

Law of Public Enterprises and Cooperatives

Teaching Material

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Introduction

The early state had tasks at its disposal very minimal in extent. Its role originally was almost entirely political and geared at the maintenance of internal peace and security and protection from external aggression. The early state did use to carry out trade and engage in economic activities but only to a limited extent - merely to finance itself and accumulate wealth to cover its administrative expenses. No expenditures used to be earmarked for societal and economic ends. Moreover, the relatively small commercial undertakings were run by administrative departments that constitute the state itself. This shows that commerce was a field of action for a state only incidentally because the administrative departments undertake commercial activities as secondary and subservient duties to their normal tasks of public administration.

But with the proliferation of tasks expecting state accomplishment accompanied by expansion of economic concepts and accordingly with the emergence of a modern state, i.e., welfare state or activist state, such old functions had to be radically changed. The activities of the modern state have become diverse and multifarious, and thus administrative departments are no more capable of simultaneously discharging administrative functions and economic activities. The role of the state in the economy has greatly increased so that it has to ensure economic growth of a country and provide welfare services to its citizens. In short, the function of the state has become the adoption of a policy which would secure distribution of ownership and control of material resources of the society to serve the common good and which ensures that the operation of the economic system does not result in the concentration of wealth and means of production to the detriment of this common good.

The role of the state is even greater in the current world of globalization where the different and distinct economic units all over the world operate to create a single economic community. The stiff competitive environment in the global market requires a government backed entrepreneurship. Globalization is a trans-boundary phenomenon and it has much to do with economic authority of a state. A modern state cannot watch the global economic impact from the

sidelines; it rather engages itself in devising economic policies that help its own economic units and that appropriately respond to foreign economic forces.

The question intimately turns out to be what mechanisms are available to the government in actively taking part in the economy as a whole. There could be several individual ways or the combination thereof that government prefers to adopt but a vivid scenario is that of public enterprises. Public sector enterprises reveal a massive economic function of the state, though the specific economic purpose and the dimension of the engagement intended in the adoption of public enterprise may differ from state to state taking into account prevailing quasi-political and economic factors. It has to be noted here that the political economy of the state as a whole and the place of public sector undertakings in particular would have extensive ideological foundations and can be a proper subject matter for an intellectual discourse by the experts in the field and by other stake holders, and therefore the course material at hand should not be expected to represent such a deep analysis. Nevertheless, the course developers believe that it provides a general picture of the justifications of state preference for public enterprise and their actual role in the economy.

And, of course, the particular purpose of this course material is the study of the legal regime that regulates (or claims to regulate) the public sector entrepreneurship. It is a general truth that a certain law, whether permissive or prohibitive, presupposes the real existence (at least purportedly) of the matter it is meant to govern. Laws do not claim to operate in a state of vacuum. All the same, laws may not be needed even though there is a matter in the society in reality, for there may be in place adequate non-legal mechanisms. Public enterprises indeed exist, they exist in both developing and developed countries, in capitalist and socialist ideologies, subject of course to significantly varying forms and degrees. Their general susceptibility to governance by a regime of law is rarely questionable because they are governmental entities entrusted with the task of running a huge economic unit with the ultimate ownership residing in the public at large and the public interest demands that accountability be ensured through the strongly institutionalized sanction of a legal system.

The phenomenon of public enterprise is not an exclusive subject matter for supreme authority of the law; it is rather an inherently inter-disciplinary affair requiring determination based on political and ideological inclinations. Its creation is considerably a political exercise related to the politico-economic policy of the incumbent state authority. Law rarely finds a playing ground here, but it assumes significant relevance in the determination of the form and organizational structure of the public entity decided to be created. Even at a stage where it claims application, the law should not be thought independently of the politico-economic machinery that gave rise to public enterprises. There may be cases that favor discretionary administrative decision-making rather than the standardized legal norms, government enterprise issues that seek political solution than court decisions. Thus, a law seeking application to public enterprise matters need not only be confined to its area of effective application but also should be invoked in a manner that reflects political and economic policies of the state.

In the above generic context, a look will be made of the forms and nature of laws revolving around the relationship between the state and public enterprises on the one hand and the connection between public economic ventures and private entrepreneurship on the other. The areas of contact and departure among these actors in the economy will be scrutinized having regard to the relevant legal principles.

Cooperatives, on the other hand, are associations established and managed by private persons in order to address the economic and social needs of their members. Human cooperation is an age-old phenomenon so much so that one can trace the history of cooperation to the time when people started to live together. In fact, it is difficult to give the credit to this or that society. The causes of human cooperation may be of different nature; it may be fear of natural calamity, or human exploitation as is the case in most of the earliest forms of cooperation, the need to conquer a formidable and hostile natural environment for habitation, or it could be to ameliorate human sufferings the causes of which may be ascribed to socio-economic crises. Whatever may be the *raison de etre* for human cooperation, it is this cooperation that gives birth to a cooperative society.

The significance of cooperative society cannot be overemphasized. Cooperative societies help their members to get out of socio-economic crisis. Cooperative societies prevent their members from being exploited by private businesses; Cooperative societies as part and parcel of society association, serve to guarantee the economic and even other rights of members against encroachment by government agents and others. They are important development agents as they create jobs for human solidarity, help members to shield themselves off undue exploitation etc.

Cooperative societies had fallen prey to misuse by tyrannical power holders. Their energy and recourses can be harnessed into the great benefit of humanity as much they can be utilized to the demise of human welfare. Humanity at large is seeking, however blindly, for a major transformation from a system dominated by capital to one based on human dignity and equality. The cooperative movement, when true to its principles and armed with the courage of its convictions, can prove by practical demonstration that a world society is possible in which human beings are no longer slaves but masters of economic forces. Its mission is to reach the common people by demonstrating how the principles that express their neighborly and brotherly relations in their cooperative can also inspire the mutual relations of nations.

This said, the primary distinction between public enterprises and cooperatives is thus the ownership questionthe former (public enterprises) are owned and controlled by the government while cooperatives are owned and controlled by private individuals. Nonetheless, both have common features in the sense that they both are economic associations with dual expectation to pursue other goals such as the issue of stimulating investment and addressing social concerns.

As the title of the course suggests, this material has two parts. The first part of the material which in turn consists of two sections is devoted to the discussion of law of public enterprises and privatization. Under this part, we have tried to address, the forms and nature of laws revolving around the relationship between the state and public enterprises on the one hand and the connection between public economic ventures and private entrepreneurship on the other. The areas of contact and departure among these actors in the economy will be scrutinized having

regard to the relevant legal principles. The second part of this material is entirely devoted to the discussion of cooperatives.

We have also included much thought provoking questions in the material so that the readers will duly engage in some kind of mental exercises.

PART-ONE
PUBLIC ENTERPRISES AND PRIVATIZATION

SECTION ONE
THE LAW OF PUBLIC ENTERPRISES

CHAPTER ONE
A BRIEF CONCEPTUAL OUTLOOK OF PUBLIC SECTOR
ECONOMIES AND PUBLIC ENTERPRISES

In a modern society, the state bears the responsibility to undertake all-round functions that touch upon every aspect of individual life of citizens and the society at large. The confinement of a state to conventional spheres of politics and administration is out of place, and it is equally required to actively indulge itself in ensuring the economic well-being of citizens and the nation as a whole. Given that the very essence of human life stems from the use of material resources and that these resources are scarce, and of course that the members of an organized society delegate their affairs to institutionally established powerful state, it should be no surprise that the state bears the burden of dispensing economic justice. There are several modern problems that would lead to serious economic instability unless treated with powerful hands. Such macro-economic problems as unemployment, inflation, wealth inequality and issues of economic growth, to mention only some, require the authoritative determination of the state.

The state would have economic tools at its disposal in order to discharge its functions in the economy. A government devises various economic directions that it thinks fit to effectively achieve the desired end. There would be a complex net of economic structure employed by a government and this net constitutes the public sector. The scope and content of public sector economies varies from one state to another, in some very broad and in others narrow, some having deep affiliation with the economy while some others playing only peripheral roles. The public sector is more than just a simple totality of enterprises, but is generally a special system

whereby the state uses its property (including those enterprises), which enables different forms of state intervention in the economic processes in order to deal with specific economic and social problems. The public enterprise alternative presents to the government a massive mechanism to exert sustainable influence on the national economy.

There has been an extraordinarily extensive influence in the economy by the public sector of states that have liberated themselves from colonial dependence after World War II. There has also been an exponential growth of public enterprise in these countries as a manifestation of such influence. There was no time in history when the world had experienced as rapid and radical public sector economic endeavor as that seen in the post-war period. The emergence and growth of the sector was evident in the newly liberated states irrespective of their declared economic ideology and perhaps for different purposes.

Of course, in any country the character of the public sector is definitively determined by the politico-economic ideology of the forces in the government. That is, the focus on the nature of the state is important for a true understanding of the purpose and operations of the various economic tools in the public sector because the public sector economics is in a sense a direct emanation of the state. All the same, there could be certain common economic compulsions that call for governments of the newly liberated countries to engage in the economy almost invariably. The patent reason is that, with the colonizing powers formerly in charge of the political and economic process just exiting (withdrawing), there is virtually no body else to take care of the economy and thus the young states would bear, at least for the time being, all the burden of economic functions. The economic actors in these countries during colonial periods were predominantly foreign bodies instituted by the colonizers and a big domestic economic unit is a rare phenomenon. It is more likely that the foreign capital and investment would leak out with the owner colonizer leaving the concerned country even though there were instances of maintaining the foreign economic dependence even after liberation. The nature of state involvement in the economy and the ultimate end intended to be achieved actually differ from country to country even within these newly freed states based on the ideology they adhere to. The following statements will take the matter a bit further.

The emergence of a fairly extensive public sector is a major regularity in the development of the young states. Although the scope and pace of the changes differ from country to country, the public sector and related matters have been central to their economic policies. To a certain extent, this is independent of what forces hold the reins of government, the reason being objective factors which are not rooted in the processes occurring in the multistructural economic patterns of these countries and with their economic and social situation.

The principal task facing the developing countries is to build an independent economy, overcome their economic underdevelopment and accelerate the development of productive forces. For several reasons -- such as the weakness of the local bourgeoisie, insufficient funds, and the difficulties of building modern economy in the context of the scientific and technological revolution -- this has to be done by the state. Here the state is the only force which can mobilize resources on a national scale, organize their employment and define the principal current of development. Although there are many forms of government intervention in the economy, the most effective way in which the state can secure positions in the economy and thus have the greatest opportunity to influence the direction and pace of economic development is through its own economic activity. And this economic activity is above all concentrated in the public sector.

The essence of the last two statements will be treated in relative detail later.

The public sector of a developed economy also plays certain overall roles. Developed countries of the west have already achieved the basic leverage necessary for all-round and resilient economy. They have a huge national capital accumulation that ensures continued economic well-being. This means that governments of developed nations would not bear the burden of shouldering an active economic participation as that of developing and underdeveloped states would, because they have in place a strong economic base that can be effectively run by other economic actors. This tendency is, however, not to be taken fore granted because it is determined partly, if not largely, based on the ideological preferences of the states. Yet, irrespective of any ideological tendency, countries with developed economic system find themselves acting in the economy one way or another. Their public sector vigilantly takes part in the economic affairs ranging from playing essentially regulatory roles on the economy and its active runners in general to addressing specific interests. The public sector in many of these countries concentrates in areas that are not of direct entrepreneurial significance and it at least undertakes and expands distributive and redistributive functions that are inherently associated with it such as budget,

taxation and investment. It is also often the case that a developed state would venture in particular sectors of the economy that are inadequately served by the non-state actors in order to benefit the public. In sum, the state, as a guardian of a public interest (including economic needs) and as an organ vested with supreme authority, must devise economic policies for public utility and participate in the economy to the extent the public interest demands.

The share taken up by a state in an economy, especially its extent, can also be explained by the type of the economic ideology the government of that state adopts. This reinforces the powerfulness of state machinery and its subsequent application in the proclamation of a certain economic ideology and policy within the jurisdiction of that state. Governmental authority of a state cannot only impose a certain economic direction but also can influence and shape the legal structure to operate in the context of the proclaimed economic ideology, for law is largely instrumental in nature. Thus, the nature and extent (including purpose) of public sector economic endeavor and the governing legal regime are greatly determined by the governmental economic ideology.

The well-known (and experienced) economic ideologies are capitalism and socialism, with a variety of other economic principles evolved and upheld between these two extremes. Countries embracing the socialist economic ideology are characterized by the public sector ownership and control of large-scale production and distribution facilities. They proclaim as their objective the attainment of radical social and economic changes, led by revolutionary social-political group expressing the interests of the broad masses that consists of workers, peasants, petty bourgeoisie, and the patriotic intelligentsia, and guided by society's progressive forces. The progressive lines include the securing by people's state of commanding heights in the economy and transition to planned development of the productive forces, and encouragement of the cooperative movement in the countryside. They also involve enhancing the role of the working masses in social life by imparting with them high level of socialization and gradually reinforcing the state apparatus with national personnel faithful to the people. The countries with a socialist orientation generally entrust the socio-economic function to a centralized public sector that is believed to be, compared to the pre-capitalist and private capitalist modes of production surrounding it, the more

advanced and socialized form of production, and in this capacity it expresses a historically progressive trend which meets the interests of society as a whole.

Socialist economy calls for the national mobilization of internal resources and creation of an advanced public economy that withstands the influence of the world capitalist economy. In developing countries, particularly, socialism as an economic ideology is believed to limit and gradually eliminate the neocolonialist exploitation and monopolist imperialism practiced by the developed former western colonizers. Young states of the third world tend to resort to socialist economic ideals so as to direct national resources toward a public front with the attempt of radically changing the economic state of affairs by simultaneously denying a breeding ground for alleged misappropriation by local big bourgeoisie and foreign capital.

Many socialist states resorted to widespread nationalization of a property belonging to local and foreign private sector as a basic tool of effecting public ownership and control of key economic materials. But it is conceded that the passing of ownership into the hands of the state indispensable to building the economic foundations of socialism does not by itself amount to the socialist transformation of the economy. Public ownership acquires socialist content gradually as the conditions for it are created. One indispensable condition is comprehensive revolutionary change in economic, social and political life, and the establishment of new principle of regulating property relations in general and of controlling public property in particular.

At the other end of the spectrum of the economic ideology is found capitalism. Conventional capitalism underlies the economic dominance of private groups. It is an ideology that entrusts the major economic role to the private sector, guided and reinforced by market mechanism and competition. The function of the public sector under such a system is significantly minimized and it plays regulative and supplementary roles. In liberal private-capitalist regimes, the state is officially supportive of private capital owners -- it indeed functions as the handmaiden of the private sector providing credits, subsidies and cheap services. Some authors describe this phenomenon as state interventionism, meaning the state intervening in the private sector dominated economy in order to compensate for the weaknesses and inefficiencies of private capitalism such as smoothening crises, hastening structural changes, etc. The above conception,

as it suggests, presupposes a strongly established private capitalist forces and the existence of an adequate market mechanism. Thus, it is more suitable in developed countries with advanced private capitalist elements than in developing nations.

It is unrealistic to conceive of a public sector of a third world country as undertaking merely regulative functions in a situation where local private capitalist forces are too weak and underdeveloped to engage in necessary production and distribution. There is a manifest lack, if not total absence, of local big bourgeoisie in Africa and elsewhere in the third world that forms the economic centre for the effective play of private capitalism. If there is any huge capital in these countries, it is the foreign capital found on their periphery that is based in the advanced capitalist countries. Therefore, large-scale participation by the state in production and trade is a necessity and this raises important questions about the nature of the political economy as a whole and the class character and functions of the state, especially when these countries disregard the nationalist socialism and when pure capitalism is not workable because of factors mentioned above.

The public sector intervention in the economy of capitalist-oriented developing and least developed countries has assumed a new form and goes, both quantitatively and qualitatively, beyond what is normal in advanced capitalist countries not only because domestic-internal private-sector is relatively non-existent but also because these newly liberated countries are skeptical of neocolonialist version of foreign private capital. Still, it takes place within societies which in most cases are integrated into the world capitalist economy, without the state planning and control normally associated with socialist countries. In other words, these nations have adopted a special “third path” of development which presumably is neither purely capitalist with all its elements nor socialist in the context employed by Marxists. There exist apparently conflicting situations of engagement in widespread nationalization practice and encouragement of local private capital.

The purpose of capitalist-oriented dominant state engagement in the economy is the realization of profits within a class society in a non-capitalist direction. Some scholars prefer to call this phenomena *state capitalism*. The third path approach of third world state capitalism is private-

capitalist in end through the instrumentality of progressive class force of socialist character. It focuses on the state bureaucracy as a dynamic class force capable of pursuing an independent, national strategy, although it foresees its reintegration at some later point into the world capitalist system. In view of the weakness of other internal class forces, the state bureaucracy remains the last barrier to total subordination and fragmentation in the economic neocolonialist era. National state capitalism is an effort to achieve integrated industrial development, in opposition to the fragmented, dependent development enforced by foreign capital, thereby facilitating national economic emancipation. In *toto*, state capitalism occupies a more central (strategic) role in the development of productive forces in the third world, substituting itself for the non-existing capitalist (operating in that capacity), performing actually the function of collective capitalism.

Third world state capitalism, however national in orientation it might be, has to concede its highly dependent nature on and susceptibility to easy penetration by foreign capital. There must therefore be an accompanying attempt to reduce dependence within existing structures. Still, the manifest foreign interests in the national state sector - there are several factors that induce foreign economic action to have association with capitalist state of a third world - makes it necessary to explore carefully the interaction of state and foreign capitals in order to understand the class character of this state capitalism.

Similarly, the class orientation of state capital must also be explored in relation to other internal class forces than the intermediary bureaucracy. The weakness of internal, private capitalists as a vehicle of national industrialization are apparent in most African countries and this is of course the main reason for dominant public sector endeavor. It is clear, however, that the public sector under state capitalism provides an umbrella under which local private actors flourish; state capital is deployed in the interest of a weak but expanding internal capitalist class. Thus, large-scale, direct state participation in production and commercial services is not geared toward creation of competition with the private sector; state ownership in the context of state capitalism basically is not only compatible but actively conducive to the development of private capital. This relationship is, adversely viewed, likely to pave the way for top bureaucracy to be closely involved in the private sector although relations of ownership and control are concealed through

the use of various intermediaries. A class of “bureaucratic bourgeoisie” that not only controls the public sector but which is influenced by private entrepreneurship emerges and develops.

All the above discussions, as we asserted at the beginning, clearly tell us state interference in the economy, with deferring nature and extent. Most governments discharge their economic function by establishing independent corporate bodies called public enterprises. In almost every country, public enterprises have practically become economic tools for governments for various national purposes. In view of the variety of uses to which it has been put in developing countries and as more and more of the burden of national development is placed on it, public sector enterprise needs conducive legal structure and well-thought operational guidelines within which the achievement of the public objective for which it was created is ensured. An analytic approach to such sensitive issue is necessary.

The importance of public enterprises lies largely, though not exclusively, in their impact on the economic system. But it is of course not the only form of state intervention in the economy although it is among the most visible. The building of the infrastructure through the use of state revenues, concessional fiscal rates, even the cooperative movement and the support of the freedom of contract are forms of state intervention. It will help us to appreciate the virtues and to arrive at a theory of public enterprise if one looks at it as one of the several forms of state intervention in the economy.

Public enterprise for state participation in industry may be a new form, but it is a new form for old purposes: intervention of the state to achieve certain social, political or economic goals. While this illustrates that the state is never neutral and that it encourages, promotes or induces certain forms of growth, favoring particular groups or classes, problems that public enterprise gives rise to are qualitatively different from those caused by other forms of state intervention. In such a context, it is worthwhile to examine the alternatives to public enterprise and to make an attempt to explore as to why this is becoming the preferred form. A variety of reasons are given for preference of state to establish public enterprises. The following excerpt is taken from the reasons and analysis given by Yash Ghai.

*... to fill the gaps left in the economy by private enterprise, either because of the size of investments required or because of the unpredictability of the project, to provide a basic infrastructure for the economy, to promote greater national economic independence, to provide some measure of check over or at least competition with the private sector, to obtain greater control over the economy, to ensure a more balanced distribution of industry and its rewards. It may be argued that public enterprise is not a **sine qua non** for the achievement of these purposes, except in one case. If the policy is to create a socialist economy, there is likely to be little alternative to public enterprise, where it is a necessary but not sufficient condition. But in very many countries, the purpose is often the very opposite: paradoxically, state enterprise is used for the development and strengthening of the private sector. In so far as the general aim is the control or guidance of the economy, other tools are available. The alternative approach would look at the various kinds of control open to the government with a view to some cost and benefit analysis. Various regulatory or prohibitory methods may be able to achieve as much with greater economies of time and money. The alternative approach would emphasize the importance of clarifying the objectives of public enterprises and establishing the criteria for evaluation of success.*

In the search for control of the economy, the public enterprise alternative provides a viable direction to the government. Public enterprises are employed to effect operational controls that arise from the desire to control the development of the economy, usually resulting from the failure of the regulatory model exercised by governmental agencies or from weakness of the private market mechanism. They also arise from the existence of scarcities, of raw materials, foreign exchange, etc requiring some method of determining and servicing priorities. In each case, the intention is not to let things take their own course, but to influence or control economic developments by using the best instrumentality of public enterprise to directly engage in entrepreneurship.

Public enterprise is also used to bring about greater governmental control when there is no particular problem with the private sector. In such cases, public enterprises can be used to allocate resources on a differential or discriminatory basis, for instance to promote the development of particular sections of the population. Public enterprise forms a basis of patronage and a more tightly controlled allocation of resources.

Public enterprise may also provide a better basis of control of the private sector through creating an association with private business in the form of joint venture. The government would have increased access to important commercial information, and may minimize opportunities for overpricing, price transfers and tax evasion. National capacity with all its ingredients depends on a host of decisions at firm level, and it can hardly be enforced bureaucratically without a host of rules and professional and skilled personnel. The quality of entrepreneurial personal is poor in developing countries, which makes joint ventures preferable to fill-in the gap. But here there is a counter-argument that joint ventures not only result in the private partner making the key decisions in the context of a weakened or less rigorously enforced framework of control, but that whatever potential for control might exist by virtue of capital available to the government is directed and squandered as joint ventures effectively denationalize state capital. This profit directing tendency is prevalent especially in young capitalist countries suffering from dependence on private capital (largely foreign), and the resort to joint ventures must be cautiously made.

The public enterprise alternative is also said to offer possibilities of control through providing alternative and competing institutions to those of the private sector. A vigorous and competitive public sector can establish new standards to which the private sector will be pressed to conform. Public enterprise can thus promote greater efficiency and competitiveness, and can be used to extract a greater responsiveness to national policies on the part of the private sector. It may, however, be difficult to create a vibrant and vigorous public sector of enterprises with the capacity to discharge such functions, especially if it is to be treated on a par with the private sector, as it would need to if it is to establish a model for the private sector. The public enterprises in many African countries lack such capacity since they start with various handicaps.

The economic presence of the state through public enterprise is viewed as providing sustained productive capability even if public enterprises may not be as effective as other alternatives including the regulatory system. Below is a comprehensive exposition regarding the overall virtue offered by public enterprise over other alternative ways.

From a juristic point of view, somewhat simplistically stated, the difference between the regulatory and the public enterprise strategies is that the former is a method of control without ownership, the latter of management through ownership. It is true that the autonomous character of a public enterprise may mean that the method is still one of control and not management, from the government's point of view, but the public ownership of the means of production very likely or perhaps inevitably leads to the blurring of the distinction. It is easy to believe in some circumstances that only method of control is through management. In the regulatory control mechanism, the pull is towards generalized rules even if there are large elements of discretion vested in the officials, whereas in the management method, broad discretionary power is essential. [- -] public enterprise represents an aggregation of important resources under governmental control. It leads to the creation of direct economic power at the disposal of the government, whose essential purposes may be largely political. Whether political or economic, the creation of economic power poses a number of problems and issues for the investigation of which public enterprise provides a useful starting point. The concept of economic power is of course wider than that of public enterprise narrowly defined, for it would also include ad hoc, individualized, administratively determined interventions. One reason for the choice of the public enterprise form there fore over that of the pure regulatory method may lie in the additional levers it provides even if they are no more effective means of control. Just as regards the rest of the legal systems in Africa, the legal system of public enterprise is increasingly mitigated, qualified and eventually eliminated, by administrative and political directions and decision-making, so public enterprise is seen to be more predictable, and more immediately controllable than operation through generalized standards.

This is not to say public enterprise is necessarily more successful in the control of the economy than the alternative ways. Various studies in different parts of the world have shown that public enterprises have squandered scarce resources, led to new bureaucracies, and given little effective power over the economy. It may be that at the bottom both the regulatory and public enterprise strategies suffer from the same basic problems and weaknesses: dominance of the external, largely foreign environment, corrupt and powerful local elites, who in collusion with foreign interests, manipulate the local economy for narrow class or group purposes, unresponsive political systems.

All told, public enterprises have gained enormous economic significance and are no more confined to areas of their traditional concern like infrastructure and public utilities. Today they have moved into every sector of economic endeavor, with the range and diversity breathtaking.

Studies reveal that public enterprises have a dominating share in and contribution to gross national product (GNP) and value added in both the industrialized and developing countries, indeed with varying degrees.

There are some specific theories and rationales behind the corporate entrepreneurial engagement of the state, as stated by different scholars in the fields of economics and public administration. Let's look in brief to these factors that call for undertaking through public enterprise.

One justification is the ironical concession provided by the extreme advocates of the free enterprise like Adam Smith. They state that in spite of all its advantages, a free price mechanism entailed serious drawbacks which had to be overcome in the long-run interests of the economy. An economy cannot sustain itself and grow unless it is healthy in terms of production potential which should increase with the passage of time. There must exist economies of scale at the macro-economic level which is even more provocative with industrialization and the resulting rapid economic growth. This implies the development and operations of different sectors in harmony with each other – there must exist a proper sectoral balance. Quite in contradiction, the nature of market mechanism demands that all economic activities are guided by economic rationalism which in the context of production and provision means profitability. Market system would decline to create and run those productive areas which could not yield adequate commercial returns. There are some means of production like social overheads the creation and maintenance of which does not ensure adequate commercial profit but are necessary for the development of the economy and help toward unleashing the productive forces of the economy in the long-run. These would serve as major source of external economies, lower the cost-price level (input-output ratio would be optimum and increasing), and stimulate economic growth. Thus, social overheads are theoretically justified to constitute the subject-matter of action for public enterprises. Public enterprises can maintain them at a loss. There may be revenue collection, but generally they would be non-profit ventures in strict mercantile terms.

A more specific case that clearly requires engagement by a public enterprise is the production and provision of pure public goods. Pure public goods are characterized by non-rivalry in the sense that the consumption by one member of the community does not reduce/deplete the

consumption available to others. There would not be a competition among the consumers to get the good. A pure public good is also indivisible and inexcludable. No member of the society would be excluded from enjoyment nor is it possible to divide the good and allocate it on a discriminatory basis, so that all would benefit without the need to pay the price. This is a case of free ridership where economic benefits accrue without the *quid pro quo* payment for it. Private enterprises do not engage in an activity that they cannot receive payment from every member who benefits from their provision. Obviously, it is public enterprises that should take up these activities. The case of merit goods, those so essential that consumption is increased at a reduced or zero cost such as education or medicine, also falls under public enterprise sphere of engagement because private enterprises do not naturally have the tendency to produce or provide goods at lesser prices.

In an economy, there also exist key and heavy sectors that mostly need huge amounts of investment. The venture may be too risky which private enterprise is not ready to assume, even if it has got sufficient funds. The venture may entail a lengthy projection for profits which a private, having only a limited span of life, may find it not economically feasible to engage in. But society is presumed to have an eternal life. Public enterprise on behalf of the society can take a very long-term view of costs and benefits of a project.

The economy must be helped to be resilient and flexible by the development of basic sectors - such as human resource development. It is not likely for the private sector to establish such in time and in adequate measure because of the primary profit motive. Once this "installation" is done by public enterprises, private enterprise will find it easy and profitable to expand at a rapid rate.

Sectors like electricity generation that exhibit economies of scale are not proper areas for private engagement. Leaving these sectors to a large number of firms competing with one another will not reap the required economies. Big private monopolies in areas that exhibit scale economies are also not looked at favorably because there is always a tendency to exploit the situation to their advantage and also it results in concentration of wealth. Therefore, sectors that tend to be natural monopolies must remain a public monopoly.

It is held that the final choice of a project in the interests of the economy as a whole should depend on the social marginal benefit relative to the social marginal cost instead of the private marginal cost-benefit relationship. There are services the supply of which will create externalities, which may add to the social benefits, costs or both. If social benefits exceed social costs, its production must be taken up. While on grounds of social benefits some projects are sound, on grounds of commercial profitability they are not. Private enterprises choose a project with externalities based on individual marginal cost-benefit analysis, and they will not venture if the individual cost exceeds individual benefit even if the social cost-benefit scenario is advantageous to the economy. Therefore, public enterprises should enter sectors that produce externalities on the social marginal cost-benefit analysis.

The extent to which all the above factors would become operational may vary from system to system, based on attaching as considerable attention to non-economic factors as the economic ones. There could also be inefficiencies and ineffectivenesses, and this may call for “professionalization” of the management of the enterprise, and even of the relationship between the state and the enterprises. The purpose of studying them is to avoid “a malaise eating at their heart”.

CHAPTER TWO

MEANING OF PUBLIC ENTERPRISES: DEFINITIONAL TESTS

One can find no consensual or generally agreeable definition of public enterprise. Moreover, it is called by different terminologies and these cause confusion – public undertaking, public enterprise, public corporation, national enterprise, state-owned enterprise, governmental enterprise. The public entities range from purely regulatory at one end to purely commercial at another.

H.L. Bhatia attempts to provide a distinction. He argues that “public sector” and “public undertaking” should not be equated – the latter form part of the former. He divides public sector into three categories. The first group is constituted by those public services which are provided to the members of the society free of cost, or at least with that intention. Defense, administration, justice, law and order form part of this category. These are what may be referred to as pure public goods. Those public services which are run and maintained by the Departments or as Departments make up the second category. Here are included postal services, education, roads, bridges, etc. Their finance may fall on different grounds and some of them may be in the nature of public undertakings. The third category comprises those public services which are provided not by the departments but through the means of autonomous or semi-autonomous bodies like firms, companies and corporations. These are economic units that may have, even though owned by the government, their own price policies according to different objective and criteria.

He further claims that only the last two categories constitute “public undertakings”. Even in the first category, he says, the government might charge fees for certain services, but is in the nature of taxes and for regulating the supply of some goods/services.

For Bhatia, the terms “undertaking” and “enterprise” cause confusion. He said that there is a tendency to regard public enterprise to be more like a private enterprise where there is a consideration of risk and intention to reap a profit, but a public undertaking need not be risky and it need not work for profit. But he knocks down the distinction as not a watertight and suggests the interchangeable use of the terms. He states that whether or not public undertaking faces risk

like a private enterprise depends upon numerous circumstances like the product it supplies, the market structure and so on, and a public undertaking may or may not have a policy of making a profit. A choice of price or profit does not make it one or another.

Another influential writer claims that in between the two extremes, one finds a variety of promotional, developmental and catalytic bodies. He asserts that the ambiguity has arisen because of a trend to create autonomous bodies to discharge, more effectively, tasks which would ordinarily have been undertaken by regular government departments. The taxonomy here claims that all these organizations fall under the generic category of “parastatals”. The proliferation of these parastatals has created an atmosphere of ambivalence in respect of their responsibilities, obligations and goals. For instance, entities essentially developmental or regulatory in nature are uncomfortable when asked to produce balance sheets and profit and loss accounts, and essentially business firms view social objectives as a disturbing element in their corporate life.

Behavior patterns, strategies and evaluation processes are in practice very difficult because these public institutions are not of the same nature, though grouped together in the family of parastatals. The task is therefore to determine which of these parastatals, public corporations or public bodies is a public enterprise in the real sense of the term, hence definition and need for parameters.

According to him, the core concept of ‘public enterprise’ lies embedded in the term itself – an organization which has two faces or dimensions. And if one or the other of the dimensions is not present, the body cannot be described as a public enterprise. The two faces are obtained by splitting the phrase into two parts: they are the enterprise dimension and the public dimension. We see here a double-faced relationship regarding a public enterprise--one with the private enterprise and the other with the state. Each of the dimensions exhibits characteristics as stated herein below.

2.1. Enterprise Aspect

- a) The organization is engaged in the production of goods or provision of services. This would probably cover every form of human activity.
- b) The goods so produced and the services so provided are marketed at a price. Some times a deliberate policy of underpricing may be there, but at least the intention is that no goods or services are to be given for free.
- c) The revenues so earned are adequate to cover the costs (with cost inclusive of the opportunity of venture capital, debt servicing and depreciation).
- d) The activity is based on the entrepreneurial idea of investment and return. Actual profit is not issue here; at least presence of the intention to make surpluses suffices.
- e) There is maintenance of commercial accounts which document its enterprise character. Two books of account are needed. One is a balance sheet which shows, at any given point of time, the assets and liabilities of the enterprise. The other is a profit and loss account which describes for a defined period of time, usually a year, the inflow of income and the outflow of expenditure, resulting either in surplus or deficit.

These are the indispensable elements that make up a certain entity an enterprise. The missing of one makes the entity not an enterprise, or at least not an enterprise in the strict sense of the term.

2.2. The Public Dimension

- a) There must be a public ownership. The ownership is vested in a public authority, on the behalf the public at large which could be the central government, the state government (in federations), a municipal authority, or even an existing public enterprise over a subsidiary or branch (this last case of course needs a careful look). There will usually be no doubt if ownership exclusively belongs to a public authority. A problem may arise regarding enterprises that are only partly owned by a public authority as in point ventures. It is suspected that a majority shareholding by a public authority makes the enterprise a publicly owned one. An entity with minority governmental shareholding may still be regarded as a public enterprise depending on whether the other elements of the public dimension are present.

- b) Public purpose: - the establishment of a public enterprise has in mind the attainment of some public policy goals. The rationale for setting up public enterprises is that they are better instruments for promoting developmental goals. Thus, in addition to the corporate objectives implicit in its enterprise dimension, the nature and content of the public goals which the enterprise is presumed to achieve need to be identified. Of course, it is possible that public enterprises explain away their commercial failures by pointing to their so-called “social responsibilities”, using social objectives as a post-facto alibi for poor performance. The incorporation of this element into the very concept of public enterprise makes social objectives be defined in advance to enable the enterprise to develop corporate strategies to attain them.
- c) Public control: - ultimately, all enterprises whether private or public are controlled by their owners, the shareholders. For private enterprises, we can raise two scenarios and we will see if these scenarios are workable for public enterprises.

On the one hand, there is a strong block of shareholders who are in a better position to exercise control. Family and trust-owned companies are good exemplifications where a group of shareholders control the management in all important policy matters such as investment, expansion, pricing policies, top appointment, amongst other things. On the other, there may exist a scenario that the shareholding is widely dispersed to make control by shareholders impracticable. This implies widespread shareholding to be in the hands of the average citizen and managerial control in the hands of professional management.

In the case of public enterprise, the logic of public control can be easily explained, *mutates mutandis*. The government as an owner is neither anonymous nor powerless shareholder that exists at a distance from operations of public enterprise. It is likely to exercise managerial control on the lines of family business. The government has out of its volition established an autonomous body with a corporate personality of its own, and it has handed over its management to a group of managers who act as trustees. Even if the government is vested in the power to oversee policy affairs of a public enterprise, not all of the decisions require approval of the government. Specific areas of such control and the organ entrusted with such task of approval need to be identified in advance.

Under such a framework, the government is indeed assuming the role of massive holding corporations over subsidiaries.

- d) Public Accountability: refers to the performance of the enterprise to the satisfaction of its owner. Let's take again private enterprise and the applicable measure of accountability. Shareholders judge the enterprise on the basis of the dividends they receive. They also evaluate it on the basis of the value of shares the stock market reveals, which is in turn a composite of profitability, stability, growth prospects and good will of the enterprise. With public enterprise, the situation is more problematic. There is no equivalent of the stock market, and dividend, if paid, would only reveal the financial performance and not the multi-dimensional results expected of public enterprise.

The problem may be reduced and accountability may be improved by defining the matter the public enterprise is accountable for which comprises the setting of precise goals which have been set for the enterprise and the agreed criteria of evaluation. More of accountability may be ensured by identifying the body the public enterprise is answerable to by clearly stating who the evaluators are. This is about determining in advance the agencies to which the enterprise reports which could be, *inter alia*, supervisory authority or focal point for public enterprises, and the matter to be reported to each of them.

