Industrial Policy and Development in Ethiopia: Evolution and Current Performance

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Introduction

- Revival of interest in industrial policy among academics (e.g. Rodrik, 2004; Hausmann and Rodrik, 2006; Cimoli et al., 2010; Lin and Chang, 2009, Lin and Monga, 2011)
- Controversies still remain
  - Functional versus selective intervention
  - Comparative advantage following versus Comparative advantage defying (e.g. Lin and Chang, 2009)
  - The nature of state and business relationships (e.g. Hausmann and Rodrik, 2006)
- Also renewed interest and reintroduction of industrial policy in many developing countries (e.g. Africa)
- Yet, little systematic evidence on the process and outcome of recent attempts to reintroduce industrial policy in Africa

- The aim of this study is to examine the **choices, implementation process,** and **outcome** of the Ethiopian recent industrial policy
  - Ethiopia is one of the few African countries that have formulated and implemented a full-fledged industrial policy (IDS) since the early 2000s
  - Gov't has shown extraordinary commitment & ownership.

    (implementing through subsequent development plans and various sub-sector strategies)
  - The outcomes so far are appear to be mixed

Table 1: Ethiopia vrs. sub-Saharan Africa (SSA) average

	GDP growth (annual %)		Industry (annual % growth)		Manufacturing (annual % growth)	
year	Ethiopia	SSA avg.	Ethiopia	SSA avg.	Ethiopia	SSA avg.
Average						
2001-2011	**8.4**	**4.7**	**9.1**	**4.2**	**7.3**	**3.1**
2004-2011	**10.6**	**5.1**	**10.0**	**4.3**	**9.4**	**3.6**

	Industry, value added (% of GDP)		Manufacturing, value added (% of GDP)		Manufactures exports (% of merchandise exports)	
	Ethiopia	SSA	Ethiopia	SSA	Ethiopia	SSA
2003	14	29.9	5.45	13.7	11.4	33.8
2010	13	29.8	4.90	12.4	8.9	30.7

Evolution: Industrial policy & development

- In Ethiopia, modern manufacturing factories emerged in 1920s (As of 1927 about 25 were set up mostly by foreigners)
- the sector started to get momentum in the 1950s (after brief disruption in the WWII period)
- The 1950s also marked by start of a comprehensive plan to promote the country's industrial & economic development
- Ethiopia has seen three regimes over the last eight decades
  - Imperial regime (up to 1974)
  - Dergue regime (1974-91)
  - EPRDF-led regime (since 1991)
- Successive regimes adopted different policies for the development of industry

The imperial regime (up to 1974)

- Between 1958-73 three successive development plans were implemented
- The implementation of the initiatives attracted foreign investors and boost the manufacturing sector (World Bank, 1985). But by the end of the Imperial regime ...
  - The overall industrial base was weak
  - The manufacturing sector characterized by dual structure
  - The modern sector constituted few hundreds of factories employing no more than 60,000 people
    - And dominated by import substituting light industries and foreign ownership

The Dergue regime (1974 to 1991)

- No specific industrial policy per se until mid-1980s, but
  - nationalized most of the MLSM enterprises
  - declared “a socialist economic policy’
  - put various restrictions on the private sector & market
  - Nationalized enterprises SOEs reorganized under state corporations

  → The manufacturing sector shrunk and the private sector virtually reduced into micro & small manufacturing activity
- Ten Year Perspective Plan 1984/85-1993/94
  - Public investment program an indicative portfolio of projects and production targets

The EPRDF-led government (since 1991)

- The first decade (1991-99) marked by various reforms reversing the command economy
    - Implemented three phases of IMF/WB sponsored reform programs
    - In 1998 government adopted Export Promotion Strategy
- A full-fledged Industrial Development Strategy (IDS) was formulated in 2002/03
    - Concretized into action by various sub-sector strategies and by the successive development plans such as;
        - Sustainable Development and Poverty Reduction Program (SDPRP) 2002/03-2004/05 and
        - the Plan of Action for Sustainable Development and Eradication of Poverty (PASDEP) 2005/06-2009/10.
        - The Growth and Transformation Plan (GTP) 2010/11-15/16

