ETHIOPIA'S PUBLIC SECTOR: STRUCTURE, POLICIES AND IMPACT

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1. INTRODUCTION

Meaningful economic planning implies above all that the budget will be used consciously for furthering the government's aims. While by no means all policies are exercised through or even reflected in the budget, those that can be effectively promoted via the government's spending, taxing and borrowing powers are of great importance. Closely related to these powers involving the mobilisation and allocation of resources, and sometimes greatly extending their range, is the government's broad authority over the nationalised industries, fiscal monopolies and other business-type organisations effectively or nominally under its control. For this reason the public sector in this paper is viewed as including all public enterprises.

The dividing line between public and private enterprise is easily drawn in Ethiopia since without exception all the large undertakings selling their output to the public and falling within the public sector by any definition are 100 percent government-owned. For all public firms defined in terms of majority ownership—some 40 in all prior to 1975—the government's share in the combined paid-up capital exceeded 97 percent. Even in the field of manufacturing, where mixed ownership is most common, the government's ownership share in the public firms averaged over 91 percent. Private equity capital is therefore not a factor diluting control.

Government administration in the country is highly centralised. The provinces and smaller geographical areas into which the country is divided are administrative or political divisions of the central government with virtually no financial independence. Only the municipalities, which are numerous but mostly very small, are outside the central government budget and expected to raise their own taxes and tap other local sources to cover the cost of their services. Since local government is only about one-thirtieth the size of the central government, no particular attention will be paid to it here.

Our aim in this paper is to provide for the first time an overview and broad assessment of the entire public sector. The statistical basis derives mainly from a recently completed investigation which reclassified government and public enterprise transactions within an integrated data framework conceptually consistent with the country's national accounts system.[1] The paper is divided

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into four sections. The first section places the public sector in perspective by sketching its role and importance in the total economy. This is followed by a section that focuses on the state enterprises: here we provide some comparisons of the financial performance of public and private enterprise and speculate on the reasons for the differences observed. The third section is concerned with the composition of government services, i.e. the cost of defence, education, health and so on, and with how the amounts spent on these services in Ethiopia compare with the spending on public services in a number of other African countries. Finally, in the last section we try to draw some broad conclusions regarding the consequences for income distribution and economic growth of recent changes in the revenue and expenditure sides of the budget.

2. THE PUBLIC SECTOR IN PERSPECTIVE

As in most other very poor countries, the public sector in Ethiopia is comparatively small (see Table 1). In the fiscal year ending 1972, government at all levels and state enterprises together contributed under 13 percent to the gross domestic product and absorbed about 15 percent of total final output. In a country dominated by peasant agriculture, much of it still of a subsistence nature, there is naturally little margin for communal services. This does not mean, however, that government business undertakings cannot play an important role on the economic scene.

One of the arresting features of Ethiopia's public sector is precisely the size and rapid growth of state enterprise. In terms of value added in that year, the public enterprises as a group were 13 percent as large as the nonagricultural private sector and nearly 60 percent as large as central and local government. They figured importantly, as the figures below show, not only in such traditional areas as power and water supply and transport and communications, but also in banking, which was for the most part in government hands, and in large-scale manufacturing:[2]

	Share in 1972 value added (%)
Electricity and water	83.3
Banking and insurance	73.3
Transport and communication	30.7
Manufacturing	17.3
Miscellaneous services	5.3
Wholesale and retail trade	0.3

1. SIZE AND STRUCTURE OF THE PUBLIC SECTOR IN RELATION TO THE TOTAL ECONOMY, 1971/72

(Percentage distribution)

A. Contribution to GDP	
Public sector	12.7
General government	(8.1)
Of which: central government	(7.8)
Public enterprises	(4.6)
Private sector	87.3
Agriculture	(52.0)
Other	(35.3)
Total	100.0
B. Final expenditures on GDP	
Public sector	15.3
Consumption	(10.8)
Gross capital formation	(4.5)
Private sector	86.6
Consumption	(78.3)
Gross capital formation	(8.3)
Net exports	(1.8)
Total	100.0

State enterprise, furthermore, is gaining steadily on the private sector. Its prospects for future growth (even leaving aside the new and powerful pressures for the rapid extension of state controls) can be read clearly in the figures for capital investment. In 1972 state-owned industry spent more than one dollar on plant and equipment for every two dollars similarly invested in the private sector, exclusive of residential building.