- e) Public management: this is optional requirement and its absence does not detract from the publicness of the enterprise. But its presence provides evidentiary support for publicness. Public management connotes that management (entrepreneurial decision making/running process) is in public hands, with full time managers acting as civil servants. Public management is normally not regarded as an indispensable element of the public dimension because there are mechanisms of handing over management of an enterprise to private partners through what is termed as management counteracting-out yet maintaining ownership and control.

Generally, a governmental entity must meet the above two relatively broader requirements to be called a public enterprise. If there is no public dimension, there seems to be little or no rationale for creating "public" enterprises by public-mandated state. Likewise, there would be no purpose in calling it public "enterprise", it would be rather some form of promotional, developmental or

regulatory agency but not public enterprise. These are the key parameters to categorize an entity belonging to a parastatal family as public enterprise. The organs which do not squarely fit into these categories would thus be excluded and accorded another name and role.

Theoretically, the above yardsticks seem to be workable and there is no reason not to use them for the purpose of this writing, even though we have to concede that particular consideration is necessary in certain practical cases. But overall, the above-stated criteria are the definitional tests for filtering parastatals that are public enterprises, and tell us nuts and bolts of what public enterprises are. All said, public enterprises are best understood in terms of the features they possess rather than in terms of what they directly are. But we may define public enterprise, having regard to the definitional parameters highlighted above, as a corporate economic entity with the personality of its own established by legislative enactment or decision of governmental organ to engage in the production of goods and/or provision of services for gain up on which is simultaneously imposed a significant governmental ownership and control to serve a specific societal objective. Even if it may be difficult to mechanically transplant the definition to every legal system, the definition can be upheld with all its ingredients, though to a varying degree, owing to the nature of public enterprise as a universal phenomenon.

2.3. The Interface between the State and Public Enterprises

Public enterprises are created by the act of conscious policy of the government, being given an autonomous status and conferred with juridical personality. After all, government had the option of running the proposed activity within its own structure as a government department. Indeed, in many developing countries, an entrepreneurial activity is conducted departmentally, hence departmental undertaking. The procedures and the content of such organs are similar to and part of the normal administrative channels.

Presumably the decision to create public enterprises with an independent legal status is based on the belief that the nature of the activity is better conducted outside the rigors and rigidities of government procedures and practices. The state prefers operation through these organs on the ground that a corporate structure is more suited to the business character of the undertaking and that it provides a more effective means of assessing performance. However, in this course of

action, the government has created a new politico-managerial situation with the accompanying problem of defining the relationship between itself and the corporate entity it has created. This is actually the problem lying at the heart of public enterprise management. It is the optimization of the linkage between the state and the enterprise which is a key for the enterprise's success. Of course, the extent to which government would have its hands in the affairs of the enterprise will be dealt with later in section on control. Assuming that the relationship between the state and the public enterprise is kept at its optimum (only to the extent necessary), there are certain features that characterize public enterprises vis-à-vis governmental (administrative) agencies.

One factor that distinguishes administrative agencies from public enterprises is money allocation from the state. Administrative departments obtain funds every year in the form of budget from the government treasury. Government funds are expended to public enterprises only as initial working capital with, in most cases, a condition of back payment. There is no fund allocation from the state on a year basis. A state may, however, forward public funds to public enterprises as a subsidy usually to cure them from commercial failure or to enable them achieve a further public interest. Subsidies are not budgetary allocations, they are exceptional funds allocated on contingency considerations.

Public enterprises have purpose entirely different from that of administrative agencies. Governmental agencies are entrusted with the task of performing essentially regulatory function. They have the aim of civil service. Public enterprises, on the other hand, have a corporate aim of profit-making. Employees of administrative agencies are civil servants, while those of public enterprises belong to the industrial sector and even their relationship is governed by different legal regimes.

The mechanisms of operation of the two public bodies are considerably different. The official rules and regulations employed by governmental agencies are bureaucratic, rigid and delayed. Their decision-making process follows strict procedures, and generally they operate within a situation of red-tape. Management of public enterprises, in view of the profit motive and with optimum governmental intervention, follows liberal and flexible principles that enable it remain competent and profitable in a competitive economy.

The status and types of books and accounts is also a point of comparison between governmental agencies and public enterprises. Since administrative departments do not operate for profits, it suffices that they record and keep balance sheets, that tell the assets and liabilities of the agency at a given time of the budgetary year. But enterprises, even if public, are required to produce, in addition to balance sheet, profit and loss account that shows their financial status as being in a state of either surplus or deficit.

The two public organs may also be compared on the basis of the manners of evaluating financial performance. The financial performance of an administrative agency is evaluated by an exterior body at the national level, by an organ equipped with expertise and technique established for that purpose by a legislature. Public enterprises would have their financial status evaluated at an individual enterprise level.

With regard to payment of income taxes, governmental agencies are immune because they are essentially expenditure entities. Their purpose is to spend the fund allocated to them as a budget by central treasury for specified public objectives. They do not derive income in their normal course of operations, and it is illogical to expect payment of income taxes from them. Public enterprises, however, have the aim of commercial profitability, whatever public purpose might be implicit in them. They work for the reaping of profits (at least that is the intention), and this profit constitutes a corporate income which becomes appropriate subject-matter for taxation. We will have a bit more to say concerning this issue in the later sections.

2.4. Public Enterprise versus Private Enterprise

There are many points of contact, as well as areas of departure, between a public enterprise and a private enterprise. This apparently conflicting state of affairs may place a public enterprise in a comparatively advantageous position on the one hand, and may subject it to a stiff situation vis-à-vis private enterprises because they bear the obligation of social achievement at the same time. There also exists a relatively imprecise status of semi-governmental enterprises that occupy a place somewhere between public enterprises and private enterprises.

Given that the political economy of a state allows, some times even encourages, the private enterprises to flourish and that public enterprises also operate in a competitive atmosphere, the two entities are virtually similar in structure and operations. All the essential elements making up the enterprise dimension we have previously outlined are shared by public and private enterprises.

Nevertheless, the reality is that public enterprises operate within a bit modified, sometimes even totally different, environment from private enterprises partly because of the public nature involved in their corporate life. Whether such a differential status confers upon them a privilege or a burden remains to be seen, having regard to the specific legal system of a state and to the particularities of individual enterprises. But, it is possible to forward certain factors that pertain to public enterprises as compared to private counterparts, whether these factors create a privileged position or a burdensome situation.

Public enterprises are usually created by a special statute. Their public obligations make them susceptible to governance by special legislations, and ordinary commercial laws serve only a gap-filling purpose. But all private enterprises (their formation, structure, management, rights and duties, etc) fall under the exclusive purview of ordinary commercial laws.

Public enterprises have plurality of goals and multi-dimensionality of objectives under their belt. They are assigned with, side by side with the profit end, heroic task of achieving far greater social results. This “social responsibility” is an intricate matter, it would have multiple faces and cascades in many directions. Private enterprises, on the other hand, would normally have a single goal, profit making, and they primarily judge their status using this as a yardstick.

Both public and private enterprises owe accountability (ultimately liability) to the public. But the accountability required of a public enterprise is substantially greater in degree and scope, as can be gathered from the ultimate public ownership through the representative of the state. A higher degree of propriety or probity is expected in their operations. They are to exhibit wider-scope relationships and interlinkages that fairly cover the public interest they are mandated to serve. When we come to private enterprises, their very ownership and control is private so that it is

hardly possible to make them conform to higher social and moral standards other than requiring them to operate in observance of the established laws of commerce.

There exists an external management control mechanism in the decision-making process of public enterprise. An outside body (usually the state or its particular agencies) oversees the affairs of a public enterprise by indulging itself in making important decisions. The role of this exterior organ and the extent of its involvement in the internal operation of the enterprise will be seen later. The managerial sphere of private enterprises is more often than not controlled by professional managers that are part of the enterprise itself. Differently stated, decisions in private enterprise are made at an enterprise level by an organ constituted at that very level.

It is also possible to ascribe a relatively monopolistic characteristic to a public enterprise. In a situation where private economic endeavor is encouraged, public enterprises venture on sectors in which the private sector refuses to enter or is unable to enter because of shortage of capital, absence of short-projected profits or availability of risk, or it engages in areas that exhibit high public utility so that private venture is not favored. In such cases, we can say that public enterprise relatively enjoys a monopoly over the service it renders and the activity it undertakes, even leaving the extreme scenario of a socialist economy where a public enterprise assumes a monopolistic hegemony over all sectors as a matter of policy. In the active periods of public enterprise occupation, therefore, private enterprises do not find the way to carry out these responsibilities. Nevertheless, a public enterprise may step down from its relative monopoly once it puts in place things that make private engagement easy, and this of course is dependent on the policy of liberalization or privatization the state may adhere to

Public enterprises can be placed in apparently privileged position over private rivals by acquiring artificial competitive advantages through various government granted subsidies and immunities. By artificial it means that the enterprise's privilege is not the result of superior management skills, more efficient technology, enhanced innovation, better negotiating techniques or similar economic factors; it is rather that the advantage is created by the state through taking direct or indirect supportive measures. While such privileges may be justified on the account of serving the public interest implicit in social objectives, it may at the same time be the case that they

prejudice against interests of the private sector (and discourage, and ultimately, eliminate them). They may assume that position to regulate the conduct of private enterprises, and it is also quite possible that they abuse their privileged status. Therefore, a government that cares for public interest on the one hand and that encourages the flourishing of the private sector on the other must come up with an appropriate law and policy of control and autonomy regarding public enterprises. Below are some of the privileges enjoyed by public enterprises over their private outfit, with differing scope and degree from one state to another and with varying institutional arrangements across particular enterprises.

Monopoly power, artificially created and in a different context from that discussed previously, is a manifestation of anticompetitive behavior. A state firm in such a position can shift costs on to the activities in which customers are held captive to the monopoly and away from activities where it faces competition. In other words, it can use economic profits from its monopolized activities to cross-subsidize (or underprice) activities where it faces competition.

It is normal in the commercial world that business entities may constitute their capital structure or finance their operations by resorting to loans. Public enterprises are no exception on this regard. But the advantage they derive is that they can borrow at tax-payer guaranteed preferential rates, which artificially reduces borrowing costs. The lower credit guarantee employed by a government enterprise, which could be explicit or implicit, would enable it to save enormous amount on debt service due to lower interest rates. It is said that public enterprises have special access to capital through the national bank which guarantees public bonds at interest charges less than market rates for private companies of comparable risks. By lowering debt costs, express or implied, government debt guarantees artificially enhance state owned enterprise's ability to price below rivals offering competitive services.

A related matter that indirectly puts public enterprises in a privileged position but frequently overlooked is the concept of captive equity. Here by captive equity, we are referring to the situation that, in public enterprises, equity shares are non-transferable; the shareholding of a person in the capital corresponding to its contribution cannot be withdrawn nor can it be transferred to another. Owners who funded the government firm's original capital stock are

prohibited from deciding on or otherwise disposing of their funds in the event of poor performance. This is usually done by the use of legal coercion to keep capital within the enterprise, and perhaps this is the unique feature of governmental control. Because of captive equity, government firms are absolved from paying dividends or block any expected return to shareholders to induce the latter to contribute capital returns to firm, and that artificially lowers the cost of capital relative to that of a privately owned trade entity. Conversely, public enterprises are free to dissipate owner's equity through consistent losses over time without fear of the owners selling their equity stake, and they can use that lower cost of capital to subsidize activities in which they face competition.

Public enterprises tend to be immune from bankruptcy because they can operate for years while sustaining losses long after private firms would have gone bankrupt as, partly, owners cannot withdraw capital. The insulation from bankruptcy constraint confers on them an artificial competitive advantage. The immunity from the discipline of bankruptcy also implies that a public enterprise may get into competitive benches on favorable terms and, therefore, compete unfairly and inefficiently with privately controlled companies. Further more, government firms are often exempted from various taxes, on the ground of the social nature of their activity, to which private firms are subject. Such an exemption is a selective subsidy; it arbitrarily lowers public enterprise's costs and thus raises its ability to price below more efficient, but taxed, private economic units offering competitive services. Again, certain state owned enterprises receive direct financial support to defray capital and operational costs mostly in the form of initial capital, increase of capital and financial budgetary deficit. The benefit allows public enterprises to price below those of more economically efficient ordinary commercial rivals and raises their ability to unnaturally force those rivals out by reducing the rival's share in the market. Besides, public enterprises may not be supposed to follow market principles and objectives; they may be guided by budgetary principles and their services may not presuppose a *quid pro quo* relationship. Private enterprises are greatly influenced by market forces and adhere to the principle of economic rationality.

Public sector firms are often free from a variety of regulatory requirements which private enterprises are subjected to such as, for instance, an anti-trust prosecution. In addition, they may

be exempted from certain health and safety regulations, or from quality and standard prescriptions. Public enterprises can also easily win public confidence over private firms and this helps them to create a good association with the consumer/customer public. They assume this privilege because they have a chance of public relation that makes them open their door for public opinion, mostly due to their close relation to the legislative organ.

Dear student, the characteristics as well as the privilege-burden factors we have so far been considering relate to the interface between wholly state owned enterprise (including those under majority shareholding by the government) and private enterprises. There may exist, as indeed exists in some cases, semi-state enterprise and their features and contact areas in comparison to private enterprises is even unclear. These semi-state enterprises, or combined corporations, or associated companies, as may be called in different legal literatures, are business organizations with state participation which are not parastatal organizations, but are in reality the expression of collaboration of the state, as a junior partner, with private entrepreneurs, nationals or foreigners. It signifies a joint ownership of a special type, a partnership of co-ownership between private partners and the state with the latter emerging as a minority shareholder. This ownership of the enterprise with state participation represents a transitional phase between public and private economy and may justifiably be classified as partly privatized ownership. There may be such an arrangement in socialist-proclaimed economies on a temporary basis, but the end is entirely the opposite: transition to socialist ownership.

Whether the privileges we raised above can still be enjoyed by these joint venture entities is better addressed based on the particularities of the concerned legal system. But if these enterprises are assimilated to public enterprises, there results the extension of the privileges to the private partner in the joint holding and this creates a further discrimination between private parties.

Generally, one has to be reminded that the characterizations and privileges we considered above are mere possibilities; they may not be practically exhibited by a state's legal regime of public enterprises. So, the particular features a public enterprise possesses and the position it assumes in

the economy are matters that are determined by the political economy and legal system of the state in which the enterprise exists. We will shortly have a brief look at the matter in Ethiopia.

CHAPTER THREE

THE PLACE AND FORM OF PUBLIC ENTERPRISES IN ETHIOPIA

3.1. A Short Historical Review

The emergence of public enterprise sector in Ethiopia is contemporaneous with the modernization attempts of the state itself in the early twentieth century. Though there was no clear economic policy of the state during that time, the state established some enterprises to somehow satisfy its growing administrative needs. The enterprises were established jointly by the Ethiopian state and foreigners, the state Bank of Ethiopia and the Ethio-Djibouti Railway Enterprise being good examples. For purposes of making clear distinctions, we classify the public enterprise history in Ethiopia in to three periods: the Imperial regime of Haile Sellassie, the socialist Regime, and post 1991 onwards.

3.1.1. The Imperial Regime

Though not entrenched and developed, Haile Selassie's regime is known for embracing the free market economic system. The absence of private capital at the beginning despite the proclaimed market economy had necessitated public sector engagement, and there were many public enterprises established in response to the various modernization attempts. The government used to run hotels, banks, shipping lines, etc.

Public enterprises were formed by the state as a sole owner and as joint ventures with private persons, mostly foreigners, for domestic private capital were almost non-existent. Most of the public enterprises were created in the form of public corporations as share companies. Though the state was a legal entity with an administrative (political) capacity, it was a holder in these companies.

There was, however, no comprehensive legal regime governing state enterprises despite existence of some scattered pieces of legislations that applied to some enterprises. The separate legislative instruments hither and thither did not constitute distinct legal regime as to call it law of public enterprises. Many of state enterprises during this period were organizationally and operationally similar to the private enterprises, and were governed by the Commercial Code

which came into application to regulate the prospective private business interaction. But there were exceptional state enterprises that were established by proclamation or order of the emperor dedicated to the purpose of their establishment.

3.1.2. The Socialist Regime

With the adoption of the socialist precepts, the Derg regime was characterized by state ownership and control of the major means of production (rural and urban lands, extra houses and basic production and distribution facilities). The gradually flourishing private sector was a victim of nationalization and sidelined to petty areas, and so there was a dramatic increase in the number of public enterprises.

The regulation of numerous public enterprises was undertaken by executive organ entrusted with this power and established for this purpose. Each of the enterprises was independent from one another, but the creation and management was undertaken by this organ. The governmental body was empowered not only to manage the nationalized enterprises but also to establish new ones when deemed necessary. The organ was responsible to adopt a *plan*, budget and appoint a general manager for each enterprise. Nonetheless, it proved to be an ineffective body, and consequently it failed to carry out its legal obligations.

Realizing this so lately, public enterprises having more or less similar output or input as the case may be were merged together to form a corporation. The corporation served as an intermediary between individual public enterprises and the state, as a focal point between the two. Nevertheless, the salient feature of public enterprises during this period was that they were run by executive departments. The enterprises were relatively large, but undertaken by an inefficient and ineffective governmental department. So, many public enterprises failed except some like the Ethiopian Airlines.

Finally, we feel that it is legitimate to raise a question about why the Ethiopian economy had to make a sudden shift toward adopting socialist mode of economy. What necessitated the socialist ideology and its economic system may be even a critical question because Ethiopia was not under colonization immediately before that total shift unlike many other African countries and

had a regime marking an open prospect for the private sector to succeed. The case with other African countries is a bit different, though it is difficult to say this was sufficient to induce them to embrace socialism, in that it was the government that should carry out both the normal tasks of administration and bringing a viable economic transformation, as the domestic private capital was non-existent and the existent private sector was almost entirely of a foreign origin and control. Moreover, they perhaps have the fear that adopting the economic policy (capitalism) advocated by their colonizers would indirectly contribute to leaning still on these countries (neocolonialism). Based on these considerations, we may forward the following as probable factors.

For one thing, socialism meant the collective calling for the political, social and economic environments as a whole. The adoption of the political and social organization of the socialists necessarily meant the adoption of its economic system since it is openly claimed that they cannot be considered in isolation. Secondly, it was believed that there was no strong private sector, even if a prospective potential, that was able to respond to the needy situation of the time. The government inevitably had to take part in the economy, and the ruling class of the time felt that the best way to fully get involved in the economy was through the internalization of the socialist ideology. Thirdly, Marxism-Leninism gained widespread recognition preaching the evils of colonial and neocolonial agenda of capitalist states. Also the USSR emerged as a powerful socialist state, and was very much ready to offer multidimensional support to states embracing socialism. This may have been an attractive offer for the Ethiopian political authority of the time to attach itself to socialist economic ideals. Expression of togetherness with newly liberated socialist embracing African countries could also be given a peripheral importance.

3.1.3. The Post 1991 Period

The Ethiopian state during this period has assumed two forms: one is the Transitional Government of Ethiopia (TGE) constituted by the 1991 Transition Charter, and the other is the Federal Democratic Republic of Ethiopia proclaimed by the 1995 Constitution. In both cases, the role of the state in the economy is similar--change in the role and participation of the state in the economy with a view to encourage private economic undertaking. Here the state is not to pull out of the economic activity completely; it is rather that the state actively participates in the economy while inviting the private sector to take over, and we can say that the post 1991 economic period

is a mixed system where governmental undertaking and venturing by private capital owners co-exist. Having said the above as a general background, we will look to the scope and relevance of some existing laws concerned with such role of the state. Governmental economic activity, like we repeatedly said, is usually carried out through public enterprises, apart from devising some broader policy objectives. Below is a brief consideration of the various legal documents of public enterprises following their hierarchy, starting with the supreme.

3.1.3.1. The FDRE Constitution

There are various provisions in the Constitution that indirectly refer to public enterprises. The constitutional provisions are, as they are by their nature, generic statements and they are stated in the form that authorizes other state organs to come up with specific instruments of public enterprises. Of course, right to private property is clearly recognized under Arts 40 and 41(1) & (2) of the Constitution, entitling individuals to take part in the economy in whatever means including through the establishment of independent corporate beings. All the same, the state is mandated to pursue broader economic ends. The various economic obligations of the state are carried out, among other things, by the creation of public sector enterprises.

Accordingly, the federal government has the duty to formulate and implement the country's policies in respect of overall economic social and development matters (Art 51 (2)). The federal government is also responsible for the development, administration and regulation of air, rail, waterways and sea transport and major roads (highways) as well as for postal and telecommunication services (Art 51 (9)). This particularly shows that the government executes its duty by establishing its own enterprises. The House of Peoples' Representatives, by its supreme legislative power, is empowered to enact laws on the above matters (Art 55 (2)). It can, particularly, enact laws for the establishment of public enterprises, and has so far created many of them. States of the federation also do have exclusive authority over economic matters reserved to them, and they can carry out their economic mandates through the creation of public enterprises of their own (Art 52 (2) (c)); it can, particularly, enact laws for the establishment of public enterprises, and has so far created many of them. States of the federation also do have exclusive authority over economic matters reserved to them, and they can carry out their economic mandates through the creation of public enterprises of their own (Art 52(2) (c)).

The economic objectives that the constitution proclaims as a national policy principle do also authorize the government to implement the said objective through public enterprises. Article 89 specifically imposes upon the government to take positive and progressive measures to ensure that all Ethiopians can benefit from the country's legacy of intellectual and material resources, that they get equal opportunity to improve their economic conditions and to promote equitable distribution of wealth among them. And public enterprise is the open alternative for the government to realize this objective. At the same time, the government has a duty to make sure that the design and implementation of economic projects and the corollary creation of a public enterprise does not damage or destroy the environment (Art. 92).

Furthermore, Art 41 expressly provides for economic and social rights of citizens and the correlative duty of the government. By virtue of Art 41(6), for instance, the state is obliged to pursue policies which aim to expand job opportunities for the unemployed and the poor and to accordingly undertake programmers and public works projects. Again, Art 41 (8) entitles farmers and pastoralists to receiver fair prices for their products that would lead to improvement in their conditions of life. The provision states that this group of citizens, engaging in the agricultural sector that is believed to be the back bone of the economy, have the right to obtain an equitable share of the national wealth commensurate with their contribution. The state bears the duty to enable these people to realize their rights, and it can discharge same through establishing public enterprises. The Ethiopian Grain Trade Enterprise, for instance, has a mandate of achieving such end. Moreover, by virtue of Art 89 (4), the government is constitutionally obligated to provide special assistance to economically and socially least advantaged Ethiopian Nations, Nationalities, and Peoples. The government, in order to put into practice this constitutional duty, can establish and require enterprises of its own to avoid confinement in relatively developed metropolitan areas and to expand and market their economic and social activities in rural least developed territories irrespective of incurring losses, for they are able to offset these losses from the huge profit they earn from its activities in developed areas or even they may obtain subsidy from the government for such. Public enterprises are better equipped with technological capability and expertise, and thus their undertaking in these disadvantaged areas would greatly contribute to economic and social transformation. Or else the government can appropriate resources from its

profitable public enterprises in the form of profit share or dividends to directly allocate same for specifically benefiting the least advantaged segment of the population

Public enterprises could also be pioneers in the realization of the right to improved living standards and sustainable development of Peoples as a whole and of each Nation, Nationality and People in Ethiopia (Art 43 (1)). Consistently with the social dimension implicit in their nature, public enterprises can play key role in providing all Ethiopians with access to public health and education, clean water, housing, food and social security (Art 90). Generally, the state is not merely authorized to establish public enterprises but also has a duty to establish them in so far as that is appropriate to discharge the various economic and social responsibilities mandated by the constitution.

The constitutional provisions on financial powers and taxation particularly, though indirectly, recognize the power of both the federal government and the states to establish public enterprises and to take away their profits in the form of taxes. In sum, the governmental establishment and operation of business enterprises, despite the express affirmation of private economic engagement, has a constitutional base and it can use it to strengthen its capacity to execute the various constitutional duties and to fill in the incapacities of the private sector.

3.1.3.2. Proclamations

The constitution is very general in its expressions, and of course makes only an implied recognition of public enterprise. This generality has to be specified and therefore legislative enactment is required on matters of public enterprises. There exist a couple of principal laws (proclamations) specifically dealing with public enterprises within the ambit of the constitutional provisions. Let's briefly examine them.

a) Public Enterprises Proclamation No. 25/1992

Public enterprises are predominantly regulated by this law. It was issued pursuant to the Transitional Period Charter, under which a new economic policy was proclaimed. According to the new economic policy, the economy is open for private engagement but the government makes active involvement therein. There were a number of enterprises that the Transitional Government took over from its predecessor; while many of these enterprises were retained by the

new government, some were transferred (or intended to be transferred) to private partners, some dissolved and some held jointly. The general intent of the legislator in this proclamation is, therefore, as expressed in the preamble, the regulation of enterprises that did not undergo ownership change and that have to stay under government control, and those which may be established when demanded. It is not intended to apply to those enterprises which are to be transferred into private hands. We can further infer this from the definition given under the proclamation.

The definition of public enterprise is provided under Art 2 (1) as a “wholly state owned” entity created to carry on for gain manufacturing, distribution, service rendering or other economic activities. Joint ventures with private enterprises or individuals or others seem to have been excluded from the application of the proclamation. The definition does not tell what makes the enterprise public, apart from reading ‘wholly state owned “. But it is possible to infer some elements of the public dimension we employed in the previous section such as public ownership (here exclusive state ownership). On the other hand, the fact that the public enterprise operates for gain reveals its enterprise dimension. Moreover, the phrase “economic or related activities” depicts the open possibility for public enterprise to enter lucrative sectors.

Question

In Ethiopia there are various organs (both governmental and non-governmental) that engage in commercial activities without formally assuming that position. For example, there are profit-making entities that form part of the normal administrative departments, so called departmental undertakings, yet unincorporated to constitute public enterprise proper. What stature do departmental commercial ventures and other informal ways of doing business have in the Ethiopian corporate commerce?

We have said above that the proclamation was promulgated during the Transition Period under the Charter of the time. That charter also managed to establish two tiers of governmental units – autonomous regional self governments bestowed with certain administrative and other independence, and central government given ultimate and superior power and control. In line with such ultimate dominance, public enterprises were to belong to the central government (Art.2 (8)). But a question might arise about the enforceability of this provision under the current

federal structure, as the proclamation is still effective. States have their own constitutional power to run public enterprises and the provision in the proclamation that has denied autonomous self-governments formed under the Charter the right to create and run enterprises of their own is no more applicable to states under the current federation.

b) Supervising Authority Establishment Proclamation No.412/2004

Two intentions are expressed, as can be inferred from the statements in the preamble and from specific provisions. One relates to the governance of enterprises that have to be under state ownership whether by continuation of the previous ones or through creation of new ones. The second intention is concerned with facilitating the transfer of public enterprises previously in the hands of the state to private ownership. The theme of this legislation is the establishment of a governmental agency entrusted with the specific task of controlling and protecting the proprietary interests of the state in public enterprises with its powers and responsibilities clearly defined in that very law. This governmental body is the Supervising Authority, and has a controlling power over both fully state owned public enterprises and partly owned enterprises. This can be gathered from the cumulative reading of Art 2 (2) and Art 3 of the proclamation.

c) Privatization Proclamation No. 146/1998

This piece of legislation is not intended to regulate the operation of public enterprises; rather it is concerned with the situation of ending ownership or control by the state in public enterprises and paving the way for substituted action by the private sector. Article 2 (3) states that the proclamation is not merely concerned with public enterprises as defined by proclamation No 25/1992; it also includes entities which may be designated by the government as public enterprises for that specific purpose.

d) The Civil Code and the Commercial Code

It may be worthwhile to examine the scope of application of title III of Book I in the 1960 Civil Code because one might include public enterprises under “Bodies Corporate under Public Law”. This last phrase refers to the state and the church, and that title contains provisions recognizing the state and its departments as legal persons and as capable of acquiring rights and

incurring liabilities. Of course, the state has exclusive ownership over the entities it establishes as public enterprises. But public enterprises, possessing separate legal existence from the state, do not seem to be contemplated by the legislature in this part.

Public enterprises are excluded from the ambit of Title III because for one thing, the provisions do not apply to profit-making entities and, for another, the state is mentioned and accorded a legal personality in its capacity of administration only, i.e., to render functions consistent with its nature. The problem is that public enterprises, unlike other profit-making entities, are not expressly cross-referred to the application of the Commercial Code. So, one might be wondered by the absence of a lead to apply provisions of the Civil Code and Commercial Code to these profit-oriented parastatals in the absence of specific laws. But having regard to the civil status of public enterprises and by virtue of Art 4 of procl.25/92, the Civil Code provisions have a complementary application. The general provisions of civil law that govern relationship of all parties in that capacity such as contracts, property, torts and the like are applicable to public enterprise affairs.

Coming back to the Commercial Code, can we apply its provisions to public enterprises had there not been separate legislations? The state and the church are excluded from the purview of the Commercial Code. Art 4(1) of the code states that bodies corporate under public law, to mean the state and the church, are not deemed to be traders even if they engage in one of the activities stated under Article 5. They will not be excluded if they only participate (Art 4(2)) – meaning that state activity would become proper trade subject matter where it undertakes same in partnership with other persons. Again joint ventures involving the state are governed by ordinary commercial laws.

The exclusion of bodies corporate under public law from the application of Commercial Code provisions does not refer to public enterprises because, as indicated above regarding title III of the Civil Code, they have separate corporate existence from the state. Therefore, as it is a profit-making venture and may probably enter activities listed under Art 5 of the code, it would be governed by the Commercial Code in the absence of a separate statute. But fortunately, we have separate statutes of public enterprises. Still, Art 4 of procl.25/92 recognizes the gap-filling

application of the commercial code provisions, i.e., where provisions of the proclamation are inadequate. There are also provisions in the proclamation addressing specific matters that expressly cross-refer the matter to coverage of the Commercial Code.

3.1.3.3. Regulations

We have numerous Council of Ministers' Regulations that address affairs of each public enterprise. Every enterprise is to be created by the issuance of establishment regulations (Art 47(4) and Art 6), and therefore we have as many regulations as the number of public enterprises. So, it is not necessary to mention specific regulation here, and they are enterprise-specific different in scope and content from one public enterprise to another.

3.1.3.4. Millennium Development Goals

This does not constitute law, it merely equates to a policy. Millennium Development Goals (MDGs) are international ends to which states of the world aim. They are declaratory statements; they are not legal norms so that failure to achieve them is not backed by sanctions. Since MDGs are state-inspired, their realization is more probably attempted through the instrumentality of public enterprises.

MDGs are eight goals that 189 UN member states have agreed to try to achieve by the year 2015. The MDGs were officially established at the Millennium Summit in 2000, where 189 world leaders adopted the United Nations Millennium Declaration, from which the eight-goal action plan, the "Millennium Development Goals", was particularly promoted. MDGs were developed out of the eight chapters of the UN Millennium Declaration, signed in September 2000. The eight goals break down to twenty-one targets.

Ethiopia as a member state of the UN is a signatory party to the Millennium Declaration and is currently aspiring to achieve the MDGs. Public enterprises can directly or indirectly contribute to the achievement of the goals and the realization of the targets. Theoretically, it is possible for public enterprises to have a big share in the attainment of all goals. But public enterprises can perhaps directly involve in meeting such goals (and the targets thereunder) as the eradication of extreme poverty and hunger, ensuring environmental sustainability, and the creation of global partnership for development.

With regard to eradicating extreme poverty and hunger, a target is set to halve, between 1995 and 2015, the proportion of people whose income is less than one dollar a day and who suffer from hunger. The economic endeavors of the state through public enterprises to acquire the financial capability to at least meet this number would emerge as principal contributors. There is also a target of achieving full and productive employment and decent work for all, including women and young people. The establishment of a public enterprise generates huge employment opportunity and is the key in providing jobs that suit citizens. Public enterprises, owing to social objective, would undertake to ultimately serve a public interest whatever that might comprises.

The goal of environmental sustainability aims at meeting the targets of integrating principles of sustainable development into the country's policies and halving, by 2015, the proportion of people with no sustainable access to safe drinking water and sanitation. Public enterprises are good economic instruments at the disposal of the government to set examples for other entrepreneurs by showing that a consideration of environmental and social utility of a project will be decisive on that project's success in the long-run.

Globalization as one MDG demands a governmental economic capacity to endure in the free flow of economic goods and services. Public enterprises may provide such a capability. Because they are intended to be professional economic entities with a simultaneous aim of serving the public interest, they are better ways to make available the benefits of new technologies especially information and telecommunications that the current global relationship requires. They are also pivotal in providing access to affordable essential drugs in a developing country like Ethiopia.

Generally, MDGs are not laws, nor are they directly concerned with public enterprises. But as goals, their realization can be best effected through public enterprises. The dual status of public enterprises helps the government to raise revenue and to attain the MDGs.

3.2. Types of Public Enterprises

Public enterprises may be classified based on their organization and function. Organizationally, the establishment of a public enterprise may belong to any of the three categories -- public corporations created by statute; government companies governed by the same law as private enterprises; and societies registered for the purpose of undertaking commercial activity. But, in

Ethiopia, the last items have separate legal regime and they are referred to as cooperative societies and not public enterprises even if they have the attainment of social purpose as their goal. Functionally, public enterprise may be broadly classified as financial institutions (insurance, banking), promotional and Development undertakings, and commercial & industrial undertakings.

For legal purposes, however, the above is not a good classification. A more useful division can be made based on the forms of business organization they assume. Much of the discourse on structure centers on the relative merits of different organizational forms, principally the government department, the public corporation and the company. It focuses on the compromise between public control and autonomy in pursuing of virtues of efficiency and end realization. The following except gives a background on the need for autonomous organization of a public enterprise outside the government's structure.

Even though earliest form of public enterprise was in most countries the departmental form, there now appears to be a consensus that it is not a very appropriate form. The case against the department form is that it is too bureaucratic, prone to delay, has rigid financial regulations, and does not provide room for commercial initiatives that seem necessary in a business enterprise. Sometimes, particularly in Latin America, the case against the department is that it is part of the structure of administration which is corrupt and incompetent, and that it is necessary to set up new independent institutions which would be free from that machine. While the textbook case against the department form, and the case for more flexible and autonomous institutions, is well-known, it is not obvious how the different forms actually operate and what the practical significance of the differences are. Certainly many of the strictures against the department form are not justified. It is possible to have separate budgets; extensive delegations of power and authority are possible, etc. To a large extent, the textbook case is based on the European economies, where the basic system is well established and few people want public enterprise to introduce any qualitative change. Autonomous institutions, conforming largely to the modes of the private sector, but redressing the weaknesses of the market mechanism without challenging it, seem to be well-suited. But the major objective of

*public enterprise in the developing countries, whether informed by socialist or capitalist aspirations, is not to make minor adjustments to the system; the overwhelming case for public enterprise is to transform the system. Given the odds which public enterprise must work against in those circumstances, it is important that it be strongly backed by the government. Equally, since the public enterprise is regarded as a key instrument of government policy, its autonomy has little constitutional or economic justification. The case for autonomy had to be based on considerations of efficiency and responsiveness to policy. A heavy price may be paid for the distance between the government and the enterprise. The adoption of formal autonomous institutions leads to **ad hoc** interventions, increasingly blurred lines of responsibility and thus to the evasion of responsibility.*

The above statements reveal, having carefully examined the pros and cons in establishing public enterprises in the extreme forms of the department and the private form, the necessity of creating a public enterprise as an independent entity in a manner that preserves its allegiance and ultimate answerability to the government. The next issue would thus be what form and structure would represent the above-stated guideline. Below is a brief account of the discourse on the corporation and the company forms for public enterprise.

There are some *a priori* assumptions about the relative merits of these two forms. It is assumed that the public corporations are more responsive to the broader governmental machinery, ensure a better accountability of the institution, are easier to operate since they are forms for public sector business endeavor, while such use of the company is regarded as somehow improper, since the company belongs to the private sector. It is claimed that a company form may be used only if the government intervention is that of a joint venture with the private sector. The problem is no neat technical distinctions may be made as public corporations often carry out their functions by establishing fully or partly owned companies while the laws of companies sometimes apply to public corporations. It is of course difficult to come to any conclusions on the relative merits of different forms; practically every known type of public enterprise is to be found working well in some circumstances and badly in others. Thus, it is extremely difficult to say to what extent the performance of a particular enterprise has been affected by the form that the political authorities have given it, as to isolate this factor from all the others is usually

impossible. It is also not easy to identify the criteria for the choice of form, and quite often the form seems to be an accident of history than based on a careful consideration.

