INDUSTRIAL POLICY OF ETHIOPIA

A. AN OVERVIEW

- The impulse for an industrial policy in Ethiopia comes from the need to attain a high growth rate of exports.
- In turn, high growth rate of exports is required, in the first instance, to remove the threat of balance-of-payment constraint on GDP growth.
- Thus industrial policy is intended to serve fast growth of exports by supporting selected sectors/industries

OVERVIEW CONTINUED …

- The industries that would get selected:
  a) have a clear comparative advantage and can be scaled-up
  b) can acquire comparative advantage upon removal of market failures and establishment of new markets
  c) can build comparative advantage with multi-faceted government interventions

B. THE FLOWER SECTOR

1. START-UP PHASE

- Exports of cut roses commenced in 2000, with a small-scale farm established by a businessman of Indian origin based in Uganda who had no direct experience of flower production
- By 2003, there were two additional exporters, an Italian foreign investor and an Ethiopian, along with some five or six Ethiopian investors at implementation phase.
- It was quickly found out that:
  - Ethiopia was able to enter the top end of the flower market as the quality of its cut roses easily compares with the best in the world (Ecuador and Colombia),
  - Exports of flower was highly profitable.

2. INITIATIVE TO ENGAGE

- Towards the end of 2002, the government became aware of the big opportunity to replicate and scale-up production of flower and earn sizeable amount of foreign exchange from exports.

- Targets were set and decisions made to make suitable lands held by government as well as credit available to both foreign and domestic investors.

- The aim was to put 1000 ha. under production by the end of five years, looking at Kenya's output and export earning.

3. FRAMEWORK FOR SCALING-UP

- At the end of 2002, area covered under greenhouse was some 15 ha, while total area of land held by investors (not more than 10) probably did not exceed 150 ha.

- To scale-up from this base, government came in with a multi-faceted support starting from 2003, focusing on:
  a) access to land,
  b) access to long-term credit,
  c) infrastructure and
  d) air transport coordination

4. ACCESS TO LAND

- Prior to 2003, private investors were able to obtain land by only leasing it from small farmers. This was a tedious process as it requires consolidation of several small holdings.
- Starting from 2003, land held by the government was made available within the vicinity of the airport in Addis Ababa, leading to the creation of flower enterprise clusters.
- Government intervention resolved a land lease market failure which would have chocked off fast scaling-up .
- Private ownership of land would not have been the answer, either.
- Additionally, the lease price of government land is cheaper than of the small farmer.

5. ACCESS TO CREDIT

- Development Bank of Ethiopia (DBE) had long been viewed as a tool for policy-based lending. The implementation of an industrial policy provided the occasion for the pursuit of this role designated to the Bank.
- Two circumstances allowed DBE to support the flower sector. First, funds could be made available from the excess cash held by the Commercial Bank of Ethiopia (CBE), another state owned bank. Second, Ethiopia maintained a relatively low interest-rate regime compared to SSA or Least Developed Countries (LDCs).
- Access to long-term credit at affordable interest rate was thus made available.
- Arguably, the existence of a relative low interest regime is the outcome of a macro policy not to liberalize financial and foreign exchange markets.

6. INFRASTRUCTURE

- The clusters are located within the vicinity of Addis Ababa, near to the main roads. Hence the farms have easy access to roads.
- For these same reasons, the farms are reasonably well provided with electricity and telecommunication services.
- Exports of flower is an information-intensive activity, since timing is critical as the product is perishable and each enterprise carries out exports several times a year.
- Each farm has cold storage facility where flowers are stored for a short period until they are transported to the airport in Addis Ababa. To protect themselves against electricity outage, they all possess generators.

7. AIR TRANSPORT COORDINATION

- In the earlier years air space was normally available in passenger flights of Ethiopian and Lufthansa. The latter charged $1.10/kg and the former $0.85-90/kg.
- Exporters incurred loss at one time or another.
- In the following years (2004-2005) the volume of exports increased sharply. Coincidentally, the frequency of passenger flights also increased. Despite this, space availability for shipment of flower could have become more uncertain.
- Through out this period the government played an important role in bringing together exporters and EAL. It fostered closer working relationship between the two, and for EAL to nurture its cargo market taking a long-term view. However, EAL was not asked to operate at below cost recovery price.