Table 2: The Ethiopian industrial policy and development phases

	Imperial period (pre-1974)	The Dergue regime (1975-91)	The EPRDF regime (post 1992)
Guiding policy/vision	Market oriented	Command economy	Market oriented
Public/private role	Private-led	State-led	Private-led but also strong state
Ownership structure	Dominance of foreign owned enterprises	Dominance of public owned enterprise	Dominance of domestic private owned enterprises
Target industries	Import substituting and labor intensive industries (e.g. Textile, food, cement)	Import substituting and labor intensive industries but also basic industries	Export oriented & labor intensive industries (e.g. Textile, leather, agro-processing, cement)
Envisaged key player	foreign investment	Public sector investment	Domestic private sector
Policy instruments	Protection of domestic market through high tariff and banning of certain imports Provision of economic incentives & preferential credit scheme	Protection of domestic market through high tariff and quantitative restrictions Financing, subsidizing, ensuring monopoly power for the SOEs	Direct support for selected export sectors through capacity building and other means Provision of economic incentives & preferential credit scheme

Fig. 1: Growth in GDP, Industry and manufacturing value added (Ethiopia, 1982-2010)

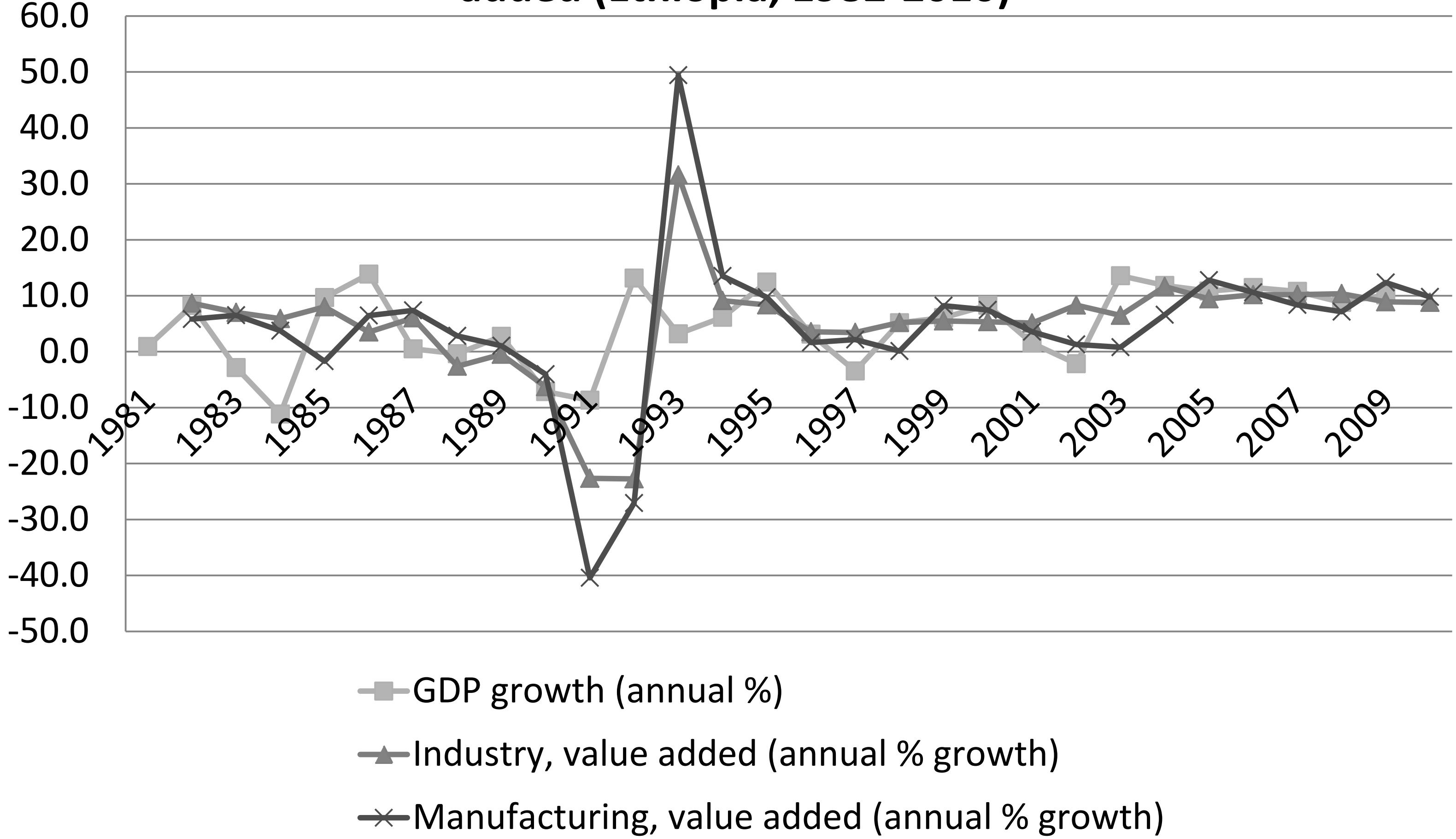


Table 3: Entry process, ownership, and average size in the MLSM

	Number of establishments		Employment		
year	Total	Public share (%)	Total ('000s)	Public share (%)	Total average size
	(1)	(2)	(3)	(4)	(5=3/1)
1979/80	351	45.3	76.63	88.85	218.3
1985/86	369	48.8	90.85	93.33	246.2
1990/91	275	52.4	84.00	93.08	305.5
1995/96	627	25.7	90.04	86.25	143.6
1999/00	788	15.5	95.71	56.13	121.5
2004/05	1207	10.4	110.16	48.70	91.3
2009/10	2172	6.4	186.80	25.67	86.0

-high entry – more than doubled in the last decade alone

-shrinking public share

-declining average size

-suggests most entrants are private owned and small in size

Table 2: Manufacturing size distribution (2007/08)

Firm size category by employees	Number of establishments: number	Number of establishments: Share (%)	employment: number	employment: Share (%)	Value added: Millions Birr	Value added: Share (%)	fixed capital per labor (000's Birr)	Value added per labor ('000s Birr)	TFP
