro or macroeconomics, particularly the phenomenon of population change (the values of age group size, growth rate, dependency ratio, distribution, socio-economic behaviours, objectives and activities of age groups). I used the temporal and spatial effects of demographic forces and rapid population growth to identify population economy system in the country.

Population economy can be defined in terms of the management of an economy by part of the population that is growing rapidly in the country. The objective of the population economy is for reproduction, survival and multiplication of households under conditions of demographic transition, institutional and technological constraints. Population economy is not for profit, capital accumulation and investment. The definition of population economy includes the activities and outputs of smallholder agriculture and the urban informal sector. It includes all “non-observed economies” that are not covered in national accounts. In the population economy households determine what to produce, how to produce it, and how to distribute it. Neither the state (authority) nor the market (demand/supply) dictates how to allocate their scarce resources and how to distribute the produced goods and services.

Thus, the national economy of Ethiopia is not one-dimensional where everything is commoditized. Rapid population growth in the country has its own economic system which is very fragmented and that lacks the mechanism of growth enjoyed by market and state economies. It is possible that within a given country one can find the existence of different independent economic systems. Different types of economic systems exist not only between countries, but also within a country. In the case of Ethiopia there are three types of decision making process in resource allocation, production and distribution.

The three dimensional approach has implications in measuring and accounting gross domestic product (GDP), the value of the goods and services produced by the Ethiopian economy in a given time period. Traditionally, GDP is calculated using the expenditure, income or production approaches. These approaches are relevant for a one dimension economic system where there is in place the necessary mechanisms affecting the speed of an economy; namely division of labor, specialization, and technology that affect scale and growth rate of output capacity. Under such self-sustaining structural conditions the economy

can go fast or slow down depending on investment and technology (long run growth factors). By knowing when the economy speeds up or slows down, governments and business can plan, since the consumption/income of one household is the consumption/income of another.

In Ethiopia where the factors of one-dimension economy (such as the market economy) have not yet reached to a critical mass of economic actors, it is not enough to know the value (size and growth rate) of the output but also who producing the output, what is produced and how it is used. There are institutional differences in the ways how and why the society allocate resources, produce and distribute goods and services. In three dimensional economic systems the growth determinants differ depending on the institutional character and organization of the economic systems belonging to different entities.

Economic taxonomy approach is particularly important to understand why and how to develop market based private sector in Ethiopia. The 3D approach combines institutions, technology and factor markets as one and this is important for identifying long term policy strategies of developing the private sector, which was and is the engine of growth in Europe, USA and Asia.

Data Sources

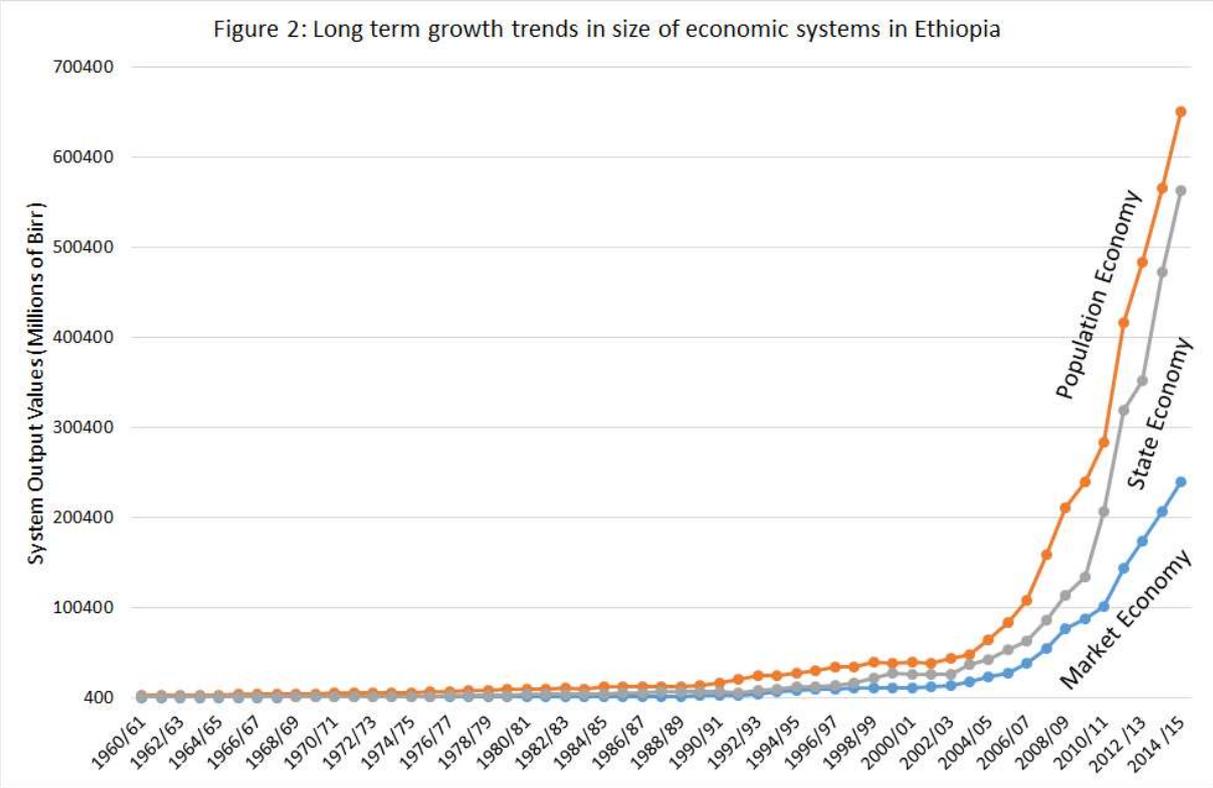
Before proceeding to the research findings it is necessary to say few words on data sources. The economic activities of the households, firms and state are systematically recorded in national accounts. National Accounts Department of the Ministry of Finance and Economic Development (MOFED) systematically prepares data on institutional and industrial sectors to measure macroeconomic categories of production and purchase of the country. The most widely used values that is measured in national accounts are the aggregate measures of gross domestic product or GDP.

