Chapter 5

Democratic Developmentalism and Agricultural Development Led Industrialization*

This chapter reviews the two guiding principles of Democratic Developmentalism (DD) and Agricultural Development Led Industrialization (ADLI) which Ethiopia, one of the poorest countries in Africa, has embraced to advance its development under strong state leadership. DD is a political regime conceived recently in Ethiopia to execute development policies. Meanwhile, ADLI defines the policy orientation which was formulated in the early 1990s and subsequently elaborated in stages and put into serious implementation from the early 2000s. DD and ADLI constitute a complementary set of governing principles that inform the politics and economic development of Ethiopia.[1]

Both principles are in the early stages of implementation, and it is therefore too early for comprehensive evaluation. Nevertheless, they contain many points of interest for latecomer countries trying to establish a development-oriented regime in the international environment of the 21st century.

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1 The basic literature on Ethiopia's DD is a series of statements and unpublished documents by Prime Minister Meles Zenawi from around 2006. Meanwhile, general research on DD, not confined to the Ethiopian context, is found in Edigheji (2005) and Robinson and White (1998). For ADLI, the key literature includes the internal documents of the Ethiopian government discussed in the text: *An Economic Development Strategy for Ethiopia* (1994), *Rural Development Policies, Strategies and Instruments of the Government of the FDRE* (2001), *Ethiopian Industrial Development Strategy* (2002), and *A Plan for Accelerated and Sustained Development to End Poverty (PASDEP) 2005/06-2009/10* (MOFED of Ethiopia, 2005).

5-1. Steps toward a developmental state

5-1-1. Initial formulation

The Ethiopian attempt to build a developmental state in the current form dates back to the early 1990s when an interim regime of the Ethiopian People's Revolutionary Democratic Front (EPRDF) was established by ousting the previous socialist dictatorship by military force. The EPRDF was an association of ethnic political groups led by the Tigray People's Liberation Front (TPLF), which spearheaded the anti-government fight from 1975 onward (Ishihara, 2001). With the coming of the Interim Government in July 1991, Ethiopia abandoned economic planning and adopted a market-oriented economic system. The national economy at that time was on the verge of collapse. The radical shift in policy orientation was necessary because of the failure of the previous socialist government to realize economic growth and improve living standards; the need to secure finance and cooperation from donors and international financial institutions; and pressing economic issues in transition from civil war to peace. This policy shift opened the door for the private sector to play an important role as opposed to the previous hostile environment that kept the private sector and market forces at bay and in a very rudimentary state.

During the transition period from 1991 to 1995, important policies were adopted and incorporated into key policy documents. The policy thrust of the Interim Government was proclaimed in *Economic Policy for the Transitional Period* in 1992, which contained a shift toward market orientation, removal of most restrictions on private sector activities, and liberalization and reforms in sectoral, investment, and public enterprise laws. Meanwhile, the Interim Government retained some features of the previous regime such as the state ownership of land and development centered on agriculture and rural areas. The idea of ADLI took concrete shape as an overarching economic strategy between 1992 and 1994, and *An Economic Development Strategy for Ethiopia* in February 1994 highlighted the concept of ADLI to define its strategic direction. On the political front, the Charter of the Interim Government in July 1991 upheld peace and democracy as guiding principles and introduced federalism based on ethnic autonomy. The Communist Military Junta (Derg) of the previous regime was replaced by a multi-party political system.

These changes were incorporated in the new constitution, which established the Federal Democratic Republic of Ethiopia in August 1995. Additionally, the first phase of the structural adjustment program of the international financial institutions was also put in place during the transition period.

The main motivation behind ADLI has been the recognition that Ethiopia is an agrarian society in which the bulk of the population (84% in the 2007 census) resides in rural areas earning a livelihood from land. Agriculture has long dominated the economy in terms of output, employment, and export earnings. The government emphasizes that economic development and structural transformation should be initiated through robust agricultural growth, and that peasant farmers and pastoralists should be the main agents of agricultural transformation and economic growth. It is argued that labor and land are the main—and abundant—factors of production in Ethiopia and that their effective use should generate rapid and sustainable development. These arguments were clearly stated in *An Economic Development Strategy for Ethiopia* of 1994, mentioned above.

Initially, the ADLI strategy targeted smallholder farms, especially crop producers, so as to achieve rapid growth in agricultural production, raise income for rural households, attain national food self-sufficiency, and produce surpluses which could be marketed to the urban or industrial sectors. More specifically, the government introduced measures to provide smallholder farmers with technology and better farming practices, improved seeds, fertilizers, irrigation, rural roads, and marketing services. A rise in agricultural output was expected to stimulate industrial production by providing food and industrial materials, thus establishing a link between the rural and urban sectors. The industrial sector, in turn, could produce input to agriculture such as fertilizers and farming tools and equipment as well as consumer goods for rural households. Such dynamic linkage, which we will call *Core ADLI* (see below), was intended to ignite the first stage of industrialization until the economy moved into a higher level of development.