Micro (< 10)	43,338	95.7	138,951	51.0	1,140	11.0	7.3	8.20	
small (10-19)	846	1.9	10,690	3.9	186	1.8	22.9	10.84	0.86
medium (20-49)	519	1.1	14,757	5.4	401	3.9	47.6	21.63	0.97
Large (>= 50)	565	1.2	108,226	39.7	8,590	83.3	70.0	42.59	1.18
Total	45,268	100	272,624	100	10,317	100			

The present industrial policy (IDS) principles and practices

The IDS principles

- The IDS is based on a broader development vision - ADLI
  - The philosophy of ADLI is that agriculture development plays a leading role in the industrialization process by preparing various conditions for full-fledged industrialization
  - → **Primary principle** of IDS is the **linkage** b/n industry & agriculture
- Other principles
  - **Export oriented** sectors should lead the industrial development and be given priority
  - **Labor intensive** sectors also be given priority to maximize employment
  - **Public-private partnership** – gov’t not merely as a facilitator but also as a leadership
    - Recognizes the private sector as engine of growth but makes distinction between ‘rent seeking’ and ‘developmental’ capitalists

Mechanisms of engagement

- Mechanisms of engagement with the private sector
  (1) Creating conducive environment
  (2) Direct support for selected sectors
- The IDS identified a number of concrete intervention areas to **create conducive business** environment
  - maintaining macroeconomic stability
  - building a functioning and well-regulated financial sector
  - creating dependable infrastructure services;
  - developing skilled and effective human resource;
  - creating efficient civil service and legal framework;
  - developing industrial zones in major cities and towns with all required infrastructure facilities

Macro (in)stability

year	Min. deposit rate	lending rate min-max	inflation rate	Real interest rate[1]	Real effective exchange rate
1999/00	6	10.5-13.5	5.4	3.8	100.0
2000/01	6	10.5-15	-0.3	17.6	93.9
2001/02	3	8-10.5	-10.6	12.7	91.1
2002/03	3	8-10.5	10.9	-5.1	104.1
2003/04	3	7-10.5	7.3	3.0	105.8
2004/05	3	7-14	6.1	-2.6	100.4
2005/06	3	7-14	10.6	-4.1	109.9
2006/07	4	7-14	15.8	-8.3	129.6
2007/08	4	8-15	25.3	-17.1	145.6
2008/09	4	8-16.5	36.4		197.3
2009/10	4	12.25	2.8		151.8

