



Industrial Policy Direction of Ethiopia : Suggestions for PASDEP II and the Next Five Years

GRIPS Development Forum
November 24, 2009

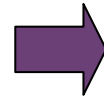


Background

- Over the recent years, the policy content of Ethiopia's trade & industry (T&I) have been significantly enhanced.

SDPRP (02/03-04/05)

No independent T&I chapter.



PASDEP (05/06-09/10)

T&I chapter, with targets for selected sub-sectors based on the IDS (2002).

- Further upgrading of T&I policy is needed in the PASDEP II period, as GoE plans to expand the policy scope and measures of industrial support.



Background

- Ethiopia has vigorously learned the basics of industrial policy formulation in a relatively short period and built institutional foundations to tackle the next round of challenges:
 - Policy documentation
 - Selective export promotion; export steering committee; industrial policy toolkit;
 - Higher-level TVET;
 - Development centers and institutes (MOTI); public-private dialogue; public administration reform;
 - Infrastructure;
 - Strategic mobilization of ODA, FDI, and academics, etc.



Our Purposes

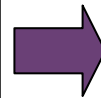
- Provide ideas and issues that may be useful in drafting T&I chapter of PASDEP II (2010/11-2014/15).
 - Vision and orientation
 - Expected content
 - Issues to be stressed
- PASDEP II T&I chapter should be followed by the 5-year implementation plan of MOTI.

PASDEP I



PASDEP II

- Principles of IDS
- Priority industries & targets (focusing on production & export earnings)
- Cross-cutting issues (PSD, privatization, SME, export, etc.)



- Review of industrial performance

- Medium-term vision & orientation
- Priority industries & targets
- Priority issues & targets



1. Review of Recent Performance

- Industrial growth and exports:
 - First three years of PASDEP I: very positive
 - Last two years of PASDEP I: negative effects of an overheated economy and global financial crisis
- Ethiopia's recent macroeconomic difficulty by itself does not give a compelling reason to change its industrial policy.
- The performance of productive sectors (e.g., industry, agriculture) is determined by a combination of private effort, policy effort, and external circumstances.



Review of Recent Performance

- Industrial policy should be designed and evaluated for its contribution to long-term industrial achievements ($\alpha x_t + \beta z_t$), rather than short-term cyclical events (e_t).

$$y_t = \alpha x_t + \beta z_t + e_t$$

y: industrial performance

x: private effort; z: industrial policy;

e: unpredictable shocks



Review of Recent Performance

- Nevertheless, there is little evidence that Ethiopian industries have made strong progress in quality improvement, international competitiveness or structural transformation in the last several years, despite all-out policy support to the selected export industries.
- Assessment of both costs and benefits of policy support should be conducted.

Recent Economic Performance

	(Ethiopian year) (Western year)	1991 1998/99	1992 1999/00	1993 2000/01	1994 2001/02	1995 2002/03	1996 2003/04	1997 2004/05	1998 2005/06	1999 2006/07	2000 2007/08
Real GDP growth (%)		5.2	6.1	8.3	1.5	-2.2	13.6	11.8	10.8	11.1	11.3
Nominal GDP (millions of Birrr)		58,789	66,648	68,027	66,557	73,432	86,661	106,473	131,641	171,834	245,585
Nominal GDP (millions of USD)		7,828	8,188	9,167	7,794	8,559	10,042	12,306	15,164	19,539	27,939
GDP per capita (USD)		129	131	127	118	126	143	171	205	257	357
Sector share (% of GDP) <u>1/</u>											
Agriculture		51.2	49.8	50.9	49.1	44.9	47.0	47.4	47.1	46.3	44.6
Industry		12.4	12.4	12.1	12.9	14.0	14.0	13.6	13.4	13.3	13.1
Service		37.2	38.7	38.0	38.6	41.7	39.7	39.7	40.4	41.4	43.4
External relations (% of GDP)											
Export		11.6	12.0	12.0	12.6	13.3	14.9	15.1	13.8	12.7	11.8
Import		24.0	23.9	23.7	26.6	27.4	31.6	35.5	36.5	32.1	26.9
Trade deficit (export - import)		-12.4	-11.9	-11.7	-14.0	-14.1	-16.7	-20.4	-22.7	-19.4	-15.1
Total trade (export + import)		35.6	35.9	35.7	39.2	40.7	46.5	50.6	50.3	44.8	38.7
FDI (approval, millions of Birr)		1,080	1,627	2,923	1,474	3,369	7,205	15,405	19,980	46,949	92,249
(approval, % of GDP)		1.8	2.4	4.3	2.2	4.6	8.3	14.5	15.2	27.3	37.6
Population (million)		60.8	62.9	64.4	66.3	68.2	70.1	72.1	74.1	76.1	78.2
Population in rural area (%)		85.5	85.3	85.1	84.9	84.7	84.4	84.2	84.0	83.8	82.9
Population in poverty (%)		-	41.9	-	-	-	-	38.7	-	-	-
Exchange rate (Birrr/USD, period average)		7.51	8.14	8.33	8.54	8.58	8.63	8.65	8.68	8.79	8.79

