[This is not an article, chapter, of conference paper!]
The private sector in Ethiopia is positioned as a supplement to the state-owned economy. Since the last 55 years, the share of the private sector to the gross domestic product (GDP) remained low at 12.5% on average and currently stood at 20%. This means that the ability of the private sector to organize and push for regulatory reforms have been limited because of top-down approach of development and policies. In this article I advocates bottom-up, local and endogenous approach to private sector development in order to increase the private sector size, organizational capacity, political and economic role.

Before reviewing the effects of top-down approach of development and policies for self-development of the private sector, it is necessary to define what is meant here by private sector. There are several definitions of the private sector available in the literature such as an economy which is not controlled by the government or private entrepreneurs who undertakes the risk of engaging in business. However, both definitions doesn’t satisfy the criteria because the former talks about economies that do not function through market processes such as smallholder agriculture while the later includes self-employed individuals who started business as a means of survival, mostly found in the informal sectors of the urban economy.

In my definition, the private sector includes all business that are managed and owned by incorporated enterprises and individual entrepreneurs who have started and grown their business taking advantage of unique business opportunities. Private sector can be defined as part of an economy owned by individuals and/or corporates who have motives not only of making profit (price minus cost) but also investing it to make more profits.

**History of state-led top-down development**

Usually states typically intervene in private transactions in a society when such transactions have the potential to benefit a few at the expense of many. In the case of Ethiopia, the reason for state intervention in the economy was different. It was not related to the need to remedy the failure of the market (not related to the idea of addressing market failure). Rather, it was related to the idea of developing the national economy.

This approach has started since the middle of the 1950s every since the launching of The First Five-Year Plan (1955-1961). Since then the government prepared and implemented successive plans to transform agricultural and improve industrial productivity, eradicating illiteracy and diseases, and improving living standards for all Ethiopians.
Top-down programs for promoting local development through transforming communities and sub-regions continued after the 1974 revolution. In 1975, the military socialist regime nationalized private companies, banks, insurance companies and other financial institutions. In March 1975, the regime nationalized rural land and granted peasants "possessing rights" to parcels of land not to exceed ten hectares per grantee. After 1991, the same approach continues. The difference is that today’s national and local development program directed by the state is extensive, faster and deeper.

Despite good intentions, the hitherto top-down approach to national and local development has failed to bring sustainable economic growth and poverty reduction. There are vast literatures assessing the performance of government policies (choice, design, implementation and outcomes). Using meta-theories, such as the concept of underdevelopment, scholars like the late Professor Eshetu Chole, have examined the nature and characteristics of the national economy during the imperial era, the Derg socialist regime, and the post-Derg period. Despite changes in regimes, Ethiopia remained “underdeveloped”, to borrow the word from the title of his book.

The macro-economic thinking, approach and policy performance of the three regimes have been assessed with a display of erudition by Professor Alemayehu Geda, in his book “Reading the Ethiopian Economy”. According to his study, the economic performance of the country, though varied across the three regimes, is “generally disappointing”. Not only there continues scarcity of goods and services, the country also got into debt as it borrowed money from international institutions, and as in the case of large-scale land acquisitions, resources are taken away from local people. The studies of Professor Eshetu and Alemayehu shows that our approach to economic development matters: top-down thinking state-led development or bottom-up approaches led by market and local actors.

**Effects of top-down approach**

Often top down thinking and approach is criticized for its reasoning at the aggregate level much to the neglect of micro-economic foundations (rationality of households and firms). In the case of Ethiopia this is not only true but also, as the empirical evidence show, the top down approach has stifled the size and growth of the market forces and self-reinforcing economic development process at the local level. As a result, the size of the market based private economy is the least important part of the national economy.

In Ethiopia the top-down development programs have limited effect on private sector development considering the resources invested, the number of years it has taken, and growing size of the population. If there is any top-down effect it was level effect (raising the slop slowly) and not growth effects (modifying growth path at higher rate) and that too happened during the incumbent government in the early 1990s. As a result of the government’s privatization program, liberalization, foreign investment and donor support,
the size of the private sector level increased from 11Pct in the early 1991 to 17Pct in 1995 and has remained unchanged significantly since then and stood at 20Pct, currently.

From my point of view the top down perspective and the macro-economic thinking prevailing in the past six decades did not make a proper inquire into the origins of population and market economic systems running in parallel in the country. Analysis of the effects of rapid population growth and the workings of the market (study of individuals, families, firms or other small homogeneous groups as buyers and sellers) are neglected or received only lip services. Under top-down approach and macroeconomic policy models the government is assumed to have full understanding of the transformation and growth problems of the country. Such type of approach and intervention resulted mainly to the growth of the economy directed by the state. According to 3D system accounting of GDP, the size of the economy controlled by the government has increased from 22Pct in 1992 to 39Pct in 2015. The size of this type economy increased at the expense of the market and the population economies (consisting mainly individuals, households and firms).

Studies by distinguished scholars and the 3D methodology of macro aggregate empirical results shows that we have to change in the style of thought and approach to create more jobs, develop technology, increase investment, accelerate economic growth and improve the standards of living. My view is that the top down and macro-economic approaches, which underline the role of the state have a useful role to play in economic thinking and policy, only if it’s underlying microeconomics are understood. It is under this condition where there private sector reach critical mass/size and where there is unflinching local self-development process that we have the right mix of private and state cooperation as we witnessed in the developed countries. Succinctly stated, the horse has to come before the cart, not vice-versa. I advocate the approach of local and private sector development as panacea to economic problems facing the country.

