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PRIVATISATION AND CAPITAL ACCUMULATION: EMPIRICAL EVIDENCES FROM ETHIOPIA

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ABSTRACT
This paper examines the connectivity between privatisation and private capital accumulation. Many previous studies have proved that privatisation has had a direct and positive effect on capital accumulation through attracting private investment. Ethiopia, one of the least developed countries (LDCs), and having spent two decades of communism, has implemented privatisation programme as a means of attracting a sizable investment such as the foreign direct investment (FDI). We used data over ten years, 1994/95 to 2003/04, and applied correlation and regression analyses to establish the effect of the Ethiopian privatisation programme on capital accumulation. The empirical results show that privatisation is robustly negative to capital accumulation. We suggest that the country needs to improve economic and political stability as well as openness coupled with revitalising the privatisation programme to prevent the Ethiopian economy from further capital sabotage.

Keywords: Privatisation, capital accumulation, FDI, openness, private investment
JEL Classification Number: E22, F15, F21, L33

INTRODUCTION
Across the globe, privatisation has become one of the instruments of economic reform process. The reason for privatisation has deeply been debated since its formal introduction in the 1980s. However, a clear observation upon privatisation for the past three decades indicates that privatisation is adopted by the world economies for some specific reasons only, particularly for

economical and political considerations, depending upon their perspectives. The manifesto of privatisation differs from one economy to another depending on a country's objectives and agenda. Many countries irrespective of their economic status have launched privatisation programme with a different mixture of these agenda. There are the strong evidences that many developed countries have had accelerated privatisation which is equally important for economical and political missions (Esser, 1998; Aharoni, 1988 and 1991), whereas in the developing countries, privatisation stands more for economical and less for political reasons, targeting only the economic growth (Donaldson and Wagle, 1995) and social uphill.

Privatisation as a strong reform measure aims at various economic missions such as ensuring sustainable development through efficient private participation and investment, reduction of budget deficit and external debt, increase of social overheads, whereas as for political missions, it works at extending and widening ownership to public and reducing the government burden – preferably a withdrawal from the whole to the part in state intervention. Among all these missions, attracting investment particularly from the private investors, which is indispensable for accomplishing both economic and political missions, is considered a golden rule not only to avoid shortage of capital, but also to lead an economy towards sustainable economic growth.

Privatisation, in fact, brings about private investment which has become the most important source of finance for developing countries. The case was entirely different before the 1980s which failed to see and implement privatisation as a tool of macroeconomic liberalisation facilitating private investment (Sadar, 1995:2). Since then, however, privatisation has grown strongly and rapidly in a number of developing countries. This development has helped to create an attractive business environment, and has intensified the interest of private investors. Privatisation, moreover, may explore the covered avenues to the extent of benefiting a country including attracting foreign direct investment (FDI)(Economic Perspective, 2001:3) because many studies have already proved that the relationship between privatisation and FDI variables is significant and positive. Sadar (1995) proves this through regression analysis over a cross-section of 36 countries for the period of 1988 to 1993.

There are two strong reasons of how privatisation attracts investment: First, privatisation itself can serve as a tool for capital flow since private investors spend their sizable wealth for purchasing those state owned enterprises (SOEs), and in terms of further investment such as capacity expansion, modernisation and renovation in what they have purchased. Second, any privatisation programme, if well tailored, has already been proved to have a positive correlation with direct investment that comes from the new domestic and foreign investors. This is because of the reason that the privatisation programme itself acts as a media popularising a country as an attractive investment location. Cook and Uchida (2003) justify that if privatisation were sufficiently extensive and had efficiency-inducing effects, it would increase the opportunities for investment in newly privatised enterprises by releasing them from the capital constraints previously faced under public ownership. Moreover, it would reduce crowding out and provide more credit to the private sector.

Thus, privatisation has many connections with investment which is sometimes imponderable. The size, speed, processing, regulatory framework and market creation are the impetus affecting the flow of investment, particularly the speed at which privatisation moves is said to have linked positively with investment. No one can refute the fact that the greater the speed, accuracy and feasibility of the programme, the higher will be the investment an economy attracts. But, many African countries have failed in this regard, leaving their investment potentiality including FDI unused owing to the poor processing and slow rate of privatisation (Eden, 1996).

Not only is investment, but even other benefits of privatisation are neither known nor realised particularly in African countries, which is mainly due to the attitudes of top level politicians and legislators. Miller (1997) questions the credibility of legislators and officers, who obviously impede the privatisation activity as they feel too comfortable to stick to state-run enterprises. He has also found that the pressure coming from their side has preceded some of the privatisation activities across the world. Further, the small size and fragmentation of most African economies, their structural rigidities, vulnerability to continuing political instability, low levels of infrastructure, poorly developed financial markets and lack of institutional support and business capacity are the major challenges affecting the private sector development through privatisation (IFC, 1999).

