

# **Assessment of the Ethiopian Investment and Export Policy**

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# **A Statement of Gratitude**

**First and foremost to**  
**National Graduate Institute for Policy Studies**  
**(GRIPS), Japan**  
**and**  
**Japan International Cooperation Agency(JICA)**  
**For**  
**Financing and Their Intellectual Leadership**

**Yet all weaknesses remain mine alone!**

# Policy Implications of Globalized Competition

1. Global competitive market dictates the parameters of competition
2. Global governance of global value chains
  - Global buyers/lead firms/: large, globally networked and hence control over global supply of commodities, **information & market concentration**, thus **market power concentration!**
  - Global buyers **dictate every term (drivers) of competition**: price, quality, standards, packing, delivery time, etc.
  - Multiple competitive drivers instead of price only imply development intervention should aim to achieve those **non-price competitiveness too**;
  - Point of development intervention should be not the firm but **the value chain!**
  - Danger of **immerization**: exporting at great subsidy and **eventual loss**

# Ethiopian Investment & Export Incentives

## 1. Investment incentives,

- a. **Exemption of import duty** highly used
- b. **Tax holidays(relief)** less used related to overall weakness in tax enforcement in the country;

## 2. **Export schemes**, (voucher, duty-drawback, bonded warehouse) have not been used, or at best used by few;

- a. Voucher scheme relatively better and improving over time, yet, the latest figure is **<20%** of exporters

<b>No</b>	<b>Incentive and Support Mechanism Types</b>	<b>Responsible institution(s) for offering and administering the service</b>	<b>Remarks</b>
1	Duty free importation of capital goods	Mol and ERCA; duty-free capital goods and spares importation,	Highly used and mostly abused
2	Personal income tax exemption for expatriates for 2 years	Mol, ERCA and beneficiary investors	Important for those who rely on foreign companies to construct, erect and operate their projects
3	Tax holidays; exemption of business income tax for 2 to 7 years	ERCA and beneficiary investors	Rarely used. Firms do not apply for such service owing to high tax evasion, unconditional reporting of loss for long period of time

<b>No</b>	<b>Incentive and Support Mechanism Types</b>	<b>Responsible institution(s) for offering and administering the service</b>	<b>Remarks</b>
4	<b>Exemptions from indirect taxes, VAT, Sur tax, Withholding and excise taxes,</b>		
5	<b>Export Promotion instruments:</b> Tax exemption on raw material used for export product <ul style="list-style-type: none"> <li>• Duty exemption</li> <li>• Duty Draw back scheme</li> <li>• Voucher scheme</li> <li>• Bonded Manufacturing warehouse scheme</li> </ul>	MOTI and custom Authority	Rarely used due to bureaucratic hurdles and huge data requirement

<b>No</b>	<b>Incentive and Support Mechanism Types</b>	<b>Responsible institution(s) for offering and administrating the service</b>	<b>Remarks</b>
6	<b>Credit facility</b> (for investment and working capital)	Development Bank; for instance 1.5 billion Birr Credit Facility with 7.5–9% interest rates, 3-year grace period, 30/70 equity/loan ratio, business itself as collateral – only 30–40% has been utilized;	Highly used but still complaints about access and credit administration
8	<b>Industry area facilitation</b> (land preparation)	Federal and Regional investment office and municipality;	Highly used
9	<b>Human resource development, training</b>	Aggressive investment on higher learning and vocational training schools,  Dedicated institutes/agencies,	
10	<b>Production and market linkage</b> with foreign investors	MOTI, dedicated agency to promote textile and leather industries, flower and export other commodities	
11	<b>Others: Industry Development Institutes</b> are established to facilitate all the above and any other problem		

# Voucher Usage Rate

	2005 /06	2006 /07	2007 /08)	2008 /09	2009 /10	Average
Export value of exporters which have benefitted the voucher scheme (million)	115	209	257	279	403	253
Total Annual Export value (in billions)	1.02	1.20	1.50	1.50	2.13	1.50
Share of voucher based exports from total exports (in %)	<b>11</b>	<b>17</b>	<b>17</b>	<b>19</b>	<b>19</b>	<b>17</b>



# Why exporters fail to use export facilities?

## 1. Excessive data requirement

- Detailed, absolute and perfect export plan with long export order, with no room for adjustment

## 2. Control based management system in ERCA and overall civil service of the country; while the task requires result-oriented/based management system, with discretionary power of the civil servant to evaluate the request for settlement of uses of the voucher scheme.