The debate is even tied up to the wider, and more important, question of the impact of form or superstructure on the content or the base. The question could arise in different contexts. It may, for instance, relate to whether it is possible to bring about fundamental changes in the society through law and institutional forms. Form is at one time regarded as very crucial so that the law providing for the creation of public enterprise is likely to determine in large measure all other organizational relationships. At another time, the alleged decisiveness of the legal form of an enterprise is eroded, or has proved illusory, and it is alleged that there is indeed no discoverable correlation between the legal rights and obligations of a public enterprise and the quality of the performance which it achieves. The question is inherently fluid that conclusive, or even tentative, answers are not possible.

Inherent in the nature of the discourse on form of public enterprise is that while it is understandable that some sort of relationship between form and substance (content) exists, it is more difficult to explain the dimensions and details of the relationship. The form is not merely an empty shell; it is a device for an aggregation of resources, creation of bureaucracies; the pursuit of goals and a vehicle for entering into relationships with other groups. In time the form can define and elucidate the underlying problems, if only by discovery its own limitations. But what impact it has on change or what the minimum fit between form and substance necessary to set some interaction in motion is is an important question that the dialectics of form and substance needs to address. A consideration of historical dimension of public enterprise may partly help to settle this issue. Public enterprises are subject to different pressures and constraints, and perform different functions at different stages of the growth of a country, and it is unhelpful to suppose that the same form and the same set of relationships should persist through all periods. Control may be more important in the early stages of an enterprise, while greater autonomy may be required once the places of policy and program are clear. It is also possible that institutions which begin with considerable autonomy are brought under increasing control in the course of time, not merely for economic reasons. A series of

studies of firms/enterprises exploring key issues over a period can provide a useful basis for the analysis of form in relation to its appropriateness for different economic activities, and the degree of consistency at time and over time, and the nature of change over time.

The form is not independent of the larger socio-political factors, although it is not easy to isolate the importance of traditional forms and the legal legacy from more direct political and economic influences. There is little doubt that the legal corporation form owes its appeal to historical factors. Britain evolved the form, and it was used in the colonies and ex-colonies. The legislation as well as the rhetorical justification of it was taken over from Britain, and little thought was given to the very different politico-economic environment and the very different underlying assumptions of public enterprise in the ex-colonies. And the continued influence of the common law and legal education system and policies ensures that the form remains dominant. A changed political situation may affect the choice of form; a conservative leadership may prefer the company form, while a radical leadership may be intolerant of the autonomy implicit even in the corporation form.

The choice of form could also be dictated by the relationship envisaged between the public and the private sectors. The company form for the public sector may allow for a closer collaboration with the private sector; it is also the more convenient form if the eventual destination of public sector undertaking is private ownership, as the transfer of shares is the easiest way to transfer assets. The preference of one form over another can also be determined or at least influenced by external forces. Western loan agencies have a preference for the public corporation form, for the servicing and repayment of the debt is more secured in this form and it is believed to utilize the loan for public purposes; equally, it has been alleged that countries of Eastern Europe prefer to deal with public corporations because the communist do not want to deal with capitalist forms such as private companies. Foreign private interests may also influence the form. They may prefer the company form, since it facilitates collaboration with local governments, its ideological connotations are more congenial for them, and it is a form in the structure and operation of which they have special knowledge and expertise. It also connotes a particular distance from the decision-making machinery of the government, and so allows

a greater scope to initiatives by the foreign private partner in cases of joint ventures. But here again it is difficult to generalize; a foreign private partner may prefer a corporation form because it hides the reality of its own participation. In certain situations the easier access that a corporation or even a departmental body provides to the bureaucracy and so provides ways to by-pass red tape for governmental approvals of licenses, work permits, exchange controls exemptions, may lead the foreign partner to abandon the company form for a closer embrace with the government. And since effective control depends less on the legal form than on knowledge and expertise of the subject matter, the internal organization of the enterprise, and the contractual relations between the private partner and the government, the question of the form may not much exercise the private partner.

In view of the above background, let's now look to the Ethiopian case of form that a public enterprise assumes. The Public Enterprise Proclamation (25/92) recognizes two forms of enterprises – one is a wholly state owned organization, i.e. public enterprise, that is governed by the proclamation itself and the other a business organization to be established by virtue of Art 42(2) (a) and be governed by the Commercial Code. The Supervising Authority Establishment Proclamation (Procl. No.412/2004) provides for wholly state owned share companies and joint ventures in which the state is a partner. Finally, Privatization Proclamation (Procl. No.146/1998) allows the emergence of a share company whose all shares are held by the state (Art. 5). For the purposes of our law, an entity is to be a “public enterprise” only when these conditions are met – that it is wholly state owned, that it remains under state ownership and control (not intended to be privatized), and that it is governed by the separate legal regime of public enterprises (the Commercial Code provisions serving only a subsidiary application in case there is a gap left).

The law does not specify the form of the public enterprise except stating that it is a “wholly state owned”. Ruling out joint ventures as possibilities of public enterprise form as collaboration with a private person on a business basis is to be governed by the Commercial Code, the public enterprise law envisages one of the two forms - the corporation and the company. The partnership form by its nature needs at least two persons (individuals) with the personality traits of the partners and mutual understanding

between them given much importance; obviously public enterprises cannot assume this form as the state is a single person and never an individual to which personality trait may be infested.

The company form is a private sector concept, and assumption of this form by a public enterprise would reveal its organizational similarity with privately owned enterprises. There could be factors that would lead to newer forms of public undertakings which conformed to the private undertakings in organizational set-up. Some of the virtues of investing in the company form may be inferred from its definition. Comprehensively and in a legal sense, a “company” may be defined as an association of many persons who contribute money or money’s worth to a common stock and employed for a common purpose, and the common stock resulting from the contributors is denoted in money to constitute capital of the enterprise and the proportion of capital to which each member is entitled is his/its shareholding.

One can easily gather that a company is a person artificial, invisible, intangible, and existing only in contemplation of the law, and being a mere creation of the law, it possesses only those properties which the charter of its creation confers upon it either expressly or as incidental to its very existence. Again, being created by law, law alone can dissolve it. It is a separate form, and is capable of surviving beyond the lives of its members. It enjoys perpetual succession and is an immortal person. In addition, not merely is it a legal institution, rather a legal device for the attainment of any social or economic end.

The existence of a capital structure divided into shares also characterizes the company form. For it is an association of capital there arises as a matter of necessity the need to recognize the extent of contribution provided by members through entitling them to certain rights regarded as extension of their right to property. Members are to benefit from the proceeds (and to bear risks) and to possess votes in the decision-making process in proportion to their contribution. Thus, division of the capital to shares and assigning shares (bearing various rights) depending on contribution are in the nature of such institutions of capital as companies.

The main characteristic of a company form is limited liability. The liability of the members or shareholders is limited to the capital invested by them. The creditors of the company cannot obtain satisfaction from the assets of its members, and similarly the creditors of the members have no right to the assets of the company. Indeed limited liability of the members is the reason why a great many people invest their money in companies. The following statements tell the importance of limited liability:

Limited companies are off springs of a proved necessity, i.e., that humans should be entitled to engage in commercial pursuits without necessarily involving the whole of their fortune in that particular pursuit in which they are engaged.(...)

The privilege of limited liability for business debts is one of the principal advantages of doing business under the company form of organization, and the legal status relating to limited liability is set to further, both theoretically and practically, the commercial prosperity of the company more than any other status conferred by legislationIt has, to the advantage of the investor as well as of the public, allowed and encouraged the aggregation of small or comparatively small sums into great capitals, which have been employed in undertakings of great public utility, largely increasing the wealth of a nation.

Companies can be formed as limited by guarantee, just as there are companies limited by shares. In companies limited by guarantee, in addition to or in absence of a share capital, a member is required to provide a guarantee. A guarantee without share capital does not obtain its initial working funds from its members, but from some other source (s) such as grants, endowments, fees and the like. But that with a share capital raises its initial capital from its members, while the normal working (operational) funds would be provided from other sources such as fees, charges, etc. In this case, the guarantee is intended to reinforce the financial position of the company as in the case of a company limited by shares which normally creates a reserve fund. A guarantee company is not suitable for ordinary business purposes. However, clubs, trade associations, research associations, and cooperative societies may resort to it.

Finally, it is noteworthy to highlight the classification of a company to private and public. Private companies are formed usually to run business within a family, a trust or the like, and a

restriction is imposed on a maximum number of members. Its capital is pooled together from certain persons only and does not admit membership by external contributors. A limitation is laid on the free transfer of shares, and the company cannot issue negotiable (transferable) securities though assignments are possible subject to further company requirements (such as, for instance, transfer only to members). There is no necessity of holding a general meeting for decision-making and may be done away with. These companies admit of confusion between management and ownership in that, mostly, shareholders or representative trustees also take charge of the decision-making process. It is by virtue of the above characteristics that a private company is described as an incorporated partnership, combining the advantages of both elements, the privacy of partnership and the permanence of company organization. Private companies can keep their affairs to themselves and at the same time enjoy continued existence irrespective of members.

A public company on the other hand is created by the public subscription of shares through offering prospectus, and thus public capital is created. A situation of dispersed ownership by shareholders scattered over a wide area emerges out (and this makes it public), and it is likely that management is taken by non-owning professional managers. It is also public in the sense that there is no legal limit on the number of members and anyone with capital can join it, but a minimum member number is stated. Public company is bestowed with the power to issue transferable securities; decision-making by general meeting of shareholders is mandatory.

Can the company form, as explained above, in the private sector be taken to represent public enterprise form in the Ethiopian law? By virtue of Article 7 of proclamation No. 25/92, public enterprises do have the personality of their own, shall have rights and duties, and, most importantly, they have limited liability. Public enterprises are similar to company on this regard. But the problem is that public enterprises governed by the proclamation are “wholly state owned”, and one might question the importance of dividing into shares the capital exclusively controlled by a single person and may logically conclude that the company form for public enterprise is not within the contemplation of the law.

All the same, it is possible to say that even if the state is a single personality it cascades into different administrative agencies having their own legal existence, and consequently that a company divided to shares so held by these administrative departments may emerge out under

the public enterprises law. Division of capital to shares may provide administrative ease in, for instance, the appropriation of profits and, above all, it invests the entity with great measure of independence in management conditioned by the more commercial nature of its operations with the additional powers of issuing transferable securities. This entity resembles the share company in Ethiopia, and the government has the option of establishing a wholly state owned share company by virtue of Art 47(2)(a) of Procl. No. 25/92 and Art 2(2) of Procl. No. 412/2004. Such share company is to be governed by the commercial code, and not public enterprise proper to be regulated by the special public enterprise law. There is also a share company form that a public enterprise may assume pursuant to Art.5 of Procl. No. 146/1998, but with a different purpose - converting the public enterprise to share company for privatizing it as transfer through shares is the easiest mode.

The corporation form possesses the combined features of public law and private law – it is wholly owned by the state created by a special statute defining its powers, duties and immunities, and prescribing its relationship to established departments and ministries; it is also a corporate body having legal personality with all the attributes of personality, obtaining funds from borrowing and its merchandise revenues (also authorized to use and reuse its revenue), not subjected to the employment relationship, budget, accounting and audit laws and procedures applicable to non-corporate entities. More importantly, a public corporation is characterized by a capital not divided to shares. The assets of a corporation as such, taken as a whole, are not divided into shares or stocks.

Public corporations are traditionally considered as nodal centers for the governmental control of various individual state enterprises, and they act as massive holding organizations over the particular entities. The legal framework of corporations is primarily concerned with the purpose of guaranteeing the ongoing activities of the entities subordinate to them and creating the conditions in which their economic unity can be ensured. To this effect, the corporation takes over part of the individual enterprise's external relations (in the realms of supply, marketing and supply) and handles them in a centralized way.

Relations between the corporation as a whole and the enterprises it comprises are of a dual character, as they are relations of both civil and administrative law. Concerning relations of civil

law, both corporation and enterprise act as independent and equal legal status. But the principal sphere of their relations is on the administrative plane, embracing such forms of management by the corporation as planning, coordination and supervision. In its relations with the ministry or other department to which it is subordinate, the corporation is an integral object of management. The key indicators of economic activity are established for the corporation as a whole, not for the individual units. The corporation itself lets and assigns overall plan targets and other indicators of the performance of its enterprises.

There are certainly corporation forms practically established in Ethiopia, and governed by the public enterprises proclamation - good examples being the Ethiopian Telecommunications Corporation as established by Council of Ministers Regulation No. 10/1996 and the Ethiopian Electric Power Corporation established by Council of Ministers Regulation No 18/1997. The establishment regulations tell no detail about the features of a corporation form. It is not even created in a manner that authorizes it to take control of other enterprises and it seems to be an independent legal entity carrying out all functions by its own, even though a reasonable interlinkage with some enterprises cannot be ruled out. What seems to be evident in the establishment regulations that conform to the conception of corporation in the context we stated above is that it conveys a closer allegiance to the government for it is made to comply with the social and economic development policies and priorities of the government, and that it is a mechanism through which activities more of service or developmental than commercial are undertaken. The fact that they involve and operate a huge public capital may have also influenced the government to prefer a corporation form for corporations are primary public sector economic mechanisms. We may say that, in Ethiopia, corporations are currently so-called not because they are big enough to function as holding enterprises of operative public enterprises but because they are recognized as huge investment entities carrying out economic and business functions of their own.

On the whole, the Ethiopian public enterprise proclamation does not state any clear form that the enterprise is to assume. It doesn't even make mention of specific features of a public enterprise apart from providing for certain general characteristic that every economic entity may possess. And the majority of public enterprises established in accordance with the law bear the name

“enterprise” and not any other particular form. The law of public enterprises on form is very general and the establishing organ seems to be given wide of a discretion to specify the form that the enterprise is to assume in so far as it fulfils the elements of the definition, like it did in creating corporations.

Question

Sole proprietorships are not recognized by the Commercial Code of Ethiopia as a corporate form of doing business. Neither is a one-man company that is prevalent in common law countries. Can public enterprises, having regard to their definition as wholly state-owned, assume such a form? Thoroughly explain.

CHAPTER FOUR

ESTABLISHMENT AND OPERATIONS OF A PUBLIC ENTERPRISE

4.1. Establishment of a Public Enterprise

4.1.1. General Considerations

Before rushing into the establishment of a public enterprise, even when its importance is irrebuttably justified, certain projects must be carried out. Creation of such a public body of economic significance cannot be an overnight process, and there are various issues to be considered before setting it up. In other words, the existence of the public enterprise presupposes the fulfillment of certain general pre-conditions. Detailed requirements may be needed by the law to be met. Most often the law states specific requisites. The law may also provide for the general preconditions, but it need not do so. Because these general preconditions involve the overall assessment of various factors from different perspectives, they would be considered any way even if not specifically provided by the law. So, in addition to or/and in the absence of detailed provisions regarding prerequisites, certain economic, social and legal issues are worth considering before the enterprise is set up.

The major economic condition would be ensuring the consistency of the enterprise with national plan or the national economic policy. Because public enterprise would play a great role in the economy, they should not emerge as undermining the policy. It is about making an economic choice, and this choice, whether positively or adversely, would have a direct impact on employment, consumption, savings, foreign exchange, income distributions and other macro-economic matters of national significance.

A feasibility study must be conducted so as to make a sound decision, having regard to the commercial viability of the venture. Cost-benefit analyses must be made for the maximization of profit or benefit based on the comparison between the revenue that will be generated and the cost of establishment and operation. This is in turn evaluated based on a number of factors such as capacity (size) of market, location of the enterprise, availability of raw materials and the like. The feasibility study needs to take account of the pay-back period of a public enterprise. An

enterprise is not merely expected to forward certain proceeds from its profit every time, but also it is to pay back through time the amount allocated to it by way of initial working capital. Generally, enterprises with short pay-back period are preferred to those with long back-pay period. The state needs back the amount it expended on the entity for pump priming, i.e. channeling it into other investment fronts to create an opportunity for further resource mobilization, or even for servicing its existing debt. Further more, an enterprise (particularly public) must not be seen in isolation from other economic and commercial entities. The enterprise as “part and parcel” of the whole economy would necessarily have certain dependence upon other enterprises, whether public or private, right from input supply through production process to the distribution stage. Thus, the degree of such dependence and its probable effects need to be included in the feasibility study.

Certain social factors could equally demand prior consideration. The creation of a public enterprise may bring about undesired effects on the society. These potential social repercussions need to be addressed beforehand. A manufacturing enterprise established in a certain area may cause the eviction of the inhabitants of that area as a result of which resettlement would become another problem. Such possible consequences must be managed before making decisions. Environmental issues occupy a prominent part in the broader social matters. An enterprise that emits hazardous gaseous elements into the air or releases toxic wastes into the local water bodies in the vicinity of the population necessarily tampers with the right to a clean and healthy environment which is an integral part of a constitutionally and internationally guaranteed right to life. Such negative externality must be done away with.

The consideration of legal framework is an important subject matter. Legal constraints would be remedied and the legal status of the enterprise would be clearly identified. The relationship of the enterprise with the state and private rivals may also be a subject of determination by law. Prior consideration of the legal regime would enable the enterprise to know in advance its rights and duties vis-à-vis the state and third parties.

4.1.2. The Actual Establishment Process

The requirements that need to be complied with in the middle of creating a public enterprise are set out under articles 5 and 6 of Public Enterprises Proclamation No.25/1992. The basic requirement is the determination of capital, which is the leverage of the enterprise over the years. The amount should be known in advance. Capital may have two features. Authorized and paid up. Authorized capital is the total amount of money or its worth formally adopted for the operation of the enterprise (Art 6(4)). All the authorized capital may not necessarily be paid beforehand. A certain amount may have to be paid in advance before the commencement of the corporate life of the enterprise, and this constitutes paid up capital (Art 6(5)). And any cash paid as part of the capital is to be deposited in a bank in the name and to the account of the enterprise under formation. This would function as a security to third parties who in good faith deal with the interim enterprise. Third parties are further helped to vindicate their rights and the establishment the enterprise is reinvigorated by the impermissibility of withdrawing the deposited funds until the enterprise acquires separate legal status (Art 5 (5)). There is no further condition with capital payable in cash; it is the easy form of contribution. Capital could also be constituted by in kind payments; this requires reduction to simplest form of monetary expression through correct valuation by experts (Art 5 (1)(a)). The law has tried to make the expert valuation of the property more reasonable in financial terms having regard to all the attendant circumstances by requiring the appointed experts to prepare a report containing a detailed description of the property, the value given to each item constituting the property and the method of valuation. Up until the enterprise is formed, the body called the Supervising Authority undertakes similar obligations to that undertaken by founders of a share company under the Commercial Code for incorrect valuation of property contributed in kind and for all unnecessary expenses made prior to establishment.

Then comes a decisive stage of issuance of legislation for conferring on the enterprise the capacity to live a legal life of its own. Article 6 of the Proclamation expressly states that every public enterprise is established by Council of Ministers Regulation, and the enterprise acquires a full-fledged corporate status only upon enactment of regulations. This same provision lists down in a seemingly limitative manner the details that the establishment regulation is to contain. The form, content and purpose of establishment regulations of public enterprises are more or less

similar, *mutates mutandis*, to the memorandum of association of private business organizations, especially share company even though the regulations are more authoritative and no additional requirement of registration is necessary. Three of the ten items that the regulations should contain are unique to public enterprises – the statement that the enterprise is governed by the Public Enterprises Proclamation (Art 6 (2)), the statement that the enterprise shall not be liable beyond its total assets, and the name of the supervising authority (Art 6(9)). We don't find these in the memorandum of association of share companies as provided under Art 313 of the Commercial Code. While these requirements can be inferred from the provisions of the proclamation pursuant to which the regulations are issued, it is required that this state of affairs should be expressly stated in the regulations for this legislative document is a direct authority from which the enterprise acquires its existence. The regulations should also contain the statement that the enterprise may open branches (Art 6(8)), but the share company memo of association goes one further step to require the name of branches, if any (Art 313(3), Comm.C). The MoA of Share Company on its part contains certain elements that are not possessed by the regulations, differences mostly pertaining to the shareholding and kinds of shares inherent in the nature of public companies.

The issuance of establishment regulations and their subsequent publishing in the Negarit Gazette would give rise to legal personality which in turn warrants the conferring of capacity upon the enterprise. Article 9 of the Proclamation grants general capacity, which is necessary to accomplish its purpose and to perform related activities. This type of capacity is limited to powers incidental to effect the purpose for which it is created. This power is co-extensive with the powers of all other economic activities and demands the enterprise to operate within the general competitive atmosphere. Special capacity on the other hand, as provided under Art 9(2), refers to certain particular capacities without limiting the generality stated under Article 9(1). Most of the elements listed to constitute special capacity are as a matter of principle attributes of personality. To sue and be sued; to acquire, possess, own, dispose of (alienate), pledge or mortgage movable or immovable property; to enter into contractual transactions; and to invest money received in revenue are all manifestations of special capacity and are of course attributes of personality. Public enterprises are also entrusted with special capacity to issue and accept

negotiable instruments (commercial instruments, transferable securities, etc), and can also open and operate bank accounts under such a capacity.

4.2. Capital of Public Enterprises (Arts 19-22)

Capital is an amount upon which the whole investment is based. It signifies the permanent liability of the enterprise and can be returned / repaid only at the time of winding up. The life of the enterprise is conditional upon the maintenance of such amount and it provides security to creditors. The importance attached to maintenance may be explained by the mandatory creation of legal reserve funds and the discretionary establishment of some other reserves.

The Proclamation provides, under Art 20, that the amount of capital paid up before or during establishment of the enterprise shall not be less than one-fourth of the authorized capital. Authorized capital, nominal or registered capital, as is some times referred to, is the totality of sums records as the maximum amount which the enterprise is entitled to raise. Paid up capital is that part of capital which is in actual possession of the enterprise or which has already been transferred to the enterprise through payment. The authorized capital is to be fully paid up, fully transferred to the possession of the enterprise, within five years from the date of the enterprise's establishment.

The alteration of the authorized capital (increase or decrease) is permitted only after fulfillment of stringent procedures. Why is capital of an enterprise increased or decreased and how? The case with private business organizations is legitimately helpful here. Increase of capital is induced by the expansion of the business activities of the business organization. Capital of share companies, for instance, may be increased by the issue of new shares or by an increase in the par value of existing shares (Art 464, Comm.C), and the increase is accompanied by an amendment to the MoA as decided by the extraordinary meeting of shareholders (Art.462 *cum* 423, Com C). The company may raise capital by issuing new shares in return for cash, paying off current debts with shares, or capitalizing reserves or other funds at the disposal of the company, and this is referred to as equity financing; the company may also increase capital through issuing new shares by the conversion of debentures to shares; by resorting to loans, which may be referred to as debt financing.

The increase of authorized capital of a public enterprise, as warranted by expansion of economic activities, is to be effected by allocation of funds by the government, as it did by providing the initial working capital or to be paid out of the net profits of the enterprise (Art 21, Procl 25/92). Making the necessary changes, we find more or less similar mechanisms with companies. And, as with share companies, the increase is to be backed formally by Council of Ministers' amendment regulations as impliedly mandated by Art 47(4) of the Proclamation. The Council of Ministers has so far issued amendment regulations with respect to increase of capital. To mention some, the Ethiopian Airlines Enterprise Establishment Regulation No. 81/2003, Emergency Relief Transport Enterprise Establishment Regulation No 85/2003, Ethiopian Seed Enterprise Establishment Regulation No.100/2004, Ethiopian Electric Power Corporation Establishment Regulation No.90/2003, and Ethiopian Telecommunications Corporation Establishment Regulation No.99/2004 are all amendment legislations concerned with increase of authorized capital.

The reduction of capital in share companies may be caused by losses (Art 486, Comm.C), or for reasons given by auditors and approved by meeting (Art 484 *cum* 375(2), Comm.C). The manner of decrease is by reducing the par value of shares or by exchanging old shares for a lesser number of new ones, without of course prejudicing the rights of third parties (Art 487 *cum* 489, Comm.C). The case with public enterprises is not much different even if the reasons for reduction are not explicitly spelt out; it could be conditioned by losses in the broader sense of the term (such as actual losses, the gradual decrease in profitability and market share, etc.) or by governmental decision for purposes of privatization. The provisions of Art 22 also state in particular that capital may be decreased due to proposal by the auditors or where it was decided to be decreased following a proposal by the management board of the enterprise to that effect, or where the authorized capital has not been fully paid within the legally stipulated time-limit. No specific procedures are stated by the law as to the manner of effecting the reduction. But the reduction cannot be undertaken in a manner that prejudices third party interest and creditor rights.

4.3. Name and Trademark

Name and trademark are civil attributes having the effect of individualizing an enterprise and its produce/services respectively. Name is indeed a crucial device for exercising all other juridical acts that legal personality and the resulting capacity entitle a corporate entity. An enterprise acquires rights and incurs liabilities in its own name; it brings a lawsuit and defends same using its own name. So, there is a possibility for name to be civilly injured and to cause civil injury to others. Thus, the law rightly specifies what name should look like and sanctions its use. Art 23 (Procl.25/92) gives a meaning to “name of an enterprise” as the name under which the enterprise carries out its activities. It is mandatorily stated that the name clearly designates the activities. The name should be displayed outside the premises of the enterprise, so that it be known to the public. Name and its use should not offend public policy and morals and it must not prejudice the rights of third parties. The failure to observe the above obligations is penalized by an award of damages by court or grant of injunctive relief.

A trademark is defined, under Art 25 Procl 25/92, as the name, designation, emblem or any other distinctive sign used by an enterprise to distinguish its goods or services. In modern commercial world, trademarks involve a huge economic turnover and they have gone to the extent of acquiring recognition by intellectual property laws. A law of trademarks fights against unfair competition and abuse of same. An enterprise is free to choose any trademark at all since, according to Art 140(2) of the Commercial Code, the use of a trademark is not compulsory. The use of a trademark presupposes effecting registration with the appropriate government office and publishing same in a newspaper of general circulation (Art 26(3)). The establishment regulation does not have trademarks in its list, so publicity must be effected if one is chosen. The use of a trademark that contravenes or offends public policy and morality, and that prejudices rights of third parties is sanctioned by the court’s authority to order an enterprise to pay the resulting damages or prohibit the enterprise from using the trademark giving rise to the dispute by granting an injunction (Art 26(4)).

4.4. Operational Requisites and Mechanisms of Public Enterprise Corporate Objectives

There are two assumptions for according a public enterprise with a corporate status. One is that the organization is set up as a business firm and will operate in such a manner as to create surpluses and adequate returns on invested capital. The second is the simultaneous duty of the organization to be an instrument of national policy and to discharge some developmental goals. These are only stated in broad terms and depict the general character of the enterprise. The specific identification and articulation of the corporate goals of each public enterprise is needed. The statutes creating public enterprises would have such corporate objectives stated. But these statements of intent are inadequate for corporate planning. They are more in the nature of definition of the enterprise's field of activity, its jurisdiction and powers. The goals tend to be stated in highly generalized terms, as is implicit, for instance, in the preamble or the definitional provisions of the Public Enterprises Proclamation No. 25/1992 -- no priorities indicated, no quantifications made, etc. On the other hand, in a legal document which defines the constitution of an organization, it is prudent to provide for flexibility and not to constrain growth and diversification of the organization consistent with the ever changing corporate realities. In this sense, the establishment statute would function as an 'enabling clause' that enables public enterprises to devise corporate targets in a manner that suits their own realities. The corporate objectives could be generally reduced to the following forms, with the possibility of further specification:

- Financial and Commercial objectives
- Production and Productivity objectives
- Marketing and Service objectives
- Development objectives
- Growth objectives

4.4.1. Financial and Commercial Objectives

Because public enterprises would be the pioneers of social and economic change and the engines of growth, profitability in purely financial accounting terms seemed an irrelevance. The case for financial stability, commercial viability and adequate return on investment rests on the following compulsions.

Firstly, the production of goods and services entails costs and these costs cannot be wished away whatever the idealist posture of the state may be. Somebody has to pick up the bill as there is no such thing as a free lunch. The assumption is that the costs will be collected from the public or consumers in the form of prices. If public enterprises are unable to do this for whatever reason, the resultant deficit will of necessity be passed on to the public exchequer. The deficit may result from conscious underpricing on social grounds. The agreement forwarded here is that public enterprises have an obligation to control inflationary forces and to provide goods /services to the weaker sections of the society at subsidized rates, the losses being referred to the broad back of the state. The reality of the broad back of the state has to be examined to determine whether the beneficiaries of such underpricing are in fact the poor. It is ultimately the back of the tax-payer and the plausible solution is direct taxation [possessive] so that the bill will be taken up by the more affluent. But if taxation is essentially indirect, that is regressive in nature, the effect is the exact opposite. In point of fact the budgets of most developing countries depend heavily on indirect taxation. In this context, deliberate underpricing policies aiming to benefit the poor that cover their deficit through use of indirect taxes are self-defeating and would place an unnecessary burden on the financial status of the enterprise. Rationalizing commercial objectives in advance helps to avoid such an apparent contradiction.

Secondly, the source of funding has begun to change. These days, substantial portion of investment funds comes from borrowings from non-governmental sources such as development banks, commercial banks, public debentures, foreign loans, etc. The lenders enter into commercial transactions and the loans have to be repaid with interest. This raises the question of debt servicing, which is possible only if the enterprise is generating surplus.

Thirdly, the burden of public enterprise has placed unbearable strains on public budgets. Far from promoting development, resources which could have been usefully employed on developmental projects have now to be diverted to meeting public enterprise losses. Public enterprises traditionally enjoy immunity from bankruptcy, and states more often than not find themselves in the practice of bailing-out sick enterprises under the guise of social purposes. But

it seems that immunity is so rigidly established in public enterprise, which the country itself does not have.

Fourth and last, the creation of a public organization in the form of public enterprise is a declaration of intent, or at least it should be, that it is expected to be financially viable. Otherwise there is no need for the state to establish in such form, for that can well be undertaken within its own rigors.

The case for financial viability has been made so as to emphasize that the corporate objectives of a public enterprise must have specificity in regard to the expected returns on invested capital. The next issue is how to do this and what constitutes reasonable surplus. Below are certain factors for measuring the extent of financial surplus expected of a public enterprise.

4.4.1.1. The Critical Financial Ratio

An appropriate financial ratio to assess the returns on investment of public enterprise can be proposed by taking a look at the case of private investment. In private ventures, source of the invested fund is either equity participation of the members (entrepreneurs, promoters, share holders) or loans raised from financial institutions, banks or public debentures, or both. The debt-equity ratio, the leverage, varies according to the mercantile practices of different countries and according to the nature of each entity. The character of the money coming from the two is not the same; rights and obligations differ. Loans have to be repaid and they bear interest. The payments have to be made irrespective of whether the firm is making profits or losses. They are thus in the nature of costs. Equity on the other hand has the character of risk or venture capital; there are no guarantees of return, and the dividends payable are related to net profits.

The investors are interested in the amount which will be available for distribution after all costs are covered, depreciation accounted for, and interest on loans as well as income tax paid out to the government. The relevant ratio is thus post-tax returns on net worth – net worth constituting shareholders funds and reserves.

This formula, it is claimed, is conceptually valid but not practically so for public enterprises. Public enterprises have also a capital structure in terms of debt and equity. But the distinction between loans and venture capital tends to be blurred. For one thing, unlike the private sector, the source of funds, both equity and debt, is generally the same -- the state provides the equity, and the state provides the loans in most cases. For another, the debt-equity ratio is often distorted. In some countries, investment funds are provided almost entirely as equity. In others, the pendulum swings to the other end and the funds are wholly in the shape of loans. In some others, an *ad hoc* 50-50 formula is adopted. Furthermore, there is a possibility that interest rates charged on loans are below the market levels. This may be partly a compensation for discharging social obligations or for undertaking low-profitability, long-gestation investment. Whatever the reasons might be, the underpricing of capital creates distortionary effects in the accounts. Thus, a more meaningful formula for the public situation is pre-tax returns on total capital employed. Total capital employed includes equity, reserves, long-term loans (debts), and working capital.

4.4.1.2. The Rate of Return

This is the question of specifying the reasonable rate of return on total capital employed as considered above. In terms of pure financial logic, the rate of return should not be less than the opportunity cost of capital. The opportunity cost of capital varies from country to country and from period to period within the same economy. The current level of interest rates and the availability of risk are good indicators of the variation.

Theoretically, there is no reason why this formula should not be adopted and incorporated in the financial objectives of public enterprises. It represents the return which would otherwise have been earned if the funds were invested elsewhere in the economy, and this provides an insurance against the misallocation of resources. But it would not be a feasible proposition to apply it across the board to all public enterprises, because the spectrum of public enterprise is very wide. There are long-gestation investments and quick yielders; there are high profitability areas catering to the rich and low profitability areas catering to the poor; some are capital-intensive and others labor-intensive; some are monopolies while some others survive in the fluctuating markets of the competitive world. These differences must be recognized and it would be impractical to demand the same rate of return from all kinds of enterprises. So, it is better that the

opportunity cost of capital be used only as a guide. Thus, those enterprises which are more favorably placed could be asked to produce returns substantially higher than the opportunity cost; low profitability areas may get their return fixed below the opportunity cost of capital, but even in this latter scenario there is an absolute cut-off point that the return must at least meet their debt servicing obligations.

4.4.1.3. The Portfolio Approach

Such proposal perhaps can resolve the dilemma of differential rates of return. The proposition is that, at some central point in the economy (the ministry of finance or a nodal centre for public enterprises), the total investments made in public sector ventures are viewed as an investment portfolio. The strategy would be to ensure that, on average, the total returns from all enterprises measured against the total investment in all enterprises would be equal to the opportunity cost of capital. This would provide the necessary leverage to make adjustments in individual cases, leaving the solvency of the portfolio intact. This of course constitutes an indirect system of cross-subsidization but it has the virtue of combining financial pragmatism with social realities.

This approach is the “bread and butter” of the transnational corporations. These MNEs also face the problem of diversity in investment with varying rates of return. Their solution is to regard their entire system as a portfolio, as their share values in the market (stock) represent a composite of all their operations put together. The governments of developing countries are indeed massive holding corporations that control a large number of public enterprises from the center, and can adopt the same formula.

4.4.2. Production and Productivity Objectives

Production is an integrated managerial discipline which takes into account productive capability, availability of inputs and market situations. It is the essence of entrepreneurship. There are dangers of excessive state intervention in fixing such goals.

- i) The targets take on an excessively central role, without adequate regard for financial, marketing and service objectives and other peripheral matters.
- ii) Aiming to achieve high production targets, a disregard of cost-effectiveness happens.

- iii) They are sometimes fixed without an eye to marketability, resulting in the accumulation of stocks of unsold goods.
- iv) In the worry to step up production, there is a risk of cutting corners on quality.
- v) As sometimes fixed in excessively aggregate terms (tonnage) without considering the value of various end products, it results in the distortion of the product mix.

This is not to say that production targets should not be arrived at, it is rather to say that it should be essentially an internal managerial exercise. The role of the government should shift from production targets to productivity goals, from the static concept of absolute levels of production to a more dynamic concept of productive use of resources and assets.

4.4.2.1. Capacity Utilization

This is a productivity goal which is a measure of productivity of machines and equipments. It is about stepping up utilization until it reaches the optimum. There is unutilized and underutilized capacity with the resultant waste of national resources and increased production costs, and the realization of this target is very decisive. Goals at improving capacity utilization have to be preceded by a diagnostic analysis of why utilization is currently low. For instance, if the reason for current lower utilization is shutdown due to plant breakdowns, the remedial action would simply be introducing systems of preventive maintenance. Likewise, lower utilization may result from loss of work hours due to strikes or go slows lockouts, the remedial action of which could be improving industrial relations and negotiating with unions. If again it is known that lower utilization is caused by production undercutting due to power shutdowns, an improvement measure may be taken by negotiating with power authorities or examining the possibility of captive power plant.

4.4.2.2. Consumption Coefficients

The account of consumption coefficient is another equally important factor of productivity -- particularly of inputs (raw materials). It represents the ratio of usage of raw materials to outputs and determines the level of output with a given consumption, e.g., of fuel, energy. A reduction in energy inputs for the same output or an increase in output for the same level of energy inputs

would not only result in cost-efficiency but would also meet a pressing developmental goal -- energy conservation. It can also be used for inter-firm comparisons.