- Gov't envisaged single digit inflation – but high since 2005/06
- Low interest rate – virtually negative real interest rate
- REER appreciated by 52% b/n 2004/05-2009/10 → undermining competitiveness

Institutional and regulatory reforms

- Ethiopia implemented a wide range of institutional reforms since the early 2000s
  - established competition policy
  - Revision of business registration
  - revision to the investment code,
  - modernizing the tax regime and introduced value-added tax (VAT),
  - Partially reforming the customs administration
  - Established public-private consultative forums
- Civil Service Reform Program (CSRP) a key initiative
  - Service Delivery Improvement Policy (PSIP) was key component and was introduced in priority Ministries and agencies that interface directly with the private sector
  - It promoted Business Process Engineering (BPR) as management initiative

  → Service delivery substantially improved

Table 5: Trends in the Doing Business Rankings: Ethiopia

Indicators	Time Period				
	2008	2009	2010	2011	2012
Ease of Doing Business					
Ease of Doing Business – Rank (1, 183 worst)	116	107	104	111	127
Doing Business - Starting a Business – rank	118	93	89	99	163
Doing Business - Closing a Business – rank	74	77	82	89	117
Doing Business - Enforcing Contracts – rank	78	57	57	57	50
Trading Across Borders - Doing Business (1, 155 worst)					
DB - Trading across borders rank	152	159	157	157	161
DB - No. of documents for export	8	8	8	7	7
DB - Days for export	46	49	44	42	42
DB - Cost to export (US$ per container)	2087	1,940	1890	1760	2160

Some reversals in reforms and ranking

- The post-2010 fall in the country ranking of doing business is mainly associated with the gov't recent moves to introduce and enforce a number of erratic regulations
- Foreign exchange shortages
    → gov't shutdown 94 warehouse of coffee exporters
- Soaring inflation
    → futile effort through price caps
    → revised the business registration (reduce monopoly in imports)
- Similar actions in relation to land and customs administrations
- Starting 2011 private banks are forced to purchase NBE bonds with 27% of their lendable capital to finance massive public investments
  →Leading to crowding out of the private sector
- Reducing confidence and policy predictability

Sectoral policies

- The 2003 IDS declared priority sectors for government direct support
  - textile and garment;
  - meat, leather and leather products;
  - other agro-processing industries (e.g. sugar and sugar related industries),
  - construction
  - micro and small enterprises (MSEs)
- The list of priority sectors has been updated through time.
  - the flower industry and some import substituting industries (such as metal and engineering, chemical and pharmaceutical) were sequentially added

Sectoral policies cont.

- Targets and accompanying government supports were explicitly stated in the country five-year development plans
- Government provided extensive support largely directed at the exporting firms and industries
  - economic incentives,
  - capacity building,
  - cluster development and
  - direct public investment
- National Export Development Committee, chaired by the Prime Minster sets export and productivity targets

Direct support in practice: three industry cases

- The **textile and leather** (hereafter, T&L) industries are the two most preferred export industries that received enduring attention of the Ethiopian policy makers
- The **flower industry** emerged spontaneously but with the full support of the government it became successful and a celebrated export industry

The T&L industries

- Government set ambitious targets for the T&L sectors each to generate US$ 500 million by the end of 2009/10
- In the textile sector
  - massive investment from the private sector worth of US$ 1.6 billion was envisaged
  - It was also planned to create self-sufficiency in fabrics
  - the government planned to invest directly in the textile sector including through joint venture with foreign investors.
- The leather sector
  - The main direction of the leather industry plan was to change the mix of exports toward processed and finished goods.
  - it was planned to upgrade the capacity of tanneries and the finished products to produce finished leather products
    - Discouraging H&S export imposing above 150% tax

T&L cont.