# Overall on incentives

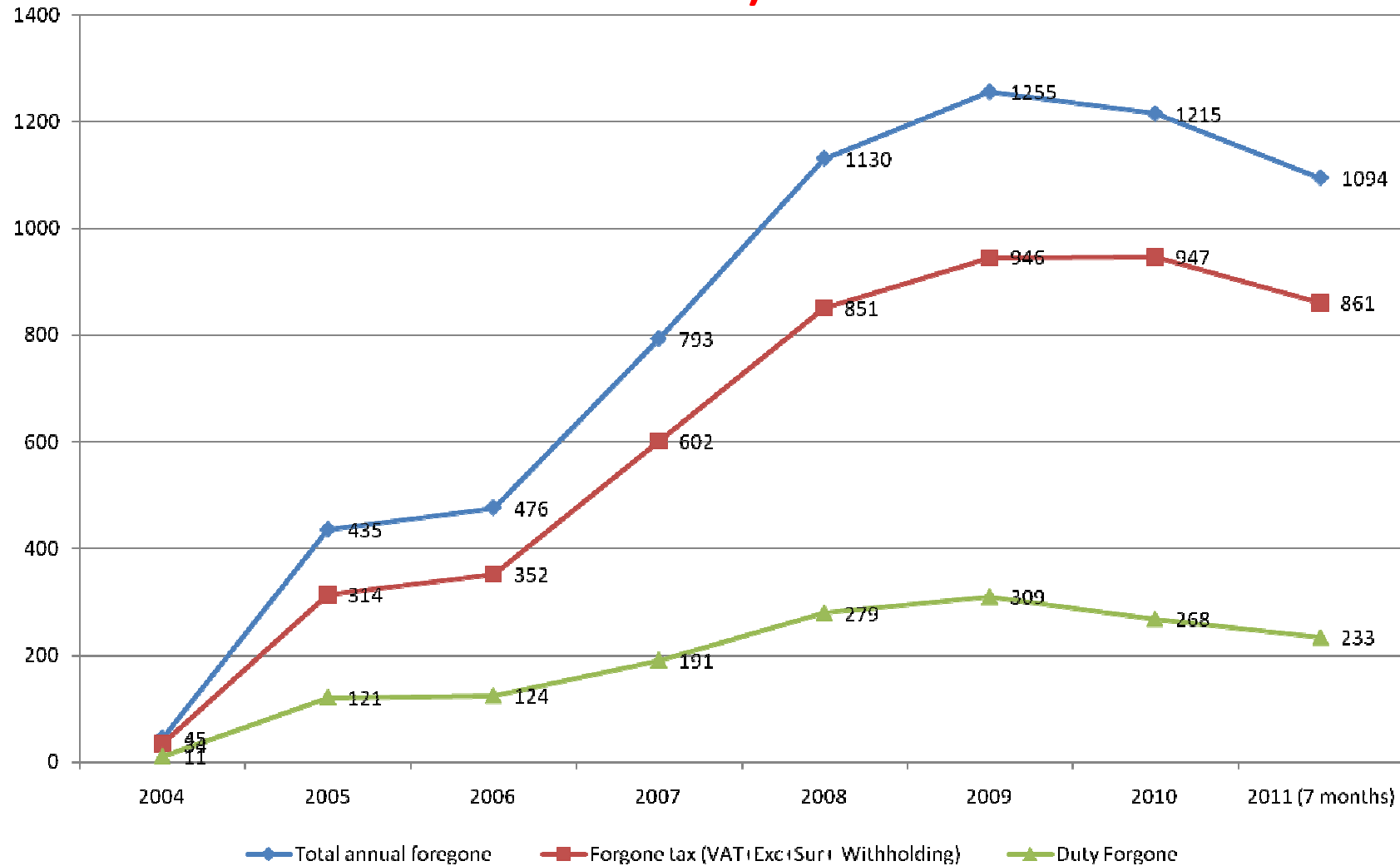
1. **Productivity** not at the center of support
2. **Innovation** not at the center of support
3. Globally incentives target at the industry not at the chain, but competitiveness is being determined by performance along the **value chain**. Ethiopia should be innovative to recognize this new reality and direct its policy attention at **solving development bottlenecks along the value chain!**
4. **From the literature, instead of tax holidays, consider to lower CIT;**
5. **Consider the introduction of accelerated depreciation instead of the ongoing straight-line depreciation;**

# **Foregone Revenue & Costs**

# Foregone Revenue & Costs

1. Though there is holistic support we concentrate on investment and export incentive instruments and schemes
2. Foregone duty and tax elements include :
  - a. **Import duty exemption (customs duty)**
  - b. **Forgone tax including VAT, Excise Tax, Sur Tax & withholding tax.**

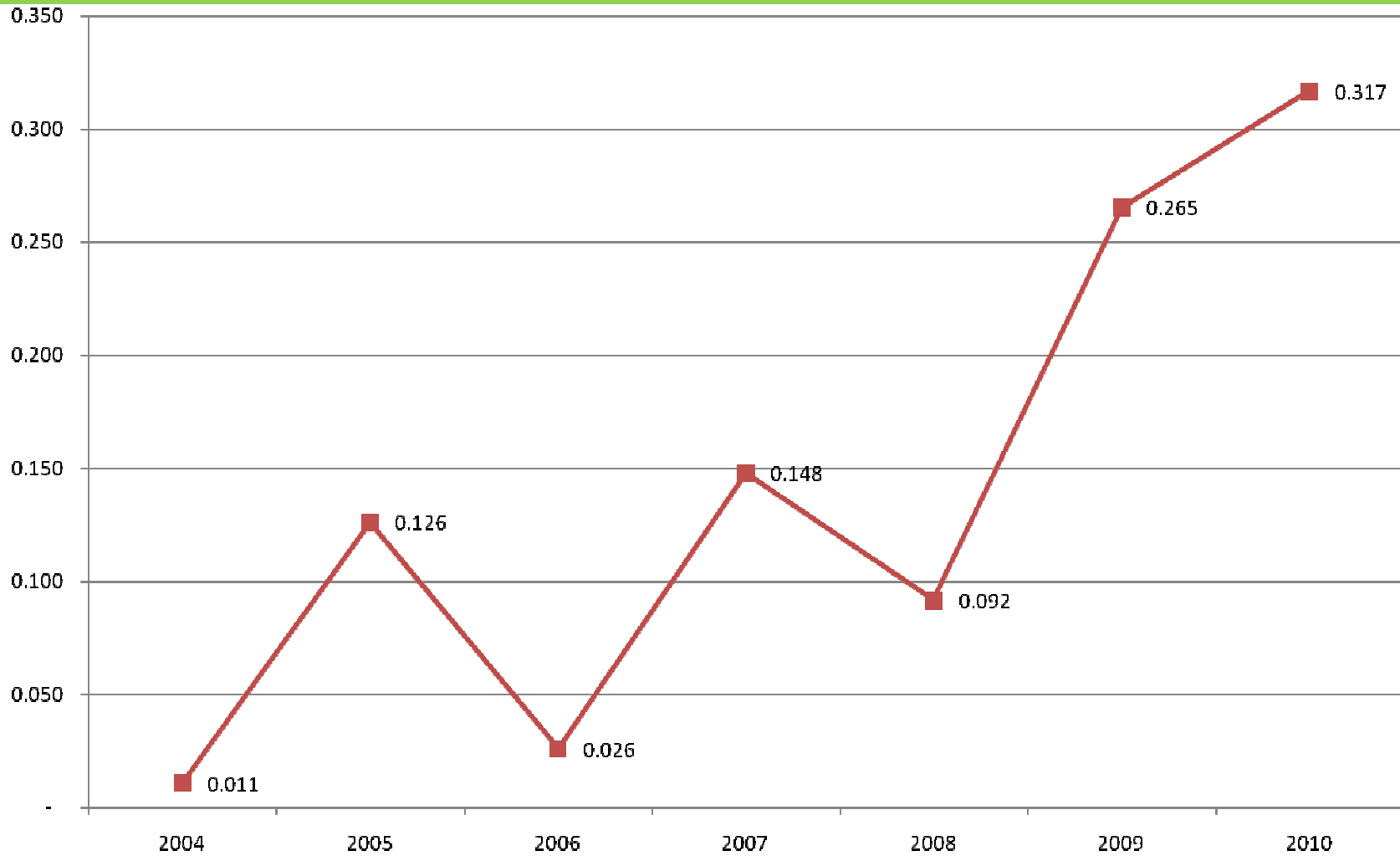
# Annual Forgone Government Revenue, (in millions USD)



# Forgone Import Duty

1. The **absolute size of foregone revenue has been consistently increasing** over the period 2004-2010
2. The foregone customs duty per additional unit of investment has been increasing from the order of ETB **0.01** to ETB **0.32** per one Birr of additional investment.