Sources: Ministry of Finance and Economic Development, National Bank of Ethiopia, and Ethiopian Investment Agency.

1/ Do not add up to 100% due to estimate errors of intermediary margins of financial institutions (service sector).

Results Achieved: Export value of priority sectors

Unit: USD million

(Ethiopian Year) (Western Year)	1996 2003/04	1997 2004/05	1998 2005/06	1999 2006/07	2000 2007/08	Avr. Growth
Leather & Leather Products	43	67	75	89	101	27%
Textile & Apparel	9	7	11	13	15	17%
Agro Processing	20	34	36	43	52	29%
Total	72	108	122	145	168	24%
Country's total	597	819	1,008	1,185	1,481	26%
Share of the three sectors	12%	13%	12%	12%	11%	

Source: Ministry of Trade and Industry (presented at the EDRI-JICA workshop on Dec.15, 2008.)

Note: Export earning targets under respective Five-Year Action Plans include:

- Leather & Leather Products: Generate USD 500million by 2009/10.
- Textile & Garment: Generate USD 500 million by 2009/10.

Results Achieved: Export value of LLPT sector

Unit: USD million

(Ethiopian Year) (Western Year)	1996 2003/04	1997 2004/05	1998 2005/06	1999 2006/07	2000 2007/08
Semi process skin	43	56	58	49	67
Semi-process hide	4	7	7	8	12
Finished leather	-	3	8	27	12
Footwear	0.8	0.8	2	5.6	10
Total	43	67	75	89	101

Source: Ministry of Trade and Industry (presented at the EDRI-JICA workshop on Dec.15, 2008.)

Note: The Five-year Action Plan for leather & leather products aims to: (i) shift to producing crust and finished leather products; and (ii) generate export earnings of USD 500 million by 2009/10.



2. Essence of Policy Orientation

Proactive Industrial Policy

- The policy orientation of Ethiopia's IDS (2002) deserves special attention and dissemination.
 - Improving business climate generally and for all
 - Responding quickly to the needs of the private sector
 - Creating dynamic comparative advantages -- with private sector-driven, but with strong state guidance
- Clearly stipulate that Ethiopia is pursuing a **proactive industrial policy**. (This is not new; re-affirmation of IDS principles.)



Proactive Industrial Policy

- This policy orientation differs from:
 - Socialist planning and state production
 - Laissez-faire and rapid integration under small government (basic approach or “Washington Consensus”)
 - Developmental states with infant industry promotion (E. Asia in the past)
 - FDI-led industrialization (E. Asia now)

Comparison of Two Approaches

	Basic Approach (or Washington Consensus)	Proactive Approach
Market-driven development under globalization	Yes	Yes
Retaining sufficient policy tools for latecomer industrialization	?	Yes
Dynamic capacity development	?	Yes
Internalizing skills and technology	Yes	Yes
Effective public private partnership	Yes	Yes
Deep knowledge of the industry	?	Yes
A strong state	?	Yes



Future Direction

Expansion of Policy Scope and Measures

- Ethiopia's future industrial policy should take account of its improving policy capability over the recent years, as well as changing circumstances.
 - Ethiopia should broaden the policy scope and measures for industrial promotion, building on the past policy and institutional efforts.
- ➔ PASDEP II T&I chapter should clearly explain the planned policy shifts, with their reasons.



Expansion of Policy Scope and Measures

- The list of priority sectors should be broadened from a few export-oriented industries to include import substitution industries which have high domestic demand (=high impact on reducing BoP pressure) and whose technologies are relatively easy to learn.
- ➔ More detailed list of newly promoted industries must be constructed with careful studies and clear selection criteria.