Notwithstanding the fairly substantial investment spending by the public sector, total gross fixed capital formation, private and public, has averaged only about 13 percent of GDP over the last decade, with no discernible trend[3]. The maintenance of even this low level of domestic investment has depended on a significant although not unduly large inflow of foreign capital. In 1972, for example, gross saving financed about 85 percent of the nation's domestic investment. Of this saving, more than a fifth originated in the public sector, most of it in the public enterprises. Nevertheless, the public sector's capital expenditure greatly exceeded its saving. In the state corporations investment spending was some 70 percent larger than the funds generated internally during the year. In sharp contrast to this situation, private capital formation apparently failed to keep pace with private saving.[4]. The lame investment performance of the private sector thus dampened somewhat the expansionary impact of the deficit public sector (see Table 2).

3. THE PERFORMANCE OF STATE ENTERPRISE

Granted that state enterprise is now a significant feature of the Ethiopian economic scene, the question arises: How successful has this extension of government into the commercial realm been? Do the government's business ventures represent a wise use of scarce resources? We can only claim to have made a beginning towards supplying answers, but our findings are at least provocative.

Based on the detailed financial reports of Ethiopia's state enterprises as reported to the Ministry of Finance, it appears that the average rate of return in 1972 was in the neighborhood of 9 percent on equity capital (excluding the central bank). This average return is pulled up considerebly by the extremely high ratio of profit to government equity in the state tobacco monopoly.

2. THE FINANCING OF GROSS CAPITAL FORMATION IN THE ECONOMY, BY SECTORS. 1971/72 (Eth.$ million)

	General Govt.	Public Enterprises*	Total Public Sector	Private Sector	Total Economy
1. Gross saving	42.9	65.5	108.4	402.5	510.9
2. Plus: Net capital transfer received	(1.3)	2.7	1.4	7.5	8.9
(a) Domestic	(7.5)	—	(7.5)	7.5	—
(b) Foreign	6.2	2.7	8.9	—	8.9
3. Plus: Net borrowing	60.3	42.5	102.8	(19.4)	83.4
(a) Domestic	16.2	105.1	121.3	(121.3)	—
(b) Foreign	44.1	(62.6)	(18.5)	101.9	83.4
Equals: Gross domestic capital formation	101.8	110.7	212.5	390.6	603.1

* Includes the National Bank of Ethiopia.

If the firm is excluded the figure drops to around 7 percent; and if the highly profitable Commercial Bank of Ethiopia, which is fully government owned, is also excluded, the average return is only 5 percent.

Comparisons with the performance of private concerns can best be made for the state's manufacturing plants, of which there were 13[5]. Many of these are in a monopolistic position in such fields as tobacco, oil refining, cement and pulp and paper, but even among the monopolies only one or two have returned substantial profits, with most yielding a very modest or even negative return. For all state manufacturing together, the ratio of profits before tax to paid-up equity capital averaged less than 10 percent in 1972—and a mere 1 percent without the tobacco monopoly, where the bulk of the profits originated. 1972 was by no means an unusual year, since about as many of the 13 have regularly made losses as profits.

While the corresponding return to all privately owned manufacturing firms is uncertain, our analysis of 235 large private manufacturing companies covered in the annual survey of manufacturing conducted by the Ministry of Commerce and Industry and the Central Statistical Office, indicates a rate of of return on equity capital (including reserves) of about 20 percent in 1970/71. This figure looks high, but it should be noted that interest rates paid by the companies on their substantial loan capital have been comparatively low, thus boosting the leverage of equity capital. The ratio of earnings before interest to the book value of fixed assets also appears to be in the neighbourhood of 20 percent.

As a measure of the average productivity of capital in these firms a figure of 20 percent may well be on the high side because of inflation. Assets should be revalued to reflect higher replacement costs and earnings reduced to eliminate capital gains which creep in as a result of basing provision for depreciation and charges for inventories drawn from stock on original cost. But there are also factors which can cause the bias to be in the opposite direction, e.g. the method of spreading depreciation over asset lives and the understatement of profits resulting from such practies as the charging of excessive management fees and the fictitious valuation of trade transactions with foreign affiliates. It would take us too far afield to pursue these matters here.

Because so many of the public manufacturing concerns are monopolies there are only a few lines in which government and private firms are in real competition, textiles being the most important field. We have been able to analyse in detail the performance of the two state-owned textile firms and six large private textile companies. In 1971 the government concerns made substantial losses—as indeed they did in other years—while the private plants earned substantial profits[6]. Net value added per worker was more than 4½ times as high in the private as in the public companies, even though the latter were more capital intensive. Only compensation per worker turned out to be comparable (details in Table 3, first two columns).