Ethiopia, which is no exception to the aforementioned scenario – can be considered an economy in transition – finding its path full of challenges with a view to improving a better investment climate through privatisation. The reason is that there has been not more than one and half a decade since the country surfaced out of socialism. The Derge – the Marxist military government – came in 1974 which ruled the country with more centralised and communistic ideals. After the ousting of the Derge regime, the country in line with other African countries, implemented privatisation in 1994 with a view to solving its major economic ailments, such as weak operating mechanisms of SOEs, economic instability, increasing budget deficits, alarming high external debt and steady increase of poverty rate. Nonetheless, the programme is devised in such a way that it would generate the required revenues through encouraging the private sector's expansion which in turn is expected to be guaranteed by a smooth flow of investment. Ethiopia, suffering from the low per capita income and high rate of poverty, has also understood the obstacle of the vitality of the private sector's investment, and has attempted to attract a substantial investment through its own privatisation paradigm.

The purpose of this paper is to critically analyse the relation between the privatisation and private capital accumulation in Ethiopia, using data over the period 1994/95[1] to 2003/04. The

[1] The Ethiopian fiscal year begins on 8th July and ends on 7th July

study mainly emphasises the changes and effects on private capital accumulation brought by the privatisation programme in the country. The paper is organised into five sections. The next section outlines the methodology adopted for the study which is followed by a subsection on model specifications. Section 3 analyses the magnitude of privatisation, and its effect on certain macroeconomic variables through simple correlation analysis as a pre-test to the empirical analysis of capital accumulation. Section 4 discusses the effect of privatisation on private capital accumulation, followed by empirical testing and interpretation. The final section provides a summary and thus, concludes the study.

METHODOLOGY OF THE STUDY

Data was collected from the Ministry of Finance and Economic Development (MoFED), Gazettes of Government of Ethiopia (GoE), Ethiopian Privatisation Agency (EPA) and also from the development reports and data bank of the International Financial Institutions such as the World Bank and the International Monetary Fund (IMF). The privatisation for this study implies only the privatisation of state owned enterprise (SOEs), but not real estates and lands[2]. The study used data over only ten years, 1994/95 to 2003/04[3], referred to as the privatisation period. It applies regression analysis with the help of various functional and policy variables that may contribute to the investment potentialities of a country. A regression model, explained with more details subsequently is developed using the perspectives of the heterodox model which does not conclude that the non-significant variables

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[2] Real estates and lands, which were taken over in violation by then Derge Regime during 1974 to 1991, have been handed over to their previous owners in the wake of the country's political transition. As these transactions were made for a nominal restitution fee in return, it lacks a sound economic justification to be called as privatisation.

[3] As the privatisation programme commenced its first transaction in 1994/95, the period of study is limited only to ten years, lacking a sufficient data of time series for regression analysis.

necessarily imply that the hypothesised causal links are invalid (Weeks, 2001). Correlation is applied, preceding the regression analysis, to examine if privatisation has any linear relationship with some of the important macroeconomic variables affecting capital accumulation.

Model Specifications

We have made an attempt to bring empirical evidence of the Ethiopian privatisation on private capital accumulation, using the heterodox growth model found in Weeks (2001). In principle, I (Independent) variables have to be selected with great care (Cook and Uchida, 2003:130). In view of this, I variables are chosen for every model with ample justifications with a view to drawing a reasonable result. Any result obtained from this regression that exhibits a significant level of multicollinearity (that is, a regression showing that a variance inflation factor (VIF) is greater than five) is discarded from these results. Moreover, the results are adjusted for the presence of autocorrelation. Durbin-Watson is used to detect the autocorrelation and also the analysis is ensured that homoscedasticity is met.

The model presented below is constructed with a view to including all the basic macro relationships: GDP growth, savings, inflation, real interest rate, privatisation and war with Eritrea, a dummy variable. Of these six variables, real interest rate and privatisation are policy variables.

$$In[PK/Y]t = b_0 + b_1 In\,[y]_{t-1} + b_2 In\,[S/Y]_t + b_3 In\,[p]_t + b_4 In\,[r]_{t-1} + b_5 In\,[PRIV/Y]_t + b_6 D_t + u_t$$

The response variable, private capital accumulation $[PK/Y]_t$ represents only the private investment accumulated over the study period. Gross capital accumulation, which is often referred to as a proxy for investment (Cook and Uchida, 2003:131), is put off, because it includes both private and public investment. Moreover, in countries like Ethiopia dominated by public investment its inclusion may not reveal a correct result. Thus, public investment is subtracted from the gross capital accumulation. In the above equation, growth rate of output, lagged one period, $[y]_{t-1}$ indicates that investment is assumed to respond to changes in output in the previous period. The inclusion of growth rate of GDP as an independent variable in the regression can be justified from the standpoint that the causality runs from growth to investment and not vice versa (Barro and Sala-i-Martin, 1995). It is further assumed that inflation [p] has a negative effect on the private sector element of investment, by fostering a short-term preference for non-productive investments with a rapid turnover (Weeks, 2001:58). Savings as a share of GDP $(S/Y)_t$ and the real interest rate of lagged one period $[r]_{t-1}$, a policy variable that tends to influence each other are included as variables which determine not only the major portion of investment, but also are strongly influenced by the available investment opportunities (Griffin and Icknowitz, 2001). Privatisation variable $(PRIV/Y)_t$, the explanatory variable in the model is assumed to have inflated the inflows of investment. War with Eritrea (D_t), which broke out in 1998, is fitted as a dummy variable (where D=1 for the war situation and 0 otherwise) in order to capture its effect on investment and also its inclusion has the assumption that it affected the country's investment climate during the study period.