The factor may also involve planned “negative” efficiency, which in a sense means that the government may justifiably direct a public enterprise to utilize indigenous raw materials and components in place of imported ones. This is believed to serve a developmental purpose of import substitution, national self-reliance and foreign exchange earnings/savings. This planned restriction by the government might be motivated by the lower cost of domestic items and their ready availability.

4.4.2.3. Labor Productivity

This factor is an instrument of measuring human productivity. Governments of developing countries are faced with the growth scenarios of gross overstaffing in public enterprise with the anxiety of developmental goals of employment generation. This is a counter-productive policy in the long run. Given a certain level of human skills, given the realities of the learning tendency of human beings and given the level of automation, it is possible to determine the optimum staff component in terms of numbers and skills profiles.

An allied and consequential issue relates to work norms, which is tied up to the relationship with trade unions and incentive payments. Patient dialogue between the government and workers on participative styles of management and decentralization of decision-making may create the right working atmosphere.

4.4.2.4. Total Factor Productivity

It is artificial to compartmentalize the above measures of productivity. The productivity of machines, materials, workforce and money is a highly integrated network – highly interrelated and one influencing the other. For instance, a certain level of automation which is primarily a measure of productivity of machines cannot be meaningful without a certain number of workforces. Thus, no measure is made in isolation; rather the sum total productivity of all factors is to be considered.

4.4.3. Marketing and Service Objectives

This corporate objective is about measuring the effectiveness of the enterprise in its marketing and service activities, and it's tested by looking the enterprise's performance vis-à-vis its main constituency (customers, consumers, clients). The recipients of the products and services of public enterprises are the ultimate judges of performance. It is about establishing goodwill, and if this is done, the heroic stance of achieving social objectives is an insignificance as goodwill is nothing else than winning acceptance from the society. But unfortunately public enterprises do not specify their marketing objectives in advance.

The design of these objectives is made by identifying the market. The market position of the enterprise may be monopoly, oligopoly or the state of competition; the location of the market could be domestic or foreign; the supply-demand situation might show shortage or surplus, the product could be a luxury or necessity; and the nature of the customer may be industry or the public. These variables and their consideration create very different marketing situations which affect the character of the enterprise, the relative strength of the buyer and the seller and the social dimension. They influence the designing of marketing objectives on the one hand and the scope/intensity of government intervention on the other.

First, in a competitive position such as in export markets where supply far exceeds demand, enterprises have to fight for their share in the market. Their objectives have to include competitiveness in terms of costs, quality and service. In monopoly situations such as where the enterprise is located exclusively in sheltered domestic markets where demand exceeds supply, there is no compulsion of competitive firms. Marketing tends to be neglected. Here comes the real test of social role. Second, where public enterprises are competing, government intervention is unnecessary and unlikely as the market acts as economic enforcer. In monopolistic situations, the government emerges as protector of consumers through price controls, distribution and independent quality controls. Again a vigilant government intervenes more in the case of marketing and pricing of necessities than luxury items of the affluent. The government has also to assume greater responsibility where the enterprise is directly selling to the public than to industries. Governmental intervention may again be needed in pursuance of greater developmental goals. Public enterprises may be needed to broaden their marketing base so that

they avoid concentration in lucrative metropolitan areas and provide to rural areas. They may be forced to earn foreign exchange by engaging in exporting part of their product while they can sell profitably at home. Public enterprises competing with their private rivals may act as moderating force to reduce the price line. They may also be obliged to vary their product mix and produce items relevant to average citizen such as low-priced textiles. All these matters can be incorporated into the enterprise's plans in an efficient manner based on an open dialogue and atmosphere of understanding with the government.

4.4.4. Developmental and Social Objectives

It is legitimate to ask the question: is there a dichotomy between “business” and “non- business” aims of a public enterprise? If ideas like being a model employer, investing in research and development, improving the quality of goods and services, and responding positively to the environment are in the list of social responsibilities of public enterprises, it becomes paradoxical that well managed private firms also follow such objectives. Successful private firms indeed follow the above objectives and they do not do that out of patriotism or out of idealist view of their obligations. It is rather because social success is by and large attributable to commercial success. It is precisely the public enterprise which are financially successful who are good social performances -- good employers, have long-term developmental view of R &D, support the environment, upgrade quality of goods and services. Those with large deficits are worst offenders from social point of view -- poor employers, cut corners on quality, do not have the means to go for R & D, no assistance for the environment, etc. Thus, there is no dichotomy and no conflict between social and commercial objectives, with the success in the latter a pre-condition for success in the former. The achievement of financial viability, generation of surplus, relieving the state budgets of the burden of deficits and contributing to resource mobilization is by itself a major developmental responsibility. The productive use of assets and the optimized employment of resources is a matter both for economic and social concern. Consumer satisfaction is the discharge of an important social obligation.

Still there are social objectives which are not part of the normal business practice, and they need to be disentangled from those making part thereof. For instance, there might be a phenomenon whereby the government may resort to conscious underpricing for social reasons due to a

political compulsion. This may constitute artificially driving the enterprise into a loss and then bailing it out by meeting the deficit. A subsidy may also be granted for covering the difference between the real cost and the controlled price. In a sense, the enterprise secures the revenues partly from consumer and partly from the government and its profit and loss account remains unaffected.

Making social objectives concrete and operational in the corporate objectives is determinant in the overall success of a public enterprise. They must be defined before the operational stage and should not be a *post facto* rationalization of enterprise behavior, i.e., social objectives should not operate as an alibi to justify commercial failure. The social goals should be capable of translation into operational goals.

4.4.5. Growth Objectives

Public enterprises are living organisms having entrepreneurial life of their own. They have life cycles which in some cases are extremely long. Long-term development objectives take time to attain. Thus, with the passage of time, along with their importance in achieving long-lived plans, expansion in coverage and amount, and diversification in product and service of public enterprises is a normal expectation. This is designed on a national frame of reference based on a dialogue between the government and the public enterprise.

4.5. Accounting and Auditing of Public Enterprises

As business entities, public enterprises are expected to exhibit prudent accounting practices. The fact that they are created to attain a certain social policy goal on the behalf of the public makes them amenable to high degree of compliance with established accounting principles, and marks the importance of external auditing system over the financial record of the public enterprise. The Proclamation provides for certain guidelines of accounting and auditing.

4.5.1. Accounts of a Public Enterprise (Articles 27-31)

An enterprise, just like private traders and enterprises, is required to keep books of accounts following generally accepted accounting principles (GAAS). Accordingly, a public enterprise should draw up and maintain the two important accounting records: balance sheet and the profit

and loss account. The provisions in the proclamation regarding the keeping of accounts are not detailed enough. The proclamation promises that the supervising authority issues directives on the details of the accounting aspect of the enterprise (Art 27, second allinea). Meanwhile, there are detailed rules in the Commercial Code. We can apply these rules on accounting matters not sufficiently provided for in the Proclamation, by virtue of the cross-referring provisions of Art 4 of Procl. No.25/92.

According to Art 28(1), the accounting period of a public enterprise is a financial year that is to be determined (by the supervising authority). This is a bit similar to the accounting year of business entities governed by the Commercial Code (Art 67), except for those businesses at liberty to choose accounting year of their own. The financial year is structurally and in composition different from the fiscal year of public finance, that starts on Hamle 1 and ends on Sene 30, but it may coincide with such timewise. In principle the closing of accounts coincides with the end of a financial year -- an enterprise must close its accounts at least once annually, for instance, for tax purposes. Closing of accounts refers to the working out of the whole expenses and income, and finally to determine profit or loss. The annual closing must be completed within three months following the end of the financial year and failure to do so may entail liability. The enterprise is obliged to prepare an annual report as regards the state of activities and affairs during the last financial year and their financial equivalent, and the statement of achievements and major plans/programs to be implemented in the upcoming financial year and the monetary equivalent corresponding to them.

Reserve Funds: - These are all profits preserved for the undertaking and not forming part of the capital, and profits not distributed as dividends. An enterprise has various reserve funds -- legal reserve funds, technical reserves, etc. While legal reserve funds are imposed by law and are thus mandatory (that is why they are legal), the establishment of other reserve funds and determination of their utilization is the discretionary power of the concerned enterprise. A public enterprise is required not only to establish a legal reserve fund but to maintain it while it continues its operations. This is effected by transferring 5% of net profits into it annually until the reserve becomes 20% of the capital. There is a similar situation in the Commercial Code on share companies (Arts 453,454,456). Its intended purpose is to maintain the capital of the

business entity, and particularly public enterprise may utilize the reserve fund for covering losses and unforeseeable expenses and liabilities.

Payment of Taxes and Duties: - The provisions of the Proclamation state that the relevant laws concerning taxes and duties would apply to enterprises [Art 30 [1]]. This means that the enterprise will pay taxes and duties recognized by the Ethiopian law of taxation on all its taxable activities. All the same, Art 30 (2) foresees the exemption of public enterprises from the obligation of paying taxes and indeed gives license to the legislature to issue law to that effect. The exemption could specifically be made of public enterprise, excluding other corporate entities from the privilege.

The taxation, and at the same time exemption, of public enterprises is a relatively controversial matter resulting in criticisms. Those who oppose taxation of public enterprises argue that it is impractical because demanding payment of taxes from these entities amounts to the withdrawal of funds from one purse of the state and transferring it to another. They claim that, as taxes are not the only sources of revenue for the government as the state also derives revenue from the profit that the enterprises it owns make, the corporate profit that is to be taxed is ultimately channeled to the public treasury any way and that taxing a worth that will have the same destination with the tax is nonsensical. Those who support the taxation of public enterprises on their part criticize exemption specially granted for these entities to result in the unequal treatment of equals – that while private enterprises are taxed for the same activity, public counterparts go untaxed. They regard this circumstance as an unfair practice.

Nevertheless, the above criticisms do not seem to be deep-rooted for they failed to appreciate the separate corporate existence of public enterprises for business purposes (even if not in strict sense) from the government machinery on the one hand, and the social aspects implicit in their very creation on the other. Theoretically, and juristically, public enterprises have independent legal existence from the state and are autonomous legal persons for all legal purposes. It has, as a consequence of legal personality conferred upon it, a civil capacity of its own to be a party to various juristic acts. It is legally separate and different from the administrative structure of the state whatever other ties may it have with the state and therefore the privileges and immunities

available for the state in the conventional sense cannot be enjoyed by public enterprises. They are entities established and striving for profit-making, and they, like any organization that ventures in commerce, are obliged to pay tax on their profit. Again, in case where private enterprise and a public enterprise are engaged in the same activity, be it production or service provision, it would be unfair to tax the private one and exempt the public enterprise. This creates difference in venture costs between the private [which are higher] and the public enterprise engaged in the same activity. As a result, it produces the ill effect of discouraging the private enterprise from competing with the tax-exempted public enterprise in the market. Furthermore, public enterprises are big organizations with potential huge turnovers. The government, especially that of developing countries, needs this fund to directly allocate it to specific developmental projects. But the use of mere dividend (based on net profit) scheme to take away enterprise turnover into public treasury would be unable to capture other big-sum turnovers. Thus, use of taxation helps the government to make enterprises channel more revenue to the treasury; it also operates as a financial control mechanism over public enterprise activities. However, a public enterprise may turn out to be a beneficiary of legal exemption owing to its social responsibilities. Even in this case it cannot be boldly said that public enterprises are exempted from tax because the exemption would have in mind activities which are non-commercial, and any entity, not just public enterprises, may benefit from such exemption if it undertakes that activity.

In Ethiopian legal regime of taxation, almost all tax legislations include public enterprises into tax-paying category of persons though deductions and exemptions may be granted in certain justifiable cases. Thus, despite the Public Enterprise Proclamation's provision for the exemption of public enterprise from tax on its activities as a whole, the various tax laws recognize them as separate corporate entities from the government and oblige them as a matter of principle to pay taxes. For instance, the Income Tax Proclamation No. 286/2002 regards public enterprises as *bodies* deriving income from entrepreneurial activities and, therefore, as appropriate taxpayers [Arts 2(2), 17, 19(1)]. This same law has excluded them from the exemptions that seem to be available only for the different levels of governments on their revenue incidental to their normal tasks of administration (Art 30(1)). Similarly, other legal documents of taxation include public enterprise within the ambit of their application. One may consult the Value Added Tax

Proclamation No.285/2002 (Art 2(5), the Turnover Tax Proclamation No.308/2002 (Arts.2 (3),2(5)(6),2(12),6), and the Excise Tax Proclamation No. 307/2002 (Arts. 2(3), 4, Schedule). All these laws treat public enterprises that carry out business activities as “bodies” and accordingly subject them to taxation on their corporate taxable activities. As a matter of fact, all the latter three tax laws envisage an indirect taxation that enable the public enterprise to meet its tax obligations by increasing the normal price by the amount of tax. This may happen to be burdensome on the customer public which the enterprises were set up to serve.

Payment of State Dividends: - It is a fact of the business world that the net profit obtained by a legal business organization is ultimately to accrue into the patrimony of the owner or the shareholders as the case may be. The state is an owner of public enterprises, and it is legitimately entitled to receive dividends on the capital it has invested in public enterprise. The Public Enterprises Proclamation No.25/92 and the Distribution of Profits of Public Enterprises Regulation No.107/2004 both provide for the payment of state dividend.

The dividend devolving upon the state is accounted for after the determination of the net profits. “Net profits” is defined as any excess of all revenue and other receipts over costs and operating expenses properly attributable to the operations of the financial year including depreciation, interest and taxes (Art 2(7) of procl, Art 2(2) of reg). And state dividend refers to the remaining balance after deduction of the transfers to the legal reserve fund and other reserve funds from the net profits (Art 2(9) of procl, Art 3(1) of reg). Thus, the amount for payment into state budget is due after the actual cost of production and rendition are deducted, tax obligations met, and allocation to reserve funds made. The public enterprise supervising authority is an organ empowered to determine the amount of the dividend to be paid to the government from the net profits based on the legal provisions and proposal of the enterprise’s executive (Art 11(8)). The supervising authority submits, under regulation No.107/2004, to the Ministry of Trade and Industry a statement on the annual net profits of every public enterprise and the distribution of the net profits (reserved deducted). Under these regulations, the net profits has two destinations-- 60% as dividend to the government (Art 3(1)(a)) and the balance 40% to the Industrial Development Fund (Art 3(1)(b)).

The Industrial Development Fund is created by Proclamation No. 412/2004 (Art 13(2)), whose financial sources are deductions from the net profits of public enterprises (Art 13(2)). The purpose of the fund is to finance the rehabilitation and expansion of existing public enterprises and to undertake studies of public enterprises to be established and to serve as the initial capital of same (Art 13(3)) of procl. No. 412/2004 *cum* Art 6 of reg No. 107/2004).

Questions

- 1. What sort of liability may a public enterprise bear for failure to keep proper books and accounts and to make necessary reports?*
- 2. Public enterprises are created to partly serve the public interest. But imposition of indirect taxes (such as VAT, TOT and Excise Tax) provides them with the opportunity to effectively shift their tax burden to the public. Don't you think that there is a contradiction? Comment.*

4.5.2. Auditing of Accounts of Public Enterprises (Articles 32-34)

The correctness of the accounts of public enterprises is to be verified by an external inspection system. The supervising authority of public enterprises appoints auditors outsiders to the enterprise so that the latter would make an objective scrutiny of the accounts kept by the enterprise. The supervising authority carries out the appointment when such power is not given to the Auditor General under other laws, and must ascertain that the external auditors so appointed satisfy the criteria set by the Auditor General and that they are free from any form of influence.

The law imposes the duty of cooperation on all concerned persons in the course of auditing. The law comprehensively states to the effect that any person who has received, paid or expended or is in charge of the accounts, the money or property of the enterprise being audited shall, when requested, have the obligation to produce to the auditors the accounts to be audited and to furnish them with the necessary information (Art 33). Thus, all persons having a direct or indirect contact with the accounts of the enterprise are bound by law to offer help in the inspection process whenever asked to do so.

The power, duties and liabilities of auditors are similar to those of share companies under the Commercial Code, and are indeed cross-referred to the application of the latter via the provisions of Art 34 of the Public Enterprises Proclamation No.25/92. Thus, making the necessary changes, Articles 373-376, 378 and 380 Commercial Code govern the powers, duties and liability assumed by auditors in the investigative process of public enterprise accounts.

4.6. Managing Various Interlinkages

Interlinkages represent the cohesiveness of the total system and interdependence of various factors in the economic game. In public enterprises, interlinkages take on a managerial face -- in their day to day operations managers are constantly faced with external influences, pressures, and demands from the government, customers, suppliers, trade unions, the physical environment, the private sector and other public enterprises. The management is supposed to positively deal with all these interconnections.

In so far as the linkage with private enterprise is concerned, a state of competition and ultimately a question of acquiring market share arises. Competition does not necessarily imply economic antagonism, and it could take a positive face based on dialogue and exchange of information between the two sets enterprises. The management of the linkage not only is beneficial to consumers but fosters effective co-existence of enterprises.

A linkage with workers/employees is a matter deserving attention. The shop-floor level or industrial labor is perhaps a unionized labor comprising workers who have the right to form trade unions to enter into negotiations and industrial action with the management and to resort to strikes. This is particularly unwelcoming to a labor-intensive enterprise. There fore, maintaining industrial peace through the adoption of participative styles of management and incentive mechanism would be a good sign of well-managed linkage.

The relationship with customers and their protection is also an issue for management. Customers are the ultimate constituency of goods and services of enterprises, and are in a right position to judge them. The essence of there judgment (positive or negative) will have a direct effect on consumer attraction and ultimately in marketing goods and services. Enterprises in monopolistic

and oligopolistic situation may tend to disregard customer interest, but its long term effect may be adverse, and appropriate management is preferable.

Public enterprises will have a contact with the physical environment, whether positive or negative. Some public enterprises, such as those engaging in manufacturing, may produce negative externalities on the physical environment that harbors human inhabitants and may jeopardize the ecological balance. This situation puts the enterprise in a state of losing public confidence and may face a legal action of public interest litigation type. Enterprises working in conformity with environmental needs are in the opposite welcomed by the public and this lays a ground for success. This is a linkage that the enterprise cannot isolate itself from and that deserves managerial treatment.

Public enterprises may have to make foreign contacts, especially those taking part in imports and/or exports. The link may involve imports of technology, raw materials, spare parts and components; it may also relate to the employment of expatriate experts and creation of joint ventures. Thus, these links force the enterprise to adopt a foreign policy its own.

Finally, the enterprise must worry about public opinion. The public opinion is actually the composite of how many of the above linkages are treated and public enterprise needs to establish goodwill which is the most valuable incorporeal asset, by positively responding to the public opinion.

CHAPTER FIVE

STRUCTURE, MANAGEMENT AND CONTROL OF PUBLIC ENTERPRISES

5.1. Organizational Structure

Though public enterprises exist for the purpose of serving a sensitive public interest side-by-side with the profit-making end, they must be capable of resisting the stiff competition exerted by private enterprises. This means that they need to have suitable organizational set-up and efficient management systems so as to remain competent in the market. If the state owner directly intervenes in the day-to-day affairs of the enterprise under the guise of protecting its ownership interests, neither of the objectives is to be met. We had a number of public enterprises during the previous regime, but they failed to realize their ends due to the administrator state's direct and improper involvement in the internal operations of the enterprise.

We have already said in our previous sections that government departments are inherently weak to run commercial enterprises efficiently and on sound business lines due to the existence of rigid procedure, red-tape and delay in their functioning. This was the case during the PMAC reign, and in contrast to the very reason for setting up separate bodies to undertake activities of a commercial nature, administrative agencies managed to exercise substantial control over matters of day-to-day administration of public undertakings. While there must be a mechanism through which the accountability of public enterprises to the state owner is ensured, too much control may destroy their efficiency and thus defeat the very purposes for which they have been created. The success of the public enterprise would be ensured by efficient management alone when it has to compete with private enterprises in the same sector. And efficient management would be secured only when the public enterprise is entrusted with operational autonomy. It is being cognizant of this basic per-requisite and in line with a newly adopted economic policy that the preamble of the Public Enterprises Proclamation provides in a comprehensive and expressive manner that:

It is necessary to create an organizational structure whereby public enterprises can enjoy management autonomy and thus enable them to be efficient, productive and profitable as well as to strength their capability to operate by competing with private enterprises.

Organization in this context refers to the structural arrangement of the enterprise either/both horizontally or/and vertically for the purpose of stating the relationship among and the functional assignments of different organs within the enterprise itself in order to achieve a certain predetermined goal. It stands for the division and allocation of tasks among different units of the enterprise and their coordinated functioning. Management refers to the whole acts of planning the activities of the enterprise, allocation and coordination of resources, supervision follow-up of performance, and undertaking feedback /assessment of the work/ so as to obtain utmost result. Management involves making relational and sound decisions concerning the above matters with a view to derive maximum benefit out of the undertakings.

The organizational set-up spells out the decision-making and decision-taking powers of organs and their hierarchical relationship. The structure, management and decision-making are intrinsically intertwined matters as the organizational arrangement shapes the management system. Three-level interconnected but separable organizational sphere is apparent: external – the vertical relation with the state (state direction); internal – the internal structure of the enterprise itself (structure); horizontal – the relation the enterprise has with other public enterprises, private sector, and foreign capital (market factor). Leaving the peer relationship with other enterprises, we focus here on the internal structure and decision-making hierarchy of a public enterprise with a subsequent discussion of the enterprise's link to the state.

The Public Enterprises Proclamation contains provisions that set out the organizational pattern deemed to confer relative management autonomy upon the public enterprise. Article 10 puts forth what the organization of a public enterprise should look like and says each enterprise shall have Supervising Authority, Management Board, General Manager (and Deputy General Manager as may be necessary), Management Committee (not mentioned under the seemingly exhaustive list, but inferred from Art 16 (1) (I) and the Necessary Staff (employees). The supervising authority appears in Art 10(1) as if it were part of the organizational set-up of the

enterprise. But it is an organ belonging to the executive government bestowed with the protection of the ownership rights of the state over a public enterprise than an organ operating within the enterprise itself for the enterprise; it is a controlling organ that plays a role of limiting extreme autonomy of the enterprise. This will be seen later on, but for now our concern is the enterprise itself as a separate body and its own internal structure that consists in Management Board, General Manager (Deputy Manager), Management Committee and the Necessary Staff.

5.1.1. The Management Board (Articles 12-15)

Boards may be established with different natures in different systems. There could be advisory boards – that propose decisions and not make them; functional boards – that make routine decisions of the day-to-day affairs of the enterprise; or policy boards – that have wide powers and make long-term decisions. The management board of a public enterprise in Ethiopia is best categorized under policy boards. According to the proclamation, the management board is not expected to exhibit high functionality; it is simply to formulate broad directions and policies. Detailed managerial matters are formulated and executed by another internal managerial organ, but of course within the ambit of the general policy laid down by the board.

5.1.1.1. Formation and Composition

The members of the MB are all physical persons (individuals), as juridical persons are not fit for assuming such offices as boards. The number of the members is to be between three (minimum) and twelve (maximum); the exact number, within the given range for a particular public enterprise is to be determined by supervising authority (Art 11(1)). Limiting the number to a maximum twelve is deemed to be workable as the board is thought to be a unit and making the composition uniform is important. Twelve is an ideal composition for a collective decision by a unit like MB; at the same time more number would make decisions not swift as an increase in the number of board members would increase diversity that ultimately decreases the uniformity of board decisions.

Modes of assuming office in the board are election and appointment. Election is carried out by the general assembly of workers, and not more than one-third of the members are to assume office by this method. The rest of the members are appointed by the supervising authority, and

chairman of the board is appointed from among these. The supervising authority being an executive organ of the state, it seems to be the case that the government is having its own personnel, who could be outsiders to the enterprise, in the internal decision-making process of the enterprise. Of course election or appointment is to be made on the criteria of profession, experience and competence. This serves the purpose of mitigating election or appointment based on mere political affiliation. The above criteria also depict the relative consistency of state policy with the need to run enterprises efficiently/professionally. Calling upon mere politicians to assume office in the MB of public enterprise is not different from allowing the running of the enterprise by administrative agency.

An individual can have a membership in two non-competing enterprises. This clarifies the possibility that an outsider to the enterprise may become a member of its MB. The term of office of members is fixed to be minimum three years and maximum five years with reappointment or reelection possible upon expiry. This has a virtue of flexibility in board composition and there is an open prospect for the accommodation of change. The office term of members is not to expire at the same time, and it seems that this is required to maintain the continuity of the decision-making processes of the board.

It may be the case that a person withdraws from membership in the MB before expiry of his/her term; the law foresees such a phenomenon by recognizing resignation and removal of members. Resignation is the voluntary withdrawal of member from his post. The effect of resignation is an assignment of another member in the same manner as the resigning member was assigned and this is done by the board consultation with the supervising authority. Removal refers to the dismissal (involuntary) of a member where there are sufficient grounds that make him unfit to continue his membership. The power to dismiss or remove falls in the exclusive purview of the supervising authority. The authority can remove both elected and appointed members, and where the removal concerns a member elected by the general assembly of workers, the supervising authority notifies the assembly for the purpose of electing another in replacement.

5.1.1.2. Powers and Duties of the Board

The MB of public enterprise acts upon its powers and discharges its duties in a properly convened meeting. The deliberation of the board is conducted in accordance with the procedures given in article 13 of the Proclamation. The powers and duties of the board relate to the fact that it is of a policy making nature. It lays down broad and long term directions, as can be inferred from the fact that it convenes monthly - it meets at least once a month, even though it may do so for more in cases of urgency.

The decision made by the board is a collectivity, and there is no such thing as an individual decision by a single board member. A unanimous or even a simple majority decision is deemed to be made by the unit as a whole. Even the role of the chairperson of the board is limited to exercising discretionary powers to call meetings in cases of urgency and to offer a casting vote to break a tie (Art 13(2) & (5)). His functions are generally restricted to facilitating meetings so as to make the board to be able to respond to demanding circumstances through appropriate and timely decisions. So, final decision-making process is never effected on an individual basis, but at the board level (collective decision).

The law has conferred on the board a wide range of powers and duties. Article 14 (1) entrusts the board with an open-ended power to decide on policy issues that reside outside the purview of the supervising authority. The MB is the highest decision-making body at the enterprise level, but not all decisions that pertain to the enterprise are taken up by it. There are certain even broader policy matters upon which the government is to act, and if there is any role of the MB as regards these matters, it is merely propositional. For a better understanding of the types and nature of matters falling under decision-making sphere of the MB, it is worthwhile to briefly touch upon the relationship it has with the supervising authority even though we are bound to see same in the context of controlling governmental actions over public enterprises.

According to Article 14 (1) and 11 (3), the powers and duties of the supervising authority and those of the MB seem to be non-overlapping, and of course, in principle, they are not. It seems that all residuary powers of policy-making that are not assigned to the supervisory authority belong to the board (just like the power division between the federal government and the states in

the Ethiopian Federal Constitution). It is provided in a manner that the powers of the supervisory authority or policy matters are expressly stated and that the remaining powers are reserved to the MB. But still there is problem in distinguishing policy areas belonging to the board and the SA in some instances – there are issues over which both organs have a say. Certain policy matters appear both in the exhaustive power-list of the SA and in the non-limitative power enumeration of the board. Nevertheless, the apparent power conflict may be resolved by having regard to the nature of the say each of the organs has on the matter. It seems that the type of say the organs exercise on the same issue is slightly different.

The board has only an advisory, or recommendatory, function upon the issues while the SA is empowered to exercise a final say. That is to say, the policy issues are formulated by the board, but would be submitted to the SA for approval. The board would simply recommend its policy formulations to the SA to consider it, but it cannot insist that they should be accepted. The board only proposes and the SA, as the final say rests in it, disposes (even negatively by rejecting it). What are these matters? The reading of the different provisions in the Public Enterprises Proclamation No. 25/1992 gives the following:

- 1) Arts 11 (10) & (12) (these do not directly appear in the powers and duties provision, but validly inferred)
 - investment plan of the enterprise (expansion)
 - annual and long-term corporate targets of the enterprise
- 2) Art 14(8) - periodic reports on the state of activities of the enterprise and financial reports. It is difficult to call this a policy matter, but the report is normally expected to be general in the sense that it is limited to describing or explaining activities of the enterprise and its financial status in broader terms. The board is to submit this non-detailed information to the SA for final say.
- 3) Art 14(9) – increase or decrease of capital of the enterprise. The capital is the foundation for the enterprise. It is thus something to do with the life of the enterprise, it deserves to be treated a policy matter.

Like said previously, the abovementioned matters do not fall within the supreme decision-making powers of the board. But the board managed to play influential role and thus it is vested in partial policy-making powers.

Thus, in view of the above considerations, we can categorize the powers of the board into two based on the nature of the say it exercises. These are recommendatory power and final decision-making power. The latter can be in turn divided into two – exclusive power and approval role. The recommendatory powers pertain to matters we have just considered above over which the SA exercises final say. The final decision-making power refers to the board's supreme decision-making authority over matters that either it takes on right from the initiation or that are recommended to it by the general manager.

We preferably refer to the board's power to render final and definitive decision as exclusive where the matter resides within the sole authority of the board right from the initiation stage through creation to finality. Here can be included all matters other than those falling within the competence of the SA either exclusively or by way of recommendation submitted to it (art 14 (1)). The board again exercises exclusive power over appointment and dismissal of the general manager, and determination of his salary and allowance (art 14(2)). The power also extends to the inquiry of whether proper books of accounts are being kept, and ensuring the same (art 14(7)).

By approval roles we mean that recommendation is prepared and presented by another body (usually the general manager), and that the MB acts upon it on a final basis. It does not, however, refer merely to positive (acceptance) action, negative (rejection) is also possible. The matters subject to such role of the MB are the following:

- ❖ The employment, assignment and dismissal of officers accountable to the general manager, including their salary and allowance. These are usually department heads directly reporting to the general manager (officials having no direct connection with the general manager and other ordinary workers are excluded).
- ❖ Adoption of internal regulations, work program and budget. Internal regulations perhaps refers to work rules (such as safety rules, disciplinary rules, etc) containing

and specifying the function and conduct of the various departments and individuals. Work program has to do with the drawing of time & place frameworks and the specific type of task corresponding to the provided time & space frameworks. Budget should not be as broadly understood as employed in public finance – it is simply a sum allocated to carry out a specific project undertaken by the enterprise.

- ❖ Long-term loans and credits. This includes both borrowing and lending.
- ❖ Sale of fixed assets that do not affect the existence of the enterprise. What are fixed assets? The proclamation does not define this, but article 78 of the Commercial Code speaks of them to consist of assets used for working, assets not so used, assets completely amortized and assets in the process of amortization. We can employ this definition by virtue of article 4 of the Public Enterprises Proclamation. Existence of the enterprise is an issue of pressing concern so that the supervising authority would have some say on it. As such, sale of indispensable assets that affect the life of the enterprise calls the SA in to the stage. It is thus only sale of assets that do not affect the existence of the enterprise that the board can unilaterally approve.

Finally, the failure to carry out duties by the board entails liability. Due care and diligence is required of Board members. Breach of this duty results in joint and several liability to the enterprise for damage caused by their failure. The law is silent on liability to third parties. It may, however, be argued that since the board is found in a position inaccessible to third parties to hold it directly liable, the third parties would vicariously claim liability from the enterprise. In any case, we have a situation whereby a member cannot render an individual decision, but incurs individual liability. This seems to be the practical way for redressing the damages as the board is not a separate entity from the enterprise to be held liable as a corporate body, even though members may be held liable collectively in their individual capacity. However, a member who has dissented from the decision-making that caused the damage is exempted from liability.

5.1.2. The General Manager

Organizationally, the office of the General Manager, hereinafter GM, is one of the few pillars of effective management in the decision-making hierarchy of a public enterprise. The GM is an appointee of the Management Board and is accountable to the Board (Arts 14(2) & 16(2)), and

thus comes second within the hierarchy of authority in the organizational structure of the enterprise. His office usually carries out execution functions. He puts into practice policy matters decided by the Board, and he administers the daily affairs of the enterprise (Art 16(1) (i)). The GM is the top management personnel who discharges the tasks of organizing, directing, administering and controlling the enterprise as one economic unit. In short, he is a chief executive officer of the enterprise who runs the enterprise and sustains its life on a daily basis.

The general manager is an agent of the enterprise whose agency authorization arises from the law (Art 18), and an enterprise carries out its legal activities, acquires rights and incurs liabilities primarily through the representation of the GM. He is specifically empowered to represent the enterprise in all dealings with third parties and in legal proceedings brought by or against it (Art 16(1) (b)). The GM presides over meetings of a management committee he establishes in accordance with art 16 (1) (l) of the Proclamation.

Even if all the above functions seem to be distinctly assigned to the GM, it does not mean that the Management Board will not have any say at all. Even the General Manager's appointment and dismissal by the board itself cannot be made to the prejudice of the enterprise. We don't expect distinctness of organs with distinct say in the same economic enterprise. An enterprise is an economic unit with interdependent systems striving for profit realization, thus there must be a sort of checks and balances in addition to liabilities at law.

The GM is responsible for all the tasks he is assigned to, and he is liable for any damage he causes to the enterprise either negligently or intentionally (Art 17). Since he is an agent of the enterprise, liability may come upon the enterprise through his improper actions and he is obliged to redress such damage in accordance with relevant laws such as contracts, torts and provisions in the Commercial Code.

5.1.3. The Management Committee

The Management Committee is an organ established by and accountable to the General Manager. It renders an essentially advisory function. It advises on the operations of the public enterprise. The committee also deliberates on the progress, plans and decisions of the enterprise. The

Management Committee is an organ entrusted with a task of assisting the General Manager carrying out his executive functions in the enterprise.

5.1.4. The Necessary Staff

Apart from stating in generic terms that every enterprise's organization contains the necessary staff (Art 10(4)), the Public Enterprises Proclamation does not have detailed provisions on the composition and kind of staff. This is a matter left to the determination by internal regulations or by the bylaws of the enterprise.

The staff in this sense refers to employees and workers of the enterprise found at the shop floor level; it includes the rank and file at the bottom where the enterprise actually operates material activities. As it seems, the shop floor level does not take part in the decision-making process. But the fact that it is made part of the very organization of the enterprise shows the importance of such category for the life of the enterprise. As the enterprise's viability is highly dependent on the performance of the shop floor level, a great consideration must be made to achieve the most out of this force by avoiding industrial disputes through, for instance, adopting a decentralized decision-making structure, sustained training to upgrade skills, and a scheme of performance stipends.

Questions

- 1. Compare the organizational structure of public enterprises in Ethiopia with that of ordinary business organizations (e.g. share company), and identify its peculiarities.*
- 2. Draw a sketch of the organizational set-up and the corresponding decision-making hierarchy of public enterprises in Ethiopia.*

5.2. Autonomy and Control of Public Enterprises

Public enterprises are geared toward profit-making, though not solely so. The realization of such principal motive won't be an easy task, particularly in a market-oriented economy wherein private enterprises exert stiff competition. The best way to overcome the challenge from the market and to stay therein being profitable is through making an economic choice in favor of ideals of efficiency and effectiveness. And efficiency and effectiveness are ensured when an

enterprise is capable of exercising operational autonomy, of course as wide autonomy as its success demands, and conducts its affairs free from the constraints of state bureaucracy.

Does autonomy mean absolute freedom? Big no! Even in a competitive market where private enterprises predominantly engage, the state intervenes in the economy for regulating the behavior of market actors through the creation of general economic policies. The market may produce undesired effects if left unregulated. There are, for instance, such market failures as inflation and unemployment, and these macro-economic matters are of course corrected by the state. So, the perfectly competitive market is merely an idea, and its reality is perhaps unwarranted as it may produce negative consequences and the state has to intervene in order to make sure that these repercussions would not exist. Of course, in such case, the state takes a controlling measure on the market in generic context in the sense that no specific enterprise referred to by the intervention and it is for all.

In the case of public enterprises, the state exercises control over them for some more reasons. One is conditioned by ownership rights; another is that the state must see to it that they are achieving the public purpose for they are created. Unlike in the case of market full of non-governmental enterprises, the state exercises control moving down at an individual enterprise level. Because of the abovementioned interests, there must be a mechanism through which these organizations are made accountable to the state. So, the autonomy that a public enterprise should have is a certain degree of freedom that the management of the enterprise enjoys in making decisions pertaining to the operations of the enterprise.

