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

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP growth (annual %)</th>
<th>Industry (annual % growth)</th>
<th>Manufacturing (annual % growth)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001-2011</td>
<td>8.4</td>
<td>4.7</td>
<td>9.1</td>
</tr>
<tr>
<td>2004-2011</td>
<td>10.6</td>
<td>5.1</td>
<td>10.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Industry, value added (% of GDP)</th>
<th>Manufacturing, value added (% of GDP)</th>
<th>Manufactures exports (% of merchandise exports)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Ethiopia</td>
<td>SSA</td>
<td>Ethiopia</td>
</tr>
<tr>
<td>2003</td>
<td>14</td>
<td>29.9</td>
<td>5.45</td>
</tr>
<tr>
<td>2010</td>
<td>13</td>
<td>29.8</td>
<td>4.90</td>
</tr>
</tbody>
</table>
Evolution: Industrial policy & development

- In Ethiopia, modern manufacturing factories emerged in the 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 Growth and Transformation Plan (GTP) 2010/11-15/16
<table>
<thead>
<tr>
<th></th>
<th>Imperial period (pre-1974)</th>
<th>The Dergue regime (1975-91)</th>
<th>The EPRDF regime (post 1992)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guiding policy/vision</td>
<td>Market oriented</td>
<td>Command economy</td>
<td>Market oriented</td>
</tr>
<tr>
<td>Public/private role</td>
<td>Private-led</td>
<td>State-led</td>
<td>Private-led but also strong state</td>
</tr>
<tr>
<td>Ownership structure</td>
<td>Dominance of foreign owned enterprises</td>
<td>Dominance of public owned enterprise</td>
<td>Dominance of domestic private owned enterprises</td>
</tr>
<tr>
<td>Target industries</td>
<td>Import substituting and labor intensive industries (e.g. Textile, food, cement)</td>
<td>Import substituting and labor intensive industries but also basic industries</td>
<td>Export oriented &amp; labor intensive industries (e.g. Textile, leather, agro-processing, cement)</td>
</tr>
<tr>
<td>Envisaged key player</td>
<td>foreign investment</td>
<td>Public sector investment</td>
<td>Domestic private sector</td>
</tr>
<tr>
<td>Policy instruments</td>
<td>Protection of domestic market through high tariff and banning of certain imports</td>
<td>Protection of domestic market through high tariff and quantitative restrictions</td>
<td>Direct support for selected export sectors through capacity building and other means</td>
</tr>
<tr>
<td></td>
<td>Provision of economic incentives &amp; preferential credit scheme</td>
<td>Financing, subsidizing, ensuring monopoly power for the SOEs</td>
<td>Provision of economic incentives &amp; preferential credit scheme</td>
</tr>
</tbody>
</table>
Fig. 1: Growth in GDP, Industry and manufacturing value added (Ethiopia, 1982-2010)
Table 3: Entry process, ownership, and average size in the MLSM

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

- 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>
<thead>
<tr>
<th>Firm size category by employees</th>
<th>Number of establishments</th>
<th>employment</th>
<th>Value added</th>
<th>fixed capital per labor</th>
<th>Value added per labor</th>
<th>TFP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro (&lt; 10)</td>
<td>43,338</td>
<td>138,951</td>
<td>1,140</td>
<td>7.3</td>
<td>8.20</td>
<td></td>
</tr>
<tr>
<td>small (10-19)</td>
<td>846</td>
<td>10,690</td>
<td>186</td>
<td>22.9</td>
<td>10.84</td>
<td>0.86</td>
</tr>
<tr>
<td>medium (20-49)</td>
<td>519</td>
<td>14,757</td>
<td>401</td>
<td>47.6</td>
<td>21.63</td>
<td>0.97</td>
</tr>
<tr>
<td>Large (&gt;= 50)</td>
<td>565</td>
<td>108,226</td>
<td>8,590</td>
<td>70.0</td>
<td>42.59</td>
<td>1.18</td>
</tr>
<tr>
<td>Total</td>
<td>45,268</td>
<td>272,624</td>
<td>10,317</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>
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

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

- 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

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