ETHIOPIAN PRIVATISATION PROGRAMME–AN OVERVIEW AND ANALYSIS

The Ethiopian Privatisation Agency (EPA) was established in February 1994 by proclamation No. 87/1994, made in accordance to Article 9 (d) of the Transitional Period Charter. Since then EPA is the lead agency in carrying out the process of privatisation of SOEs. A board of management, consisting of five permanent members, who are designated by the government and a general manager, administers the agency. The agency is directly accountable to the prime minister office in all matters. In addition to this, the chairman of the board of the enterprises under privatisation and one of the representatives of workers in that board participate as non-voting members (Transitional Government of Ethiopia [TGE], 1994).

According to the latest proclamation No. 146/98, issued in December 1998, EPA is committed to attaining objectives such as: generating revenue required for financing development activities undertaken by the government; changing the role and participation of the government in the economy to enable it to exert more effort on activities requiring its attention; and promoting the country's economic development through encouraging the expansion of private sector (Government of Ethiopia [GoE], 1998). In addition to the powers and duties vested under proclamation No. 146/98, EPA is also conferred, under proclamation No. 110/1995 and its amendment proclamation No. 193/2000, with the power to investigate and decide on claims of ownership in respect of properties confiscated in extra-legal manner through directives as well as through written or oral orders.

Measuring the Ethiopian Privatisation

Measuring privatisation is the most crucial task before assessing its impact on any variable be it economic or social. No doubt, the privatisation proceeds help in this regard to judge as to how much the scale of privatisation is in a given country. But, it would not reveal the real magnitude of privatisation unless it is related to the output of the country. Keeping this in mind, the magnitude of privatisation is the sum of privatisation proceeds collected during the year, as a share of GDP which is used to measure the size of the privatisation. This measurement is used as privatisation variable through out this study which is almost same as the privatisation variable used by Cook and Uchida (2003) and Plane (1997).

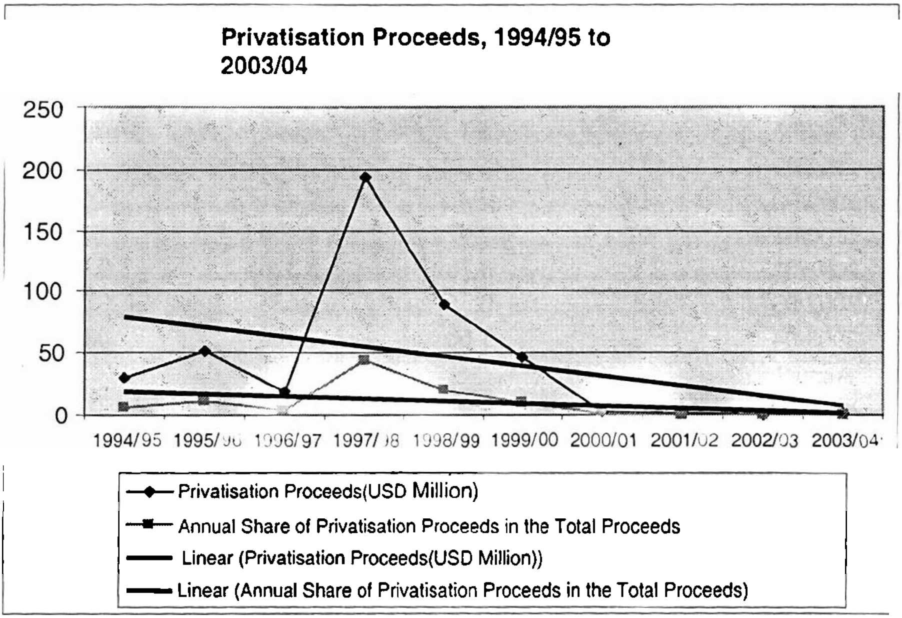
Table 1: Magnitude of Privatisation Transactions, 1994/95 to 2003/04

Year	No. of Privatisations	Privatisation Proceeds (PP) (USD Millions)	GDP (USD Millions)	PP/GDP (In Percentage)
1994/95	14	29.54	5,779	0.51
1995/96	116	51.46	6,393	0.8
1996/97	26	18.72	6,725	0.28
1997/98	9	193.1	6,647	2.91
1998/99	21	89.12	7,067	1.26
1999/00	16	45.87	7,451	0.61
2000/01	11	2.97	8,106	0.04
2001/02	1	0.76	8,326	0.009
2002/03	3	0.56	6,638	0.008
2003/04	3	1.60	7,408	0.021
Annual Average	22		6,277	0.21
Total	-	433.7	-	-

Source: EPA (2004) and World Bank (2004)