# Forgone Import Duty to Support one Birr of Realized Investment

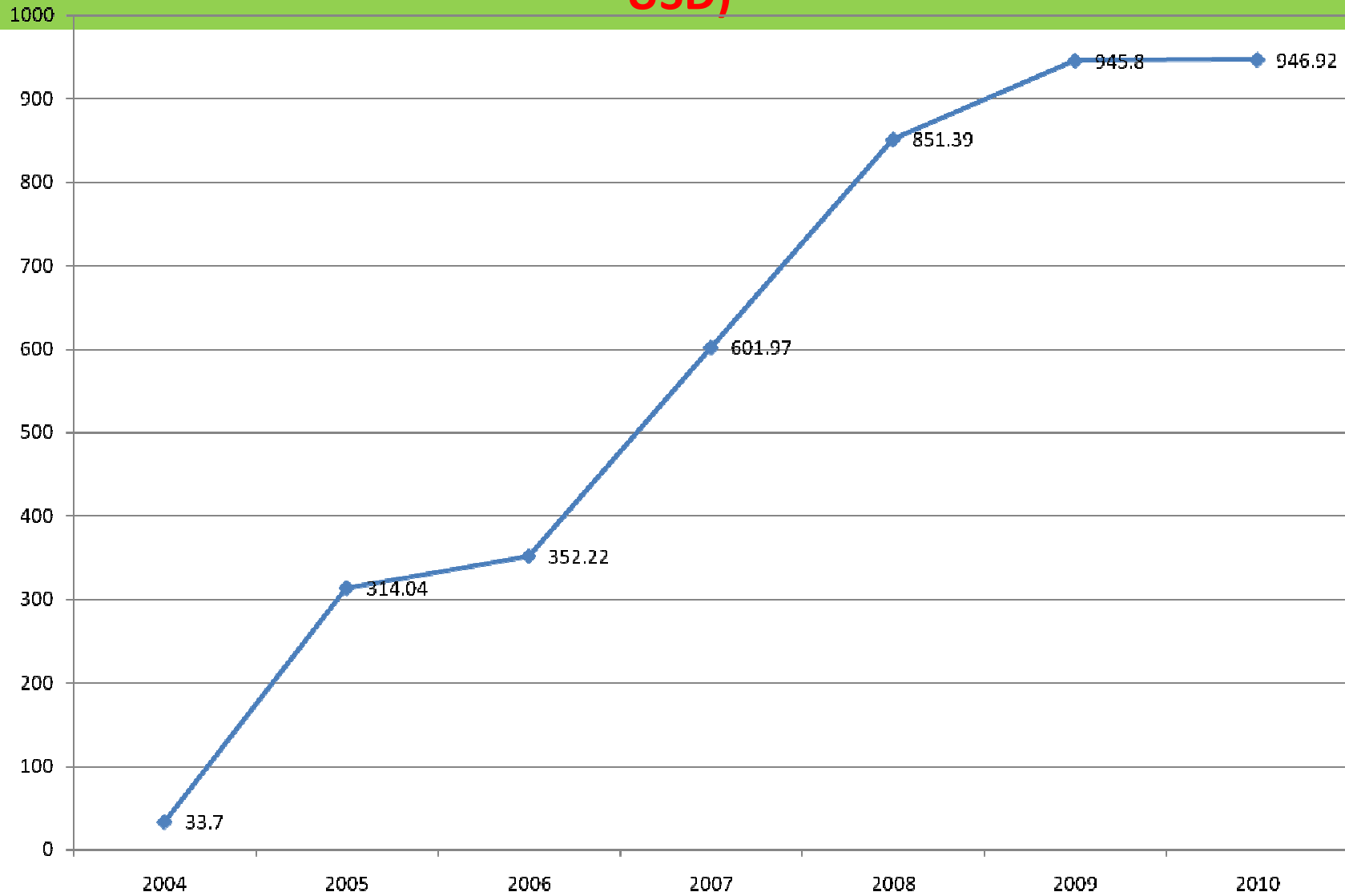


# Foregone Tax Revenue

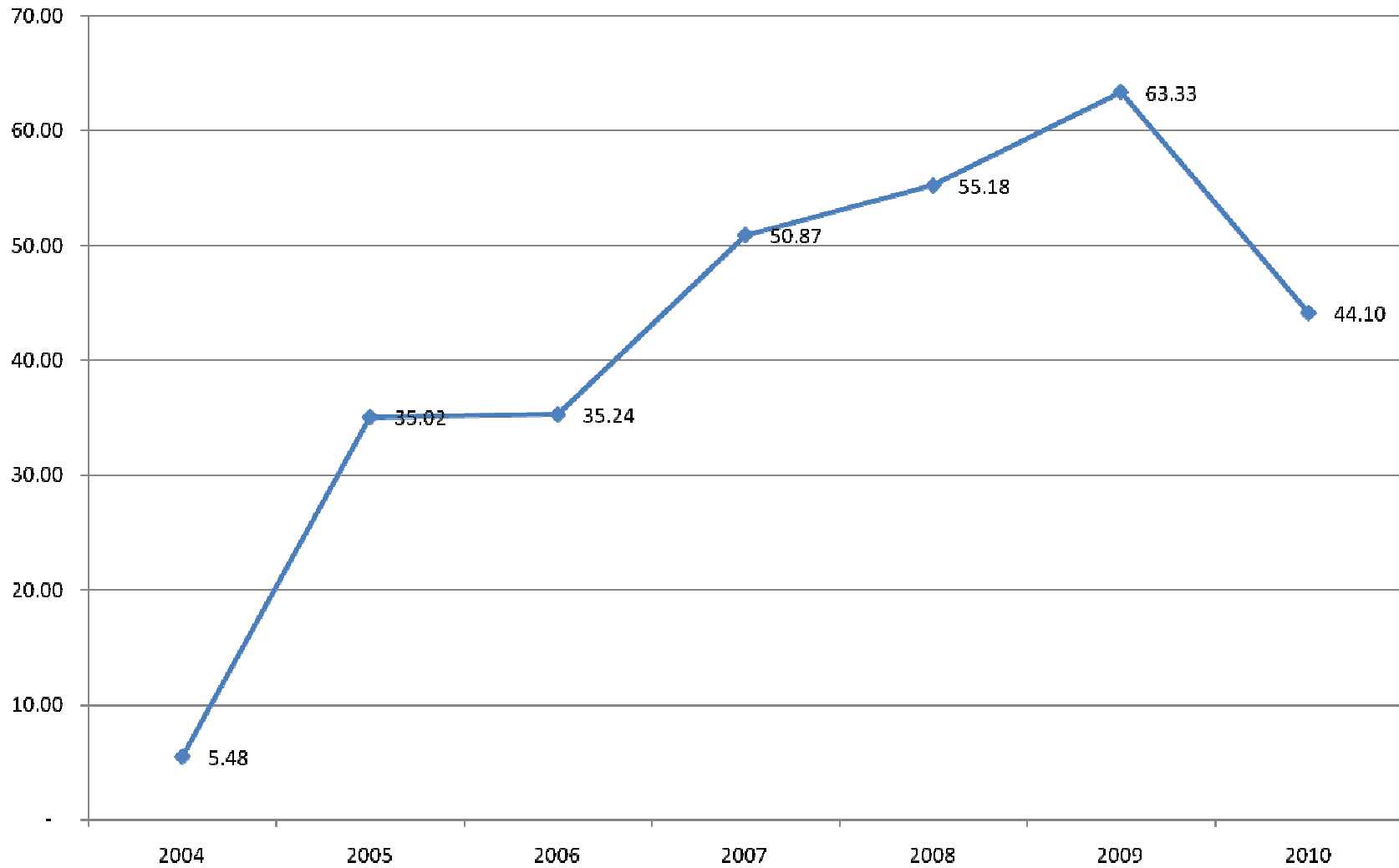
1. The foregone tax revenue from VAT, Excise tax, Sur tax, Withholding tax, has been **high and increasing over time**;
2. Yet, **export promotion schemes are not fully utilized**. Voucher only <20% of exports. Had these export promotion schemes were fully used, foregone