Expansion of Policy Scope and Measures

- The scope of promotion measures should be also broadened, with greater emphasis on **internalizing skills and technology and managing market instabilities** (not only incentives and export monitoring).
- Time limits and the graduation rule of promotion measures should be introduced in advance, to avoid policy misjudgment and political capture.

➔ Promotion measures should be available to all eligible enterprises until the time limit of promotion expires (regardless of pioneers or latecomer copycats).

Cf. This approach differs from Prof. Rodrik's "pioneers only" rule (2008).

Proactive Industrial Policy and Expansion of Policy Scope

	Basic Approach (or Washington Consensus)	Proactive Approach
Export Promotion	(1) Liberalize, privatize, open up, level playing field	(2) Policy skill and in-depth industrial knowledge required
Import Substitution	(1) (Same as above)	(3) Very high policy skill and in-depth knowledge required

When the policy scope is expanded from (1) to (3), the following measures become more relevant:

- **Time limit and graduation rule**
- **Competitiveness and value creation**
- **Clear selection criteria for priority sectors**
- **Master Plans and Action Plans with an effective implementation mechanism**

Medium-Term Industrial Vision



- What Ethiopia plans to attain in the next five years, guided by the long-term vision and principles of ADLI & IDS?

➔ Internalization and scaling up of skills, technology, and other capabilities that support the competitiveness and value creation of the manufacturing sector (for both export-oriented industries and import-substituting industries).



3. Expanding the Scope of Priority Industries

- Clarify new (and continuing) priority sectors for the next five years.
- For each priority sector, targets and policy orientation for the PASDEP II period should be spelled out.
- Master Plans and Action Plans must be drafted subsequently to give more details; and implementation should be followed up with an effective mechanism.



Priority Industries (1)

Export-Oriented Industries

- The following **export-oriented industries** can continue to be supported in the next five years:
 - Leather and leather products
 - Agro-processing
 - Textile and garment
 - Floriculture



Export-Oriented Industries

- However, there should be studies to review the performance of these industries in response to policy support and evaluate the static and dynamic costs and benefits of policy support.
- For agro-processing, the concrete mix of targeted crops or products should be re-examined (incl. performance review of the sugar industry).



Priority Industries (2)

Import Substitution Industries

- The following **import substitution industries** may be added to the priority sector list.
 - Steel
 - Metal processing
 - Cement
 - Glass
 - Consumer soap and detergent (“chemicals”)
 - Popular medicine (“pharmaceuticals”)
 - Other



Import Substitution Industries

- For each candidate industry, a preliminary feasibility study should be conducted.
 - Industry deserving policy support
 - ➔ A full-fledged MP with detailed Action Plans should be drafted.
- Drafting MP for import substitution industry should proceed in realistic steps; start with one or two industries, and then cover all industries by the end of the PASDEP II period.



4. Expanding the Scope of Priority Issues

- Current PASDEP discusses: privatization, SMEs, trade-related issues, export development, and PSD.
- In the future, greater attention should be paid to the enhancement of competitiveness, industrial human resource, logistic efficiency, and industrial linkage and structure, etc.

1. Quality-based competition
2. Matching industrial human resource with demand
3. Agriculture-industry linkage
4. Geographical aspects of industrialization



Priority Issues (1)

Quality-based Competition

- Ethiopia has made progress in implementing “benchmarking,” as a method to enhance quantity-based competition.
- In the future, Ethiopia should pursue not only quantity-based, but also quality-based competition, depending on product type and targeted markets.
- Policy tools for quality-based competition, such as *kaizen*, branding, strategic marketing, design training, and so on, should be added and strengthened.

Priority Issues (2)

Matching Industrial Human Resource with Demand

- Ethiopia's effort to build new technology and engineering universities is highly commendable.
- At the same time, demand for this human capital must be prepared as its supply is being greatly increased.



Priority Issues (3)

Agriculture-Industry Linkage

- Key to the success of ADLI.
- Serious policy effort should be made in agro-processing industries to enlarge the existing links and to create new ones.
- The quality and content of the agro-processing industry MP and Action Plan and effective cooperation btw. MOTI and MOARD become crucial.