5.2.1. Nature of Autonomy vis-à-vis Control

The dilemma of reconciling the necessary freedoms of action of the organs of public enterprises with their national functions is a genuine one. It is claimed that:

Almost every nation – whether it is developed or developing and whether its governmental philosophy calls for maximum use of public or private enterprise, and regardless of its basic form or organization – has been, or is now confronted with the problem of reconciling the requirements of public enterprises for operational and

financial flexibility with the need for controls to ensure public accountability and consistency with government policy.

It means that while there is no doubt as to the need of both autonomy and control, the question remains that of degree – what the scope of autonomy is and to what extent the state stretches its controlling hands to public enterprises and in what ways. There could be various factors that may be employed to draw a line of demarcation between autonomy and control.

We may start with considering the types and nature of decisions that may be made in relation to public enterprises. The analysis of decisions may not merely function as a tool of discerning the touching areas between autonomy and control, but they may help to identify the avowed theory and objectives, to monitor the results of implementation and to impose accountability. Decisions can be redistributive, implementational, or regulatory; and this may help to solve the apparent dilemma relating to autonomy and control of public enterprises.

Redistributive (or high level) decisions may pertain to some theory of distributive justice concerning the development and allocation of the resource, to some set of values and social goals to be realized. These decisions, in the form of policy and planning statements and legislation, are nominally made by political executives, central planning agencies or legislatures. They may be highly politicized because for they can ostensibly affect the interest of significant groups, and we might expect to be made in highly visible political arenas and by institutions and processes designed for that setting. We can easily see that public enterprises are not autonomous enough to pass decisions having redistributive effects, and to such extent their conduct is controlled by the political machinery of the government.

There also decisions concerned with implementation of distributive policy – implementational decisions. These may feature in many forms: micro-planning and budgeting specific projects, awarding contracts, allocating, and many other transactions. Plainly viewed, public enterprises are instruments for carrying out the broadly framed redistributive goals. In as much as they function as mediums of execution, they may have to make much of the implementational decisions, elaborating and specifying the distributive targets in a way that suits their

operational systems. But, implementational decisions may also be passed by government such as, for example, where a ministerial department may have to execute a parliamentary redistribution decision. In this case, the analysis of the content and social impact of the decisions which characterize the life and work of the enterprise may show the extent of the autonomy and control.

Finally, there are regulatory decisions – those which independently review the legality or wisdom of implementational (and occasionally redistributive) decisions. Schemes of regulation exist both within and without a public enterprise. Its board of directors ‘regulates’ when it reviews the decision of managers and others, and enterprise lawyers perform such tasks when they advise on the legality of an implementational decision. Regulation also takes place outside the enterprise proper: ministers, cabinets, organs of political parties, parliamentary committees and questioners and, occasionally, courts may engage in regulation. These tasks should become important when, and to the extent that, the enterprise is implementing a scheme of distribution which affects social interests. Regulation can be used as a means to vindicate redistributive decisions when implementation has failed to achieve that purpose. Regulatory decisions are more associated with control over public enterprise, though review mechanisms within the enterprise can be taken as an aspect of autonomy.

The nature and extent of autonomy can be deciphered through scrutinizing the specific matters related to the corporate life of a public enterprise. What are (or probably are) enterprise matters over which the enterprise enjoys full autonomy, and those seeking overseeing by an external state organ?

Decisions of a policy nature are part of the enterprise’s corporate life. From our discussions in the preceding section, we have said that the management of a public enterprise is not autonomous with regard to the formulation of broader policy issues. It has only a partial decision-making power, either it only recommends such decisions or its sphere of action is very minimal. It seems that governmental control is justified here.

It is perhaps right to say that a public enterprise should be given a great deal of autonomy over personnel management. One of the principal purposes of constituting public economic

enterprises in the form of a separate juristic entity operating commercially rather than in the form of government department is to detach the status of the personnel, and the scales of remuneration from the civil service. The personnel of public enterprise have generally the status of private employees (employees in the industrial sector); their remuneration is not tied to civil service scales, their legal status is not subject to civil service disciplinary and other regulations, and collective bargaining applies to the regulation of employment as it does in private industry. This is based on the conception that public enterprises should as far as possible approximate to the ideas of business management and not be tied too closely to the civil service.

An enterprise should also have autonomy over its own financial management, except on dividends devolving upon the state, payment of taxes and auditing of their accounts. There would be freedom from the budget appropriation process, at the very least for operating expenses. Autonomy would be enjoyed free from the usual restrictions upon expenditure, from governmental purchasing and contracting regulations. Enterprises would be free to receive and retain operating revenues, to apply same to operating expenses and to borrow in the open capital market.

A public enterprise needs to have freedom in planning its activities, or to mind its business, in a manner it deems best. The state-owner must act with self-restraint on matters residing within the professional competence of the economic bodies it has created. The enterprise is presumed to have been built on professional standards so that the economic profitability and success of the enterprise is ensured by giving adequate autonomous sphere of action to the expertise of the enterprise. An enterprise must have autonomy to adopt systems that help it to flexibly respond and conform its operations to changing technological and economic conditions. Governmental mechanism is relatively rigid on this regard, and does not promptly accommodate changing realities. A number of other factors may be raised to justify autonomy of public enterprises from the state.

5.2.2. Control of Public Enterprises

As sufficiently highlighted earlier, there is no question on the need of the government to oversee the activity of its enterprises. The degree to which, the matters over which, and the manner in

which the state exercises control over public enterprises are important issues to consider right now. We begin by forwarding certain indicators of control, and we will see the structure of control over public enterprises in Ethiopia.

In principle, interference is permissible in cases of actions *ultra vires* and in questions of general policy concerning the safeguard of national interests. As to the mechanisms of intervention, distinction could be made between *a priori* and *a posteriori* controls. The former refers to statutes and regulations defining and circumscribing the powers of enterprises, the methods of appointing the members of the managing board and determining the composition of such boards, and the machinery for prior approval for certain well-defined transactions or undertakings. The latter, *ex post* controls as sometimes called, come into picture with regard to the manner and degree of supervision exercised by the concerned governmental department and by parliament. Control in accordance with prior settled standards is viewed to be better as *ex post* controls, allegedly, cause tensions on the parastatal which is the very *raison d'être* of this organizational form. A priori control mechanism leaves little or no space for discretionary authority of an official or a government committee for a statute law may with advantage define the status, powers, and functions of the organs of the parastatals. Legislation could also define the relationship between the state and the enterprises, the alteration of their share capital structure, liquidation, amalgamation, etc. These are decisions of principle which require government's involvement statutorily prescribed. On the other hand, discretionary control schemes that give powers to oversee the enterprise based on personal whim are not looked at favorably by entities such as enterprises.

The state can exercise control over public enterprises through its various organs that are outside the organizational structure of the public enterprises. There can be a parliamentary control. Parliament by its nature cannot closely and effectively control functioning of individual public enterprises. But control of a general nature can be exercised. Members of parliament may pose questions and elicit information on important matters relating to public enterprises, and may cause a full discussion by the parliament if the subject-matter is of a sufficient importance. This is a superficial control as it may end up being a matter for mere debate by individual parliamentarians and it may not result in decision-making.

A more effective method of control is exercised through specialized committees on public enterprises. The enterprise is required to submit report of its activity from time to time, and auditors would check the accounts of the enterprise. The committee would then examine the report and the accounts. It examines in the context of autonomy and efficiency of public undertakings (i.e., it does not intrude into the daily affairs); it inquires whether their affairs are being managed in accordance with sound business principles and prudent commercial practices. The committee would then recommend its findings to the parliament for consideration – whether to approve or reject the report and account of public enterprise as it examined, but it cannot insist that its recommendation should prevail. There should be a fair number of committees to examine within a reasonable time the functionality of a large number of public enterprises. Of course, matters of government policy as distinct from business functions of public enterprises, and matters for consideration of which machinery is established by any special legislation under which a specific public enterprise is formed, are excluded from the purview of such committees.

There may also be a mechanism through which the judiciary can exercise control over public enterprises through its decisions so that the enterprise would not arbitrarily act in contravention of legal obligations and in disregard of contractual stipulations. It is obvious that a public enterprise, even though state-owned, has a legal personality of its own, and is a distinct and separate entity from the government. And in some countries, there is what is termed as “privileges and immunities” clause granted in favor of the state and its employees (may for liability in contracts, torts or any others). The state is immune from court proceedings that may be brought against it by individual complainants in certain matters. A public enterprise is liable as any other incorporated body, and it cannot enjoy those privileges. It can be sued in court under ordinary laws.

Questions

- 1. What is the scope of judicial control in Ethiopia?*
- 2. Can the broad principle of “Exhaustion of Administrative Remedies” be invoked by public enterprises so as to relieve themselves from, or at least postpone, a court action against them?*

The most influential control is undertaken by the government, i.e, the executive department of the state. It is necessary to ensure that public enterprises follow national policies formulated by the government and that they do not misuse their status/power under the guise of operational autonomy. Control is exercised through various ways government retains the power to appoint top personnel and also the power to remove them. For example, in our case, government nominees are included on the Management Board, the highest decision-making organ at the enterprise level. According to article 12(3), at least two-thirds of the members is appointed by the government, and, pursuant to article 11(2), chairmanship of the board is assumed by one of these government-appointed members. Important decisions in the enterprise's management may be subject to governmental approval (one may consult Articles 11(8-11), (12), 14(8) & (9) of Proclamation No.25/92). Auditing of accounts of the enterprise may be made by government-appointed external auditors (Arts.11 (4), 32), but subject to the auditing that may be carried out by the office of the Auditor General under the mandate of the legislature. Because it considerably affects the proprietary rights of the state, capital expenditure exceeding a particular sum requires prior approval of the government. There may also be a provision for the power to issue directives and orders by a concerned governmental organ, and this provides a formal (*a priori*) scheme of control (Art.47 (4)).

Governmental intervention is also necessary because of the need to maintain sectoral relationships between various public enterprises. An individual public enterprise is part of the whole economic system, or it is necessarily part of the public sector economies at least, and thus the government has vested interest in shaping the conduct of the enterprise in a manner that maintains sectoral balance. The enterprise is after all created by the government as one economic unit of the system, and it is supposed to waive certain freedoms of deciding its own economic projects for the purpose of the interconnection stretched by the government in the public sector economies.

In Ethiopia, governmental control of public enterprises is exercised by specified organs: the Supervising Authority, the Ministry of Trade and Industry, and the Council of Ministers. The whole range of public enterprises are to be overseen by these organs hierarchically and in their respective competence. In some countries, there is what may be called sectoral control. That

means a public enterprise engaging in a certain economic activity is controlled by the immediate concerned ministry or agency – an enterprise venturing in building and construction is, for instance, controlled by the ministry of infrastructure, that engaging in broadcasting or printing is answerable to the ministry of information, etc. This mechanism produces an effective and useful control because the activities of both organs are highly related, but it may be problematic in itself in directing inter-enterprise relations unless coupled by another measure of control.

a) Supervising Authority

This is an organ designated by the Council of Ministers with a view to protecting the ownership rights of the state (Art 2(2), Proclamation No.25/92). This shows that it belongs to the executive department of the state and is not part of the enterprise's organizational set-up though it appears in the list under article 10. It is even expressly recognized as autonomous federal government office having its own legal personality (Art. 3(1), Proclamation No. 412/2004). It has its budget allocated by the government every year (Art.11) and it is required to keep complete and accurate books of accounts (Art.12).

Nevertheless, the supervising authority contemplated by Procl.No.25/92 and that established by Procl.No.412/2004 seem to be different. Under Procl.No.25/92, there seem to be as many supervising authorities as there are public enterprises (Art.6 (9), 10(1), 47(1) (b)), and is to be designated by the Council of Ministers (Art 2(2) cum 47(1) (b)). But under Procl.No.412/2004, a single authority is established (Art. 3), and it does not apply to public enterprises for which specific supervising authorities and designated by other laws or decisions of the government (Arts.2 (2), 14).

Supervising authority established under its Establishment Proclamation No.412/2004 exercises four forms of functions.

1. It is vested with the power to cause the establishment of new enterprises. It particularly exercises this function in sectors where private enterprises could not participate 'for various reasons', and which will be bottlenecks for the overall economic development if not remedied (Article 5(3)). For discharging this, it is required to undertake project

studies (Art. 6(2)(a)). In a sense, this function also carries with it the SA's power to oversee the enterprise it has caused to be established.

2. As the name indicates, the SA is mandated to supervise and control the management of public enterprises already in existence with a view to protect the ownership rights of the state (Arts.5 (4-5), 6(2) (d-i), (k), (m)). Moreover, the realization of protecting ownership interests of the state in public enterprises is effected when the SA offers the necessary support to public enterprises in helping them attain higher level of capacity utilization and the employment of better management systems and technology so as to improve their performance and maximize their achievements (Art. 5(2)). It undertakes studies and provides guidelines to this effect (Art. 6(2) (c)).
3. Whenever there is a need and necessity to undertake division and amalgamation of public enterprises, it undertakes appropriate studies and submits recommendations to the Ministry of Trade and Industry (Art. 6(2) (j)).
4. Lastly, and most importantly, it is mandated to take all the necessary measures to implement the privatization program.

The SA contemplated by Procl.No.25/92 also undertakes four forms of activities, with some slightly different from that of the recent Proclamation and also there are overlappings.

1. From the very outset, the principal purpose for which a SA is to be designated is to protect the ownership interests of the state (Art. 2(2)). To do so, the law confers upon it powers as enumerated in Art.11. This basic function overlaps with that under Procl.No.412/2004.
2. It proposes amalgamation and division of public enterprises to the Council of Ministers (Art.11 (11)). This is something decided by the ministry under Procl. No.412/2004.
3. It has the power to propose transfer of the enterprise or its management in any manner (through sale, etc). In other words, it proposes privatization of the enterprise (Art 11(11)).
4. It proposes the dissolution of an enterprise. This is not provided in Procl.No.412/2004.

Both SAs belong to the executive department of the state. But Procl.No.412/2004 expressly recognizes it as an autonomous federal government office and having its own legal personality (Art. 3(1)). Accordingly, it is expressly authorized to own property, enter into contracts, and to

sue and be sued in its own name (Art. 6(3)). Procl. No. 25/92 simply authorizes the Council of Ministers to designate a SA for each public enterprise. There is no indication that such authority would have a legal existence of its own; to designate does not mean to confer legal personality. It may be that the CMs has to determine such in the regulations it is empowered to issue under the Proclamation.

The organizational structure of the SA under Procl. No.412/2004 consists of the Privatization Board (for effecting privatization), the Director General (appointed by the CMs), Deputy General Directors (appointed by the Ministry of Trade and Industry as may be necessary), and the Necessary Staff. The Director General is the chief executive officer of the SA, and he/she directs and administers the activities of the authority. He/she exercises the powers and duties of the authority; that is to say he/she particularly controls public enterprises and is a representative of the SA in all respects.

Note that the SA protects the ownership interests of the state not only in public enterprises (fully owned by the state), but also in share companies in which the state owns shares (Art. 5(5) of Procl. No.412/2004). It represents the government in general meeting of shareholders of share companies and nominates directors on the behalf of the government (Art. 6(2) (1) of same).

b) The Ministry of Trade and Industry

The ministry generally oversees and decides with finality over the activities and recommendations of the SA. This can be gathered from the fact that the SA is made accountable to the ministry (Art.3 (2)).

c) The Council of Ministers

The CMs has a wide role under Procl. No.25/92. “Government” in this law refers to the executive, and it is run by the CMs. The ‘government’ appoints the Director General of the SA, and fixes the percentage of deduction from the net profits of public enterprises to channel to the Industrial Development Fund established under Procl. No. 412/2004 (Art.13), which it has done by issuing the Distribution of Profits of Public Enterprises Regulation No.107/2004.

Questions

- 1. Can the Council of Ministers designate a separate supervising authority for a public enterprise it establishes after the coming into force of the primary legislation Public Enterprises Supervising Authority Proclamation No.412/2004?*
- 2. Enumerate the controlling roles the CMs has over public enterprises under the Public Enterprises Proclamation No.25/1992.*

CHAPTER SIX
AMALGAMATION, DIVISION, CONVERSION, DISSOLUTION
AND WINDING UP OF PUBLIC ENTERPRISES

6.1. Amalgamation and Division

Amalgamation is the union of two or more enterprises, either by the taking over of one enterprise by another or by the formation of a new enterprise (Art.35 (1) of Procl. No.25/92). Taking over means that the assets and liabilities of the second enterprise become part of the first, and its personality vanishes. The first becomes a bigger enterprise operating under its previous personality. Merger of two or more public enterprises may result in the disappearance of their personality and the assumption of a new single legal status.

Though the law does not provide for the details, it is possible to put forth conditions that cause amalgamation. It is necessitated, for example, by the need to eliminate redundancy where activities can be effectively discharged through combined and united undertaking, and thereby it avoids the wastage of public resources. The reduction of market share and the consequential risk of bankruptcy may induce the government to amalgamate enterprises so as to enable them to overcome the problem they face while operating individually by jointly continuing their venture. This may provide an alternative to the government to bail-out its sick enterprises through the creation of a conglomerate with successful enterprises rather than letting them go bankrupt.

We may cite two cases of amalgamation among those so far decided by the Council of Ministers: the Ethiopian Grain Trade Enterprise Re-establishment Regulations No.58/1999 and Muger Cement Factory Re-establishment Regulations No.53/1999. The regulations do not contain detailed reasons on why the amalgamation is made, but it could be attributable to the cause we have attempted to provide above. But one thing seems to be evident – the amalgamation under both laws is formed by the ‘taking over’ of one enterprise by another. Both regulations are named “re-establishment” legislations, suggesting that an enterprise is re-established just to take another enterprise into itself. Thus, the Ethiopian Grain Trade Enterprise established under Reg. No.104/1992 takes over the Ethiopian Oil Seeds and Pulses Export Corporation (Art. 2, Reg.

No.58/1999), and Mughar Cement Factory established under Reg.No.100/1992 takes over the Addis Ababa Cement Factory established under Reg. No.101/1992 (Art.2(1) of Reg.No.53/99). All the same, it may be argued that the “take over” is not complete as the “establishment” laws of the “taking over” enterprises are repealed and totally governed by the “re-establishment” regulations (Arts 9 of both Procl. No.58/99 and Procl. No.53/99).

Division is simply the reverse process to amalgamation and refers to the breaking down of an enterprise into two or more enterprises having their own legal existence. The reasons for the decision to divide could be to meet the expanding activities of the enterprise, or else to avoid unnecessary coalition of activities that could best be run in separate institutions.

The principal question accompanying amalgamation and division is that of rights and obligations of the predecessor enterprise. The law states that rights and obligations of the enterprises considered for amalgamation and of that being divided are transferred to the resulting respective enterprises (Art. 37, Procl. No.25/92). It is further required that the amalgamation or division should not prejudice the rights of creditors so much so that no decision shall be taken to amalgamate or divide if the enterprise(s) resulting from the amalgamation or division is(are) unable to meet the obligations toward third parties (Art 36(2)&(3)). Transfer of rights and obligations is a relatively complicated matter in the event of division than it is in amalgamation. The SA authority is empowered to determine the distribution of the rights and obligations of an enterprise being divided to the enterprises resulting from the division (Art 38). But in any case the rights of the creditors are protected in that, by the provisions of article 38(2), the enterprises resulting from the division are held jointly and severally liable.

Questions

- 1. How are/is amalgamation and/or division carried out under the Commercial Code? Is that undertaken under the Public Enterprise Law different from this?*
- 2. Amalgamation may cause workers' lay-off. Discuss how this problem is remedied having regard to the reduction of workforce under the labor law.*
- 3. How is division to be distinguished from opening branches and subsidiaries?*

6.2. Conversion

This is not expressly provided for in the Public Enterprises Proclamation, but can be inferred from various provisions. Conversion is the change of the legal form of the enterprise. Under the proclamation, the Council of Ministers can establish any enterprise in the form of a business organization under the Commercial Code (Art 47(2) (a)). This implies that it can convert a public enterprise form into one of the forms of doing business in corporate bodies recognized by the Commercial Code. Moreover, Art 5 of the Privatization of Public Enterprises Proclamation No. 146/1998 authorizes the SA to convert a public enterprise into Share Company for the purpose of carrying out privatization of the enterprise. Even under the Commercial Code itself, conversion of one form of business organization into another is recognized (Art 544(1)).

Question

What is the possible reason for the conversion of a public enterprise form into a private company form?

6.3. Dissolution and Winding-up

Dissolution refers to the coming into end of the corporate life of an enterprise because of occurrence of something beyond its control. There are six grounds for the dissolution of a public enterprise stated under Art 39 of the Proclamation. These are:

- The expiry of the life of the enterprise as fixed in its establishment regulations
- Completion of the venture for which the enterprise was established
- Failure of the purpose or impossibility of performance
- Loss of seventy-five percent of the paid up capital of the enterprise
- The judicial declaration of bankruptcy
- A decision of the Council of Ministers affecting the existence of the enterprise (such as where the CMs wants to dissolve enterprises that it deems not any more necessary).
The Council of Ministers has, for instance, dissolved the Engineering Design and Tool Enterprise established under Reg. No.124/1993 (Reg. No.15/1997) and Addis Metal Pressings Enterprise established by Reg. No.38/1998 (Reg. No.102/2004).

While the last ground of dissolution is peculiar to public enterprises, all the other grounds are also recognized under Art 495(1) of the Commercial Code in the event of dissolution of ordinary business organizations. But there are a couple more grounds that appear in the list of Art 495(1) to dissolve private business entities.

Winding-up is the process of liquidation of a public enterprise under dissolution. It involves, among other things the appointment of liquidators and their rights and duties, calling creditors, payment of debts the enterprise owes and collection of credits due to the enterprise, and the devolution of any surplus assets to the government. Except in the case of bankruptcy, the liquidation process for all grounds of dissolution is carried out in accordance with articles 41-45 of the Public Enterprises Proclamation. With bankruptcy, the winding-up process is conducted pursuant to, *mutatis mutandis*, the provisions on the bankruptcy proceedings in Book V of the Commercial Code. But even in this case, the limitations associating to the amount of the assets in the bankruptcy for conducting the proceedings by way of summary procedure provided under article 1166(1)&(2) of the Code are not applicable to dissolution of public enterprises. Summary procedure is upheld in the liquidation of public enterprises irrespective of the requirements of the Commercial Code (Art 40(2)).

PART TWO

PRIVATIZATION

CHAPTER ONE

THE WHAT, WHY AND HOW OF PRIVATIZATION

1.1. The ‘Whats’ of Privatization

There are two ‘what’ questions on privatization viz, what is privatization? And what is currently being privatized?

What is privatization?

Privatization is a very intricate subject on which varying opinions were held by analysts. Nevertheless, it is possible to provide a workable definition of privatization.

Privatization refers to a process of transferring ownership of business from public sector/government/ to the private sector/business. In broader sense, it refers to transfer of government functions to the private sector including revenue collection and law enforcement experience (of some countries) has it that it is not necessarily ownership right over the property that can be privatized as some countries are experimenting with ways of transferring management without transferring ownership through managements contracts and leases. Privatization is a value laden concept based on the private public dichotomy. It is a predominantly – conception rooted in the *laissez faire* theory whereby government assumes a marginal role in market regulation/economy and the private sector takes he lion share in the production and service sector.

What is being privatized?

There are virtually no limits on what can be privatized. This is evidenced y the number of enterprises recently privatized. It includes the return of nationalized enterprises to their former owners as well as management contracts, leases and sale of minority shares and small retail outlasts. Thus, any public resource under government control can be transferred to the private sector.

1.2. Why Privatize

Privatization, recognized as one of the most important economic policy reforms from the 1970s has attracted significant attention from scholar and the literature on the topic is now vast. Yet there is little agreement on the reasons why governments ----- for privatization. Generally, privatization is opted for three main reasons:

a) It improves the use of public resources:

Nations can privatize in an attempt to improve the use of public resources. The Finance Minister of Mexico uses a very telling example to illustrate how privatization can improve the use of public resources. Although only 2% of the Mexican population has even flown, the Mexican government, in an effort to upgrade the fleet of its national airline, paid an amount that could have covered the cost of paving over half of the nations' unpaved road. In addition, the accumulated losses of Mexico's large public steel mill now exceed ten billion dollars with a fraction which the government could have provided a potable water, sewerage, hospitals, and education to the poor in every community in southeastern Mexico. These examples are not unusual or in any way peculiar to Mexico as the situation is more or less the same in almost all developing countries.

Public enterprises divert the scarce resources of public money and public management skills from high priority uses. Privatization would free those resources for other more important tasks such as education, health, and nutrition.

b) It improves operating efficiency

On top of its importance in enhancing allocation of public resources, privatization after improves the operational efficiency of the privatized entities and thus results in more efficient uses of resources.

An in-depth study conducted by the World Bank on the efficiency effects of privatization in Mexico, Malaysia, Chile and Great Britain shows consistent net improvements in efficiency in the companies studied. The causes for the increased efficiency of privatized enterprises are rooted in competition and private property right.

If public enterprises are not unfairly supported, then the efficiency of private and public enterprises will be the same. However, public enterprises tend to be supported unfairly as government are reluctant to let their public enterprises go bankrupt despite the direct impact on a national budget from losses sustained by public enterprises. Rather than sustaining these losses, government attempt to prevent them by eliminating competition. By allowing competition, privatization creates pressure for enterprises to perform or fail.

The existence of private property right, on the other hand, is the other root cause for improved performance since profit-oriented owners --- their companies to perform better at lower costs and to be more service and client-oriented. Unlike the public owner, private owners are usually quicker to change management and faster to respond to opportunities. The reason for this is the fact that private owners are motivated by their own state in the company and in part to the fact that they are free of the political constraints that bind government.

c) Privatization improves dynamic efficiency

It is quite evident that privation has almost always caused an increase in investment and innovation. The Chilean Telephone Company, for instance, increased the number of phone lines by 12% in three years after it was sold. The newly privatized Mexican Phone Company, TELMEX, is laying down 8,400 miles of fiber optic cable to link Mexico's 56 large cities.

In addition, private owners have strong incentive to recognize opportunity more readily and seize it more aggressively than public bureaucrats. Finally, as the private sector is free from political constraints, their dynamic efficiency is increased.

1.3. How to Privatize

The desired effects of privatization can be obtained only if proper privatization is executed. As effective privatization is difficult to accomplish especially for institutionally weak countries, due legal should be had to the 'How' of privatization.

i) Governments must create a conducive environment

As privatization is an end in itself, governments should create a conducive environment that encourages competition. Chile is one of the most successful privatizers not just in terms of number of enterprises sold but in terms of the efficiency efforts of privatization.

So, governments should take privatization only as part of a larger program of reforms designed to create an environment that promotes efficiency such a program usually includes: trade reforms encouraging competition and export; price reforms liberalizing markets; regulatory reforms safeguarding competition by removing obstacles to private entry and exist; and legal reforms assuring proper disclosure, enforcement of contracts, and due process.

ii) Governments must streamline the privatization process

Needless to state that determining the value of public enterprise is very difficult as privatizing an enterprise can be thought of as a commodity that has never been put to market test. Expert advice plays a massive role in alleviating the difficulty by an accurate and realistic value as a floor price.

Thus, governments of privatizing countries must assess what technical advice is necessary, and hire a team of different kinds of advisors, including people who can help them design regulatory and policy frameworks to maximize the benefits from privatization to the economy as a whole.

iii) Governments must prepare the enterprise for privatization

In order for the government to attract buyers who are willing to pay a reasonable price for an entity and to invest in improving the efficiency of the entity, governments must make the enterprises desired for sale more attractive. This could be done by eliminating the debts of the enterprises. In addition, as contingent liabilities such as pension funds, large severance pay agreements, or claims for environmental damages are massive deterrents to privatization, governments should remove those liabilities, if any.

Layoff could also be another form of preparation as successful privatizations have tended to lay-off redundant workers before sale.

CHAPTER TWO

ARGUMENTS FOR AND AGAINST PRIVATIZATION

As much as there are ardent supporters of privatization, there are many anti-privatization scholars. Let's begin with pro-privatization arguments.

Proponents of privatization believe that private market actors can more efficiently deliver more goods or services than government due to free market competition which will in turn, ultimately lead to lower prices, improved quality, more choices, less corruption, and quicker delivery.

Moreover, governments have few incentives to ensure that the enterprises they own are well run. One problem is the lack of comparison in state monopolies. It is difficult to know if an enterprise is efficient or not without competitors to compare against. Another is that the central government administration, and the voters who elect them, have difficulty evaluating the efficiency of numerous and very different enterprises. A private owner, often specializing and gaining great knowledge about a certain industrial sector can evaluate and then reward or punish the management in much fewer enterprises much more efficiently.

In fact, many proponents do not argue for the privatization of everything as they are well aware of the effects of market failure and natural monopoly. But, there are some, though very few, who think that everything can be privatized, including the state itself.

In general, pro-privatization proponents challenge state ownership on the following grounds:

- **Performance:** State-run industries tend to be bureaucratic; governments mostly tend to be improving their function only when their poor performance becomes politically sensitive. This can, in turn, be easily reversed by another regime.
- **Corruption:** A monopolized function is prone to corruption; decisions are made primarily for political reasons/personal gain of the decision maker, rather than economic ones.
- **Accountability:** Managers of privately owned companies are accountable to their owners/shareholders and to the consumer and can only exist and thrive where needs are met. Managers of public enterprises, on the other hand, are expected to be more

accountable to the broader community and to political ‘stakeholders’. This can reduce their ability to directly and specifically serve the needs of their customers and can bias investment decisions away from otherwise profitable areas.

- **Goals:** A political government tends to run an industry or company for political goals rather than economic ones.
- **Security:** Governments have had the tendency to ‘bail out’ poorly run businesses, often due to the sensitivity of job losses, when economically, it may be better to let the business fold.

The proponents of privatization, on the other hand, raise very sound arguments in favor of privatization.

They say that opponents of privatization dispute the claims concerning the alleged lack of incentive for governments to ensure that the enterprises they own are well run, on the basis of the idea that governments are proxy owners answerable to the people. It is argued that a government which runs nationalized enterprises poorly will lose public support and votes, while a government which runs those enterprises well will gain public support and votes. Thus, democratic governments have an incentive to maximize efficiency in nationalized companies, due to the pressure of future elections.

The controlling ethical issue in the anti-privatization perspective is the need for responsible stewardship of social support missions. Market interactions are all guided by self-interest, and successful actors in a healthy market must be committed to charging the maximum price that the market will bear. Privatization opponents believe that this model is not compatible with government’s missions for social support, whose primary aim is delivering affordability and quality of service to society. Some also point out that privatizing certain functions of government might hamper coordination, and charge firms with specialized and limited capabilities to perform functions which they are not suited for, in rebuilding a war-torn nation, infrastructure, for example, a private firm would, in order to provide security, either have to hire security, which would be both necessarily limited and complicate their functions, or coordinate with government, which, due to a lack of command structure shared between firm and

government, might be difficult. A government agency, on the other hand, would have the entitlement of a nation to draw upon for security whose chain of command is clearly defined.

Furthermore, opponents of privatization argue that it is undesirable to transfer state-owned assets into private hands for the following reasons:

Performance: A democratically elected government is accountable to the people through a legislature, congress or parliament, and is motivated to safeguarding the assets of the nation. The profit motive may be subordinated to social objectives.

Improvements: The government is motivated to performance improvements as well run businesses contribute to the state's revenues.

Corruption: Government ministers and civil servants are bound to uphold the highest ethical standards, and standards of probity are guaranteed through codes of conduct and declarations of interest.

Goals: Governments may seek to use state companies as instruments to further social goals for the benefit of the nation as a whole.

Capital: governments can raise money in the financial markets most cheaply to re-lend to state-owned enterprises.

Lack of market discipline: Governments have chosen to keep certain companies/industries under public ownership because of their strategic importance or sensitive nature.

Cuts in essential services: If a government-owned company providing an essential service (such as water) to all citizens is privatized, its new owner/s could lead to the abandoning of the social obligation to those who are less able to pay, or to regions where this service is not profitable.

Concentration of wealth: Profits from successful enterprises end up in private, often foreign, hands instead of being available for the common good.

Political influence: Governments may have easily exerted pressure on state-owned firms to help implementing government policy.

Downsizing: Private companies often face a conflict between profitability and service levels, and could over-react to short-term events. A state-owned company might have a long-term view, and this be less likely to cut back on maintenance or staff costs, training etc, to stem short term losses.

Profit: Profit companies do have profit maximization as their most predominant goal. A Private company will serve the needs of those who are most willing (and able) to pay, as opposed to the needs of the majority, and are thus anti-democratic privatization in Ethiopia

The following points are excerpted from St. Mary's Module for Distance education learners prepared by Ato Muradu Abdo.

CHAPTER THREE

PRIVATIZATION IN ETHIOPIA

3.1. Background Issues Related to Privatization in Ethiopia

As far as the function of a government in the economy in the developing countries is concerned, the most influential argument for state enterprises in developing countries in the 1960's and 1970's was that the existing very small amount of skill and capital these nations have would be best used if the state played a greater role in concentrating and coordinating these resources. This position sought to entrust the state with active managerial, administrative and distributive functions. This belief lost its importance in the wake of great public enterprise failures in 1990's. Many governments in developing countries began to adopt policies designed to reduce the scope of the intervention in the economy as results of these failures and the collapse of the Soviet Union; this entailed, among others, the transfer of these undertakings into private hands. The Ethiopian government was not unaware of this general trend.

Consistent with this general shift to the private sector, the IMF and the World Bank strongly advised the Ethiopian government to close down those unprofitable public enterprises and to transfer others into private hands in 1992 and there after. These international institutions promised to help the government both technically and financially in the process of accomplishing the transition.

In 1991, the country had numerous state owned businesses. Most of them were considered as national liabilities rather than assets. Some survived because of heavy state subsidies; others due to their monopoly positions. Efficiency and profits had no place in many of these enterprises. Generally, professionally incompetent, loyal and non-business minded individuals had been managing these public enterprises.

At the great cost of commercial exigencies (i.e. flexibility and timeliness), state entities had been administered nearly the way as the government used to administer other administrative unit. Thus terms of finance, management and qualified personnel, these entities failed completely. The country had to think about the future fate of its failing business entities.

In the year 1991, arguments both in favor and against privatization were raised. Those who are against privatization argued that government is not inherently inefficient and that failures had to be attributed to institutional weaknesses in these public enterprises. The former said reform does not help in achieving economic efficiency; transfer of public enterprises to private hand would do.

Those who are against privatization argued that failure of public enterprises did not necessarily mean privatization was the solution. They argued that it is a big logical fallacy to think that the fact that X has not worked always means that Y will be the best solution. They asserted that public enterprises could be efficient if greater administrative autonomy is assured, if they are put in harder budget constraints, if the number of employees number is cut into appropriate size, if merit based recruitment and promotion of workers is set in motion and enforced strictly, and if flow of profits to the central treasury is required by law. For them, public enterprises failed purely because these critical elements were lacking. Moreover, this side of the argument advocated for a parallel growth of the private sector. If government creates a viable business environment, it is possible to have a private sector without significant privatization of public enterprises. In this way, the size of the state economy would be reduced as the private sector can grow faster than state owned entities both in number and in size.

Three arguments were made against these arguments opting for the status quo-the continued existence of public enterprises in this country. It is not a simple question of playing with logic. In fact it is contrary to the experience of the experience of other economies in transition where privatization is considered better than the performances of state owned entities. In 1980's most state enterprises performed very poorly not only in Ethiopia but also in many East European countries. Given this general experience, it is unsound to stick to logic. A second response was that if public enterprises can be managed like private enterprises there is, then, no economic advantage for the government to retain them under its control. Some body else can do the job with equal and even better and greater efficiency. It is sensible for the state to privatize such entities and concentrate its limited resources on highly needed activities. Thirdly, argument for the side-by side growth of the private sector very much tends to ignore the following points. The country has extremely inadequate infrastructure. Communication network is at its lowest stage of

development. Energy supply is not adequate, despite the country's immense potential. Besides, the purchasing capacity of the population is very low. The seventeen years of socialist rule resulted in little formation of private capital and low level of business management skills. The 1974/1975 massive nationalization of the then growing businesses without any compensation severely damaged the confidence of both domestic and foreign investors. On the other hand, the present government did not want to lose particularly financial aid from the IMF. At least, it appeared to have taken the advice from the IMF into consideration. It could not also disregard the then great move towards privatization; nor did the government want to privatize all public enterprises and thereby lose its resource for its political and economic maneuvers. The latter, however, seems to have loomed larger. Thus it came up with a very unclear policy and law of privatization, which reflected a stand by the government to privatize some public enterprises but not others, without setting out the basis and reasons for such dichotomy.