tax would have been substantially large and increasing over time.



## Forgone tax (VAT + Excise + Sur + Withholding) (in Millions USD)



# Share of foregone tax to Export (in %)



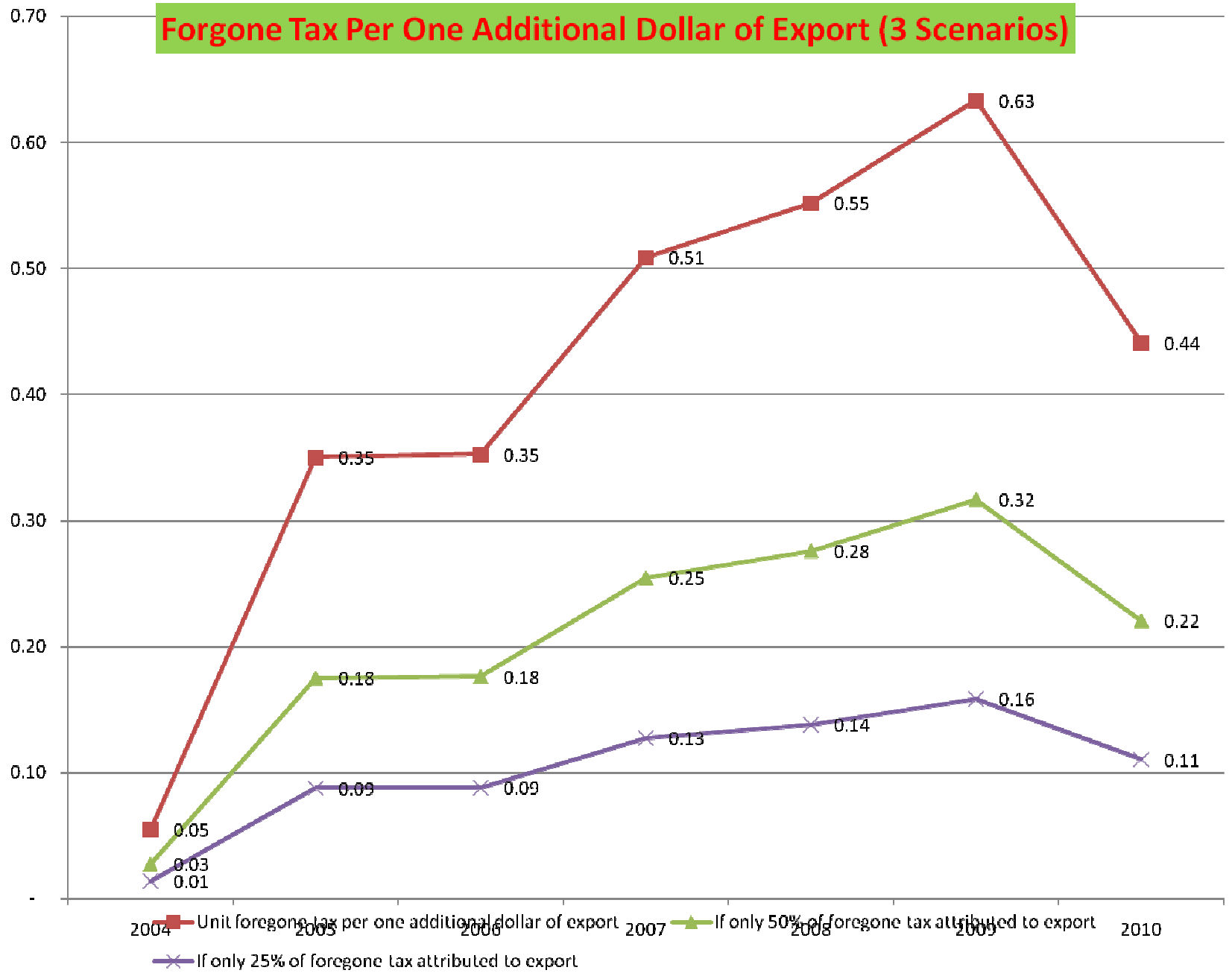
# Foregone Tax Revenue

1. But **difficult to attribute all foregone tax revenue to exports**
2. What if we attribute the foregone tax revenue to exports under **three scenarios: 100%, 50% and 25%** attributed to export?