Table 1 reveals that the privatisation was started with 14 maiden transactions which contributed on an average USD 43.37 million a year, and the volume rose up to USD 51.46 million in the following fiscal year 1995/96. Privatisation proceeds collected during the first phase, 1994/95 to 1998/99 were more lucrative than the second phase, 1999/00 to 2003/04. Of the total proceeds, 88.07 per cent were collected during the first phase which was a good sign of progress, whereas, in the second phase, it was only 11.93 per cent which shows a poor performance. It is also observed that the earlier phase was considered a boost, owing to the proceeds received during the fiscal year 1997/98 which was the peak moment in the Ethiopian privatisation history that yielded USD 193.1 million, constituting 45 per cent in the total proceeds collected during the privatisation period. Since then, there has not been any commendable progress in the privatisation revenues. In total, the programme yielded USD 433.7 millions. Nellis (2003) finds that the size of privatisation in the country over the period constitutes only 4.7 per cent of the total sale proceeds received in the whole African region.

Figure 1: Privatisation Proceeds, 1994/95 to 2003/04



Source: Finance and Administration Department, EPA (2004)

Figure 1 shows an outright fall of privatisation revenues after the fiscal year, 1997/98, shrinking the net magnitude of the privatisation. Further, there was a high degree of uncertainties on privatisation proceeds—measured by the standard deviation (σ = 2.17) of the flow of privatisation proceeds as a share of GDP—fluctuating highly during the study period. It is distressing to note from the findings that PP/GDP has not reached a three per cent figure over the period. The only impressive year was that of 1997/98, bagging a two per cent PP/GDP ratio, owing to the sale of a mining enterprise— the most expensive sale ever in the Ethiopian privatisation history.

The analysis after the fiscal year 1997/98 shows a declining trend of 1.26 and 0.61 per cents of PP/GDP for 1998/99 and

1999/00 fiscal years respectively. The size reached the lowest record level even after these fiscal years with an average of 4.25 transactions per year. During the fiscal years 2001/02, 2002/03 and 2003/04 only one transaction per year was recorded. As a result, the average PP/GDP ratio during the study period became too little, accounting for 0.21 per cent which fell to the lowest amongst those poorly performing countries.

Privatisation and its Effect on Macroeconomic Variables

The magnitude of privatisation, which includes the total flow of proceeds, expressed as a share of GDP, has made a direct impact on various variables of economic growth and capital accumulation. To prove this, we examine the relationships between privatisation variable and budgetary deficit in per cent of GDP, and openness, the correlation details with the selected variables for this study is given in annexure 3A. The inclusion of these two variables was justified by taking into account their uniqueness in nature. Budgetary deficit, which is expected to have a decreasing effect as a result of privatisation, has been ignored in many studies. Further, its effect on capital accumulation is enormous as it is considered an important factor for crowding out that increases the public sector deficit, resulting in the reduction of private sector investment.

The openness[4]—otherwise conceived as the worth of international trade to a nation—is defined as the average of imports and exports, expressed as a share of GDP which is always expected as a result of privatisation to have a positive and significant effect. Week (2001) posits that the share of imports and exports is assumed to be functions of the real exchange rate. It is further noted from his heterodox model that the import share increases with the rate of growth, and holding the exchange rate constant, export will rise with an improvement in the terms of trade boosting further investment.

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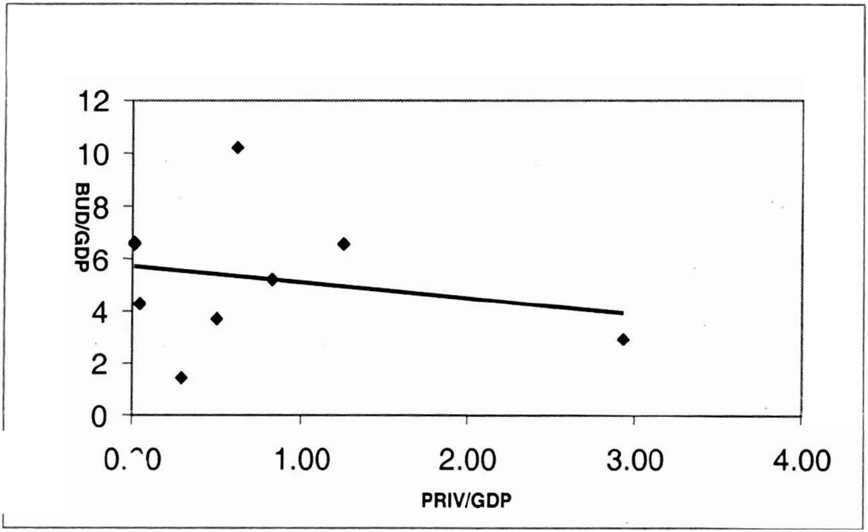
[4] Openness used in this study refers to the average of exports and imports expressed as share of GDP. The same measurement can be found in many studies including Baumol and Alan (1997).