7. AIR TRANSPORT CONTINUED …

- The exporters' association started to charter cargo flight in late 2005, and by 2008, EAL has leased two additional aircrafts (Boeing 747) for shipment of flower and vegetables.

- While it was exporters who faced problems of securing flights in earlier years, now the problem seems to have reversed, as it is EAL which seeks certainty of adequate cargo for its scheduled flights.

8. LOOKING AHEAD

- The size of the flower sector at the end of April 2008 in terms of area under cultivation and land holding of farm is as follows:

	Area under Cultivation in ha	Land holding in ha
Greenhouse flower	732	2763
Open air flower	136	239
Flower cuttings	54	304
TOTAL	**922**	**3306**

- Additional area under preparation amount to 221 ha for greenhouse flower, 21 ha for open air flower and 10 ha for flower cuttings. With these, the total area under production would soon reach 1174 ha.

8. LOOKING AHEAD CONTINUED …

- The sector is highly labor-intensive, and presently employs some 40,000 workers, mostly women.
- It accounts for about 8 per cent of the value to the merchandize exports of the country, as of 2008.
- The greater challenge in the coming years is likely to be in the area of domestic value addition.

C. LEATHER AND LEATHER PRODUCT INDUSTRY

1. Background

   a) <u>Pre-1974</u>

- Ethiopia commenced exporting raw hides and skins along with the opening-up of the economy in the 1920s.

- In the 1960's there were a handful of tanneries and mechanized footwear factories, all under the proprietorship of foreign investors.

b) 1974-91

- The tanning and footwear factories (mechanized) were nationalized.

- A large tanning factory was established by the government with a loan from Czechoslovakia, which was prepared to buy processed leather (crust and finished) for repayment purposes.

- The nationalized factories were expanded.

- Exports of raw hides and skins was prohibited, and replaced by semi-processed leather (pickled and wet blue hides and skins).

- Exports of crust and finished leather started in small quantities.

2. POST 1991 DEVELOPMENT

- anning and footwear factories expanded in size and increased in number.

	Tanneries		Footwear	
Year	No. of Plants	Expansion Projects	No. of Plants	Expansion Projects
1993	7[a]	2	4[b]	2
1999	21	8	11	12
2005	23	14	16	16
2008	23	14	17	17

a – o/w 6 were state owned

b – o/w 3 were state owned

POST 1991 DEVELOPMENT CONTINUED…..

- There were two phases of growth in the leather and leather products industry (LLPI), i.e. tanneries and footwear factories; up to 1999, in response to devaluation and liberalization and since 2000, partly in response to the industrial policy.

- Devaluation created a favourable condition for tanning, as it resulted in a huge price differential between the domestic price of raw hides and skins and export price of semi-processed leather. A similar favourable condition was also created for producers of footwear as domestic prices also increased, following price increase of imports.

POST 1991 DEVELOPMENT CONTINUED…..

- The footwear sector as a whole (including cottage industries) faced stiff competition of imports from China with cheap men's footwear during 1999-2001. The industry agitated for increase in tariff, but government stayed put. In the end, the domestic industry outcompeted imports.

- LLPI had shown that it has the potential to be a winner by the time the government selected it.

3. POLICY OBJECTIVES AND MEANS

- There are two objectives:
  a) To shift exports from pickled and wet blues to crust and finished leather
  b) To export leather footwear
- The approach is to go up the value chain through push and pull effects.
- The means are mainly:
  a) Access to unban land
  b) Access to long-term credit
  c) Benchmarking and problem identification
  d) Training
  e) Target setting

4. ACCESS TO LAND

- Taking advantage of the land tenure system in the country, the federal government established industrial zones in Addis Ababa, and the regional governments followed suit in various major towns.
- Infrastructural facilities were provided over time.
- This allowed a faster industrial growth than would have otherwise been attained through land-lease market.
- LLPI benefited from this non-specific policy.

5. ACCESS TO CREDIT

- LLPI benefited from policy-based lending through DBE.

- Given that LLPI is almost entirely under the ownership of domestic investors, access to long-term credit under favourable terms is of critical importance.