## Foregone Tax per Additional One Dollar of Export

Year	If 100/% of foregone attributed to export	If only 50% of foregone tax attributed to export	If only 25% of foregone tax attributed to export
2004	0.05	0.03	0.01
2005	0.35	0.18	0.09
2006	0.35	0.18	0.09
2007	0.51	0.25	0.13
2008	0.55	0.28	0.14
2009	0.63	0.32	0.16
2010	0.44	0.22	0.11

## Forgone Tax Per One Additional Dollar of Export (3 Scenarios)



## Other costs incurred by the government

1. **Holistic support** for which data are not available
2. So the above assessment is based **on partial figures**,
3. **Credit facilitation**
4. **Prior land allocation**: No (or no access to) data on number of such land allocation, opportunity cost of land, etc.
5. Prior **access to inputs** in shortage: cement, for how many and how much
6. **Training**, data on number of training, training duration, training cost per trainee are not available/not accessible/;
7. **Market search** etc are real costs, but for which there is no ready data to incorporate and assign it to particular sectoral/industry/ investment
8. Cost of **industry development institutes**: Leather, Textile, Diary & Meat, Flower & Horticulture, and probably others
  - a. **Establishment cost** should be high
  - b. **Running budget** of Ethiopian Leather and Leather Institute for 2010/2011 was ETB 1.6 million, multiplying by 5 more developmental institutes or taking a weighted sum of such number of institutes would give high cost figure,

## Foregone & Cost

Overall the **foregone duty and taxes are on the high side.**

The **other costs** of holistic support are expected to be on the high side

At a time when the government direct investment in major developmental projects is increasing, the **opportunity cost** of such foregone government revenue should definitely be high.

# **Benefits/Outcomes/ of the Incentives Systems**



# Benefits

1. **Sufficiently long period to expect visible change** in contribution to GDP, investment, export, production capacity etc.
  - a. Investment Incentives 1993-1996 -2012(13-16 yrs)
  - b. Export incentives since 2001-2012 (11 years)
  - c. Industrial policy since 2003 (9 years)
2. Contribution of the manufacturing industry to GDP remained **marginal and stagnant over time**,
3. Low investment rate, of all, **low investment realization rate**, (< **20% for recent years**)
  - If investment low, then output, employment, export necessarily are low and below plans and expectations

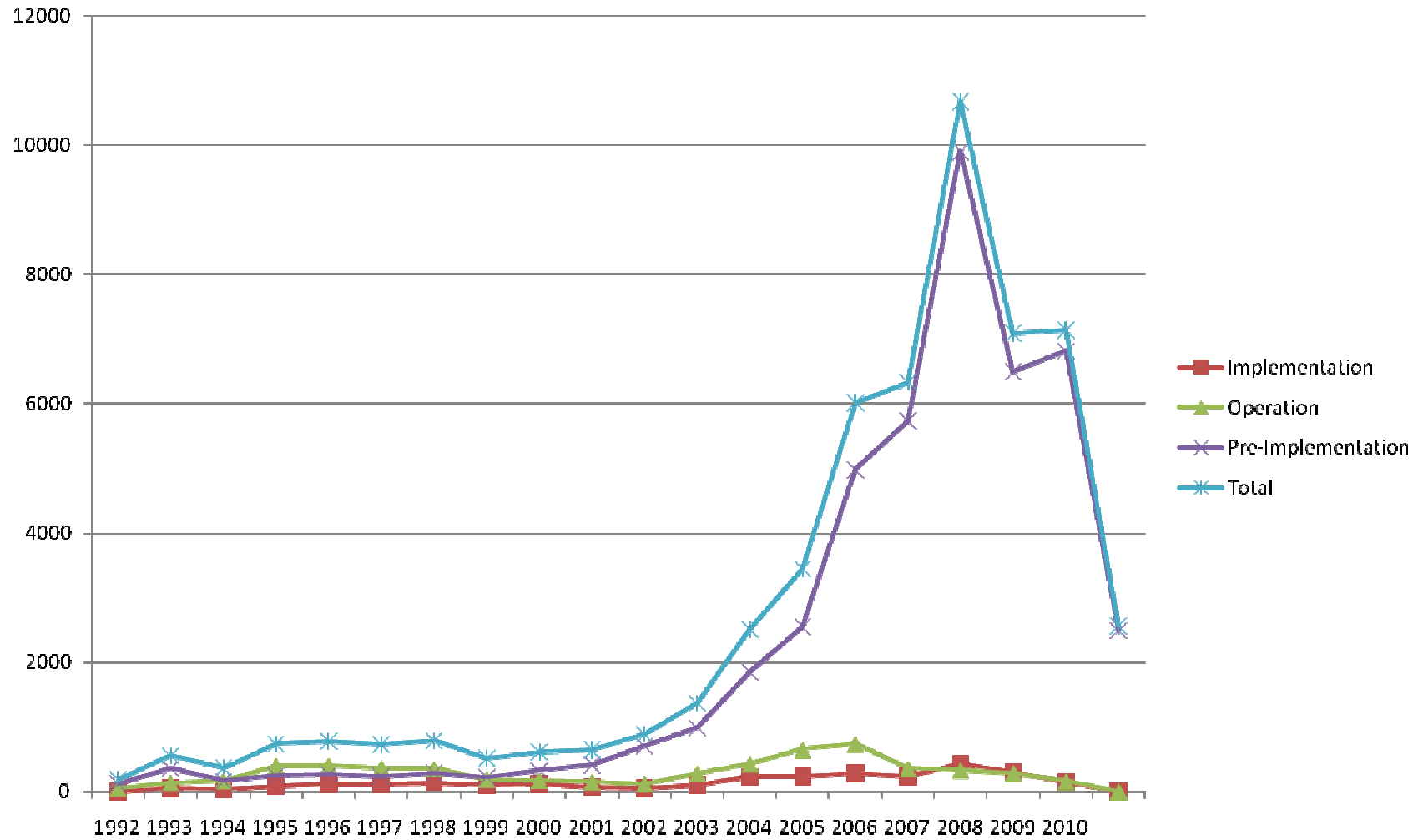
# Percentage share of the manufacturing industry from Ethiopian GDP (in %)