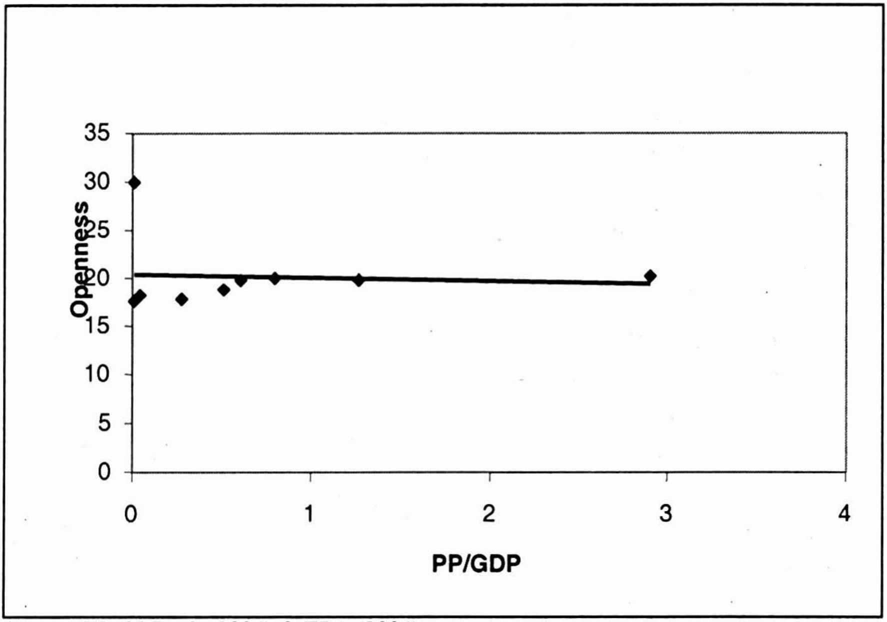
Figure 2: The Correlation between Privatisation and Government Budget Deficit



Source: World Bank (2004). *African Development Indicators* and EPA (2004), *Privatisation Proceeds from1994/95 to 2002/03*

The result shown in Figure 2 indicates that there is no correlation between the privatisation variable and the budgetary deficit. A test of coefficient of correlation shows that there is a weak correlation between these two variables (r = -.224). It can also be explained that there is a little five per cent variation (r^2 = 0.05) in the budgetary deficit by the variation in the privatisation variable. Hence, it may be said that the privatisation in the country has no impact on the budgetary deficit which is one of the high fiscal determinants deciding the private capital accumulation, particularly private capital.

Figure 3: The Correlation between Privatisation and Openness



Source: World Bank (2004) & EPA (2004)

The same test is applied on the openness of the country, the result as shown in Figure 3, is the same as the budgetary deficit, proving that there is no correlation between the privatisation variable and openness(r = -0.099). The openness variable could explain much less than one per cent (r^2 =0.0098) of the variation in the privatisation variable. Nonetheless, openness may not be a major determinant of privatisation. Indeed, some of the developed countries including the USA whose economies are relatively open (Baumol and Alan, 1997:28), their privatisation is dominated by indigenes unlike the case of Ethiopia.

The foregoing discussions and analyses show that privatisation made little improvement on the macroeconomic environment, thus a limited impact on capital accumulation. The variables taken for the simple analysis proved insignificant correlations, owing to the slow and small privatisation, coupled with poor processing. These findings raise a doubt about the conduciveness of the privatisation paradigm towards capital accumulation, and even as to whether it acquired the minimum advantages of privatisation which have been gained in the rest of the developing world.

ETHIOPIAN PRIVATISATION MODEL AND ITS RELATIVITY TO CAPITAL ACCUMULATION

Creating and improving the investment climate is a top priority in a modern world, particularly for the developing African countries because investment is considered an engine for economic growth and poverty reduction in the long run. The task of attracting a sizable investment in this regard for many African countries is indispensable, and should be pursued multifaceted given that investment leads not only to a simple growth, but also it creates sustainable jobs and opportunities for citizens and entrepreneurs.

Ethiopia, which was one of the previously fiscally unattractive for investment in the Sub-Saharan, is now an investment driven and friendly country, where it is believed that investment helps to reduce the cost of goods consumed by the poor people, and improves their living conditions directly. It, moreover, contributes to an expanding tax base by indirectly enhancing the government's interest in improving health, education and welfare of the people. Ethiopia, ranking one of the highest in poverty (World Bank, 2004) and the lowest in the human resource development index (UNDP, 2003), had realised a decade ago the paramount importance of investment after the installation of the new government in 1991. Commencing with the Investment Code Reform No. 15/1992, the government established the Ethiopian Investment Authority (EIA), followed by the establishment of the Ethiopian Privatisation Agency (EPA) in 1994. Further, the

Investment Code Amendments in 1996 and 1998 and their reenactments with the broader objectives in 2002 are worth mentioning to enrich the Ethiopian investment drive, calling the potential domestic and foreign investors to exploit and develop the immense natural resources (GoE, 2002).

Investment climate after a series of proclamations and reforms provides incentives for development related investment, reduces capital entry requirements for joint ventures and technical consultancy services, permits duty free entry of capital goods (except computers and vehicles), opens the real estate sector to expatriate investors, extends the losses carried forward provisions, cuts the capital gains tax from 40 to 10 per cent, full repatriation for foreign investors and gives priority to investors in obtaining land for lease. However, the foreign participation in the most profitable energy and financial services was, however, restricted posing obstacles to privatisation and investment climate of the country.