The economic policy of the transitional government in 1991 favored continuation of certain state enterprises. This policy translated into a law in 1992 whose preamble in relevant part reads: '..... whereas as long as public enterprises have to stay under government control, it is necessary to create an organizational structure whereby they can enjoy managerial autonomy and thus enable them to be efficient, productive and profitable as well as to strengthen their capability to operate by computing with private enterprises.....'

In 1994, the government issued another law reaffirming that it would continue to hold public enterprises. Its preamble in pertinent part runs: '... Whereas it has become necessary to privatize public enterprises other than those which have to stay under government control in accordance with the economic policy.'

One might say that the government is concerned with the immediate impact of massive and rapid privatization of public enterprises on the well-being of the poorest segment of the population in items of price fluctuations, unemployment and removal of price controls. Concern for the undesirable social consequences of swift privatization, however, has not been advocated by the state in any event the country has to pay a certain price to stop resource-wastage and to attain a certain level of development. The IMF did not exert pressure on the government to sell out

public enterprises immediately; nor would it do so given the bitter experiences of ‘shock treatment’ East European countries. No body with a sound understanding of economies in transition would argue for a swift transfer of public enterprises. Another explanation for the small percentage of privatization of public enterprises in Ethiopia is that the government is persuaded by and committed to arguments for structural and managerial reforms in public enterprises and that it in fact has introduced such introduced such reforms.

There are various reasons for privatization as we have discussed above. The reasons provided for in the law (Art 3) are three.

- 1) To generate revenue required for financing development activities undertaken by the Government;
- 2) To change the role and participation of the Government in the economy to enable it exert more effort on activities requiring its attention and
- 3) To promote the country’s economic development through encouraging the expansion of the private sector.

Question

Despite adopting the privatization policy, the Ethiopian government has preferred to continue its monopoly over key sectors like the telecom and electricity distribution. The absence of liberalization with regard to such sectors is claimed by some as having contributed to the country’s failure to accede to the World Trade Organization in the normally expected time schedule. How much is this claim tenable?

3.2. Privatization Laws: The Past and the Present

Herein below a brief discussion is made about the development of the institutional aspect of privatization in Ethiopia.

3.2.1. The Ethiopian Privatization Agency

Immediately after the assumption power by the current Government of Ethiopia in 1991, it adopted a market economic policy. The government then issued a law regulation privatization in

1994, i.e., the “Ethiopian Privatization Agency Establishment Proclamation No. 87/94. The proclamation, in its preamble, states the following to be the objective of privatization.

- ◆ The economic policy of the transitional period stresses the need for changing the role and participation of the state in the economy, in order to revitalize the economy and to create a strong basis for all-round future development through sustainable and reliable growth;
- ◆ It has become necessary to privatize public enterprises other those which have to stay under government control
- ◆ To direct and execute such privatization by a autonomous public agency vested with the necessary powers and duties.

Question

Do you think that these objectives may be summarized to mean: change in the role of the state in economy, the need for the establishment of a government unit to take care of privatization matters? Do you think that these purposes are still valid? Why?

Proclamation No 87/94 established the Ethiopian Privatization Agency with the objectives of carrying out the process of privatization of public enterprises in an orderly and efficient manner. The Agency was empowered, under Article 5, to: undertake detailed studies on the economic, technical and price evaluation of public enterprises which the Government has decided to be privatized; submit to the government recommendations regarding the modalities of privatized of public enterprises; privatize public enterprises in accordance with modalities approved by the Government; identify those public enterprises to be privatized while having outstanding debts; facilitate the payment of such debts; coordinate the activities of the concerned Government offices in the process of privatizing public enterprises; create conditions which facilitate the successful completion the privatization process; prepare detailed records of manpower, assets, financial and legal affairs of public enterprises that are going to be privatized..... carry out other activities necessary for the fulfillment of its objectives. the Agency was supervised by a five – person Board designated by the Government with the powers, among others, to approve studies on the evaluation of assets and the determination of prices of public enterprises that are going be as well as ensure the supervise the preparation of action programs and procedures and

as well as ensure the systematic execution, the legality and the transparency and efficiency of the privatization process.

Question

Do you think that powers of the Agency and the Board are specific or too general? Do you think that powers of the Agency should have been worked out in greater detail and specificity?

For example, the proclamation did not address the following issues:

- The meaning of privatization of public enterprises;
- Whether the Agency had monitoring power over privatized public enterprises;
- Then fate of the workers of privatized enterprises in cases of reduction of work forces;
- The different modalities of privatization of public enterprises;
- The issues of pricing and determination of public enterprises to be put to privatization and those to remain in the hand of the state.

3.2.2. Board of Trustees

In 1996, Ethiopian passed and law to supplement the then in place law on the issues of privatization (proc. 87/94).The new law referred to as the establishment of the Board of Trustees for privatized public Enterprises, proc. no 17/96 The preamble of this law stated that:..... enterprises other than those to remain under government ownership, are to be privatized pursuant to the Economic policy; it is found necessary to establish an organ having legal personality, to follow up and handle receivables, debts and obligations as well as legal cases pending after sale and transfer of enterprises privatized in consequence thereof. From this it is clear that the aim of the establishment of the Board of Trustees was to take care of issues linked to already sold out public enterprises. As to be in charge, the board is accountable to the prime minister and is established with the objective of collecting receivable, takeover debts, obligations and follow up legal cases not transferred to the buyer upon privatization of a public enterprise as well as to efficiently work to wards the attainment of same.

Under Article 6 of proc No 17/96, the Board of Trustees is given the following powers:

- To ensure, upon commencement of handover of an enterprises to the new owner, that all cash held at hand by the enterprise is counted and deposited in a bank account to be designated in advance, reconcile same with bank statements and other financial documents;
- To cause inspection and supervision for item – by – item tallying and reconciliation as to whether the quantity and conditions of fixed assets, stock row materials and finished products during handover, effected by the Ministry of Finance, corresponds with what is shown in the books of the enterprise;
- To call upon creditors in accordance with its own schedule and plan. receive their claims together with the supporting documents, given decision there on after due inspection and verification;
- To issue the final balance sheet of the privatized public enterprise
- To submit to the prime minister detailed reports in receivables and payables as wells as pending court cases of the enterprise, send a copy of the same to the Ethiopian privatization Agency.
- Unless otherwise provided in the contract concluded between the Ethiopian privatization Agency and the new owner of the enterprise:
 - To collect receivables out sanding as at the date of privatization of enterprises, take appropriate measures for collection there of;
 - To submit to the government, and have settled, the debts of the enterprise, settle same it self upon approval, and discharge its other obligations;
 - To takeover and follow up, by way of substation, court cases relating to the enterprise, effect out of out settlement as appropriate

Question

What is the striker of the Board of Trustees? What is the composition of the Board? Do you think that such a composition represents the concerned bodies?

The Board of Trustees has following organs: a Board of management and general manager. Members of the Board of Management are to be drawn from: an appointee of the prime minister who is act as a chairperson, a representative of the supervising Authority of public Enterprises, a

representative of the Ethiopian privatization of Agency, and the General Manager of the Board to appoint by the prime minister upon recommendation of the Board.

What are the powers and responsibilities of the Members of the Board of management?

The Board of Management is to direct, as the superior authority, and supervise the activities of the Board; to ensure and supervise the collection of receivables outstanding as at the date of privatization of the enterprise, to submit to the government, and obtain approval for, the settlement of the debts of the enterprise, ensure and supervise due settlement of same upon approval and to undertake proper follow-up and supervision on the settlement of legal cases relating to the enterprise in or out of court. Are members of the Board of Management liable for their action? Is the liability individual or joint and several? What does joint and several liability mean? Members of the Board of Management are duty bound to carry out their duties with due care. They shall be jointly and severally be liable for damage attributable to failure to exercise due care.

Article 14 of proc No 17/96 revokes the legal personality of public enterprise privatized pursuant to proclamation No 87/94 upon the completion of its handover to the new owner and its existence as a public enterprise shall cease thereupon; rights and obligations of an enterprise as at the final date of handover is transferred to the Board of Trustees; the Board is required to publicize the privatization of an enterprise with the view to notifying third parties of the sale, through a newspaper having wide circulation or other mass media upon completion of its handover.

In 1998, the Government must have felt the law in place to regulate the privatization process was inadequate as it specific provisions outlining issues of definition of privatization, modalities of privatization and other host of issues associated privatization. The government responded by issuing Proclamation No. 146/98 referred to as Privatization of Public Enterprises. The preamble of the proclamation for the privatization of public enterprises in its preamble provides that it has become necessary to change the role and participation of the state in the economy and to encourage the expansion of the private sector and thereby promote the economic

development of the country. According to this Proclamation, the Country's Privatization Program has the following objectives: to generate revenue required for financing development activities undertaken by the Government; to change the role and participation of the Government in the economy to enable it exert more effort on activities requiring its attention; to promote the Country's economic development through encouraging the expansion of the private sector.

3.2.3 Amalgamation of the Privatization and Supervisory Authorities

In 2004, the Government merged the Ethiopian Privatization Agency and the public Enterprises Supervising Authority by virtue of proclamation No 412/2004. Do you think that such merger is appropriate? Proclamation No 412/2004, in its preamble, provides that: " it has become necessary to change the role and participation of the state in the economy and to encourage the expansion of the private sector and thereby promote the economic development of the country; as long as public enterprises have to continue under state ownership, it is necessary to provide them with such guidance and support so as to enable them to be competitive and profitable and thereby plan appropriate role in the implementation of the country's industrial development strategy and the enhancement of economic growth. In order to achieve these objectives, it has been found appropriate to amalgamate the Ethiopian Privatization Agency and the Public Enterprises Supervising Authority. Do you think that these objectives are any different from the objectives of privatization stated earlier in discussing the preambles of Proc No 87/94 and Proc 146/98?

The Privatization and Public Enterprises Authority (the Authority) shall pursue the following objectives:

- ✓ Implement the privatization program in accordance the privatization of public enterprises legislation and in a transparent and efficient manner;
- ✓ Support public enterprises in attaining higher level of capacity utilization and the employment of better management systems and technology thereby to improve their performance and to maximize their achievements;
- ✓ Cause the establishment of new enterprises in sectors where private investors could not participate for various reasons and which will be bottlenecks for the overall economic development;

- ✓ Supervise the management of public enterprises and
- ✓ Protect the ownership rights of the state in public enterprises and share companies.

The Authority has the following powers and duties as stipulated under Proc 412/2004.

- ✓ Submit, to the Ministry of Trade and Industry, the list of public enterprises and government shareholding to be privatized, and obtain approval thereof;
- ✓ Cause the undertaking of all necessary preparatory works for the privatization of enterprises;
- ✓ Determine bid evaluation criteria for the selection of investors participating in privatization; and design ways and means of encouraging domestic investors to participate in the privatization of enterprises;
- ✓ Prepare necessary documents to be used in the privatization process;
- ✓ Take all necessary measures to publicize the privatization program and its implementation;
- ✓ Through post privatization monitoring ensure compliance of investors' obligations and undertake impact assessment of the privatization in general.
- ✓ Undertake project studies for the establishment of public enterprises;
- ✓ Evaluate and submit to the Ministry, for its approval, project proposals presented by investors intending to invest in partnership with the government and follow the implementation of same;
- ✓ Undertake studies and provide guidelines with a view to assisting public enterprises in building their capacities;
- ✓ Appoint and remove the chairperson and members of boards of management of public enterprises and fix their fees;
- ✓ Approve the appointment of external auditors of public enterprises;
- ✓ Approve corporate targets and investment plans of public enterprises;
- ✓ Follow up and evaluate the performance of public enterprises
- ✓ Approve financial reports of public enterprises as audited by external auditors;
- ✓ Issue directives on writing off the accounts of public enterprises and follow up their implementations;

- ✓ Undertake appropriate studies and submit recommendations to the Ministry of Trade and Industry where the amalgamation or division of public enterprises becomes necessary;
- ✓ Represent the Government in general meetings of shareholders of share companies and nominate directors on behalf of the government;
- ✓ Give final decisions on requests to retain employees and management staff members of public enterprises in service beyond retirement age.

3.2.4. Organization and Powers of the Board of the Authority

The Authority has A Board, a Director General and Deputy General Director. The members of the Board are to be appointed by the Government. The Board has the following powers: Oversee and supervise the implementation of the privatization program; ensure the orderly execution, the legality, transparency and efficiency of the privatization process; issue directives necessary for the proper implementation of the privatization program; decide or submit recommendation to the Ministry of Trade and Industry, as may be appropriate, on the policy issues relating to the implementation of the privatization program; examine complaints submitted to it in relation to the execution of the privatization program and give administrative decisions thereon; assume the power of the Board of Management under Proc 146/98 as discussed above; ensure the return of private properties taken illegally by the former government; and take all other measures necessary to expedite the privatization process.

The list of enterprises to be privatized shall be determined by the Government upon the recommendation of the Supervising Authority. The management of an enterprise decided to be privatized shall have the duty to prepare the enterprise for privatization in accordance with directives given to it by the Agency.

The Authority may, where it deems it necessary in the course of preparation for privatization, cause the conversion of an enterprise to a share company. The capital of such share company shall be divided into shares and shall totally be held as government shares. The provisions of Article 312(1)(b) and 315 of the Commercial Code shall not be applicable with regard to a share company formed under this Article or by taking an enterprise as government contribution. Until such time that the Agency start transferring shares of such share company to private ownership:

authorities given to share holders meetings under the Commercial Code shall be deemed given to the Supervising Authority; all directors of the company shall be appointed by the supervising Authority; and the provisions of Articles 307(1), 311, 347(1) and 349 of the Commercial Code shall not be applicable; provided, however, that other provisions of the Commercial code shall be applicable with the necessary change. Do you think that the following issues are relevant to conversion: the meaning of conversion; the effect of converting a given public enterprise into a share company; the reason for the government giving precedence to a share company over the other forms business associations such as a cooperative society, a partnership and a private limited company; as to who is to decide whether a given public enterprise should be converted into a share company; the question of whether all public enterprise determined to be privatized should be subjected to a conversion; and the task of conversion?

What is to be valued; what involves in valuation of a public enterprise about to be privatized who should be involved in the valuation process; on the basis of what factors should valuation be made; is the purpose of the valuation to obtain a floor price or an indicative price or the exact price of the public enterprise subjected to valuation?

An important factor in transparency is valuation. A realistic valuation is necessary to set a floor price as a basis for negotiations and as a check that the deal is legitimate. Thus, when outsiders judge the privatization process they often compare the sales price with the so-called “value” of the enterprise. Determining the value of public enterprise, however, may be difficult.

A privatizing enterprise can be thought of as a commodity that has never before been on the market. Therefore, how do you decide its value in the absence of market test?

Often, the book value of a company bears no resemblance to the company’s market value, especially if the company has a poor track record, redundant layers of employees, and a host of operating problems. Governments often are forced to rely on an independent body to assess the value of the company, leading sometimes to very unrealistic results. Yet, it is crucial to establish an accurate and realistic value as a floor price.

3.3. Modalities of Privatization and Issues Incidental to Privatization

The Agency shall undertake studies to adopt detailed procedures enabling the use of various appropriate modalities of provocation. Any modality selected for the privatization of an enterprise shall be subject to the approval of the Board. The procedures to be followed in the use of any modality of privatization shall be based on the principles of transparency. Where the Agency is unable to privatize an enterprise that could be dissolved on grounds specified under Article 39(1)-(5) of the public enterprises proclamation No. 25/ 1992 using modalities other than liquidation, it is hereby authorized to exercise the powers given to the supervising Authority with regard to the dissolution and winding – up of enterprises under Articles 41-45 of said proclamation. The Agency may agree that the price of an enterprise be paid in Birr or in convertible foreign currency. Notwithstanding the provisions of Article 1750 of the civil code, the price of an enterprise shall be paid in the currency specified in the contract.

For the purpose of determining taxable income, the calculation of depreciation of assets shall be based on their valuation done in accordance with this proclamation; provided, however, that it shall be based on the actual amount paid by the buyer where the tender price is lower. The Agency shall send to the concerned tax authority the breakdown of asset values. The Agency shall send to the concerned tax authority the breakdown values of assets transferred to the buyer and which are subject to the payment of stamp duty in relation to documents of title to property. The provisions of Article 5(6) of the Stamp Duty Proclamation No. 110/98 shall not be applicable with regard to the values of assets transmitted by the Agency under this Proclamation. Note: Article 5/6 of Proc No 110/98 reads: (a) the stamp duty payable on the value of the property involved as agreed upon between the transferor and the transferee provided however that such valuation is agreed by the Federal Inland Revenue Authority; (b) Where the value agreed between the transferor and the transferee is not acceptable to the Federal Inland Authority, the value of the property involved in the transferor of title shall, for the purpose of calculating the stamp duty be determined by a special committee which shall be appointed for such purposes by the Federal Inland Revenue Board. Why is this provision disregarded in relation to valuation of public enterprises being prepared for sale? Does it mean that the valuation made by the concerned government organ is assumed to be credible or is it an attempt

to remove one of the obstacles to speedy privatization? Further, consider the following issues: the meanings of depreciation and taxable income.

What is a stamp? What is a stamp duty?

The provisions of the relevant investment laws governing the granting of incentives for expansion and upgrading of existing enterprises as well as entry requirements and guarantees applicable to foreign nationals and foreign investors shall also be applicable to investors participating in the privatization of enterprises. What incentives are to be given to a purchaser of a public enterprise who is intending to renovate or upgrade and expand it? Are incentives to be given to both expansion and upgrading activities or to either of these investments? Why should the law maker be interested in encouraging such types of investments?

Question

Do you know the entry requirements in relation to foreign investors? What about the guarantees available to foreign investors purchasing public enterprises?

Employees' pension coverage existing before the privatization of any enterprise shall continue without any interruption. Continuation of former employee's pension coverage at whose expense: at the purchaser's or government's expense? The new owner of the enterprise shall respect employers' obligations imposed by the appropriate laws with regard to employees' pension Article 13 of proc No 146/ 98 provides that the rights and obligations of an enterprise shall, upon privatization, be transferred to the buyer provided, however, that the transfer of debts shall require the consent of creditors. The same article states that even if this is the case, rights and obligation pertaining to receivables and payables shall be transferred to the Board of Trustee where the sales contract provides for the non-transferability of such receivables and payables to the buyer. How do you relate this Article to Articles 1962 and 1976 of the civil code? Is this Article related to the settlement of the debts of public enterprise?

Article 14 of proclamation No 146/98 provides that an investor who has bought an enterprise shall have the obligation to implement, within the time limit specified in the sales contract, his investment plans on the basis of which he was awarded the contract in addition to this purchase price. The investor shall have the obligation to periodically submit to the Agency information

that is necessary for monitoring the implementation of the investment plans and to allow the representatives of the Agency to enter and inspect the enterprise at any time and to make assessments. The sales contract shall prescribe penalties applicable to the investor in case of failure to meet these obligations. Do you think that the Authority has to take investments plan of prospective buyer of a public enterprise in to account consideration in stand of blindly sticking to the price offered? How can the Authority make sure that the purchaser is executing his/her investment plans as promised? Where should be the source of information about the performance of an investor has bought a public enterprise?

What should be the extent of intrusion? Do you think that post- privatization? Supervision might lead to de-privatization?

Article 18 of proc No 146/98 stipulates that disputes arising between the Agency and an investor who has participated in privatization shall be referred to the appropriate federal court unless the parties have agreed in their contract to submit such disputes to an arbitration tribunal, the proceedings there of shall be conducted in accordance with the provisions of their contract and that of the civil and civil procedure codes. Do you think that this article is necessary?

Do you think that jurisdiction depends, among others, on the amount of the claim under dispute? What if the investor involved is a foreigner?

PART TWO

LAW OF COOPERATIVES

CHAPTER-ONE

MEANING, NATURE, HISTORICAL BACKGROUD, PURPOSE, TYPES AND FOMS OF COOPERATIVES

1.1 Meaning/Definition

Although many writers try to define cooperatives in various ways with minor differences, we don't intend to go through all those definitions and discuss each of them exhaustively. We will only single out the major ones and discuss them.

To begin with the meaning provided for cooperatives by the International Co-operative Alliance, cooperatives are autonomous associations of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through jointly owned and democratically controlled enterprises.

Cooperatives could also be defined as businesses owned and controlled equally by people who use its services or who work at it. Therefore, cooperatives should be regarded as legal entities owned and democratically controlled equally by its members.

According to C.R.Fay, cooperatives are associations of persons, small producers or consumers, who come together voluntarily to achieve some common purposes by a reciprocal exchange of services through collective economic enterprises working at their common risk and with resources to which all contribute.

The official definition of cooperatives is provided for under Recommendation 193 of the ILO on the promotion of cooperatives in 2002. Accordingly, “*cooperatives are autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprises.*”

In similar vein, a proclamation to provide for the establishment of cooperative society No. 147/1998, defines cooperatives on its Art. 2 as: *“a society established by individuals on voluntary basis to collectively solve their economic and social problem and to democratically manage same.”*

What one can easily discern from the above definitions is the fact that cooperatives are built on such noble values as self-help, self-responsibility, democracy, equality, equity, freedom, mutual responsibility and togetherness. Cooperatives are, therefore, the outcome of the coming together of citizens for a common good and the need to support oneself as well as those who are part of the public at large.

As a result, cooperatives are unique in the sense that they are user-owned, user-benefited, and user-controlled as the benefits obtained are returned to members and democratically administered by members themselves.

1.2. Nature of Cooperatives

Under this topic, we shall capitalize on the unique features of cooperatives and highlight the distinguishing marks of cooperatives from other forms of business organizations.

As we have already discussed here above, cooperatives are unique in that they are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, cooperative members believe in the ethical values of honesty, openness, social responsibility and caring for others. Thus, they have conspicuous distinguishing marks from other forms of business association. We will discuss these points here under.

The first distinguishing mark relates to the emphasis given to human resource. Whereas it is human resource that is at the heart of cooperatives, it is capital which comes to the fore in the case of other business organizations. Unlike other business organizations, cooperatives pursue broader sets of values than those associated merely with profits. The needs and demands of the public at large is given due emphasis. Thus they exist solely to serve their members.

Although cooperatives operate on a not-for profit basis, they operate to make profits just like any other for-profit businesses except that the profits in a cooperative are returned to members in the form of patronage refunds (amounts of payments that a cooperative patron receives at the end of the year based on his/her use of the cooperative not on the basis of his investment or ownership share).

The other main distinguishing features of cooperatives relates to the three peculiar features of cooperatives, i.e. “user-owned”, “user-controlled”, and “user benefit”. The “user owned” principle signifies that the users are the ones who are financing the cooperative by transacting businesses; “user-controlled” implies that the board of directors is elected by the members of the cooperative and serves as a link man (liaison) between members and the manager. “User-benefited” indicates that the members are the ones profiting from the cooperative because patronage refunds are returned to the members on the basis of the amount of business they conducted with the cooperative.

The uniqueness of cooperatives can be derived from the facts that the customers, owners, patrons and members could be the same person.

In a nutshell, cooperatives are distinct from other forms of business organizations in that they:

- i. Are owned and democratically controlled by their members (those people who use the cooperatives’ services or buy its goods);
- ii. Return surplus revenues (income over expenses and investment) to members proportionate to their use of the cooperative, not proportionate to their “investment” or ownership share;
- iii. Are motivated not by profit, but by service to meet their members’ needs for affordable and high quality goods or service;
- iv. Exist solely to solve their members’ problems; and
- v. Pay taxes on income kept within the coop for investment and reserves.

Surplus revenues from the cooperative are returned to individual members who pay taxes on that income.

In fact, this doesn't mean that cooperatives and business organizations do not share common elements. Business organizations and cooperatives manifest the following shared features:

1. Contract

Both forms of associations evolve from the mutual consent of their members. Thus, consent is at the heart of both. The origin of business organization is rooted in the consent of the partners (shareholders) as much it is the case with cooperatives. Therefore, the existence of a valid contract is indispensable for the coming into existence of cooperatives and business organizations.

2. Plurality of persons

As no one can conclude a contract with himself/herself, it appears mandatory that there must be at least two persons. By the same token, there needs to exist at least two or more persons for the creation of business organizations and cooperatives. In fact, there is a difference between the two with regard to the minimum number of members required for their validity. This very point will be discussed in greater detail in the forthcoming sections. But all the same the number cannot be less than two.

3. Common Interest

It is necessary that the members in both forms of associations should have a common purpose no matter what their purpose might be. The members need to have an intention to advance common purpose. Nonetheless, their purpose can only be a lawful and a legitimate purpose.

4. Collaboration

In order to advance the common interest, it is imperative that members in a business organization have an intention and consent to collaborate. The same holds true for cooperatives too. As one can understand from the very name itself, cooperation and/or collaboration is central to the essence of cooperatives.

5. Contributions

It is naïve to think that having a common agenda (meeting of the mind) and showing willingness to collaborate is sufficient to attain a certain goal. Thus, for this goal to be attained, it is imperative that members make contribution of resources be it in kind or in cash or both.

Thus members in both associations (business associations or organizations and cooperatives) should make contribution which could be tangible or intangible property, experience/expertise in creating/managing business.

6. Purpose

Although cooperatives are formed for purpose much broader than merely making profits/gains, they share common purpose with business organizations in that they have the purpose of making profit. But one should not forget that making profit is the ultimate and sole purpose for establishing business associations whereas this is not in the case with cooperatives.

7. Formality

As it is required by the law that an agreement to create a business organization be made in writing, registered and publicized, cooperative agreements need to be reduced into writing, registered and publicized. Those agreements creating business associations are called memorandum of association and those creating cooperatives are known as *by-laws*.

8. Legal personality

Legal personality is bestowed upon both association following registration, and publication and deposit of the necessary documents such as the memorandum of association or by-laws and other requirements, if any.

9. Limited liability

As much as members in share companies and private limited companies enjoy the benefit of limited liability, members in cooperatives enjoy the same benefit.

10. Role of members

With the exception of share companies and private limited companies where capital is given due emphasis (as they are capital associations), the role of members in other forms of business associations (ordinary partnership, joint venture, general partnership and limited partnership) is supposed to be very high and very crucial as they are personal associations. Similarly, the role of members, not their capital, is given high emphasis in the case of cooperatives. Thus, cooperatives share a number of features with partnerships.

In spite of the aforementioned similarities, there are some points that make cooperatives distinct from PLCs and SCs. To begin with, since PLCs and SCs are capital associations, both are required to have a minimum start-up capital which is not the case with cooperatives. In addition, whereas a minimum of two persons can form business associations (2 for PLCs and 5 for SCs), at least 10 persons are required to establish/create cooperative society. Moreover, obtaining profit is not the primary purpose of cooperatives. But profits could be obtained incidentally in the course of achieving another goal-advancing the interest of its members. But amassing profit is the primary purpose of forming business associations.

Review Questions

What do you think is the rationale behind the need to require cooperative to have at least 10 members? Why do you think is minimum capital requirement missing in the case of cooperatives?

1.3. Historical Background of Cooperatives

1.3.1. General

Under this topic, a brief survey of the general development of cooperatives with special emphasis on cooperatives development in Ethiopia will be made.

It goes without saying that it is of paramount significance to trace the historical origin of cooperatives.

As the word cooperation used in common parlance designates the idea of living and working together cooperative efforts have occurred throughout history. Since early man cooperated with others to help kill large animals for survival, people have been cooperating to achieve objectives

that they could not reach if they acted individually. Cooperation has thus occurred throughout the world.

Ancient records show that Babylonians practiced cooperative farming, that the Chinese developed savings and loan associations similar to those in use today.

Furthermore, in ancient times people learned to cooperate and work together to increase their success in hunting, fishing, gathering foods, building shelter, and meeting other individual and group needs. Historians have found evidence of cooperation among peoples in early Greece, Egypt, Rome, and Babylon, among Native American and African tribes, and between many other groups.

Many historians also agree that early agriculture would have been impossible without mutual aid among farmers as they had relied on one another to defend land, harvest crops, build barns and storage buildings, and share equipment. These examples of informal cooperation and working together were the precursors to the cooperative form of business and the foundations for cooperative movement.

The earliest cooperative movement is believed to have appeared in Europe in the late 18th and 19th centuries, during the era of industrial revolution. As people moved from farms into the growing cities, they had to rely on stores to feed their families because they could no longer grow their own food. Working people had very little control over the quality of their food and living conditions. Those who had money gained more and more power over those without money.

Early cooperatives were, therefore, set up as a means to defend the interests of the less powerful members of the society, workers, consumers, farmers, and producers.

The cooperative movement has its roots in the Lancashire textile town of Rockdale, England, where, in 1844 harsh living conditions and inadequate consumer protection (the adulteration of food by private traders) inspired 28 working men to adopt a new approach to supply of food and

other goods and the provision of social and educational facilities for ordinary working people by setting up a retail cooperative society, the Rochdale Equitable Pioneers Society.

Those 28 Rochdale men pulled together a meager capital (two pence per week (240 pence = 20 shillings = 1 pound)) and arranged to rent the ground floor of an old warehouse in Toad Lane for ten pounds per year (although this was only agreed to by the owner after one of the members of the society put the lease under his own name). After paying this rent and making some necessary repairs, only fifteen pounds remained. With this amount they purchased 28 pound of butter, 56 pound of sugar, six hundred weights of flour, a sack of oatmeal, and some fallow candles.

They then began selling those items, and the society quickly grew to include other enterprises. The founders also established a unique combination of written policies that governed the affairs of the cooperative and served as foundations for present day cooperatives' principles. Among these rules were democratic control of members, payment of limited interest on capital, and net margins distributed to members according to level of patronage.

Based on its success, the Rochdale set of polices became a model for other cooperative endeavors, and became known as the general principles that make a cooperative unique from other business associations.

The pioneers and other early cooperators owed much of their inspiration to the cooperative writings of Dr. William king (1786-1865), a Brighton physician and philanthropist and Robert Owen (1771-1858), a welsh manufacturer and social reformer.

Robert Owen, in particular, is said to have been the founding father of the cooperative movement. He believed in putting his workers in a good environment with access to education for themselves and their children. These ideas were put in to effect successfully in the cotton mills of New Lanark, Scotland, where the first cooperative store was opened. Spurred on by this success, he came up with the idea of forming "Villages of cooperation" where workers would drag themselves out of poverty by growing their own food, making their own clothes and ultimately become self-governing.

Others like Dr. William King took Owen's ideas and made them more practical. King believed in starting small, and realized that the working classes need to establish their own operatives and he saw his role as one of instruction. He then came up with a monthly periodical called *The Cooperator* (as of May 1, 1828) which gave a mixture of cooperative philosophy and practical advice about running a shop using cooperative principles. He advised people not to distance themselves away from society, but rather to form a society within a society, and to start with a shop. He said, "We must go to a shop every day to buy food and necessity – why then should we not go to our own shop?"

He also proposed such noble rules as having a weekly account audit, having three trustees, and not having meetings in pubs (to avoid the temptation of drinking profits). On this basis, the Rochdale pioneers, as they became known, set out the Rochdale principles in 1844, which in turn laid down the basis of the cooperative movement today.

The success of Rochdale pioneers led to the growth of cooperatives in various fields of life in the UK. By the early 1900s, cooperatives were so widespread and well organized that they formed the cooperative party to represent members of cooperatives in parliament. UK cooperatives retain a significant market share in food retail, insurance, banking, funeral services, and the travel industry in many parts of the country. One of the world's largest consumer cooperatives, the Cooperative Group, is in the UK.

Important European banking cooperatives include the Credit Agricole in France, Migros and Coop Bank in Switzerland and the Raiffeisen system in Austria, Germany, Switzerland, the Netherlands, and Belgium. Spain, Italy and various European countries also have strong cooperative banks.

In Japan, there is a very large and well-developed consumer cooperative movement with over 14 million members. About one in five of all Japanese households belong to a local retail cooperative and 90% of all members are women. In addition to retail cooperatives, there are medical, housing and insurance cooperatives for customers. In recent years, Japanese consumer

cooperatives have seen the growth of community supported agriculture where fresh produce is sent direct to consumers from producers without going through the market.

In North America, the Caisse Populaire Movement started by Alphonse Desjardins in Quebec, Canada pioneered credit unions. Desjardins wanted to bring desperately needed financial protection to working people. In 1900, from his home in Levis, Quebec, he opened North America's first credit union, marking the beginning of the *Movement Desjardins*.

By the early 1900s, the United States government began to pass laws that provided for a favorable environment for cooperative development. Government encouragement for agricultural cooperatives was highest during the 1920s and 1930s. Most state legislatures established Agricultural Cooperative Acts during this time. According to United States Department of Agriculture (USDA), the largest number of agricultural cooperatives occurred during 1929-30.

South Africa has also developed cooperatives among farmers, consumers and workers throughout the 1900s. However, many of these did not observe international cooperative principles, as they often reflected and entrenched the system of racial discrimination and social inequality rather than challenging it. Nonetheless, cooperatives on agriculture, consumers, finance, workers, and social services were established during those periods and then after.

In Africa, in general, although the concept of cooperatives existed long before and during the colonial period, it flourished in its present form only after independence. The smooth development of cooperatives in Africa was hindered by the colonial rules while all the activities and establishment of cooperatives in Africa was hampered by the colonial rules while all the activities and establishment of cooperatives were regulated by it. The colonialists enact laws which suit them in their endeavor to advance their colonial rules. During this period, the cooperatives were not successful in their performance due to the onerous management of colonialists. For instance, the French national Assembly passed a decree in 1919 allowing the establishment in France's overseas territories of quasi-cooperatives known *associates de provenance*. The ordinance applies to all French speaking countries.

The other colonial power who passed Ordinance for her colony was Great Britain. The Ordinance allowed the formation of cooperatives among small holder peasants in the Tanganyika in March 1932. The ordinance is a mere gesture to safeguard the interest of the colonized but essentially it is meant to protect the interest of Britain. Thus we can say that cooperatives in Africa during the colonial era were simply impositions on African people as the laws were not indigenous to facilitate the smooth development of cooperatives.

In a nutshell, cooperative communities are now widespread, with one of the largest and most successful examples being the Mondragon Cooperative Corporation in the Basque province of Spain. In many European countries, cooperative institutions have a predominant market share in the retail, banking and insurance business. In the UK cooperatives formed the cooperative Party in the early 20th century to represent members in the parliament. The creation of International Cooperative Alliance, which was established in 1895 as an independent non-governmental association which unites, represents, and serves cooperatives worldwide and which has members from national and international cooperative organizations in all sectors of activity including agriculture, banking, credit and saving, industry, insurances, fisheries, housing, tourism and consumer cooperatives and representing more than 100 million individuals worldwide and 200 member organizations from over 100 countries, highlights the peak of cooperatives movement.

1.3.2 Cooperative Development in Ethiopia

An understanding of the status of cooperatives in present day Ethiopia demands the knowledge of traditional forms of cooperations that existed long ago as they are the building blocks for the development of cooperatives. Although one might find it difficult to trace the exact birth date of cooperatives and the exact roles they had played, one can not fail to appreciate the existence of various forms of cooperations. Living or working together is not alien to the Ethiopian people. Their unity/cooperation has been exemplified in many instances. Peasants used to cultivate their lands together by calling what is known as “Debo”, “Wonfel”, “Gige” etc; they built their hunts/houses together, and herd their cattle together. Both urban and rural dwellers always joined hand in an effort to defend their territory from foreign attacks. History has it that Ethiopian people have always been together through thin and thick.

As the saying goes “*Der biyabber anbessa yaser!*”, can be translated as “*individual threads, otherwise weak, in cooperation can incarcerate a lion*”. Cooperation has always been one of the biggest virtues that Ethiopian people treasures.

Nonetheless, this crude form of cooperation become obsolete and gave way to cooperatives’ movement in its present form. For the sake of convenience, we shall discuss cooperatives developments under the three different regimes separately.

1.3.2.1. Cooperatives During the Era of Emperor Haileselassie.

Modern cooperatives movement started very recently in Ethiopia as envisaged by Decree No. 44 of 1960.

It is with the promulgation of this Decree (Farm workers’ Decree) that cooperatives have come to acquire their formal legal status. Although cooperatives have acquired their formal legal status since the promulgation of this decree, it was not until 1978 with the adoption of the cooperative society’s proclamation No. 138 of 1978 that their status is realized in line with their objectives.