Industry/Year	1962/63	1973/74	1979/80	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
<b>Manufacturing</b>	5.4	9.9	9.2	5.5	5.2	5.2	5.2	5.0	5.0	4.9	5.0	5.0
<b>Large and Medium Scale Manufacturing</b>	2.5	5.2	5.4	3.6	3.4	3.4	3.5	3.4	3.4	3.4	3.5	3.6
<b>Small Scale and Cottage Industries</b>	4.1	4.7	3.8	1.9	1.8	1.8	1.7	1.6	1.5	1.5	1.4	1.4

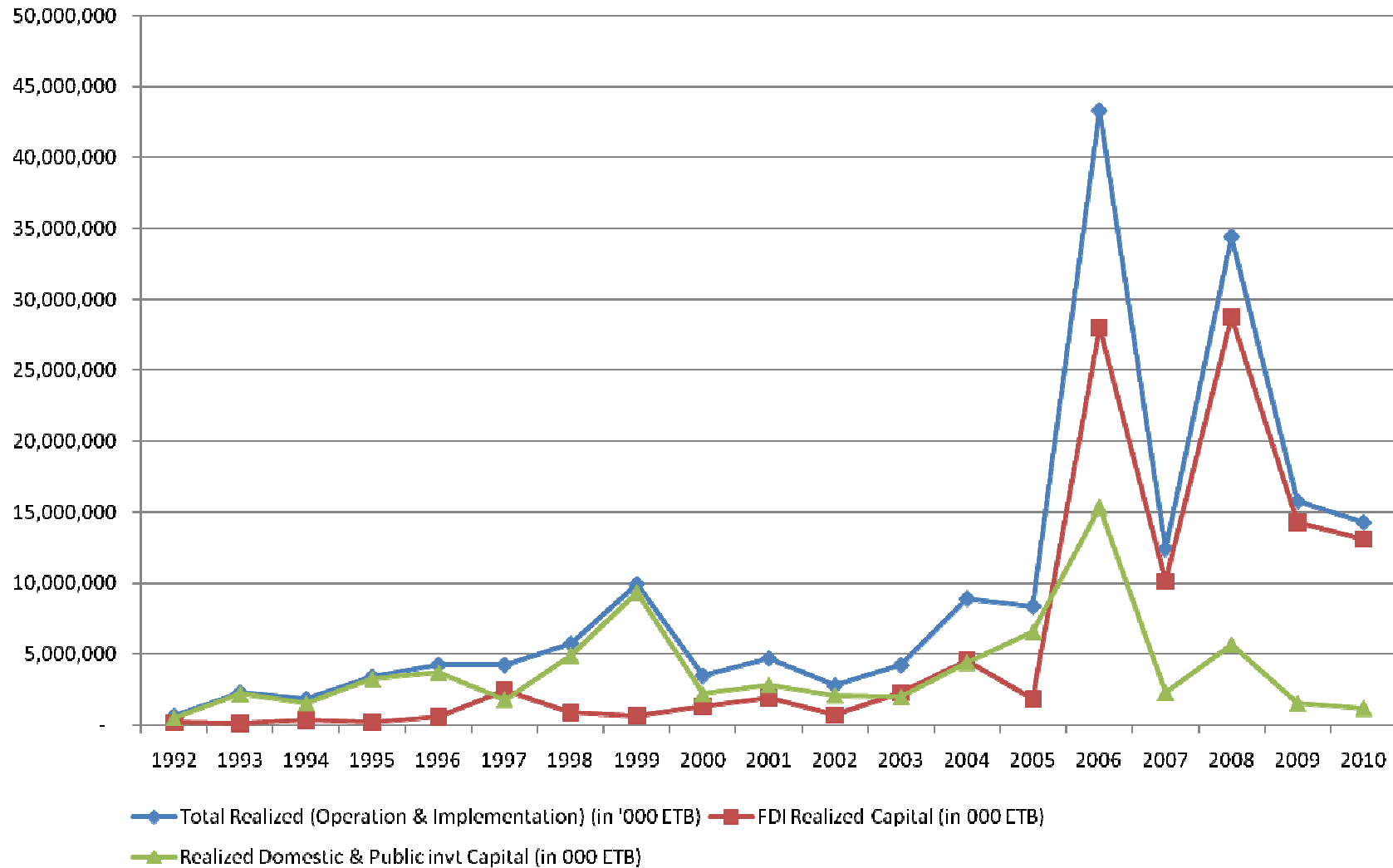
## Registered Investment by Status of Implementation

	1992- 1995	1996- 2000	2001- 2005	2006	2007	2008	2009	2010
Total Capital (in million ETB)	3.5	7.9	21.8	87.4	86.6	177.2	231.3	122.7
Share of un realized investment (Pre-implementation )(in %)	42	32	69	50	<b>86</b>	<b>81</b>	<b>93</b>	<b>88</b>
Total Number of Registered Investors	469	536	1778	6013	6336	10,672	7088	7142
Share of Pre-implementation (in %)	51	33	73	83	<b>91</b>	<b>93</b>	<b>92</b>	<b>96</b>