Since 1991, any investment that supplements the attempts of creating an openness economy has been well privileged on the payment of duties and other taxes (GoE, 1992). The guarantee is extended to investors that no asset will be expropriated or nationalised except in accordance with the regulations of the government, and upon the payment of adequate compensation. To change the negative opinion about the judiciary system, particularly among foreigners, the country signed the World Bank Treaty "International Convention on Settlement of Investment Disputes between States and Nationals of other States".

Table 2 shows the performance of private capital accumulation in the total capital accumulation—public and private, and foreign direct investment (FDI) during the privatisation period. It indicates that there was a considerable share of private investment in the total GDI, when compared to the public investment. Although the difference of annual average rate between the public and private investment as a percentage of GDP was too narrow during the privatisation period, the difference between the private and public capital accumulation was only 1.08

percentage points (Table 2), the achievement of the private capital accumulation should not be underestimated.

Table 2: Investment and its Share in GDP, 1994/95 to 2003/04

Year	Gross Public Investment/GDP (%)	Gross Private Investment/GDP (%)	GDI* or GFCF/GDP (%)	FDI/GDP (%)
1994/95	7.5	8.9	16.4	0.14
1995/96	7.5	9.4	16.9	0.16
1996/97	8.3	8.7	17.0	0.89
1997/98	7.4	9.8	17.2	0.11
1998/99	8.1	8.8	16.9	1.92
1999/00	5.2	10.7	15.9	0.68
2000/01	8.5	9.3	17.8	0.64
2001/02	11.5	9.0	20.5	0.00
2002/03	11.6	8.9	20.5	0.22
2003/04	Na**	na	22.6	0.02
Annual Average	8.18	9.26	18.06	0.27

Note: *Gross Domestic Investment (GDI) and Gross Fixed Capital Formation(GFCF) can be interchangeably used.** Not available

Source: World Bank (2004) and MoFED (2004)

Attempts to account for such a meagre difference reveals that the reason may be nothing but the transition of the country from socialism to capitalism, a period government finds difficult to withdraw its stake from public enterprises. And also, the withdrawal of state intervention from the economy has carefully been carried out in the country contrary to those of Latin American and Eastern European blocks where the withdrawal was fast and vast.

It is also found that FDI as a share of GDP accounts only for 0.27 per cent during the period. It is due to the fact that foreign investors are pragmatically more sensitive than the domestic investors to the prevalence of the economic and political conditions which they always see and analyse in a microscopic view because the only reason they invest is to enhance their welfare, whatever they perceive it to be (Ambrosio, 1976: 15). Nonetheless, the meagre flow may have its own share in increasing GDI based on the fact that there is a direct positive linear relationship between FDI, domestic investment and the growth of GDP (Thirwall, 2004: 592-93).

Table 3: Investment Performance before and after Privatisation (Average Annual Growth)

Investment Flows (as a share of GDP)	Pre-privatisation Performance 1986/87 to 1993/94	Post-privatisation Performance 1994/95 to 2003/04
GFCF	10.37	18.18
Public Investment	5.57	8.18
Private Investment	3.60	9.26
FDI	0.12	0.27

Source: MoPED (2003), MoFED (2003), MoFED (2004) & World Bank (2004)

Table 3 provides a summary of the capital accumulation between two different periods, pre-privatisation and post-privatisation. The result shows a change in the capital accumulation with a varying degree. Capital accumulation after privatisation is significant since the annual growth rate of GDI and private investment increased by 75.31 and 157 per cents respectively. The growth rate of public investment which was lower than that of private investment and, not parallel during the post-privatisation, indicating a declining interest of the state towards dominance. It is also found that FDI as a share of GDP increased but insignificantly from 0.12 per cent to 0.27 per cent.

The country's performance on private capital accumulation, compared to other Sub-Saharan Africa (SSA) countries was far from being satisfactory as the latter were able to achieve an annual average of 13.5 per cent (World Bank, 2004) during the study period. It is important to note that GDI in SSA has been lower than in other developing regions (Griffin, 2001: 21). In a nutshell, the Ethiopian's performance in attracting private investment directly or through privatisation initiatives was not robust compared to its Sub-Saharan neighbours, and was marginal relative to other developing countries in the world (International Finance Corporation (IFC)/World Bank, 2002) despite the country's investment friendly climate-creating efforts.

When analysing the causes for failure in attracting a significant amount of investment for capital accumulation, it may be due to the slow and small sized privatisation, coupled with poor processing, economic and political instability, weak openness, poor savings and unattractive commercial framework. Slow privatisation always resists investment, causing damage to many African countries with significant FDI potential (Eden, 1996). A weak capacity and poor entrepreneurial attitude of the locals, coupled with the processing constraints, may also be some of the reasons for the poorer show of privatisation and capital accumulation. Other significant variables to attract investment are the rate of growth and openness. Economic growth and openness are positively associated which in turn correlate with investment (Alesina, 1998). But the growth was found to be low and unstable in the country with a lot of ups and downs and uncertainties amidst a significant increase of the output during the privatisation period and openness also experience a similar effect. (see annex: Table 4B). Openness was found to be low with annual average of 20.91 per cent, showing the country's inward orientation and economic isolation. Selvam (2005) also states that the country's openness falls below the minimum requirements, as 30 per cent is required to call a country moderately open in an increasingly globalised environment. Bräutigam (1998) proves that if there is difficulty in maintaining macroeconomic stability, it will lead to a sharp decline in investment. The inflows of investment are thus a consequence of successful development, not a cause of it.