- Government made sector specific capacity building efforts in addition to the general support programs given to all exporters.
- Two sector specific institutions were setup to support, coordinate and guide the private sector in the T&L sectors;
  - Textile Industry Development Institute (TIDI) and
  - Leather Industry Development Institute (LIDI)
- Sector special training centers were established under them
  - Ethiopian Leather and Leather Products Technology Institute (ELLPTI)
  - Textile and Apparel Institute (TAI) were also established
- Various additional support programs was introduced to improve the international competitiveness of these industries such as;
  - benchmarking,
  - institutional twining,
  - marketing search, and
  - kaizen

Export performance indicators (T&L)

- Export performance of the T&L unsatisfactory
- By the end of the PASDEP period the actual exports were;
  - Textiles only 8% of the USD 500 target
  - H&L 23% of USD 273 million target
  - Other leather products 3.7% of USD 227 million target
- Comparing with the base year 2004/05 the growth of textile exports was in fact impressive
  - four fold up to 2010 and even further by 2011
- A recent study on the light manufacturing in Ethiopia (Dinh, et al., 2012) indicate that
  - The most obstacle for the apparel sector is **poor trade logistics** and accompanied by absence of competitive input industries (textiles)
  - the most binding constraint in the leather export is the **shortage of quality processed leather**