# Ethiopian Investment by Status of Implementation

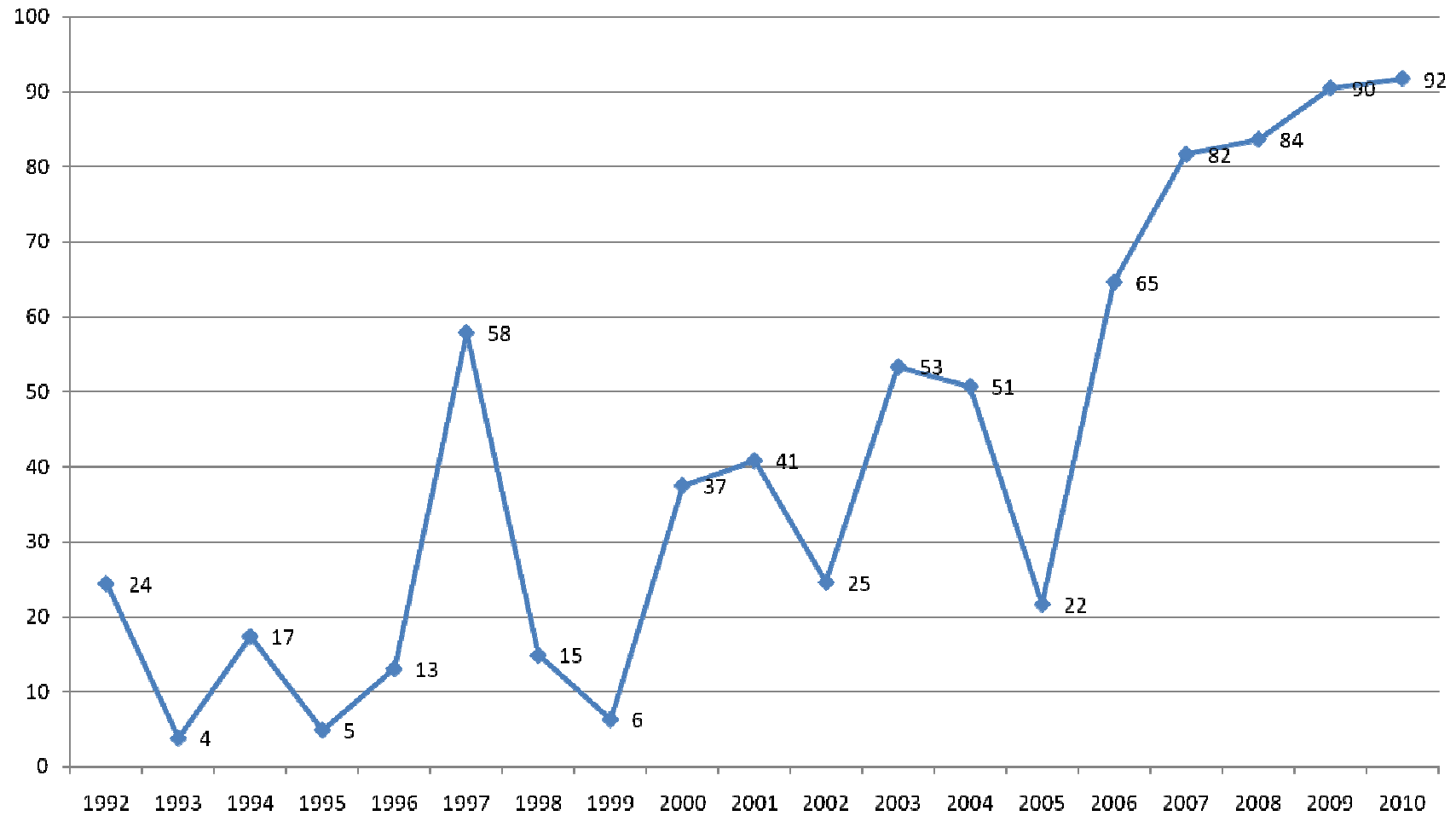


## Realized Investment by Type (FDI & Domestic) (in ETB '000)

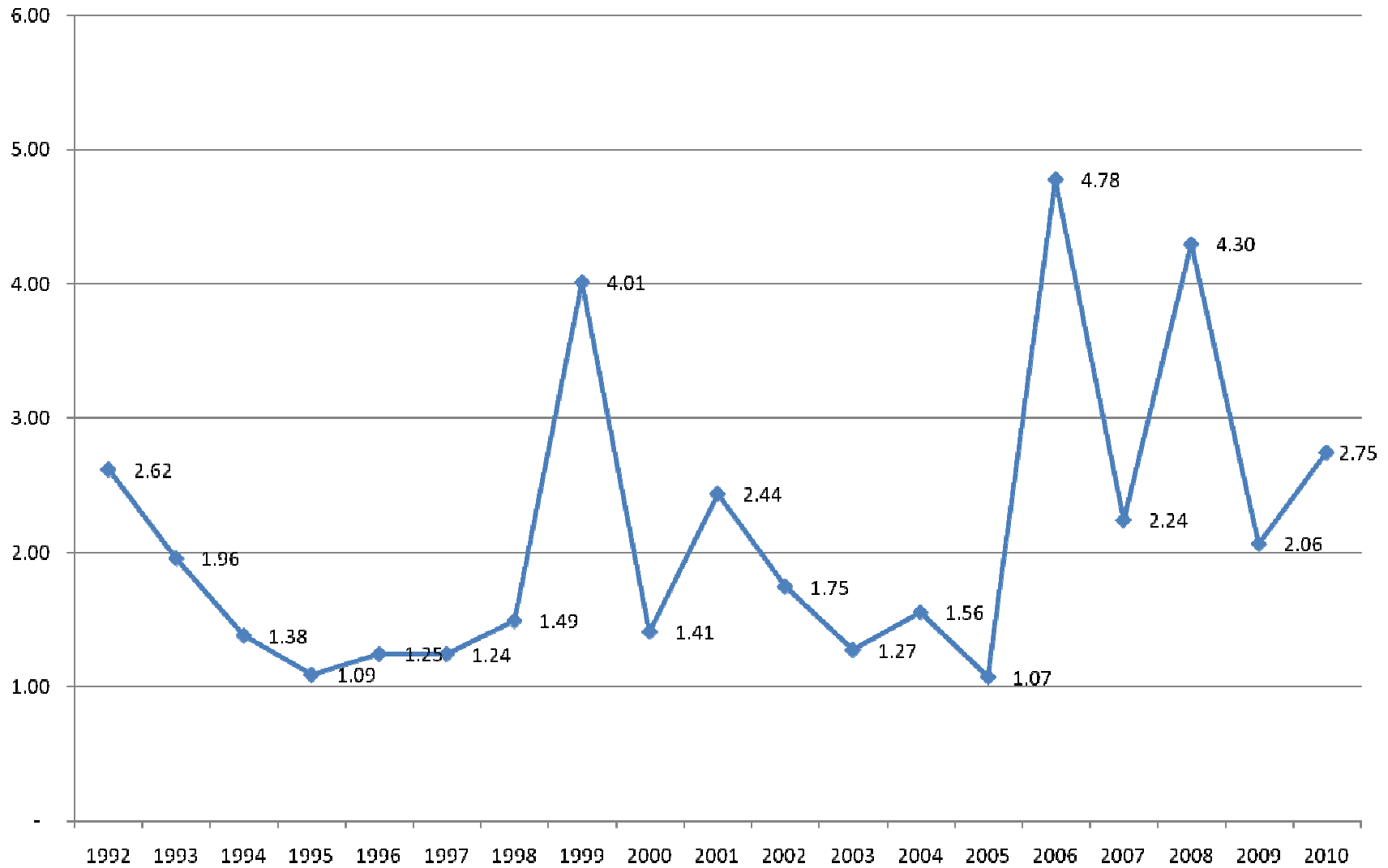


## Share of Realized FDI from total Realized Investment (in %)

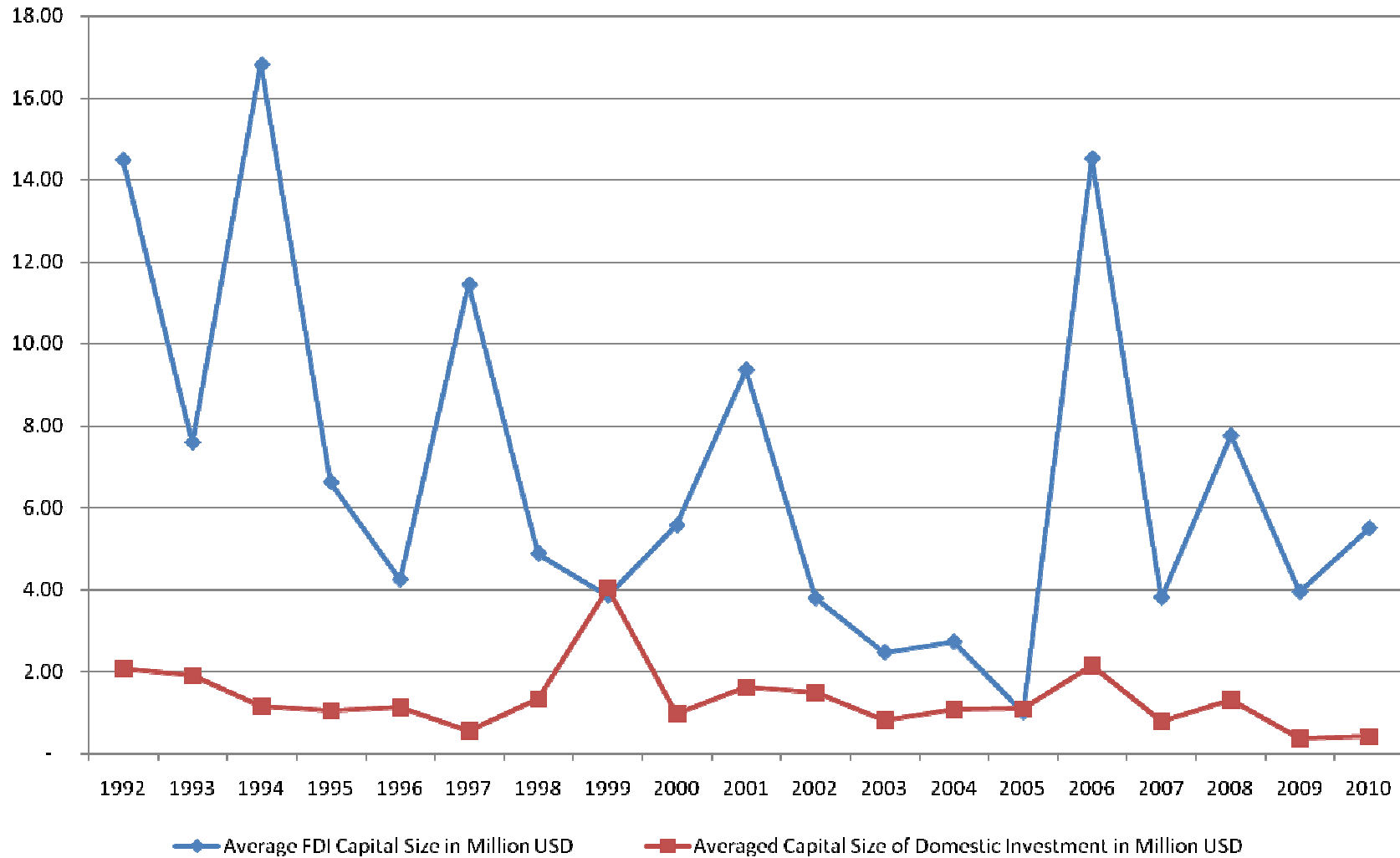
Share of Realized FDI from total Realized Invt (in %)



## Average Capital Size of Realized Investment (in Million USD)



# Average Capital Size (in Million USD)





## Observation from the investment data

- **Investment realization rate** remained quite low, particularly since 2002, for recent years as low as **<10%**
- **Average size of investment capital** is **low**, the maximum recorded throughout was **<5 million** USD, **size of FDI > domestic investment**
- **Share of Realized FDI** has been increasing & exceeding domestic investment, reaching more than 90% of total realized investment in 2009 & 2010
- Thus, **share of domestic investment** has declined to be **<10%** in the recent two years (2009-2010)

# Conclusion and Policy Implications

- The investment and export incentives aim for **price competitiveness**. The global competitive market on the other hand demands more than that: **quality, product differentiation, delivery time, meeting different standards, and related others**.
- **Sustainable price competitiveness itself** critically depends upon **productivity & innovation not on Investment incentives & support**.
- The existing Ethiopian investment and export incentives do not target for both **productivity & innovation**. Thus, need for paying attention to **productivity & innovation**