No doubt, the capacity to purchase and invest primarily correlates with savings pattern, but it was not a soothing effect in the latter part of the study period. Gross domestic savings as a share of GDP over the first phase of privatisation accounted for 7.64 per cent which declined to 4.74 per cent over the study period (World Bank, 2004). Inflation during the period was moderate, recording 3.61 per cent. However, it fluctuated highly and had risen to even 15 and 9 per cents in 2002/03 and 2003/04 respectively which might have caused a low profile for those potential investors to make long-term investment decision. On the other hand, such condition of inflation may develop a pattern of investment biased in favour of projects with a quick pay off (Griffin, 2001: 17). Nonetheless, a mild inflation, up to 5.8 per cent, is positively beneficial for growth (Thirwall 2004), particularly in developing countries. Real interest rate is one of the policy variables affecting private capital directly. Annual average of real interest rate, which was 9.5 per cent over the period (MoFED, 2004), was considered a moderate rate for the borrowers.

The war with Eritrea in 1998 has, however, caused a lot of damage to the Ethiopian investment climate, impinging investors' attitudes towards investing. The war, though now diluted, coupled with a sort of uncertainty in the economic and regulatory policies have been persisting as strong obstacles that still work against the privatisation and investment of the country. The country with a poorer market potentiality and high risks associated with the security of property rights and poor consumer preferences, should over-perform to convince investors in order to receive a steady flow of investment. The need of such task is very urgent due to the following reasons: land issue is the most haunting one in the country since the investors can buy only the factory infrastructure and business, but not the land.

Many existing as well as the potential investors are not at ease on land issue which is found to have adversely affected their further investment on modernisation and expansion. One of the investors during a focal group discussion uttered that "*much to my disgust is the land of the enterprise; my balance sheet looks so deserted without any value of land*". There have been many cases of Ethiopian investors losing the value of their investment, owing to the wrong allotment of land due for the farmers or the Rental

Commission of Ethiopia. Further, many investors see the country as a poorly judiciary nation, where several cases of expropriation remain unsettled or never to be settled. Although concrete efforts are taken, the judiciary system still operates in a rudimentary stage and many judges lack the commercial knowledge. Fear among the foreign investors still exists despite the treaty signed by the country, the International Convention on Settlement of Investment Disputes (ICSID) between States and Nationals of other States.

Above all, micro problems such as administration of tax rates, electricity, customs and trade regulations, corruption, anti-competitive or informal practices and commercial and regulatory uncertainties have been found as major hindrances in attracting investment inflows. Tax rates and its administration are the most dislikeable to the potential investors (Investment climate Survey, World Bank, 2002). The survey, which was conducted in the country, found that the commercial conduciveness and infrastructure and service facilities existing in the country were rated poor by the investors and firms. Corruption and diseases prevail, found virtually everywhere, particularly in all developing countries—but economic isolation (Sach, 2005) is the special phenomenon in the African continent. Ethiopia is no exception to this isolation.

Empirical Testing and Interpretations

The results of impact of privatisation on the private capital accumulation, tested at five per cent significance level, are given in Table 4. The model's explanatory power is substantially robust and behaved soundly with the adjusted R^2 value of 0.956. The empirical findings in the model underscores the fact that privatisation is robustly negative on the private capital accumulation of the country. The result is not surprising as the privatisation programme in the country suffered a serious setback owing to the weak institutional framework, poor processing, small size and slow pace. Moreover, the economic reforms in general, which are supposed to supplement or facilitate the privatisation, were not up to the task. Such flaws, as seen in the previous discussion, are found to be lavished on tax rates and its administration, property rights and commercial framework in the country.

Table 4: OLS Results of Impact of Privatisation on Capital Accumulation

Variables	*Co-efficient*	*T-statistic*	*Significance*
Constant	1.999	11.628	0.007
[GDP]$_{t-1}$	-0.239	-2.327	0.145
[Saving/GDP]$_t$	-0.182	-1.2	0.353
[Inflation]t	0.313	1.561	0.259
[Real Interest Rate]$_{t-1}$	0.393	2.264	0.152
[Privatisation/GDP]$_t$	-1.584	-9.584	0.011
[War with Eritrea]$_t$	-1.045	-5.274	0.034
R^2	0.989		
Adjusted R^2	0.956		
F-statistic	27.733		
Significance (F-Statistic)	0.033		
Standard Error of the Estimate	0.046		
D/W	3.084		

Note: All variables in logarithmic form
Dependent Variable: Private Investment

A negative and statistically significant result is obtained for GDP which is contrary to the outcomes of many developing countries where it carried a positive impact on the capital accumulation (Weeks, 2001). This result may be justified from the point that the country failed to stabilise the economic growth despite its moderate achievement on the growth rate over the privatisation period. Theories of economic growth give its own practical literature that economic growth is not simply an increase of productivity over a period, but it is concerned with the long run trend rise in output rather than its fluctuation (Pentecost, 2002). So, it can be said that a country cannot take advantage of investment if there has been instability despite growth.