6. TRAINING

- Towards the end of 1990s a regional training institution known as “Leather and Leather Products Training Institution” was established in Addis Ababa under collaboration with donors.
- Between 2003/04 and 2007/08, the Institute provided training for about 1,730 persons, both in leather tanning and footwear production.
- Although training is subsidised, only a small portion of the trainees are sponsored by the industry, the vast majority being individually enrolled.

6. TRAINING CONTINUED ….

- Factory owners do not want to incur costs of training, in particular the monthly salary of employee, which is the biggest component, as the trained manpower would get poached by competing firms.

- Firms are, apparently, faced with a costly labour spillover effect as the turnover of skilled labour, trained at LLPTI, is reportedly high. The turnover of untrained by skilled and semi-skilled labour is also high.

- It has been found that the training offered at LLPTI needs to be better defined in terms of discipline, oriented towards practical skills, and upgraded to B.Sc. level in a few selected fields.

7. PROBLEM IDENTIFICATION AND BENCHMARKING PERFORMANCE

- The government has sought to learn about the problems faced by LLPI through formal and informal discussions with the owners of the factories, and by deploying foreign consultants to study the sector as well as selected firms.

- Tanneries are faced with three main problems:
  i) Very high prices of raw hides and skins,
  ii) Low capacity utilization, and
  iii) Deterioration of quality due to prevalence of ecto-parasite damage

- Those businesses that have added on footwear production may be able to improve their overall profit margin, and compete better for purchase of raw hides and skins.

7. PROBLEM IDENTIFICATION CONTINUED….

- But vertical integration, which is the direction being taken by firms in Ethiopia, requires more management and technical skills out of each business.
- Performance of selected footwear factories compared to international benchmark reveals that output per person ranges 16 - 33 per cent. By contrast, the level of defects in some cases was comparable. Given the natural resource advantage in the quality of Ethiopia's skins, the firms are able to compete, but with very low profit margin.
- However, there is plenty of scope to compete internationally with simple improvements in efficiency.

8. TARGET SETTING

- irms are encouraged to set ambitious targets of production and exports, and in turn government is expected to support.
- ignificant achievements have been realized particularly in

Year	Pickled and wet blue	Crust and finished leather	Leather products[a]
2003/04	97.9	Zero	2.1
2004/05	93.4	5.4	1.2
2005/06	87.2	10.1	2.7
2006/07	64.3	29.6	6.1
2007/08[b]	61.1	29.5	9.4

a – nearly all footwear

b – 10 months outcome

8. TARGET SETTING CONTINUED ….

- Value of exports, however, has not increased as much as desired; by 46.3 per cent between 2004/05 and 2007/08 compared to an 80.7 per cent rise in the total value of exports.

9. CHALLENGES

- Tanneries have to phase out exports of pickled and wet blue hides and skins, as an export tax on these will soon come to effect. Those unable to shift production towards crust and finished leather will have to sell their produce domestically.
- Substantial improvement in efficiency has to be attained in footwear production. At present export price is barely equivalent to domestic price.
- Supply of finished leather has to be increased sufficiently to sustain a fast increase in footwear production.

D. CONCLUDING REMARKS

1. Types of Industrial Policy
   - Interventions of industrial policy can range from small to medium and big. In the case of flower it could be characterised as "small" compared to "medium" for footwear.
   - In a sense the type of industrial policy that is followed is positively related to the industry's distance from comparative advantage as starting point.

CONCLUDING REMARKS CONTINUED …

2. Type of Export Market

- Exports of flower and footwear take place in a buyer-driven global markets.

- Exporters of footwear can access the market by becoming a second-tier supplier or a direct supplier to a firm that sources its purchase from producers all over the world. In either case, the Ethiopian exporters lacks information about the range of prices offered by the same buyer or other buyers.

CONCLUDING REMARKS CONTINUED …

- There is an initiation fee, as it were, to enter the footwear market.

- Exporters of flower have knowledge of the benchmark price that obtains at the auction market in Netherlands. The problem is not lack of information, but unwillingness to repatriate the entire amount of their foreign exchange earnings to Ethiopia as required by law.