In printing and publishing we have also been able to compare the performance of the single government firm with five private competing plants Table 3, last two columns). Although the government firm is much is larger and more capital intensive than its competitors, value added per worker was significantly lower. The private printers' operating surplus (earnings before interest and tax) as a percent of paid-up capital averaged twice as high as in the government firm, and as a percent of sales about 40 percent higher. Here too only pay scales were the same.

Public enterprises should not, of course, be judged solely by their financial performance. Considerations involving employment creation, income distribution, regional development, linkages with other industries, divergences between private and social profitability due to government policies and externalities, etc. cannot be ignored. Neither, in comparing them with the private firms, can the fact that private industry is dominated by foreign ownership and bolstered by negotiated tariff protection, tax relief and liberal foreign exchange transfer policies. Nevertheless, leaving aside this last point, the absence of

3. SELECTED INDICATORS OF PERFORMANCE OF PUBLIC AND PRIVATE TEXTILE AND PRINTING FIRMS. 1970/71

	Textile Firms		Printing Firms	
	Public	Private	Public	Private
Operating surplus				
As % of paid-up capital	(12.3)	39.3	9.9	19.5
As % of gross value of production	(10.7)	14.3	7.5	10.5
Value added per worker (Eth.$)	513	2,399	2,458	2,659
Depreciation as % of gross value of production	8.7	5.8	10.4	6.6
Average annual compensation per employee (Eth.$)	1,114	1,129	1,904	1,944

clear policy directives and close supervision by the government suggests that the other considerations cannot be accepted as valid reasons for putting up with the poor financial results of so many of the public companies.[7] And while foreign ownership and the consequent siphoning abroad of much of the surplus of private undertakings, sometimes by devious means, reduces the advantages to the country of the private concerns, the poor showing of government corporations competing under favourable conditions with private firms remains a fact.

Quite apart from the inadequate contribution to the country's development made by a good part of state enterprise, the large measure of financial and administrative autonomy of many public firms stands as an obstacle to coordinated decision-making in the government sphere. On the average the public corporations relinquish to the treasury less than half of their after-tax profits, with the actual fraction in individual cases varying remarkably widely. At the same time, there is a minimum of control and supervision centrally over investment decisions and pricing policy; clear guidelines regarding the surrender or utilisation of profits are lacking; and concern with the quality of management, until recently at least, has been conspicuous by its absence.

Institutionalised arrangements to ensure that a great deal more attention is given to these factors would seem to be a matter of urgency. Instead of being permitted to go their own way, state-owned commercial ventures should be subjected to the same intense scrutiny by knowledgeable budget, planning and auditing officials as ordinary branches of government and be required to meet the same tests. Concern with the use of resources should extend to the whole of the public sector.

4. GOVERNMENT SERVICES

Even if a large part of state enterprise has been free to chart its own course, the political budget-making process which brings together finance ministry, planning and departmental officials does give expression to the government's considered views on how much should be appropriated for various purposes. It is in fact here that the government's formal planning exercises have had their biggest impact, even if planned expenditure targets were often not fully realised for one reason or another—e.g. lack of administrative capacity to implement programmes, unexpected shortfalls in foreign aid, technical factors or plain financial conservatism.

In discussing the pattern and trends of government services, we shall first talk in terms of total outlays made for various purposes, without regard to whether the expenditures involved are from the "ordinary" or the "capital" budget. This means, of course, adding together such different outlays as current expenditures on goods and services (public consumption), transfer payments, capital outlays, and some minor categories found in the budget. Allocating total spending by purpose obviously has disadvantages but is convenient. Later, to facilitate making comparisons with other countres, only spending that enters into public consumption as defined in the national accounts (wages and salaries and current-account purchases, along with most international donations in kind) will be examined.

In the fiscal year ending in 1973, the latest year for which full details are availables, spending for defence, internal order and other general administrative services accounted for just over a third of the total budget. The rest of the budget was divided fairly evenly between economic services (agriculture, industry, public works, etc.), social services (education, health, etc.) and unallocated expenditures (mainly technical assistance and other grant aid). The largest items were spending for defence, police and justice, which amounted to just over a quarter of the budget; education, 17 percent; public works and communications, 12 percent; and agriculture, 7 percent.