The result, moreover, indicates that savings is fragile in the regression. The result can be substantiated from the fact that the country recorded the lowest savings (3.53 per cent as a percentage of GDP over the study period) compared to other SSA countries. In the same line, inflation is also insignificant which could be attributed to the reason that many private investors are assumed to have invested on those short run and non-productive investments. Thus, the effect of inflation is considered insignificant and secondary. The significant and positive result on the real interest rate indicates that the moderate rate that prevailed over the study period had the possibility of encouraging the investors despite the weak credit demand of the investors (World Bank, 2003). The estimation of coefficient on war is, as expected, robustly negative to reveal that the war with Eritrea affected badly the investment climate of the country.

CONCLUSION

The analysis has shown that privatisation has contributed negatively to the private capital accumulation of the country, suggesting the country needs to review and revitalise its privatisation programme, coupled with the investors-friendly economic reforms. Privatisation should be viewed, not as an end itself, but as part of a broader programme of reforms. If the reform measures fail, privatisation cannot stand alone to succeed.

Revealing the negative effect of GDP on private capital, empirical model used by this study suggests that the country needs to maintain macroeconomic balances pragmatically rather than ideologically. It is, therefore, assumed that had the country enjoyed a comfortable macroeconomic stability and a high degree of openness, it would have accumulated a significant private capital from the domestic and foreign investors. The fragile results on savings and inflation also suggest that the country should essentially pursue macroeconomic stability despite the fact that the real interest rate is a soothing effect. The political instability, the common and chronic issue in Africa, may also provide a strong explanation for the country's poor performance on privatisation and investment. War with Eritrea has been proved to be a severe blow to the investment climate of the country. It can finally be said that a strong and bureaucratically free economic foundations along with a peaceful international relations should be a first hand priority.

Many researches into the investment reveal that cost-structures, differential returns, market growth and the institutional characteristics of the country are the most important determinants, but they are yet to come to be lucrative in the country. Investors wishing to invest always look for a favourable trade and investment regimes, good infrastructure, property rights, economic and political stability and an educated and committed workforce. Above all, the major investment incentives, particularly tax concessions need to be reformed to the extent that it should create business friendly conditions. It should also be noted that among all types of investment flows, FDI is considered an important input for the enormous gross domestic investment in which the country greatly failed. Foreign investors need to be encouraged and handled diligently as FDI can often be a catalyst for domestic investment and it may play a significant role in generating positive spill over effects, bringing new technologies and management and marketing skills and contributing to economic growth in developing countries. This study may lack a thorough analysis about the dynamics of fiscal and monetary policies such as money supply and exchange rate. Hence, a further study on these implications affecting privatisation and private capital accumulation is needed for the better understanding of the accurate connectivity between these two variables.

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Appendix
Statistical Annexure

Table 3A: Correlation between the Selected Variables for the Study

		PRIINVEST	GDP Growth	Savings	R Interest	Inflation	Privatisation
PRIINVES	Pearson Correlation	1	-.447	-.089	.445	-.056	-.836(**)
	Sig. (2-tailed)	.	.228	.820	.269	.887	.005
	N	9	9	9	8	9	9
GDP	Pearson Correlation	-.447	1	.023	-.110	-.474	.244
	Sig. (2-tailed)	.228	.	.954	.795	.197	.528
	N	9	9	9	8	9	9
Savings	Pearson Correlation	-.089	.023	1	-.317	-.164	.399
	Sig. (2-tailed)	.820	.954	.	.444	.673	.287
	N	9	9	9	8	9	9
R Interest	Pearson Correlation	.445	-.110	-.317	1	-.733(*)	-.459
	Sig. (2-tailed)	.269	.795	.444	.	.039	.252
	N	8	8	8	8	8	8
Inflation	Pearson Correlation	-.056	-.474	-.164	-.733(*)	1	.117
	Sig. (2-tailed)	.887	.197	.673	.039	.	.764
	N	9	9	9	8	9	9
Privatisation	Pearson Correlation	-.836(**)	.244	.399	-.459	.117	1
	Sig. (2-tailed)	.005	.528	.287	.252	.764	
	N	9	9	9	8	9	10

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

Table 4A: Descriptive Statistics of Variables on the Parameters Selected for the Study

	N	Minimum	Maximum	Mean		Std. Deviation	Variance
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic
PRIINVES	9	1.76	2.45	2.111	0.073	0.218	0.048
GDP Growth	9	0	2.36	1.39	0.292	0.875	0.766
Savings	9	0.11	2.08	1.29	0.250	0.751	0.564
R Inerest	8	0.29	3.07	2.27	0.312	0.881	0.777
Inflation	9	-1.2	2.71	1.01	0.459	1.38	1.89
Privatisation	10	-4.83	1.07	-1.802	0.685	2.17	4.69
Valid N (listwise)	8						