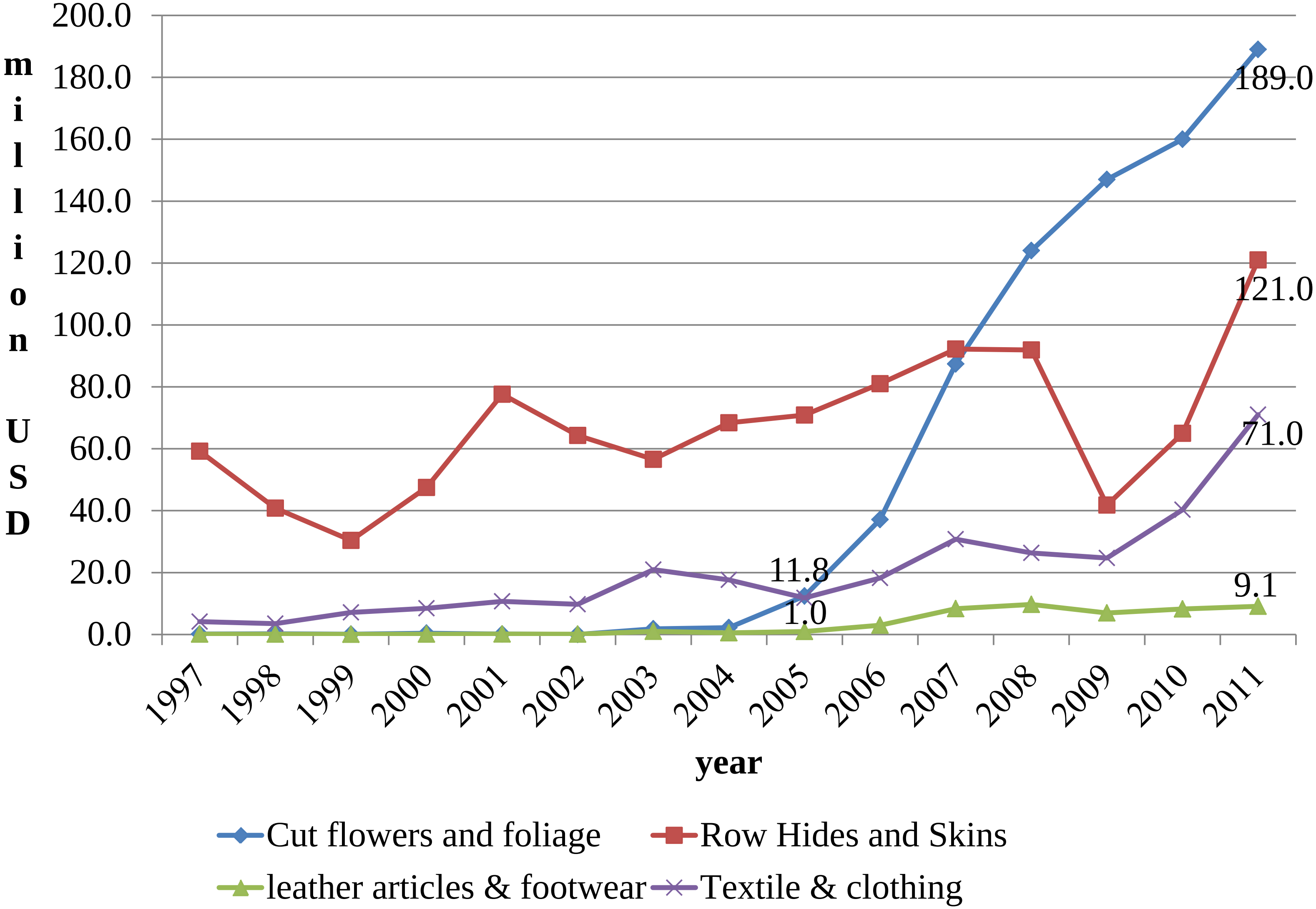
The flower industry

- The dynamics of the flower industry is different from other priority sectors
- In the mid-1990s two domestic private entrepreneurs started the experimentation
- Towards the end of 2002, the government became aware of the big opportunity through lobbying efforts of the private sector
- The gov’t decided to get engaged in promoting the sector.
  - Targets were set (1000 ha under flower production - end of five years)
  - To support the scaling-up gov’t came in with a multi-faceted support, focusing on: land, long-term credit, and air transport coordination.

The flower cont.

- The flower industry start to take-off around 2004, following the active engagement of the government
- It deomonestrated extraordinary growth and in 2008;
  - Number of farms reached 81
  - Land covered reached 1200 ha
  - Above 50,000 employment (direct)
  - The fourth foreign currency generator
  - The country became 5th largest non-EU exporter to the EU market of cut-flower
  - It became the second largest exporter in SSA, next to Kenya

Fig. 4: Ethiopia; exports of selected products 1997-2011



EMERGING AND REMAINING ISSUES

1. Are the goals yet achieved? Mixed outcome!

- Since 2003/04, GDP and all sub-sectors grew 10% or more
  - But industry contribution to GDP remain stagnant (≤14%)
- More than doubled of the country export earnings
  - But diversification mainly outside manufacturing
- High entry of firms into the manufacturing sector;
  - but new entrants mostly small → dual structure continues
  - but new entrants mostly domestic oriented → export sectors underperforming → Manufacturing contribution to merchandize export remain low (≤ 9%)
- Increasing import dependence and weak domestic linkages
  - Exports increasingly constrained by lack of quality of inputs in domestic market despite efforts to address them

- A regular review of the policies and instruments need to be instituted with the aim of identifying emerging bottlenecks.

- And more importantly policies need to be framed with a view of addressing constraints along the whole **value chain and also horizontal linkages**

2. Choice of champion activities/products

- Why has the flower industry has been successful but not the T&L industries that received the most attention long before?
- Three alternative views regarding identification of potential products
  - (i) no need for the officials to select products beforehand but create a general support mechanism in which eligible pioneer would bid and compete for it
  - (ii) government should make in depth study, select priority sectors and provide support for potential entrants
  - (iii) government might still have priority list but should be flexible enough to pick winners in the self-discovered sectors

- The Ethiopian experience supports view (iii)
- But one needs to introduce mechanism to elicit valuable information from the private sector on the potential industries through continuous consultations (Hausman and Rodrik, 2003)
  - Engaging into continuous experimentation for the emergence of that would be ‘champion’ export product

3. The nature of public-private partnership

- The Ethiopian industrial policy made a distinction b/n ‘developmental’ and ‘rent seeking’ private sector
  - Gov’t provides generous incentives and support programs to build the private sector capacity (**carrots**)
  - At times (particularly recently) it has introduced a number of measures (**sticks**) alleging to ‘discipline’ the ‘rouge’ private sector → increasing tension and policy uncertainties around the private sector.
- Yet a number of issues arise regarding the effectiveness of the instruments
  - How much rent and how long should the private sector in the selected sectors be given to bear fruits?
  - What form of relationship should be instituted between the government and the private sector?
  - How do you create an environment that maximize the social benefits and limit rent-seeking?

The nature cont.

- There are critics that the instruments (carrot and stick) are not transparent and the policy makers tend to ‘patronize’ the private sector instead of encouraging competition & innovation
- There is also emerging concern that the public investment expansion is dwarfing the private sector (e.g. credit & foreign exchange availability)
  - *“the public investment rate of Ethiopia is the third highest in the world, while the private investment rate is the sixth lowest.”* World Bank 2013
- Vibrant private sector is critical for the effectiveness of industrial policy, thus, the gov’t need to address the above and other emerging issues

THANK YOU FOR YOUR ATTENTION!!