Viewed over time, perhaps the most arresting aspect of the expenditure side of the budget are the big changes that have taken place in the level and composition of government spending. Over the last decade when GDP growth in current prices averaged 5.5 percent annually, total central government spending forged ahead at 8 percent a year (in line with tax revenues). The fastest spending increases by far were for agriculture and education, about 16-17 percent a year. Put differently, not only did the whole budget double in size in this period, but agriculture and education each got twice as big a share of the larger total at the end. These gains where largely at the expense of defence, internal order and general public administration, spending for which grew at a below average rate. At the same time, public health and community development made only the most modest gains, and support for industry and commerce declined even in dollar terms (as noted earlier, however, assistance to industry took other more direct forms such as tax and tariff concessions).

What can one say about Ethiopia's latest budget allocations? Where is it spending too much or too little? Clearly, there are too many factors involved to make any categorical pronouncements. As social scientists we can at most say whether a dollar spent for education or health, etc. is being used effectively: we may be aware, for instance, that too much is going for higher education or that health services are being overly concentrated in big urban hospitals. Except in extreme cases, perhaps, we cannot say whether more should be spent for one broad purpose at the expense of another, let alone how much. It is left to the political process to make these complex judgements based on what the country can afford, its development goals, the geographical distribution of the population, whether comparable private services are available and their price, the amount and kind of foreign aid received, defence requirements, and so on.

Nevertheless, it is interesting and revealing to compare Ethiopia in this respect with countries in roughly similar circumstances. For our comparisons we have selected nine African countries for which breakdowns of public consumption expenditure according to purpose where available (see Table 4). Total public consumption in these countries averaged a little over 11 percent of GDP, almost the same as in Ethiopia. We do not know how large public consumption bulks in the total budgets of these countries, but in Ethiopia the figure is close to 80 percent.

A number of rather striking results emerge from such a comparison. Ethiopia's defence expenditure as a fraction of public consumption not only greatly exceeded the average—23.5 as against 13.7 percent—but was the largest of any country's period. Defence measured as a fraction of total GDP, however, was highest in the Sudan by far. Ethiopia was also well above the average in public education—21.8 as compared with 16.7 percent—although educational services provided by the governments of Kenya and Zambia accounted for a larger share of public consumption; and education as a fraction of GDP was very much higher in these two countries as well as in the Sudan.

Ethiopia's most disappointing performance was in the provision of health and other social services (community development, welfare, housing, sanitation, water supply and other amenities). For public health the share in public consumption expenditure was 7.7 percent compared with an average for the other countries of 10.5 percent, and for other social services only 1.2 percent as against an average of 5.0 percent. If current expenditures for health are taken as a proportion of total GDP, Ethiopia ranked below all countries except Togo; and on this same basis Ethiopia's spending on other social services only just exceeded Upper Volta's and was far below the proportion in other countries.

Since expenditure on agriculture and other economic services and on general public services (parliament, law and order, foreign affairs, financial administration, etc.), were not out of line with other countries' spending for these purposes, it follows that the pattern of Ethiopia's communal services is distinctive mainly in that relatively large shares go to defence and also education and too little to health and other social services. If through government economies more funds could be freed for services that contribute directly to the quality of life—and, equally impotrant, if these services could be made available to segments of the population which are not reached now—not only the general welfare but the productive capacities of the Ethiopian people could be raised.

5. THE BUDGET AND DEVELOPMENT GOALS

It should be borne in mind that the scale and composition of the Ethiopian government's spending have changed drastically in recent times. Considering that outlays for defence and general public administration, indispensable though they may be, contribute less to economic growth than support of education, agriculture and industry (whether via the budget or other means), the changing picture of resource allocation to which attention was called earlier has undoubtedly been generally favourable to economic development. Whether the changing pattern of government services was also conducive to achieving a more tolerable distribution of income and wealth in the country, however, is much more doubtful. Probably the impact was so unevenly distributed over the different sections of the population as to rule out a simple answer.

There are nevertheless good reasons for supposing that at least urban-rural and inter-regional inequalities were widened rather than narrowed. While the efforts to spread education and to a smaller extent health facilities into the

4. GOVERNMENT FINAL CONSUMPTION EXPENDITURE BY PURPOSE: ETHIOPIA AND SELECTED AFRICAN COUNTRIES

(Percentage Distribution)