As we can understand from the preamble of the 1960 decree, cooperative societies were regarded as enterprises the primary function of which is maximization of profit. We can understand this when we take a close look at some of the provisions in the Decree. For instance: “...whereas, the organization of cooperative enterprises (emphasis added) can contribute measurably to this end...” Furthermore, Art. 3 reads “... the profitable sale of production (emphasis added) ...” These two quotes can lead one to conclude that the main objective of cooperatives by then was to make profits.

An attempt was also made to re-establish cooperative societies by promulgating proclamation No. 241 / 1966. But the attempt was futile as it never brought about change of fortune for the poor farmers. The reasons being again that all necessary pre-requisites for the formation of cooperatives were absent. The whole process was simply a change in form rather than in

substance. Because, members of the cooperatives were not the needy people but any interested persons or institutions who wanted to procure profit. This can be observed from the provision of Art. 14(3) of Proclamation No. 241/1960 which reads “A ministry or chartered government agency or other public authority may become a member. In addition, Art. 15(1) provides that a juridical person can become a member thereby rendering the cooperative an enterprise mainly established to make profit. This implies that cooperatives were not basically designed to bring any economic change for the peasants as individuals and/or artificial persons who were not/could not actually participate in the real activities of the cooperative were allowed to become a member. This is basically against the essence of cooperatives. The fact that there were members with unlimited liability, as per Art.3 (13) of the aforementioned proclamation, makes them similar with General Partnership (see Art. 280 of the Commercial Code of Ethiopia)

So, this also clearly manifests that cooperatives societies were treated, at least partly, in the same way as business organizations. Nonetheless, the farm cooperatives were sought to promote the economic interests of their members in particular and the Empire in general. The law desires to promote modern farming methods and agricultural practices and to promote cooperation among members. To this end, the Ministry of Agriculture has provided them with technical and financial assistance for the purpose of financing the construction of residences, minimum monthly payments to members, for the purchasing of necessary equipments, seeds and live stock.

The 1966 proclamation, on the other hand, aims at not merely regulating farm cooperatives but to capture every type of cooperative society as it was believed that the importance of cooperatives in terms of promoting self-reliance and mutual help among people who share common needs and desires has been internalized by the people. What is unique about the 1966 proclamation is that prominent persons were allowed to become nominal members. This is basically meant to enhance the reputation and good will of cooperatives by letting merchants and prestigious personalities become members. As a result, government agencies or ministries could become a member so as to enable the society utilize government facilities and personnel.

In general, the problems of cooperatives during this period can be summarized as follows.

- Societies were not receptive of new technological changes. As the objectives of modern cooperative societies were new to the rural population the small field staffs of concerned state authorities were over stretched for they were supposed to lend a hand to all the societies in running their day-to-day activities;
- Most of the cooperative workers lacked qualification in the theory and principles of cooperatives. As a result, they were inefficient, lacked incentive and enthusiasm in their work;
- Acute shortage of finance for budgetary expenses and capital investment Banks required 100% collateral from cooperatives and made excessive supervisory control over the manner of use of the loans even when they grant loans;
- The management of cooperatives was dominated by landlords and the affluent ones;
- Lack of adequate training; and
- High degree of state interference (registration, supervisions, inspection, auditing their accounts, supply credits etc... were solely handled by the government)

Review Question

In what concrete ways do you think cooperatives in those days have contributed to the development of cooperative movement in Ethiopia? Were they worth anything for they were hit by all those problems?

1.3.2.2. Cooperatives During the Derg Regime (1974-1991)

The 1975 proclamation that provides for nationalization of rural land and extra houses in urban areas on its Art.10 provided for the creation of marketing and credit cooperatives by peasant association. Although the proclamation did not provide for the creation and management of cooperatives, it disclosed the intention of the Provisional Military Administrative Council (PMAC) to give out large scale state farms to cooperatives.

In 1978, a proclamation that provides in a comprehensive way for the establishment of various types of cooperatives was adopted. This law, Proclamation No.138 /1978 envisaged collective ownership of production by way of mobilizing peasants.

Several government units were given mandates over different cooperatives on the basis of their areas of specialization. For instance, the National Bank of Ethiopia was entrusted with the duty of controlling financial matters relating to saving and credits; the ministry of Agriculture was empowered to control, supervise, and assist the establishment of producers' cooperatives in the agricultural sector.

Each cooperative is supposed to have its own article of association in accordance with the proclamation though a board of cooperatives drawn from numerous government bodies was envisaged to give direction to the cooperatives movement.

Since the country was pursuing socialist mode of development, cooperatives in Ethiopia were treated in much the same way as those in other socialist countries.

In socialist countries, cooperatives enjoy maximum freedom and protection for their proper foundation and development. Besides, they function in accordance with central planning and are not engaged in any kind of "cut-throat" competition which is the main features of capitalism. The same was more or less true with cooperatives Ethiopia.

Nevertheless, the cooperatives movement could not bring about the desired result owing to the following reason.

- As the surplus production was to be sold out to the agricultural marketing corporation at a price much lower than the market price and the members were naturally interested in highest returns from their products, farmers who were deprived of the fruits of their labour by way of compulsory marketing lacked incentives to work harder;
- Since they were required to pay exorbitant registration fees and government aid (in terms of releasing necessary fund and other financial assistance) was at its minimal, their contribution was inadequate;
- They were unable to meet their financial expectations (debts) owing to the imbalance between cost of inputs and outputs (decreased price of input and low price for outputs);

- Lack of skill and adequate training in farm management, accounting and in business management;
- Lack of proper book keeping and accounting system which exposed them to embezzlement and corruption which in turn led to low spirit and on some occasion to loss of members;
- Since management and control committees remained in office for long term (as they are politically affiliated with the government), the democratic feature of cooperatives were diminished; and
- Lack of appropriate remuneration scheme.

Review Question

What were the distinguishing features of cooperatives during the Derg Regime in comparison with those during the era of the emperor?

1.3.2.3 Cooperatives Movement Since 1991

Beginning from 1991, cooperatives began to see change in fortunes as their roles in economic development were understood better. During the imperial era, the major objective of organizing cooperatives was to produce industrial crops and hence they were organized in areas where these crops are grown. Moreover, shareholders were almost landlords and hence small holders and consumers were not given due attention.

During the Dergue Regime too, with large number of members of non-cooperative organizations pretending to be cooperative, cooperative societies and the cooperative movement as a whole used to suffer from loss of credibility in the eyes of their members and the general public at large. The publicly pronounced image of cooperatives was not reflected in the day-to-day practices. The members lacked tangible benefits and they had no role to play, hence sense of ownership faded and the group started disintegrating. As a result, the development of saving and credit cooperatives was limited.

Presently, the Ethiopian government has given due emphasis for the development of the sector and necessary legislative actions have been taken. To this effect, the government has enacted the following proclamations that apply at federal level:

Proclamation No. 147/19989 (referred as Procl. here under) as amended by proclamation No. 402/2004, Regulation No. 106/2004, and the proclamation which has established the Federal Cooperative Commission (Procl. No.274/2002). Moreover, the legality of cooperatives is duly acknowledged by FDRE constitution which is the supreme law of the land.

Pursuant to Art.31 of the Constitution, every person has the right to freely form association or join any association of his/her choice with a view to pursue a legal cause. Furthermore, as per Art.41(1) and (2), every Ethiopian has the right to engage freely in economic activity and to pursue a livelihood of his choice anywhere within the national territory, and to those his/her means of livelihood, occupation, and profession.

Thus, the Ethiopian government is doing everything it should and could to see to it that cooperatives are expanding to the required level by taking appropriate legislative measures and making appropriate policy decisions. The government has also assigned the required human resource from Woreda to federal level. There is even a plan to assign cooperatives extension workers at Kebele level which is the basic political structure of the government

Despite the fact that the operation of saving and credit cooperatives was limited to work places since 1990, there was a shift in outlook that led to promoting and organizing saving and credit cooperatives focusing on the needs and desires of the society by enlarging the common bond of association to the profession and community. It was in fact started with the demand of NGOs to line up the support of low income groups to income generating activities and to sustain the benefits by organizing in this manner.

Most cooperatives are organized on the basis of workplace (employee) common-bond. Owing to the large number of people residing in rural areas, there lies a huge potential for credit union development. Very few saving and credit cooperatives are organized on the basis of profession.

Currently, there are about 19, 147 primary cooperatives with an aggregate capital of 1.47 billion birr with membership of about 4.61 million cooperatives in Ethiopia also provide job for close to 24,000 people.

With a view to strengthen the bargaining power of primary cooperative societies, 124 cooperative unions with 992.6 million birr capital have been established all over the country. An additional 44 cooperative unions having a total capital of 4.9 million birr are in the process of forming grain marketing cooperatives federation.

N.B. The figures here above are bound to changes as cooperatives are expanding at an alarming rate.

The Ethiopian government has also embarked upon an aggressive program of economic and political liberalization, including taking steps to promote the development of democratic, free-market oriented, and professionally managed agricultural cooperatives. USAID laid the groundwork for this initiative beginning in 1994 by sending American volunteers to the field under the “Farmer-to Farmer” program managed by Agricultural Cooperative Development International /Volunteers in Overseas Cooperative Assistance (ACDI/VOCA). USAID/Ethiopia followed these initial efforts with direct funding. This brought about a cooperative renaissance in the second half of 1990s. During this time the attitude towards cooperatives had changed and people especially cooperative members had become increasingly aware of the role cooperatives could play in improving their lives.

The impact of USAID/Ethiopia and ACDI/VOCA efforts to date has been dramatic. Over 1,400 agricultural cooperatives throughout Ethiopia have been reoriented, restructured, and legally registered.

The Oromia Coffee Farmers Union is just one example of successful cooperative reorientation and development.

In the coming five years, strengthening cooperative societies by delivering services to 70% of the population is a priority. Increasing cooperative sector saving from 630 million to 1.2 billion birr by boosting rural and urban saving and credit cooperatives society, providing telecommunication

and rural electrification services cooperatives, among others, are the major focus areas of the government .

In a nutshell, agricultural cooperatives became powerful instruments of local development in rural areas. They allowed easy access to farming equipment, and added value through further processing and marketing the farmers' produce.

New forms of cooperatives were introduced to meet farmers' special needs, thereby eliminating middlemen. In urban areas, housing, consumer, industrial and craft cooperatives were established, while savings, credit and social service cooperatives flourished in rural and urban areas alike.

Key to the successful development of all these cooperatives was the Federal Cooperatives Commission (FCC), the government agency charged with promoting cooperatives in the country.

Review Question

Compare and contrast the development of cooperative societies under the three regimes.

1.4. Purposes of Cooperatives

Under this topic, the role of cooperatives in general and the place of cooperatives in Ethiopia's millennium development goals, in particular, will be assessed.

1.4.1 The Role of Cooperatives in a Nutshell

Cooperatives create job opportunities thereby providing income to many. They produce and supply safe and quality products and services to their members and the community in which they operate, they promote solidarity, tolerance, and equality, they respond to the needs of their members by providing education and trainings and they play a significant role in the national economy by contributing their fair share in the wellbeing of the entire population at national level.

The importance of cooperatives in job creation, mobilizing resources, generating investment and contributing to the national economy, and promoting the fullest participation in the economic and social development of all people is clearly stated in the preamble of Promotion of Cooperatives Recommendation No. 193 of the International Labour Organization.

In similar vein, it is provided under Art.4 of Proclamation No. 147/1998 that cooperatives are established for the following objectives.

1. to solve problems collectively which member cannot individually achieve;
2. to achieve a better result by coordinating their knowledge, wealth and labour;
3. to promote self-reliance among members;
4. to collectively protect, withstand and solve economic problems;
5. to improve the living standards of members by reducing production and service costs by providing input or service at a minimum cost or by finding a better price to their products or services;
6. to expand the mechanism by which technical knowledge could be put into practice;
7. to develop and promote saving and credit services;
8. to minimize and reduce the individual impact of risks and uncertainties; and
9. to develop the social and economic culture of the members through education and training.

1.4.2 The place of Cooperatives in Millennium Development Goals

Before we analyze the role of cooperatives in the realization of Millennium Development Goals (MDGs), it is imperative that we say few things about MDGs and the distinct aspects of the goals.

Millennium Development Goals (MDGs) are eight goals to be achieved by 2015 that respond to the world's main development challenges .The MDGs are drawn from the actions and targets contained in the Millennium Declaration that was adopted by 189 nations and signed by 147 heads of state and governments during the UN Millennium summit in September 2000. The

eight MDGs break down into eighteen quantifiable targets that are measured by 48 indicators.

The eight MDGs are:

- Goal 1: Eradicate extreme poverty and hunger;
- Goal 2: Achieve universal primary education;
- Goal 3: Promote gender equality and empower women;
- Goal 4: Reduce child mortality;
- Goal 5: Improve maternal health;
- Goal 6: Combat HIV/AIDS, malaria and other diseases;
- Goal 7: Ensure environmental sustainability; and
- Goal 8: Develop a global partnership for development.

The MDGs, although superficial on their face value as they seem mere wish list of the kind of aspirations that everyone can agree on, harbor sophisticated thinking. First, they express a broad, multi-dimensional view of development. In response to the structural adjustment programmes of the previous decade, they go beyond a simple faith in economic growth as a panacea for human ills. They talk of human development, placing human well-being and poverty reduction at the heart of global development objectives. Instead of viewing poverty as lack of income, they define it in terms of a lack of capabilities to lead full and creative lives. These capabilities include having a decent standard of living, but also living a long and healthy life, being educated, and enjoying political and civil freedoms. They, in their turn, depend on essential conditions such as environmental sustainability, equity (especially gender equity), and an enabling global economic environment.

Secondly, they are based on a set of fundamental values: freedom, equality, solidarity, tolerance, respect for nature, and shared responsibility.

Thirdly, the goals are linked to the economic, social and cultural right set out in the UN's Universal Declaration of Human Rights. This means they are not just charity but an obligation for which we are all -as citizens -accountable.

Fourthly, this obligation is spelled out in more detail as a global partnership based on mutual responsibilities between developing and rich countries. That is, developing country governments

have the primary responsibility for making the best use of their own resources and governing their countries property, while rich countries are responsible for ensuring a fair international trading system and providing more money.

This said, the question that readily crosses everyone's mind is will these goals be attained in the near future given the poor track record of success of global goals?

The tracking of progress towards the MDGs depends firstly on having reliable statistics, and the capacity of countries to provide these needs to be considerably strengthened worse still, the figures for Africa do not, include those countries from apart by war and communal violence which, if included, would make things even worse. However, the World Bank's latest assessment is that the gap between the rich and the poor is growing, and that unless current trends are reversed, the MDGs will not be met. Others agree that unless there is a radical improvement, too many countries will miss the targets. There are encouraging signs of progress in some areas alongside worrying evidence of stagnation and reversal in others.

In 59 countries, very low starting points, and failures to progress are undermining the whole project. Some scholars have aired out their fears that if trends continue as they have been in the 1990s, only the goals of halving income poverty and the proportion of people without access to safe drinking water will be met.

In regional terms, East Asia and the Pacific have made substantial progress, mainly because of high growth rate in China. In South Asia there has been a modest decline. In Latin America and the Caribbean there has been a decline, but the economic crisis in Argentina may reverse this. In Eastern Europe and central Asia, there has been a marked increase in poverty, due to the economic dislocation caused by the collapse of communist regimes. Sub-Saharan Africa remains the greatest cause for concern because, despite a slight decrease in the percentages of people in poverty, because of high birth rates, the numbers in poverty continue to rise. Statisticians have worked out that, on current trends, this region will not reach the goals for poverty reduction until 2147 and for child mortality until 2165 worse still, trends for HIV/AIDS and hunger are going in the wrong direction entirely. Some scholars are thus suggesting that

substantial revisions will need to be made in the MDGs to avoid widespread failure to achieve the targets. This is a worrying conclusion, equivalent to a footballer who cannot score a goal complaining that the goalposts are too close together.

The important issue would, then, be how far can cooperatives contribute to the achievement of MDGs? Why should we think that cooperatives might be part of the solution?

Cooperatives can make significant contribution to the attainment of MDGs. How cooperatives can be very crucial in the attainment of the MDGs will be discussed as follows.

Goal 1: Eradicate extreme poverty and hunger

Cooperatives can play a vital role in poverty reduction as they are essentially income generating associations. Furthermore, since they return any surpluses to the members in the form of a patronage refund based on the use people made of the cooperative, they make sure that the growth is equitable. The UN declares that “All countries ... should implement policies that strengthen the links between economic growth and poverty reduction and goes on to single out growth that does not discriminate against rural areas, ethnic groups or women, and that increases small farmers’ incomes, expands access to land and promotes labour, intensive growth in small and medium enterprises.” In many counties, cooperatives are still the main ways in which rural people make a living.

Goal 2: Achieve universal primary education

Needless to say that education is vital for any country in particular, underdeveloped ones, to escape their poverty traps. Thus the most important thing is that the people have to get educated at any cost.

The history of cooperatives has it that they have always been committed to education since their inception. When the Rochdale pioneers began their work in 1844, most of the adult populations of Northern England were illiterate, and few children went to school. They then made adult education one of their principles and this became a norm everywhere in Europe. In most

countries with significant cooperative sector, cooperative colleges have been founded to provide training for active members, employees and managers.

In developing countries, cooperatives have a great potential in the field of literacy training for adults. Cooperatives are not usually involved directly in providing primary schooling, but where local government fails to provide, they often fill the gaps, using their own funds to build and support local schools.

As local membership based organizations, they can build on primary education by human resource development; enabling members, managers and staff to gain the skills needed in running a business. As local civil society organizations, they can also monitor the quality of education, where they raise the incomes of poor people, they enable children to complete primary education where they raise the incomes and increase the status of women. This in turn, encourages them to complete their education.

Goal 3: Promote gender equality and empower women

The UN includes gender equality as one of its goals not only because it is important in itself, but also because it is vital to the ability to earn higher incomes, to control fertility, reduce infant mortality and improve reproductive health. How significant are cooperatives in these important goals? As organization with an open membership principle, we might expect cooperatives to be open to women. So cooperatives can play a huge role in an endeavor to empower women.

Goal 4 & 5: Reduce child mortality and improve maternal health

Every year, more than 10 million children die of preventable diseases, while more than half a million women die in pregnancy and childbirth, with such deaths being 100 times more likely in some parts of the world than others. Every where that cooperatives have raised people's incomes, or provide decent work, or healthy housing, or good quality/ unadulterated food, or the ability to save and borrow money, they can play an important role in alleviating the conditions of children and their mothers. Cooperatives have also been effective in the provision of primary health care. While maternal and child health are public issues and it could be argued that local government should provide, in remote rural areas where there are often gaps in the provision.

In USA, under the New Deal in the 1930s, the Federal Government promoted health cooperatives. And in Canada, cooperative movement provided health care for its members before the founding of a comprehensive health system. In Japan too, the agricultural and consumer cooperatives between them were responsible for mainstream health care delivery until comprehensive public health insurance led to their becoming more specialized. The same is true with developing countries like India and Sri Lanka as cooperatives, in the 1960s, were the main health service providers.

Goal 6: Combat HIV/AIDS, Malaria and other Diseases

It is estimated that some 42 million people are living with HIV/AIDS. In 2002, 3.1 million people died of AIDS. It has already killed the parents of 13 million children in Africa only. Every 8.5 million people have tuberculosis which is becoming more and more resistant to drugs and kills up to two million people per year. Every year, malaria infects 500 million people, and one million die from it.

Although no cure has been found yet, there is a progress in slowing down the spread of HIV/AIDS. In Brazil, Thailand, Uganda and Zambia public health campaigns have made a big difference. The role cooperatives can play here can not be underestimated. In most Asian countries, cooperatives are providing health care services and health education programs for their members. In India, there are 181 hospital cooperatives, and 50 cooperative education field projects providing family welfare and health awareness programmes. In 2002, these projects organized 372 health awareness programmes on HIV/AIDS for their members from which more than 1000 people benefited.

The International Cooperative Alliance which has the capacity to reach over 760 million people, in nearly 100 countries, envisages a systematic programme to raise awareness, encouraging cooperatives around the world to address the HIV/AIDS pandemic within their own organizations and communities they serve.

In addition to contributing to public health campaigns, cooperatives are a means by which people can gain micro-insurance against illness. This is particularly important in Latin America,

Senegal and Burkina Faso. They are also a means by which groups of health care providers can become more effective; pharmacy cooperatives in Ghana, and cooperatives clinics in Benin are notable examples. There are also cooperatives for HIV/AIDS victims in Kenya and South Africa.

Goal 7: Ensure Environmental Sustainability

This goal has three distinct targets. These are: to integrate the principles of sustainable development into the country's policies and prevent the loss of resources, to halve the proportion of people without drinking water; and to improve the lives of at least 100 million slum dwellers.

With regard to the first target, it is believed that cooperatives play a significant role in containing depletion of world fisheries, soil erosion, climate change due to green house effect, as they can be too good in forest and water management.

Concerning the second target, on top of the fact that one person in three in Africa does not have access to safe water and the problem is worse in rural areas, there is a problem on deciding on who should provide? In most countries services are provided by the public sector but during the 1990s the World Bank supported privatization to large transitional water companies as the public sector's record was not good. During the 1990s, private sector solutions were introduced into several cities such as Buenos Aires, Mexico City, Abidjan, Accra, Manila, and Djakarta. But they too have proved elusive as the companies have ways of excluding the poor. Higher user fees have caused water supplies to be cut off in South Africa, and provoked protests in Bolivia and Argentina. Who, then, should provide? The UN development report for 2003 says that service provision is best provided by local communities and firms, and it is up to governments to build their capacity. This provides an opportunity for water cooperatives to be considered as one important option.

Finally, cooperative can turn around the fortunes of slum dwellers that have to put up with overcrowding, substandard housing and unsafe water and sanitation resulting in high rates of disease and infant mortality. Cooperatives have an excellent track record in this regard. In USA, for instance, in the 1970s tenant management cooperatives were formed to run out-of-control

public estates. In England during the 1980s many new building cooperatives were formed to house people living in poor quality public housing. In Scotland, over 30 cooperatives were formed to buy run down 'council' estates and refurbish them.

In developing countries too housing cooperatives have also been effective in providing decent accommodation.

Cooperatives can also be very effective in providing shared services to poor people in the informal economy.

Goal 8: Develop a global partnership for development

This goal shifts the focus of attention to the international community and the developed countries, challenging them to create a global partnership for development. Poor countries cannot remove the structural constraints of rich country tariffs and subsidies, patents that restrict access to technology, and unsustainable debt. Also, large transfers of resources are needed from rich to poor nations if the latter are to reach critical thresholds in health care, education and infrastructure, and to improve productivity. This calls for the need to match the aid from outside with pro-poor policies at national level thereby opening the door for country-level poverty reduction strategies. It is believed that cooperative federations in developing countries and cooperative development agencies in the rich countries can play an important role in this process.

Thus we can say that cooperatives can directly or indirectly give the much needed momentum for the MDGs. Moreover, as community development provides community members with opportunities to bring about changes in their social, economic and cultural environment, communities join hands to form cooperatives with a view to fulfill their needs. Currently, cooperatives play a pivotal role in the poverty reduction of a nation and achievement of the MDGs.

Review Question

Evaluate whether or not cooperatives can squarely fit into the realm of MDGs? Do you think cooperatives can make genuine contribution to such pursuits?

1.4.3 The Place of Cooperatives in Ethiopia's MDGs

As to the question whether cooperatives have any role to play in an endeavor to alleviate the countries' problem by contributing to the realization of the MDGs, much has already been said. In much the same way as other developing nations, it is believed that cooperatives can make significant contribution in the country's attempt to attain the MDGs.

But what we would like discuss at this juncture is whether the country can attain the goals. Simply stated, can Ethiopia attain the MDGs?

In this regard, there is an incongruent report. According to the draft Health Service Development Plan (HSDP) joint UNDP and the Ministry of Health report of 2005, the per capita health service expenditure of Ethiopia is rated at 5.9 dollars, the least among other developing countries such as Kenya (\$31), Uganda (\$18) and Tanzania (\$5). The report also indicated that the country needs to increase health service expenditure to 34 USD. Although Ethiopia has shown significant progress in primary education, the report continues, it has yet to speed the pace in order to attain the second phase of MDGs, which is achievement of universal primary education.

On the other hand, it is suggested that Ethiopia could reach the millennium development goals. Notable in this regard is the statement by the World Bank senior vice president Francis Bourguignon on the fourth African development forum. He said that "remarkable achievements have been registered in different areas that put the country (near the) top of the 1st of developing countries." He also said that, "with the right amount of aid and a good level of implementation of the government's development policies, possibilities are high that Ethiopia should reach the MDGs."

Moreover, the Minister of Health said that Ethiopia would likely meet the MDGs in the health sector. The Minister, Dr. Tewodros Adhanom said that the maternal mortality rate was 1,068/100,000 15 years ago, while that has now decreased to 671. Similarly, child mortality rate (under 5 years of age) which was 200/1000 has now decreased to 123. About 2,500 health

stations are being constructed, training is being offered to 4,468 health officers, 10,700 health posts have been constructed, more than 24,500 health professionals were assigned to health posts. The government is also, he said, striving to provide medication to HIV/AIDS, malaria and tuberculosis. According to him, the country's health coverage service has reached 86%.

Furthermore, concrete steps are being taken by pertinent organs to see to it the goals will be attained as planned. For instance, the Ministry of Finance and economic development has devised a five years strategy plan for Accelerated and Sustained Development to End Poverty (PASDEP) which is a localized version of the MDGs expected to be achieved by 2015. This indicates how the government is committed towards the attainment of the goals.

On top of this, the greater emphasis the Ethiopian government has given to cooperatives is a big bonus in this endeavors as the latter are playing a key role in social and economic development with 7,366 primary societies, 31 union, the Ethiopian cooperative movement has a membership four million people and represents 33% of the total farmer household.

Cooperatives have mobilized over 350 million birr in savings, employ 3,800 people and some of the societies provide health and education to their members and community.

There fore, we can say that the signs are good but no one can tell with certainty that the goals will be attained or will not be attained but it is highly likely that it will be met provided that cooperatives continue to play their important role and the government keeps on exerting its relentless effort in assisting their development.

In fact, cooperatives are not without their own problems as they lack adequate training/education, lack of entrepreneurial skills, and lack of capital and absence of a national apex organization to represent the movement. The way fore ward is therefore:

- to reorganize and restructure primary/secondary cooperatives and establish specialized federation or a cooperative league,
- to develop business mentality and entrepreneurial sprit into cooperatives through capacity building,

- to put in place a clear division of function and tasks between the cooperative movement and the government;
- government needs to facilitate and create an enabling environment for the development of an independent and efficient cooperative movement;
- to develop cooperatives that exist and operate as independent, autonomous private enterprises;
- to create a clear division of labour between elected officials and professional management;
- to develop a comprehensive and sustainable system of cooperative management including management information systems and efficient auditing mechanism;
- to facilitate additional activities such as value adding , processing services and export activities;
- to coordinate and cooperate closely with cooperative organizational institutions in neighboring countries and beyond, and
- Cooperatives should use a certain percentage from their net profit for community development activities designed to reduce poverty.

This done, cooperatives can, without doubt, prove to be invaluable in Ethiopia's endeavor to attain the MDGs:

- by bringing services closer to their members at highly competitive prices, and increasing members' income by eliminating middlemen and reducing production costs;
- through improved production methods resulting from education and training activities offered to members of cooperatives, enabling farmers to improve incomes, nutrition and food security through higher yields;
- through profits accruing from efficiently managed business and reverted to the members, again raising their incomes and reducing poverty;
- through education and training activities for members promoting entrepreneurship and democratic management practices;
- by promoting job creation and stabilizing existing self-employment in urban and rural areas.

In addition, cooperatives provide the indigenous communities with culturally appropriate tools and methods to strengthen their capacities, aiming to create decent employment opportunities, sustainable livelihoods and income generation avenues.

1.5 Types and Forms of Cooperatives

1.5.1 Types of cooperatives

Cooperatives could be classified on the basis of the purpose for which they are established and on the nature of services rendered by them. Accordingly, they could be single purpose cooperatives or multipurpose cooperatives as is the case with most cooperatives.

Cooperatives could also be classified on the basis of the target group they stand to benefit, i.e. whether or not the members are the sole beneficiaries/users. In the case of consumers' cooperatives, saving and credits cooperatives, housing cooperatives, insurance cooperatives etc, the users are the members. In the case of producers' cooperatives, transport cooperatives, construction cooperatives and marketing cooperatives, the users are not necessarily members.

Cooperatives exist virtually in all forms of traditional economic sectors such as agriculture, fisheries, consumer and financial services, housing, and production (workers' cooperatives). The scope of cooperative activity also extends to large a number and activities including handicrafts, agriculture, housing, saving and credit, health and social care, funeral and schools. Lets' move on to discussing each of the different types of cooperatives mentioned here above.

N.B. Remember that these are not the only types of cooperatives currently available in the world. The following are the main ones.

1.5.1.1 Housing cooperatives

A housing cooperative is a legal entity that owns real estate and one or more residential buildings. Each shareholder in the legal entity is granted the right to occupy one housing unit sometimes subject to an occupancy agreement, which is similar to lease. It is also a legal mechanism for ownership of housing where residents either own share (share capital cooperative) representing their equity in the cooperatives' real estate, or have membership and

occupancy right in a not-for-profit cooperative (non share capital cooperative), and they underwrite their housing through paying subscriptions or rent.

Housing cooperatives come into two basic equity structures: market rate housing cooperatives and limited equity housing cooperatives.

- In market rate housing cooperatives, members may sell their shares in the cooperative whenever they like for whatever price the market offers, much like any other residential property. These are very common in New York City.
- Limited equity housing cooperatives which are often used by affordable housing developers, allow members to own some equity in their home, but limit the sale price of their membership share to that which they paid.

A housing cooperative can operate either as primary cooperative or secondary cooperative. As a primary cooperative, it would provide housing to its members. As a secondary cooperative, it would provide technical services to primary housing cooperatives.

1.5.1.2 Building cooperative (self-build housing cooperative)

Members of building cooperatives pool resources to build a house using a high proportion of their own labour. When the building is finished each member becomes the sole owner of a homestead, and the cooperative may be dissolved.

1.5.1.3 Retailers' cooperative

A retailers' cooperative, often referred to as secondary or marketing co-operative in some countries, is an association which employs economies of scale on behalf of its members to get discounts from manufactures and to pool marketing. It is common for locally owned grocery stores, hardware stores and pharmacies. Hence, the members are businesses rather than individuals.

1.5.1.4 Worker cooperative

A worker cooperative or producer cooperative is a cooperative that is owned and democratically controlled by its “worker-owners.”

Worker cooperatives operate in all sectors of the economy and provide workers with both employment and ownership opportunities. Examples include employee-owned food stores, processing companies, restaurants, taxicab companies, sewing companies, timber processors and light and heavy industry.

1.5.1.5. Producer cooperatives

Producer cooperatives are owned by people who produce similar types of products-by farmers who grow crops, raise cattle, milk cows, or by craftsmen and artisans. By banding together, they leverage greater bargaining power with buyers. They also combine resource to more effectible market and brand their products, improving the incomes of their members.

Membership is not compulsory for employees, but generally only employees can become members.

These types of cooperative are organized to carry on certain types of industrial activities.

They were started for the fist time in France to remove the exploitation of the workers by capitalists and to share the profits among the workers only.

The main purpose of these cooperatives is to instill the feeling of ownership in the minds of the workers as they would work with greater enthusiasm when they have this feeling. Thus it develops in the workers the sense of responsibility, initiative, discipline and obedience. For this to be achieved the following conditions need to be fulfilled:

- absence of bickering and jealousies among the worker members;
- the worker-members are loyal and sincere;
- the government gives full support;
- there are proper facilities or credit through credit and financial institution; and,

- there should be proper provision of marketing and transport facilities.

1.5.1.6. Consumer Cooperatives

Consumers' cooperatives were started for the first time in England about the middle of 19th C. Those cooperatives seek to ensure steady supply of consumer goods of standard quality to their members at fair prices.

The cooperatives purchased goods (which are generally demanded by the people in the locality on wholesale basis and resell them on retail basis to the members at fair prices.

The profits of the store shall be distributed among members on the basis of the size of their purchases-the principle of "bonus on purchases".

Consumer cooperatives are owned by people who buy the goods or use the services of the cooperative. They sell consumer goods such as food and outdoors equipment. They provide housing, electricity, and communications. They also offer financial (credit union), healthcare, childcare and funeral services.

The world's largest consumers' cooperative is the cooperative group in the UK which offers a variety of retail and financial services.

Japan also has a very strong consumers' cooperative with over 14 million members.

A significant number of consumers' cooperatives have been incorporate in our Ethiopia too and the government has given due attention to consumers' cooperatives as they can play a vital role in alleviating the problems related to price inflation on consumer goods.

1.5.1.7. Agricultural cooperative

An agricultural cooperative is consumes' cooperative where farmers pool their resources in certain areas.

The first agricultural cooperatives were created in Europe in the 2nd half of 19th C. They spread later to North America and other continents. They have become one of the tools of agricultural development in underdeveloped countries.

Agricultural cooperatives in Ethiopia, for instance, are being transformed into dynamic agribusiness enterprises. The Ethiopian government has also embarked upon an aggressive program of economic and political liberalization, including steps to promote the development of democratic, free-market oriented, and professionally managed agricultural cooperatives.

With such reorientation and development, agricultural cooperatives have flourished and a case in point is the Oromia Coffee Farmers' union which was established in 1998 with the aid of Agricultural Cooperatives Development International and Volunteers in Overseas Cooperative Assistance (ACDI/VOCA) an international development organization based in Washington, DC in the United State which aims at achieving economic growth in developing countries via community development, enterprise development, financial services and agribusiness systems.

Agricultural cooperatives are typically classified according to the three major functions they perform: marketing, supply, and service.

Marketing cooperatives help to sell their members' farm products and maximize the return that they receive for these goods. Marketing cooperatives can serve their members in many ways including bargaining for better prices, storing and selling members' grain, and processing farm products in to more consumer ready goods.

Supply cooperatives, sometimes referred as purchasing cooperatives, sell farm supplies such as seed, fertilizer, petroleum, chemicals, and farm equipment.

Service cooperatives provide various services to their members. Such services could be pesticide applications, seed cleaning, and artificial insemination. Service cooperatives also include organizations such as the Farm Credit System, a Network of Borrower Owned Lending Institutions that provide credit and other financial services to farmers.

1.5.1.8. Credit cooperatives

The main aim of these societies is to supply the monetary needs of their members and to save them from the clutches of unscrupulous money lenders. Among the credit cooperative societies, the most important are the agricultural credit societies which were created for the first time in Germany.

The agricultural credit cooperative societies give loans to their members for short or long periods, on their personal security on a low rate of interest; and, thus, protect them from village money-lenders who charge very high interest rates. These cooperatives do not work for profits since surpluses are distributed among members as interest free loans for productive purposes which are in turn used for the general development of the community.

Besides the above forms of cooperatives, there are other types of cooperative societies, e.g. cooperative societies for running schools and libraries, cooperative societies for purchasing seeds and cattle, cooperative societies for consolidation of holdings, cooperative farming societies and so on.

Review Question

Which form cooperative society best suits the Ethiopian situation?

1.5.2. Forms of Cooperatives

Cooperatives could take different forms ranging from primary societies to leagues.

A primary society is a unit operating at grass root level. The members in primary cooperative are individuals who share common goals or aspirations.

According to Art.3 of Regulation No.106/2006, a primary cooperative society shall be established by voluntary individuals who live or work in the same profession.

A Secondary Society or Cooperative Union is a cooperative in which all the members of primary societies which aim at developing the spirit of solidarity among societies. In similar vein, the Regulation states that primary societies having similar objectives may establish a union. The

Oromia Coffee Farmers' Cooperative, the Sidama Coffee Farmers' Union, etc are good examples of unions.

Moreover, by virtue of Art.4 (2) of the Regulation No.106/2004, an individual who carries out similar activities to that of a Union and who is willing to observe the principles of the society may become a member of the Union.

A tertiary society/a federation, on the other hand, is established by Unions having similar objectives. In addition, Cooperative Societies or individuals that carry out similar activities with that of a federation may also become a member of the federation.

Primary Cooperative Societies, Unions, and Federations may establish a League that represents all cooperative societies at national level. The same has been provided for under Art.6 of the aforementioned regulation. The League which will be established shall represent all cooperative societies in Ethiopia and it shall operate throughout the territory of the country.