## Summary and Conclusion-2

- Ethiopia needs to be innovative to recognize the need for **targeting the value chain instead of the conventional industry**; The incentives need to be pragmatically targeted at solving development bottlenecks along **the value chain!**

## Summary and Conclusion-3

- The **overall foregone import duty and tax revenue** that the Ethiopian government has been incurring appears to be on the **high side and it is increasing over time**.
- As of 2010, the Ethiopian government is foregoing Birr **0.32 for each additional Birr of investment**.
- Foregone tax revenue as a percentage share of exports is **quite high and increasing**. Increased from 5.5% in 2004 to 63% in 2009 and 44% in 2010. For each additional one US dollar export, the Ethiopian government has been foregoing more and more, \$0.05 in 2004, **\$0.63 in 2009** and **\$0.44 in 2010**. Yet we cannot attribute all foregone tax to exports only.
- If it were possible to estimate all types of costs of support, land, training, market search, running the service providing institutional arrangement of the government, it appears that the Ethiopian government is incurring huge costs to promote both investment and export.

## Summary and Conclusion-4

- On the other hand, the **outcomes** of the investment and export incentives appears quite limited in terms of **investment, export and the resultant production capacity**
- One of the major findings that deserves urgent policy attention is the **low and deteriorating investment realization rate.**
- **Effectiveness of both investment and export incentives may be related to the effectiveness of the implementation capacity of the government, specifically to the effectiveness of the civil service**

**LOOKING FORWARD FOR  
YOUR CONTRIBUTIONS,**

**THANK YOU VERY MUCH**

**!!!**