	General Public Services	Defence	Education	Health	Other Social Services	Economic Services	Other Purposes	Total Public Consum- tion as of GD %p
Botswana (1967)	. . . 53.4(?)	. . .	13.8	6.9	1.7	20.7	3.4	15.8P
Ghana (1970)	29.4	18.9	14.9	13.9	6.0	17.9	(0.5)	7.8+
Kenya (1968)	35.4	9.5	22.3	13.1	. . .	19.7	. . .	15.3
Madagascar (1969)	31.6	15.4	11.4	8.3	4.8	21.9	6.6	10.2
Sudan (1970)	43.9	17.6	16.5	8.9	1.1	. . . 11.9 . . .		24.9
Tanzania (1970)	20.0	7.1	13.7	6.3	4.7	38.0	10.0	n.a.
Togo (1969)	23.6	16.2	19.6	12.4	16.5	10.9	0.8	6.3
Upper Volta (1968)	53.3	8.6	12.4	12.4	0.9	8.6	4.8	12.3
Zambia (1970)	. . . 43.5 . . .		26.1	11.9	3.9	11.8	2.9	13.0
Average of above	33.9	13.3	16.7	10.5	5.0	18.5	4.0	11.5
Ethiopia (1971/72)*	26.8	23.5	21.8	7.7	1.2	19.0	—	10.8**

Source: United Nations, *Year book of National Accounts Statistics*, 1972 (except Ethiopia).

*Figures (except in last column) relate to Ethiopian central government consumption expenditure only but account for over 96 percent of total public consumption.

+1971 percentage.

**Excludes the very high value for Sudan (13.2 percent with Sudan).

countryside, and by such means as the "minimum package" approach (aimed at supplying extension services, credit and basic inputs) to improve the lot of the small farmer, brought benefits to some of the poor, the gains were mainly confined to those living in the more accessible and on the whole more developed parts of the country. Precisely the same can be said of the highway programme, which concentrated on providing good quality arterial roads to the almost total neglect of access roads in the remote regions of the poorest provinces.[8] Furthermore, the country's highly centralised administrative apparatus naturally led to concentrated spending in the capital and a few other urban centres.

Even in those areas which benefitted most from the government's rising expenditures on agriculture, there is reason to doubt that the subsitsence farmers where the main beneficiaries. Certainly government-assisted commercial or mechanised farming, which now accounts for upwards of 10 percent of grain production if pluses and oilseeds are included, and which dominates cotton and sugar, has grown much faster than peasant production and has even been accompanied by some uprooting of small cultivators and nomadic herdsmen for whom no alternative provision was made. In the absence of land and tenancy reforms, the incentives intended to raise productivity seem to have had little impact on the farming practices of peasants lacking security of tenure and the assurance that they themselves would be the ones to benefit from their risks and sacrifices.

The tendencies towards further widening of income differences may have been offset to some extent by Ethiopia's changing tax structure, which became more progressive over the past decade. More of the tax burden was thrown onto the better-off elements of the urban population to the advantage of the rural, and possibly to a small extent also urban, poor. Two facts support these particular conclusions: (1) while taxes on income grew at 16 percent a year, indirect taxes rose at about 7 percent and taxes based on land ownership changed hardly at all, and (2) taxed commodities (indirect taxation is still the mainstay of the tax system) are most heavily purchased by the urban population which numbers only about a tenth of the country's inhabitants.

Even now, after a decade in which total tax revenues have been growing at 8 percent a year, taxes are still only a low 10 percent of GDP. The opportunities for further redistribution of income through the fiscal system as real income rises are therefore considerable. The big challenge will be to ensure that redistributive measures, fiscal and other, will also raise the productivity of the masses.

FOOTNOTES

1. See W.I. Abraham and Seilu Abraha, "The Public Sector of the Ethiopian Economy, 1964-65", Ethiopian Central Statistical Office, Staff Report No. 7, October 1974. The dates in the title are Ethiopian fiscal years which correspond to 1971/72 and 1972/73.

2. With the spate of nationalisations in early 1975, banking and insurance were taken over completely by the government and the overwhelming majority of large manufacturing enterprises came under government control.

3. This low figure is consistent with the low 4.4 percent growth rate over the same period and implies a marginal capital-output ratio of just under 3.0.

4. "Apparently" because the magnitude and even sign of inventory changes in the private sector are unknown, and the estimates of private capital formation and saving are obtained as residuals and thus subject to considerable error. Neither is it possible to distinguish between company and household saving.

5. Nearly a quarter of all paid-iup government capital is invested in these 13 firms.

6. It is interesting to note that as a result of a determined programme of supervision by the Industry Department of the Agricultural and Industrial Development Bank there are now definite indications of a sharp improvement in the performance of the government firms.

7. Such studies as have actually been made in Ethiopia of social as opposed to commercial profitability of important industrial enterprises with government participation bear out this statement.

8. This neglect has been an important factor in delaying the delivery of relief and rehabilitation supplies to the worst drought-stricken areas in the last year or so when conditions called for an all out rescue effort.