Priority Issues (4)

Geographical Aspects of Industrialization

- Policy interest must be expanded beyond the construction of transport infrastructure to include other spatial aspects of industrialization.
 - Logistic performance of the Addis Ababa-Akaki area
 - Policy criteria for creating and operating industrial estates
 - Initiation of the construction of **Growth Poles and Growth Corridors**, as overall regional development which encompasses agriculture, agro-processing, water management, tourism and related manufacturing and services.



5. Two Additional Issues (1)

Numerical Targets

- Ethiopia should broaden the scope of industrial targets, by **introducing more indicators for skills, technology and other internal capability** in addition to the traditional “macro” targets.
- It is also important to:
 - Treat targets as indicative and interpret them carefully.
 - Translate qualitative goals into proxy variables.
 - Set goals and timetables properly (both *ambitious* and *realistic*).

Current PASDEP: Numerical Targets Related to Industry

	Baseline (end 2004/05)	Target (2009/10)
Growth rate of industry value added (%)	8.1	11.5 (average)
Share of industry in GDP (%)	13.6	16.5
Revenue generated from industrial export (leather and leather products) (USD million)	63.73	500

Source: *PASDEP Annual Progress Report 2007/08* (MOFED draft, p.121)

Current PASDEP: Major Achievements in Trade and Industry by 2007/08

1. Textile and garment	Encouraging steps have been observed; 71 projects were at different stages of operation. Export earnings recorded USD 14.5 million (15.1% higher than previous year).
2. Tanning industry	Support has been provided in manpower, machinery, market access and other areas. 5 of 16 tanneries supported registered better performance, and 3 tanneries have shifted their export to crust and finished leather products.
3. Leather export	The tanning industry generated revenue of USD 101 million, 13% higher than previous year but lower than target (USD 153.4 million). Shoe export recorded USD 9.66 million.
4. Sugar	Production was 296,009 tons (3 sugar factories), slightly above target.
5. Cement	Mugher produced 737,043 tons (against the target of 871,000 tons); Messebo produced 950,000 tons (18% higher than the previous year); five new plants produced 146,833 tons. Due to construction boom, supply gaps emerged and 613,767 tons of cement was imported in 2007/08.
6. Floriculture	Flower farms reached 922 ha (43% increase over previous year); flower export reached USD 111.7 million (against the target of USD 166.7 million).
7. Privatization	15 public enterprises (PEs) given decision to privatize; 3 PEs for re-tender; 31 PEs carried out business evaluation; 10 PEs completed transfer with different modalities, etc.
8. Export earning	Export in 2007/08 was USD 1,481.4 million (25% higher than previous year), with coffee earning 35.5% of total. Target for 2007/08 was USD 1,727.5 million. Export performance has been evaluated monthly first by MOTI and subsequently by the National Export Steering Committee.
9. WTO accession	Process has continued.

Source: Extracted from *PASDEP Annual Progress Report 2008/09* (MOFED draft, p.16)

This is a summary of more detailed discussion of achievements and challenges in the main text of the Report (pp.83-88)



Two Additional Issues (2)

Policy Documents and Organization

- All existing industrial MPs should be revised with new content and structure, and new MPs will be drafted for the new priority sectors over the medium-term (step by step).
- MOTI's policy organization must be upgraded to strengthen “horizontal” mechanisms among its departments and vis-à-vis other ministries to combine and coordinate different functions.



In Summary:

- In the next five years, Ethiopia may wish to broaden its operational policy scope from “export targets setting” to “skill-intensive industrialization” that highlights competitiveness and internal value creation.
- ➔ Domestic capabilities of both the private sector and the policy making mechanism should be strengthened.
- ➔ Appropriate targets (quantitative & qualitative) should be agreed. Necessary programs and institutions must be launched or enhanced.
- ➔ Master Plans and action plans must be drafted; and implementation should be followed up with an effective mechanism.

Possible Ingredients of Trade & Industry Ch.

Review of industrial performance

Medium-term vision and orientation

- Proactive industrial policy
- Expansion of policy scope and measures
- Internalizing skills and technology

Priority industries (possibly with targets)

- Export-oriented industries
- Import substitution industries

Priority issues (possibly with targets)

- Quality-based competitiveness
- Matching industrial human resources with demand
- Agriculture-industry linkage
- Geographical aspects of industrialization, and others