Two-pronged economic challenges: Analysis Framework to Identify Private Sector Types

There is a two pronged economic challenge that makes the development of the local and market based private economy special and pressing. The first challenge to sustained economic growth comes from the economy controlled and directed by part of the population that is growing rapidly in the country, namely the population economy. This part of the national economy is used for reproduction and multiplication of households in the country. The existence of 15 million households in rural areas and 5 million households in the urban areas is not by miracle. Vast number of empirical studies attempting to explain the livelihood strategies, activities and resources of smallholder agriculture and urban informal sector belong to this type of economy.

The population economy is fragmented, characterized by diminishing returns, and scarcity pressures in inputs, goods and services. Under condition of population doubling, in countries
where there is limited private sector development, fragmentation, low level of labour productivity and scarcity are not artificial perceptions. Using the 3D methodology GDP accounting, we have found out that over 90 million of the population is currently living on 45Pct of the GDP (about seven Birr per person).

Population loss in the form of outmigration, hunger and political unrest in the country is not a surprise. The country’s future should be based on the idea of creative destruction of the population economic system not on continued co-operation for further reproduction as has been done so far under the programs and approaches of top-down development. Private capitalism should replace the population driving force in the destruction and creation of wealth in the society. The economic system has to pass from the hands of reproductive households to the hands of wealth creators (private capitalists and labourers).

The second part of the current economic challenge comes from the growth of the economy controlled by the state. The government has been using 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 and this is officially admitted by the government. The political elites who control the non-economic factors (bureaucracy, army, security, law) control as well 39Pct of the GDP. Debunking the state economy is necessary for creation of institutional efficiency and application of corporate style of strategic planning to public sectors.

**Policy recommendations**

There are two ways of increasing the size of the private sector in Ethiopia: self-development of the private sector at local level and privatization of state and party owned businesses. The first method focuses on the emergence and growth of local entrepreneurship (or endogenous development, if one prefers). This approach emphasis the comparative advantages, resource characteristics, and entrepreneurial ability (local inhabitants’ know-how and initiative) of indigenous enterprises.

The process of self-development of the private sector at local level (i.e., the first method) does not go forward without sweeping away the existing system of the population economy. In rural areas land fragmentation and economic activities have to be consolidated and centralized through a policy of land privatization. The emergence of capitalist farmers, who use wage labour, social capital and market inputs, particularly in high-grain production areas, is absolutely essential for self-development of the private sector.

In rural towns, particularly in areas which have location advantages, local entrepreneurs should be encouraged to engage in industrial activities through the development of the local human resources. The purpose of industrializing rural towns is to provide products to meet
local agricultural inputs and household products. This program can be done through industrial planning at district level.

The second method of increasing the size of the private sector development in Ethiopia is the privatization of state and party owned businesses. Debulking the state share of the GDP and breaking its hold on the national economy through privatization reforms should proceed cautiously to avoid social, political and economic chaos. To provide stability necessary for the functioning of a free market, it is important to create an independent and pragmatic bureaucracy which has the objective of creating sustainable and endogenous industrialization.

It is not only enough to address the issues of size. Beyond increasing the size, there should be policy interventions to develop the organizational link and transaction between private sectors. Developing the market system helps to catalyse the process of competitive-ness, resilience to shocks and diffusion of innovation. There are different methods of developing the domestic market system.

Value chains is one part of a market system, which “describes the full range of activities that are required to bring a product or service from conception, through the intermediary phases of production and delivery to final consumers, and final disposal after use.” The activities constituting a value chain can be contained within a single firm or divided among different
firms, within a single geographical location or spread over wider areas. Value chain conceptualises capitalist farmers and rural town small scale industrial entrepreneurs, not as discrete entities, but as part of a system of different but linked production and exchange activities.

Cluster is another way of developing the local market system. Cluster refers to a group of companies and other institutions in related industries that are collocated in a specific geographic region. Clustering can enhance the individual capacities of small firms to access markets, and acquire skills, knowledge, credit and information. For a company to operate out of cluster is disadvantageous. But these advantages are not given. Particularly in Ethiopia these advantages do not work because of weak institutions, labour oversupply, and small size of the market.

Value chain and cluster initiatives need planning and management at the district level. Since both are parts of a wider network of rules, regulations and supporting functions, there is also a need to specify the role of the federal and regional governments in the development of market system and private sector. To promote endogenous development of the private sector, the federal and regional governments should undertake the following responsibilities: i) creating proper legal environment for the private sector to function, through private property rights and contract law; ii) subsidizing or improving access to credit; and iii) providing supportive infrastructure services such as water, power, land, transport and communication services.

The time now requires self-development of the private sector at local level. Under the most optimistic low fertility scenario the country’s population size is projected to increase to 137 million by the year 2037. A growing population needs a growing economy. The Ethiopian economy has to recover not only from backlogs but also has to re-adjust to new additional shortages every year. For reasons of top-down approach to development, a market based endogenous private sector development has never been tried in Ethiopian history. It is time now to discuss how to bring the future into the present.

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