The official publication of the Ministry which provides information on GDP by broad sectors of the economy such as agriculture, industry and services is relevant for the purpose of this study. However, disaggregated data on the share of different institutional sectors (public, private and households) is not available for a satellite account (which can be called 3D Satellite Account). As a result, I have used the consistent series compiled by the Ethiopian Economics Association (EEA) to estimate the outputs of the three economic systems.

For the purpose of this article I have modified the values of the consumption expenditure series. This data represents the final uses of output of goods and services in the given period of time. It is the sum of consumption expenditure (by households, government and non-profit institutions serving households or NPISHs), capital formation (sum of gross fixed capital formation, change in stocks and valuables) and net exports (exports less imports). I have reworked the share of the components of the consumption expenditure based on some study suggestions on private sector development in Ethiopia.

Findings: Trends in Output Growth

Figure 2 illustrates the trends of in the total value of output of goods and services produced within the respective economic systems of the country over the period of 1961-2015. The output growth of the three economic system has been remarkably low during the period (1961-1991), and came to increase in the period 1992-2003/04, and became rapid and stable since 2005. It is beyond the scope of this article to comment why the three economic systems have remained constant—neither increasing nor decreasing- for the initial period of 30 years. Suffice to mention that the economic structure was feudal and socialist between 1961 and 1991; and the economy was more regulated, inward-oriented and affected by prolonged civil war.