1.6. Principles of Cooperatives

Cooperatives are based on in-built values of self-help, self-responsibility, democracy, equality, equity and solidarity and it is in the tradition of their founders that cooperative members believe in the ethical virtues of honesty, openness, social responsibility and caring for others. The foundational principles of cooperatives are the outcomes of these values. In other words, these values underlie the principles for cooperatives, which are regarded as essential to the cooperative spirit.

These seven principles as stated on the ILO recommendation (2002) 193, are: voluntary and open membership, democratic member control, member economic participation, autonomy and independence, education, training and information, cooperation among cooperatives and concern for community. Let's discuss each of these principles one by one.

1.6.1. Voluntary and Open Membership

As this principle is anchored on volunteerism, cooperatives are voluntary organizations, open to all people able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

1.6.2. Democratic member control

Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives, members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner.

1.6.3. Member Economic Participation

Members contribute equitably to, and democratically control the capital of the cooperative. At least part of that capital is usually the common property of the cooperative.

Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible, benefiting members in proportion to their transactions with the cooperative, and supporting other activities approved by the membership.

1.6.4. Autonomy and Independence

Cooperatives are autonomous self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from internal sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

1.6.5. Education, Training and Information

Cooperatives provide education and training for their members, elected representatives, managers, and employees so that they can contribute effectively to the development of their cooperatives. They inform the general public particularly young people and opinion leaders

about the nature and benefits of cooperation. They also raise the level of literacy in the country as they could provide a wide range of education to the society.

1.6.6. Cooperation among Cooperatives

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures thereby fostering the sense of cooperation among themselves.

1.6.7. Concern for Community

Cooperatives work for the sustainable development of their communities through policies approved by their members.

More or less identical principles have been provided for under Art.5 of Proclamation No.147/1998. The Article reads:

1. Cooperative societies are voluntary organizations open to all persons able to use their service and willing to accept the responsibilities of membership without gender, social, political, racial or religious discrimination.
2. Cooperative societies are democratic organizations controlled by their members who actively participate in setting their policies and making decisions. Every member has equal voting rights and accordingly one member shall have one vote.
3. Members shall receive dividends from profit according to their share and contributions after deducting and setting aside an amount necessary for reserve and social services.
4. Cooperative societies are autonomous self-help organizations controlled by their members. If they enter into agreement with other organizations, including governments or raise capital from external sources, they shall do so on terms that ensure democratic control by their members and maintain their autonomy.
5. Cooperative societies provide education and training for their members, elected representatives; managers and employees so as to enable them contribute effectively to the development of their societies. They inform the public particularly the youth about the nature and benefit of societies.

Cooperative society work for the sustainable development of their communities through policies approved by their members.

In a nutshell, the principles of cooperatives could be summarized as: open, voluntary, and non-discriminatory membership; one member one vote; democratic management, education and training; national, regional and international cooperation; sustainable development, non-government interference; interest based on one's personal contribution not capital contribution; and self-reliance.

CHAPTER-TWO

ANALYSIS OF THE CURRENT LEGAL REGIME PERTAINING TO COOPERATIVES IN ETHIOPIA

2.1. General Overview of the Legal Regimes Applicable to Cooperatives

Currently the following laws are applicable to cooperative societies in Ethiopia at federal level: Proclamation No.147/1998(hereafter the Proclamation) as amended by Proclamation No.402/2004 whose detail, to some extent, has been worked out by regulations No.106/2004 and the Proclamation No.274/2002.

In one way or the other, all these legislations will be discussed with a major emphasis on the Proclamation No.147/1998. In addition cooperatives are regulated by their respective memorandums of associations commonly called by-laws. In cases where there are gaps in their by-laws and the laws issued to govern cooperative societies, the ordinary commercial, civil and labor laws are applicable. Let's then delve into the analysis of the Proclamation.

2.2. Goals and objectives of cooperatives

In much the same way as all other proclamations, the proclamation under scrutiny, i.e., Proclamation No. 147/1998 outlines the goals /objectives for which cooperatives may be formed under its preamble.

The proclamation aims at establishing cooperative societies which are formed by individuals on voluntary basis and who have similar needs for creating saving and mutual assistance among themselves by pooling their resources, knowledge and property, and enabling cooperative societies to actively participate in the free market economic system.

The preamble of proclamation No.274/2002 also provides that the aims of cooperative societies is to enable the rural and urban working people to solve the economic and social problems they face by themselves depending on local resources and become self-reliant by being organized as cooperative societies different in type and standard.

The preamble of proclamation 138/1978, now repealed, states the following to be the goals of cooperative societies in Ethiopia : to increase production and just distribution of goods of production and consumption; to raise the living standards of peasants, artisans and workers and to develop national economy, to combat the remnant feudalistic and capitalistic means of exploitations such as usury and laissez faire pricing to assure the broad masses the fruits of their labour according to the quantity and quality of their work, to encourage collective ownership of the means of production, to ensure the participation of the broad masses and to pool the efforts and resources of the broad masses to enable them to protect their economic, political and social rights.

Under Art.4 of Proclamation No. 147/1998, the following objectives are stated as objectives of cooperatives:

- to solve problems collectively which members cannot individually achieve;
- to achieve a better result by coordinating their knowledge, wealth and labour;
- to promote self-reliance among members;
- to collectively protect, withstand and solve economic problems;
- to improve the living standards of members by reducing production and service costs, by providing input or service at a minimum cost or by finding a better price to their products or services;
- to expand the mechanism by which technical knowledge could be put into practice ;
- to develop and promote savings and credit services;
- to minimize and reduce the individual impact of risks and uncertainties; and
- to develop the social and economic culture of the members through education and training.

A more or less similar objective has been provided for under Art.23 of the repealed Proclamation No. 138/1978.

Although, cooperatives are expected to incorporate those objectives in their by laws, they are not required to strictly fulfill all of them at a time. But all the same, the objectives for which they are established should mesh well with the guiding principles for cooperatives' operation.

Review Question

Assess the compatibility of objectives of cooperatives with the guiding principles.

2.3. Guiding Principles

In our previous discussion, we have identified core principles by which the operation of cooperative should be guided. When we come to our case, the cooperatives Proclamation describes the points discussed here above as the main goals of cooperatives(See Sec.2.2, p.42).

2.4. Prerequisites for the Formation of Cooperatives

When we talk of formation, it is quite evident that we are referring to some conditions that need to be fulfilled to create a legal entity such as cooperatives. These prerequisites are enumerated under Art.6 of the proclamation.

The first requirement relates to the number of people needed to form a cooperative. Pursuant to Art.6 (3) cum (4) of the Proclamation, a minimum of at least 10 persons are needed for the establishment of a cooperative. However, the minimum number could be modified by an appropriate authority with a view to make the society economically feasible.

The issue that readily pops up here would whether the appropriate authority could specify a number of members to be less than ten. This issue would be crystal clear when one sees the wording of Art.40 (2) of the proclamation. The sub article reads “without prejudice to Art.6 (4) hereof (emphasis added), where the number of members of a primary society falls below ten, the society could be dissolved. What one can understand from this is the society will be dissolved if the number of their members falls below ten as a result of death, withdrawal or incapacity etc but not as a result of the number of members being less than 10 by a conscious choice/ decision of the authority from the very outset.

But, when we deeply scrutinize Art.6 (4) it doesn't seem to imply that the number will be less than ten as the society will not be economically feasible with less number of members.

When you look at the minimum number of members in other countries, a minimum of at least 50 individuals are required in India to form a multi-state cooperative. Similarly, at least 15

individuals in Japan, 20 in South Korea, 25 in Nepal, and 100 in Malaysia are needed to establish cooperatives.

In our opinion the number of members in a given society should at least be greater or equal to 10 because economic feasibility has its own bearing on the number of members. If this interpretation is to be endorsed, then, the first part of Art.40 (2), i.e., “without prejudice to Article 6(4) hereof,” should be annulled and the sub article should read: “where the number of members of a primary society falls below ten.”

Review Question

Do you think the term ‘person’ in this article includes juridical persons too given the essence of cooperatives?

Another requirement relates to the composition of members. According to Art.6 (2), the law requires would-be members to either live or work together within a given area. However, this doesn’t totally exclude persons who reside outside the area where the society is to be established, as the latter could be invited into the society by way of purchasing shares from the society in cases where the society runs shortage of capital.

The rationale behind this requirement seems that people who live or work together in a given area tend to cooperate more than those who do not live or work together. In addition, it is quite understandable that people who live or work together in a given area most often face the same problem which can be fixed by themselves than by an alien.

As people who live together are also affected by the values, cultures, attitudes, challenges etc of their environment, they have a big incentive to respond to the challenges together. As such, it is imperative that those people join a hand, by way of forming a cooperative society, in order to better address their problems. Hence, that it is why, in the opinion of the writers, the law has put in place this requirement.

In fact, we are not implying that living together in a given area is a sufficient condition for cooperation as people with diverse backgrounds and ideological differences could live together in a given area. But what we are trying to say here is that people who live together in a given area stand a very good chance of cooperating and working together as it is rather very easy for them to get along with each other.

In addition to the aforementioned requirements, it is crystal clear that these persons are required to declare their intention to cooperate/work together. This intention pursuant to Art.11 (1) of the Proclamation should be manifested by an agreement which should be manifested by the by-laws/articles of associations.

The by-laws of the society, as per Art.11 (2) of the Proclamation, should in particular, contain the following:

- i. name and address of the society – According to Art.8 of the proclamation, the name of each society should be distinct from another cooperative’s name and it should be written in such a way that it contains the phrase “cooperative society and limited liability” and it should be written boldly and placed every where the society operates and written/sealed on every notices, letters, other specifications and documents signed on behalf of the society;
- ii. objectives and activities of the society in line with those mentioned under Art.4 of the Proclamation;
- iii. working place (area) of the society;
- iv. requirements necessary for membership. (see Art.13 of the Proclamation);
- v. the rights and duties of the members of the society (see Art. 14 of the proclamation);
- vi. the powers, responsibilities, and duties of management bodies (see Arts. 20 et.seq)
- vii. conditions for withdrawal or dismissal from membership (see Art.14 (1) (d) cum Art. 15 of the Proclamation.);
- viii. conditions for reelection, appointment, term of office and suspension or dismissal of members of the management committee or other management bodies (see Arts. 23 et. Seq);
- ix. condition for calling of meeting and voting of the society (see Art. 18 cum Art. 22 of the Proclamation);
- x. allocation and distribution of profit (see Art. 33 of the Proclamation);

- xi. auditing (see Art. 36 of the Proclamation);
- xii. employment of workers; and
- xiii. other particulars not contrary to this proclamation.

It should be remembered that what has been listed here above is not so exhaustive as to exclude other elements since the law has opted for an illustrative list of contents of the by-law.

One should not also forget that the by-laws are subject to amendment by the special resolution of the general assembly which is the supreme organ of the society. The appropriate authority, i.e. the Federal Cooperatives' Commission by virtue of the power entrusted to it by Art.13 (1) of Council of Ministers' Regulation No.106/2004 to provide for the establishment of the implementation of cooperative societies' proclamation and Art. 5(6) of proclamation No. 274/2002 (A Proclamation to Establish cooperatives' Commission) shall register the amendment and give evidence to the society where the amendment was made in line with the spirit of the pertinent Proclamations and regulations there under.

What the particulars of the by-laws should look like has also been provided for under Art.14 of Regulation No.106/2004. Accordingly, the by-law of a cooperative shall contain the following:

- objectives, values and principles of cooperative societies;
- administrative structure of the society;
- budget year of the society;
- manner of keeping the fund of the society and ways of its utilization;
- procedures on loans;
- procedure to be applied in the instance of withdrawal, dismissal or death of members;
- rules of procedure for the meeting of the society and notification to be given to members;
- procedures for the appointments or employment of managers and other officers of the society, their powers and duties and term of office;
- administration of employee of the society;
- matters requiring special or quorum resolutions (decisions);
- procedure to be applied in cases where the by-law of the society is amended or in cases where the society is dissolved, divided or amalgamated with other societies; and
- other appropriate particulars.

The other requirement relates to contribution. As you remember, we have discussed that cooperatives, unlike business organizations (SCs and PLCs) are not required to show a fixed amount of start up capital.

Nonetheless, this does not mean that cooperatives do not need capital as it is rather naïve to think that cooperatives can do business with no capital.

In fact, none of the currently applicable legislations directly refer to this as a primary requirement. None of them directly require cooperatives to earmark a fixed sum of capital to start work and neither should they require. But, all the same, cooperatives need to show some amount of capital that enable them run the business they are planning to do regardless of the amount.

According to Art.2 of the cooperatives societies (amendment) Proclamation No. 402/2004, any cooperative society is required to offer shares which have equal number of par values for subscription in order to raise capital needed to start its activities. Moreover, pursuant to sub-article 2 of the same Article, any cooperative society is required to collect, upon its formation, from its members at least 1/5th of the amount of the share that the General Assembly has decided to be sold.

It should also sell the rest of the unsold shares within four years time as of its establishment.

We can also discern from the reading of Art.13(2) and 14(2)(c) of the Proclamation that cooperatives need to show some capital upon registration as membership to any cooperative hinges upon the ability of the members to pay the share capital and registration fee required by the society.

The society could also sell additional shares even after collecting the entire sum subscribed by members should it need additional capital. Pursuant to Art.2 (4) of the same proclamation, the contribution could be either in cash or in kind only for the latter to be determined by the by-law of the society.

The society can also sell shares, as per Art.2 (6) of the same Proclamation, to a person who is not a member of the society when it is faced with shortage of capital.

In the opinion of the writers of this material the rationale behind the amendment of Art.16 (1) of Proclamation No.147/1998 is the fact that the Article talks about the “capital for expansion” when it does not say anything about “start-up capital”. Obviously, you cannot think about expansion capital before start-up capital. But, when you look at Art.2 of Proclamation No.402/2004, it talks about capital needed to start business. Thus, we can conclude that cooperatives need to show some amount of capital needed to start its function.

Furthermore, we can understand from the reading of Art.9 (2) (h) of Proclamation No.147/1998 that earmarking a capital (regardless of the amount) is a requirement as cooperatives not only need to have a start up capital but also they need to deposit the same in a bank account and bring a document proving the same to appropriate authority for registration. Here also the amount doesn't really matter. What matters most is that they have a capital to start functioning.

These all points, in general, are indicative of the fact that cooperatives need to have start-up capital ,regardless of the amount.

Once all these have been fulfilled, then they should seek formal registration by competent authority entrusted with the duty of effecting registration of cooperatives.

Pursuant to Art.9 (1) (2) of the Proclamation, every society shall lodge an application to appropriate authority, i.e., the cooperatives' commission or cooperative promotion bureaus and offices established in each region, for registrations together with the following particulars:

- minutes of the founders' meeting;
- the by-laws of the society in three copies;
- names, address and signature of the members;
- name, address and signature of the members of the management committee of the society;

- a detailed description which proves that the registered members of the society have met the requirements for membership in accordance with the provisions of the Proclamation and the by-laws of the society;
- name, address and signature of members of the society above primary level;
- plan of the society;
- documents showing that the amount of capital of the society and the capital has been collected and deposited in a bank account, or in a place the authority has designated if there is no bank in the area;
- the description of the land on which the society operates and ;and
- other particulars that may be specified in the regulations or directives issued for the implementation of this proclamation.

N.B. The registration of a union (composed of two or more primary societies that have similar objectives), a federation (a group of unions and cooperatives societies with similar objectives), and a league (cooperative society league of Ethiopia established at the national level) shall be effected by the Federal Cooperative Commission at the national level. The registration of primary cooperatives shall be effected by the appropriate authority as defined under Art.2 (4) of Regulation No.106/2004.

Following the application, the appropriate authority shall, pursuant to Art.9 (3) of the Proclamation shall effect the registration and issue a certificate of registration within 15 days provided that the requirements for registration have been fulfilled to the satisfaction of the authority.

In cases where the society could not meet the requirements, then the authority shall, within 15 days, issue a written explanation to the representatives of the society.

The representatives can take an appeal from the decision to the court which has jurisdiction on the decision of the appropriate authority.

The granting of a registration certificate as per Art.9 (3) of the Proclamation tantamount to the granting of legal personality as registration, according to Art.13 (2) of Regulation No. 106/2004, bestows personality upon cooperatives.

In addition, according to Art.10 (1) & (2) of the Proclamation, a society registered after having fulfilled all the requirements shall automatically become a juridical person with a limited liability as of the date of its registration. Thus, registration entitles societies to be a legal person which can sue or be sued on its own name and which shall not be liable beyond its total asset.

Moreover, according to the Cooperative Societies' Amendment Proclamation No. 407/2004, which adds sub articles 6 to 9 on Art 9 of the Proclamation, a cooperative society which has been legally registered pursuant to sub articles 3 of this article shall engage in any business as of the date of registration without the necessity of securing additional license.

Every society as per Art.17 of the Proclamation is also required to keep a register wherein shall be entered the name, address, occupation, age and sex of each members; the date on which he/she became a member or ceased to be a member; the amount of shares held and registration fee paid by each members; the name and address of the heir of the member; and any other particulars that may be specified in the by-laws of the society.

Review Question

What do you understand from the reading of the 2nd limb of Art.9 (4) of Proclamation No. 147/1998 in particular the phrase "... to high court..."? Can we say this phrase is meant to prohibit the representatives from bringing their appeal to any other court than the high court? What do you make of the reading of Art.9 (9) (as amended) which in its relevant part states "... to the higher court (emphasis added) which has jurisdiction ..."

The entire text of the Article reads: "when the appropriate authority rejects the application for the registration of a society, it shall give a written explanation to the representatives of the society within 15 days. The representatives may appeal to the high court (emphasis added) which has jurisdiction on the decision of the appropriate authority."

2.5. Right and Duties of Members of a Cooperative Society

Before we venture into the discussion of the rights and duties of members, it is of prime importance to know what is required from anyone who wants to become a member.

Pursuant to Art.13 of Proclamation No.147/1998, in order for someone to become a member of a given society, he/she should:

- attain the age of 14;
- be able to pay the share capital and registration fee required by the society;
- show willingness to implement his obligation and observe the objectives and by-laws of the society;
- fulfill other requirements which may be specified in the regulations and directives issued for the implementation of this proclamation;
- get registered with appropriate authority if it is a society above the primary society.

As long as someone has met the aforementioned requirements, he/she is entitled to the following rights and duties as provided for under Arts.14 (1) (a-d) and 14(2) (a-d) respectively.

2.5.1. Rights

Members are entitled to the following rights:

- the right to obtain services and benefits according to his/her participation not according to/ in proportion to his/her share in the society;
- the right to participate in the meetings of the society and to vote (see Art. 18 of the Proclamation);
- the right to elect and be elected;
- the right to withdraw from the society on request with payment of benefits ;and
- the right to hold up to 10% of the total paid up share capital of the society.

2.5.2 Duties

Members are duty-bound:

- to respect the by-laws, directives and decisions of the society;

- to perform those activities which ought to be performed in accordance with the by-laws and directives of the society;
- to pay for share of capital and registration fee; and
- to protect the common property of the society.

There are also conditions under which an individual may cease to be a member of a cooperative society, Viz., dismissal as a result of failure to discharge one's obligation or as a result of commission of fault, withdrawal from membership and death of a member.

As to dismissal, a member could be dismissed on the ground of failure to meet one's obligation. These could be failure to pay fully for the shares within a period specified, failure to discharge the task assigned to him/her for more than two times, failure to participate for a year in any transaction or services rendered by the society, and failure to participate in two consecutive regular meetings of the society without sufficient reason.

A member could also be dismissed on the ground of fault when he/she has intentionally caused harm or caused to have harmed the properties of the society, misappropriate the properties of the society or facilitate the conditions for the same to happen, bribed somebody or been bribed by somebody in the name of the society, sold or caused to be sold under price or bought or caused to be bought over the price of the society with a view to derive unlawful advantage, and reduced the amount or the quality of the produces or service that the society supplies.

With regard to withdrawal, a member may voluntarily quit his/her membership by either transferring his/her share (see Art.19 of the Proclamation) or abandoning his/her membership interest.

The death of a member can bring about the same consequences. On the death of a member of a primary society, his/her share or benefit shall be transferred to one of his/her heirs designated as such in the register of society or failing such designation to his legal heir at law and where such heir is a member or is willing to be a member. Where such heir is not a member or does not

wish to become a member or is not admitted as a member, he/she shall be paid the value of the share or benefit of the deceased member.

It is also provided under Art.19 (4) of the Proclamation that the transferee shall be paid the difference in cash should the share belonging to the deceased/transferor exceeds 10% of the total paid up share capital of such society.

The question that readily crosses anyone's mind in connection with this point is if this could occur at all as no one is allowed to hold a share exceeding 10% of the total paid up share capital of such society pursuant to Art.16(3) of the same proclamation. How do you reconcile, if possible at all, these two sub article. Art.16 (3) and Art.19 (4) of the Proclamation?

2.6 Privileges Accorded to Cooperatives

As cooperatives play an enormous role in alleviating the economic situations of their members, it is imperative that they are granted certain privileges and benefits. These privileges mainly includes tax exemption, the right to deposit valuables in government offices free of charge with the government official acting as custodian of such valuables, the preferential right to supply government offices with their produce in the allocation of fertilizer and rice distribution, use of butteries for shipment of their goods, entitlement to loans and credit line and exemption from prequalification requirements when bidding for a government project.

Most of these privileges/benefits were accorded to cooperatives under the preexisting laws. That judicial privileges were granted by way of allowing disputes between cooperative to be resolved by judicial tribunals who are elected by themselves, that their capital is protected by way of giving them priority of claims, that they were given financial benefits such as loans/credits and assistance, and that they were given tax exemption substantiates the fact that cooperatives were under the protective shield of the pre-existing governments.

Currently, also, cooperatives are given due attention in terms of protection. As such, there are two privileges accorded to societies under Proclamation No. 147/1998.

These are special and general privileges pursuant to Art.28 of the Proclamation. The law tries to protect the integrity of the capital of the cooperative by letting all debts owed to the society to take precedence over all other debts except the debt owed to the government. Moreover, the shares/benefits of any member may be set-off for debts due to the society from such a member.

According to Art.30 (1) of the proclamation, a member in the society has the right against attachment/sale of his/her share or benefit in the society.

The law also provides for government assistance to cooperatives.

According to Art.31 of the Proclamation, cooperatives shall:

- be exempted from income tax;
- acquire land as determined by a region or a city accountable to the federal government;
- receive other assistance from the federal government or regional government or city administration accountable the federal government.

Cooperatives in Ethiopia are also provided with institutional support. The government has established a Federal Cooperative Commission by virtue of Proclamation No.274/2002 for the purpose of promoting cooperative movement, rendering man power training and conducting studies and research. The commission according to Art.5 of Proclamation No. 274/2002, in particular, is empowered to:

- formulate polices and prepare draft laws suitable for the activities and development of cooperative societies and submit the same to the government and follow up their implementation;
- encourage that the organization of cooperative socialites be in accordance with cooperatives Proclamation No. 147/1998 and in line with the international principles – cooperatives’ organization;
- direct and supervise cooperatives’ training institute to be set up at federal level;
- undertake research and study to promote traditional and local self-help associations to modern cooperative societies, and it shall make known and disseminate the results of the study and follows up the implementation thereof;

- make that the values, principles, organization, and benefits of the cooperatives be further known by the society and educational establishments;
- organize, register, and issue of the legal personality to the cooperative society to be organized at federal level, and the cooperative societies to be established by:
 - i) two or more primary societies found in different regions, and unable to be organized at regional level due to their peculiar nature, or ii) regional cooperative societies found in two or more regions, iii) the union cooperative societies organized same way as those under above or by the union of different cooperative societies organized same way as those under ii) above;
- audit and inspect the accounts of cooperative societies to be set up at federal level and assign a liquidator, cancel them from its record when dissolved and provide uniform standards of accounting and audit for cooperative societies throughout the country;
- promote the product of the cooperative societies so that they may find market and facilitate conditions in order to bring consumers and producers to direct communication in the home market;
- provide professional and technical support to process agricultural products of the cooperative societies to industrial products so that they will have better added-value and to develop artisans products;
- provide professional assistance to create the organization of cooperatives based on the culture and experiences of pastoralists and which enables them to improve their living conditions;
- facilitate, in cooperation with regions as may be necessary, means to provide support for societies by studying and preparing projects suitable for the development of cooperative societies;
- facilitate conditions to enable the cooperative societies in different regions to exchange their products and information about the market, and share experiences with one another;
- provide technical and professional assistance with one another;
- provide technical and professional assistance for the bureaus and cooperative societies to be set up in the regions;
- establish relationship with concerned local and international organizations in order to expediate the progress and the activities of the cooperative societies;

- submit report on its performance to the concerned government organ;
- own property, enter in to contracts, sue and be sued in its own name; and
- carry out other duties helpful for the implementation of its objects.

The national regional states have also established offices for the purpose of registering cooperatives and providing them with the necessary technical assistance.

Review Questions

What do you think is the rationale behind granting all those privileges to cooperatives? Why should government single out cooperatives and provide them with those assistances? Does not that affect the competitive advantage of those which do businesses in forms other than cooperative societies?

Do you think the non-profit dimension of cooperatives justify the support? Can we conclude that government conceives cooperative societies as a mode of mobilizing the poor for economic development? Can still sill justify the extensiveness of the support?

CHAPTER-THREE

MANAGEMENT, AUDIT AND/OR INSPECTION, LIQUIDATION AND WINDING-UP OF COOPERATIVES

3.1. Management of Cooperatives

The management organs of cooperatives under the current proclamation include the General Assembly, management committees, control committee and other standing or ad hoc committee. The day to day affairs of a cooperative society can be taken care of by managers and other employees hired on the basis of the labour laws of the country.

3.1.1. The General Assembly

The General Assembly according to Art.20 & 21 of the Proclamation is the supreme organ of the society entrusted with the following powers and duties:

- to pass decisions after evaluating the general activities of the society;
- to approve and amend the by-laws and internal regulations of the society;
- to elect and dismiss the members of the management committee, control committee and when necessary the members of other sub-committees;
- to determine the amount of shares of the society;
- to decide on how the annual net profit of the society is distributed;
- to give decision on the audit report;
- to hear work reports and give proper decision;
- to decide that a society either be amalgamated with another society or be divided in pursuance of this proclamation;
- to approve the annual work plan and budget;
- to decide any issue submitted by the management committee and other committees; and
- to decide on the dissolution of the society after hearing the audit report. (see Art.6(4) of proclamation No.407/2002)

The General Assembly is so important to a society as the destiny of the society falls in its hands.

Pursuant to Art.22 of the Proclamation cum Art.20-23 of Regulation No.106/2004, the General Assembly shall meet at least once in a year. If the management committee or one-third of the members of the general assembly require a meeting to be called, an emergency meeting may be held by giving 15 days prior notice. Where the management committee fails to call an emergency general assembly, such meeting shall be called by the appropriate authority and shall in such cases be deemed to have been called by the management committee.

There shall be a quorum where more than half members of the general assembly are present. Where there is no quorum for the general assembly called, the second general assembly shall be called within 15 days as of the date of the first general assembly. Where there is no quorum for the general assembly called for the second time, the meeting shall be convened by members present. The decision passed by the general assembly, which is convened in a situation where there is no quorum shall be deemed to have been made in the presence of all members. Where there is no quorum in an emergency meeting called, the management committees shall call the second emergency meeting within 15 days as of the date of the first meeting. There shall also be a quorum where two-third of members of the general assembly is also present.

The call shall be made by the management committee 15 days before the emergency meeting is convened through a news paper having nation-wide circulation or using any means found convenient. Pursuant to Art.23 of the Proclamation, decision of the regular or emergency meeting shall be passed by a majority vote and the chairperson of the general assembly shall make a casting vote in cases of a tie.

3.1.2. Management Committee

According to Art.23 of the Proclamation, every society shall have a Management Committee to be elected pursuant to the by-laws of the society and accountable to the General Assembly.

As to their tenure, no member of the Management Committee shall hold office for more than three years and no member shall be elected for more than two consecutive terms. In fact, the general assembly can dismiss the management committee at any time.

On the other hand, it is incumbent upon the management committee members to submit for inspection all the activity they have performed during their term of office should the member decide to leave his/her office.

Moreover, pursuant to Art.24 of the Proclamation, the management committee's powers and duties shall be determined by the by-laws of the community and it shall, in particular, include the following:

- to maintain the minutes of the meeting in writing;
- to maintain the documents and books of accounts of the society;
- to prepare the annual work program of the society and implement the same up on approval;
- to call the General Assembly for meeting in accordance with the by-laws of the society;
- to execute such other decisions given by the General Assembly and;
- submit reports to the General Assembly on the activities of the society.

3.1.3. Control Committee

Every society shall, according to Art. 25 of the Proclamation have a control committee which is accountable to the General Assembly and the number of which shall be specified by the by-laws of the society. In much the same way as the management committee members, control committee members can hold office for more than three years and more than two consecutive terms. Any member could be dismissed by the General Assembly any time before the lapse of their term of office.

The control committee shall, among other things:

- follows up that the management committee is carrying out its responsibilities properly;
- follows up that the funds and property of the society is properly utilized;
- controls that the various activities of the society are carried out pursuant to the by-laws and internal regulations of the society; and
- performs other duties assigned to it by the general assembly.

The law also provides for the establishment of other sub-committees pursuant to the by-laws of the society, if need be.

Review Question

How do you rate the importance of all these organs?

3.2. Assets and Funds of a Society

As with any business start-up, financing a cooperative can be challenging as it often involves accessing capital from several sources which could prove very tough.

Cooperatives can raise capital through equity or debt financing. They can choose to incorporate either “with share capital” which allows a cooperative to raise capital by selling shares as well as using debt instrument such as debentures. A cooperative that incorporate “without share capital” can only raise capital through debt financing and may not issue shares.

In our case too, cooperatives can raise capital through equity or debt financing. But pursuant to Art.34 of the Proclamation, they can receive loans from their members or other organizations to such an extent and on such conditions as may be specified in the by-laws of the society. The interest paid on such loans can't, however, exceed the current interest rate of a bank.

In addition, the society should pursuant to Art.33(1) of the Proclamation deduct 30% of the net profit and allocate the same for the purpose of expanding their work or for social purposes or for reserve fund. The reserve fund shall be deposited only until it shall not exceed 30% of the capital of the society.

Pursuant to Art.25 of Regulation No.106/2004 cum Art.32 of Proclamation No.147/1998, the asset of a society which is registered as a reserve fund or which is obtained through donation or inheritance shall remain indivisible and common asset of the society.

Once the amount earmarked for reserve, expansion and society services have been deducted, the remaining net profit shall according to Art.33 (2) of the Proclamation, be divided among the members and the division shall be made on the basis of the shares the members have in the society (emphasis added) and on the amount of goods offered for sale to the society or goods purchased from the society by the members of the society.

The Question here would, then be: if members are being given that proportion of the net profit commensurate to their share capital, how are they any different from shareholders of business organizations? Does it, at all, go in line with the nature of cooperatives as profits in cooperative societies are returned to members in the form of patronage refunds i.e., amounts received by a cooperative patron at the end of the year on the basis of his/her use of the cooperative not on the basis of his/her investment or ownership share in the cooperative?

Fortunately however, this very sub-article has been repealed and the amendment Proclamation No.402/2004 provides for the distribution of the profit to be determined by the General Assembly. But, then, this proclamation does not say any thing about how the distribution of the net profit is to be effected as it simply mandates the general assembly.

Nonetheless, this very Article is superfluous as the general assembly had already been given the mandate by virtue of Art.21 (5) of Proclamation No.147/1998. So, the issue still remains lingering.

3.3. Audit and Inspection of Asset of Cooperative Societies

In order for cooperatives to be able to maintain the integrity of their capital and ensure their own sustainable existence, the law tries to put in place some kind of control and checking mechanism. This is done by way of subjecting cooperatives to submit themselves to audit and inspection by responsible body, i.e., the Cooperatives' Commission.

According to Art.7 of the Proclamation No. 274/2002, the commission is vested with the power to audit and inspect the accounts of cooperative societies. In similar vein, the cooperatives proclamation also mandates the commission to audit or cause to be audited by a person it assigns the accounts of the society at least once in a year. The audit shall, pursuant to Art.36 of the Proclamation, include the examination and verification of overdue debts, if any, and cash balance, securities, assets, and liabilities. The audit report should also be submitted to the General Assembly.

The commission is also mandated to make or cause to be made by a person it assigns an inspection to the organization, work execution, documents and financial conditions of the society. According to Art.37 of the Proclamation an inspection could be made when a majority of the members of the executive committee request or not less than one third of the total numbers of the society requests.

Following the audit and inspection, the person in charge of audit and inspection should keep the results in the office of the authority and the society shall keep the report in a manner open and accessible to everyone.

Review Question

What is the rationale behind keeping the results open and accessible to everyone?

According to Art.39 of the proclamation the person in charge of auditing/inspection has the obligation to report to the management committee or general assembly or the appropriate authority where the person who is or was entrusted with the management of the society or who is or has been an officer or an employee of the society, and who in the course of an audit or inspection had made payments contrary to this proclamation, regulations or the by-laws of the society, or has caused any damages to the assets of the society by breach of trust willfully or negligently, and has misappropriated the properties of the society.

After the report has been received, the authority shall give the person responsible an opportunity to present his/her defense within fifteen days. If the person alleged to have committed the working fails to refute the allegation brought against him/her, the authority shall ask him to return or pay the sum he/she has misappropriated with interest including compensation and damage. Where this could not be met by the person responsible, the authority shall take appropriate legal measures.

Review Question

What does the phrase "... appropriate legal measures ..." in sub Article 3 of Art. 39 of the Proclamation connote? Is it meant to refer to civil action or criminal action? What if the person

who has been found responsible for misappropriation decides to pay back the sum misappropriated with interest thereon? Can this prevent criminal action?

3.4. Dissolution and Winding-up of a Cooperative Society

As much as registration gives life to cooperatives, dissolution and winding-up takes their life. As you well remember from our previous discussion, once cooperatives are registered having fulfilled all the requirements, they will automatically become legal entities with all attributes of personality. Once a society is dissolved, however, it will no longer exist as a legal entity.

When we come to the causes for the dissolution of cooperatives, the law provides for grounds that justify the dissolution. Accordingly, pursuant to Art.40 (1) & (2) cum Art.6 of the cooperative societies (amendment) Proclamation No.402/2004, a cooperative society shall be dissolved:

- Where a special resolution for its dissolution is given by the members; or
- Without prejudice to Article 6(4) of the Proclamation (which allows the authority to determine on the minimum number of members in order to make the society economically feasible), where the number of members of a primary society falls below ten;
- Where the court decides for its dissolution, and
- Where the auditing reveals that it is bankrupt and when the appropriate authority ensure the same and the general assembly resolves in favor of dissolution.

After a decision for the dissolution has been made, the society should notify the appropriate authority within 7 days from the decision for its dissolution.

Once a decision for the dissolution has been made and the same has been communicated to the authority, the winding-up process will commence with the appointment of a liquidator by the appropriate authority. The authority, may, according to Art.41 of the Proclamation, determine that the remuneration of the liquidator be paid out of the accounts of the society.

The liquidator after appointment shall receive records, documents and properties of the society and shall take the necessary measure to protect the properties and rights, records and documents of the society from damage.

The liquidator who is in charge of the winding up proceeding shall in particular perform the following:

- Investigate all claims against the society and decide on priority of payment among them;
- Collect the assets of the society;
- Distribute the assets in accordance with the plan of liquidation approved by the general meeting of the society;
- Carry on the work activities of the society in so far as may be necessary for the proper liquidation of the affairs of the society;
- Represent the society in legal proceedings;
- Call meetings of the members as may be necessary for the proper conduct of the liquidation and;
- Issue notice in a newspaper that the society is dissolved and proceed with the distribution where no claim is presented within two months from the date of such notice.

N.B. this is an absolute period of limitation as no claimant shall have a right after the expiration of such limit? But, do you think it should be so absolute as to prohibit creditors to bring an action after the lapse of two months even when it is not their fault?

- Pay creditors their share on the basis of balance sheet he/she prepares upon commencement of his/her assignment;
- After making sure that all the claims have been met or verified that sufficient deposit for payment has been made, he/she may distribute the assets of the society among the members based on the amount due to them and;
- Upon completion of the winding up proceeding, the liquidator shall prepare and submit a report to the appropriate authority and he/she shall deposit the records and documents of the society in such places as the appropriate authority may direct.

Finally, when the winding up proceeding is completed, the certificate of registration shall be, according to Art.45 of Proclamation No.147/1998, returned to the appropriate authority who shall cancel the registration of the society, and the society shall, upon the date of such cancellation, cease to exist.

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