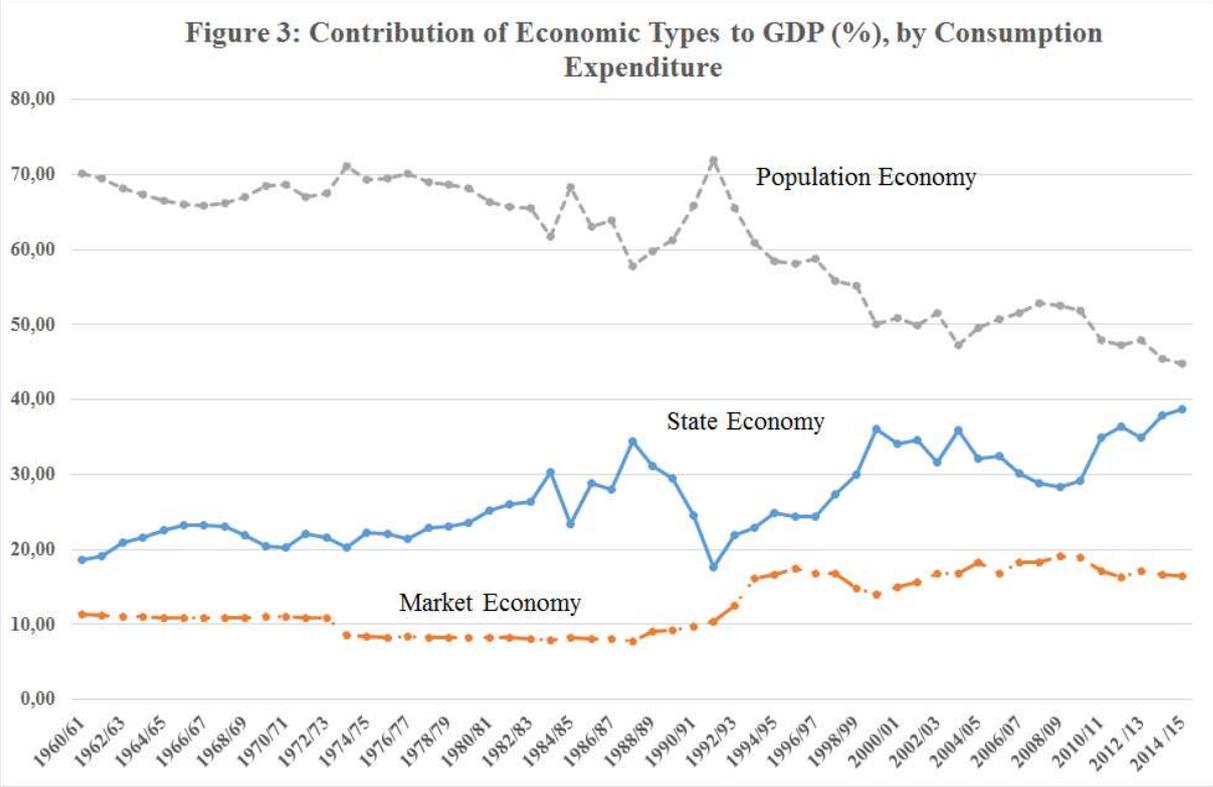


The overall pattern of increase and the sudden upsurge in the general trends since 1991 can be explain by the change in political leadership, administrative decentralization, population doubling, open trade policies and influence of economic globalization.

Economic Contribution of the Systems

Figure 3 shows the importance of each type of economic system in generating total value-added in the economy. The figure shows that the Ethiopian economy is going through transition where the contribution of population economy is decreasing with a gradual increase

in the rise of state economy. There seems to be negative correlation between the two types of economic system, in which the state economy increases as the population economy decreases. The contribution of the state economy has increased from 22 percent in 1992 to 39 percent in 2015. In the same period the contribution of the population economy decreased from 65 percent to 45 percent.



Further investigation is needed to determine cause-and-effect relationship between state and population economies. For our purpose it is important to note that the national output is still concentrated in the population and state economies. In terms of the amount it contributes to national GDP, the market based private economy is by far the least important economy. The private sector’s share of GDP on the average is estimated at 17% for the last 25 years. In developed countries, the market based private sector generates on the average 80% of aggregate gross value added in the national economy. What is happening to the “engine of economic growth” in Ethiopia?

The 3D approach to economic progress shows the low level contribution of the private sector to the aggregate national economy (which currently about 20%). Employment measure of the private sector’s contribution to the national economy shows that the share of private corporations was around 6 percent. Compared to the public sector, the private sector share in

total investment in Ethiopia is relatively low. (See Kolli, R., (2010), A Study on the Determination of the Share of the Private Sector in Ethiopian Gross Domestic Product. Addis Ababa Chamber of Commerce).

Conclusion

The three simple measures of the private sector's contribution to the national economy (share of GDP, share of aggregate employment and share in gross capital formation) shows the low level of private sector development in Ethiopia. Without a private sector, economies tend to deliver much lower standards of living because they have no means of generating profit and investment. The prospect of profit and investment drives efficiency, productivity and ultimately economic growth from which employment, income rise and prosperity flow.

What we have observed in the past decades is twofold increase in the share of GDP by the economic system controlled by the state, while the private sector remained almost constant at low level. Since the dawn fall of the military socialist regime, the federal government used many economic policy instruments and programs to increase its control over trade, financial market, fiscal relations, production enterprises, public services, etc. This is done in the name of poverty reduction, liberalization, developmental state and growth and transformation plans, among others.

Currently the state economy has expanded to such an extent that its institutions have literally become inefficient. This is conclusively demonstrated in the 17 strategic studies conducted by the government's own policy study centre (Ethiopian Policy Study and Research Centre) in areas of industrial development, urban development, agricultural modernization and good governance. Following these studies the Government has arrested considerable number of officials on suspicion of corruption.

Ethiopia now stands at a defining moment if/whether or not to develop the private sector economy. The institutional inefficiency of the state economy, the low productivity trap of the population economy and the deterioration of the market economy underline the need for long term strategy of private sector development in Ethiopia. The economy cannot operate as usual and massive strategic change is inevitable. What are the core strategies and policies of private sector development in Ethiopia? Which type or segment of the private sector is best suited for structural transformation and inclusive growth and which government policies are required to develop such a private sector? Can we have now a debate on strategic vision and long term PSD program that goes beyond some examples of constraints to doing business in Ethiopia?

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