5-1-2. Implementation and early results

The early 2000s saw the initiation of serious implementation of ADLI as well as the creation of a political model that justified state-led development in the Ethiopian context.[2] These developments were made possible by the fact that the Ethiopian government was finally able to squarely tackle developmental problems around that time, thanks to the (provisional) solution of the conflict with Eritrea as well as the passage of more than ten years after the establishment of the new leadership.

Beginning in 1995, the concept of ADLI was incorporated in the first and the second national development plans, which were published only in Amharic. The following development plan, the *Sustainable Development and Poverty Reduction Program* (SDPRP) 2002/03–2004/05, which further concretized the ADLI strategy, was prepared in both Amharic and English and took the form of a poverty reduction strategy paper in order to inform and solicit the cooperation of the international community. SDPRP promoted agricultural development and poverty reduction in rural areas by: (i) strengthening agricultural extension services; (ii) training extension agents in technical and vocational education and training (TVET) and training farmers in Farmers Training Centers; (iii) water harvesting and irrigation; (iv) improved marketing opportunities; (v) restructuring peasant cooperatives; and (vi) supporting micro-finance institutions.

However, policymakers gradually came to realize the limitations of SDPRP during its early implementation. By the time the next national development plan, *A Plan for Accelerated and Sustained Development to End Poverty* (PASDEP) 2005/06–2009/10, was prepared, there was sufficient recognition of the problems associated with an agricultural development strategy exclusively targeted to smallholder agriculture in rural areas. The productivity of the agricultural sector did not show significant improvement, and output remained volatile due to heavy dependency on the amount and timing of rainfall. In the 2002/03 season, the output of the crop sub-sector contracted by 16.5% following a decline of 3.7% in 2001/02. It was only in 2003/04 that growth in the agricultural sector in general and the crop sub-sector in particular

2 For the creation of a suitable political model, a series of statements and documents by Prime Minister Meles were noteworthy. Among these, particularly important were “Speech by HE Meles Zenawi” at the First Meeting of the Africa Task Force of the Initiative for Policy Dialogue organized by J. Stiglitz (Columbia University) at Manchester University in August 2006; and the Prime Minister’s preliminary draft on “African Development: Dead Ends and New Beginnings” in 2008.

started to recover significantly. From a long-term perspective, however, the labor productivity of agriculture has been on a declining trend (World Bank, 2007). Although agriculture has shown strong performance in recent years thanks to favorable weather, this did not herald a significant structural change such as crop diversification or productivity improvement.

PASDEP 2005/06–2009/10 made important adjustments to SDPRP 2002/03–2004/05 by broadening the policy scope from smallholder agriculture to other sectors, especially the industry sector and the urban sector. In what may be called *Enhanced ADLI*, strong emphasis was placed on growth acceleration, which was to be attained through commercialization of agriculture and private sector development (PASDEP, Eng. p.46).

In the first three years of the PASDEP implementation period of 2005/06–2009/10, good performance was recorded in agricultural and industrial production as well as export. Subsequently, however, the Ethiopian economy experienced a slowdown accompanied by inflation, balance-of-payments pressure, and a severe shortage of foreign exchange. Several causes are cited for this boom-and-bust cycle such as expansionary fiscal and monetary policies, an excessive inflow of foreign funds (including aid) relative to economic size, unfavorable weather, speculation and hoarding, and international events such as commodity inflation and the global financial crisis.

Performance of real sectors, such as agriculture and industry, is dependent on a number of factors including long-term trends in productivity and economic structure as well as short-term and largely external shocks in international economy and politics. The three-year boom starting around 2005 and the less spectacular results in the later years seem to have been affected more by short-term events rather than long-term trends produced by policy effort and private dynamism (chapter 8). Signs of significant structural change are not yet visible. In recent years the industry's share of GDP has hovered around 13–14% and Ethiopian export continues to be dominated by unprocessed commodities (Table 5-1). Although leather products and cut flowers have shown remarkable export growth, they still occupy a small part of total export without a notable breakthrough in competitiveness or productivity (Table 5-2).

Table 5-1. Basic Data

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	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 (million Birr)	58,789	66,648	68,027	66,557	73,432	86,661	106,473	131,641	171,834	245,585
Nominal GDP (million USD)	7,828	8,188	9,167	7,794	8,559	10,042	12.306	15,164	19,539	27,939
Per capita GDP (USD)	129	131	127	118	126	143	171	205	257	357
Sectoral share of GDP (%) 1/										
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
Services	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 balance (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, million 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	-	-	-
Birr/USD (annual 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/ Numbers do not add up to 100% due to estimate errors of intermediary margins of financial institutions (service sector).

Table 5-2. Export Performance of Targeted Industrial Products

(In million USD)

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Total export	597	819	1008	1185	1481	1450
Leather and leather products	43	67	75	89	101	76
Semi-finished leather	42	56	58	49	67	…
Finished leather	-	3	8	27	12	…
Leather shoes	0.8	0.8	2	6	10	…
Agro products	20	34	36	43	52	48
Textile and garment	9	7	11	13	15	14
Cut flowers	12	21	63	111	130	…
(Memorandum items)						
Sum of above four (% of total export)	14.1%	15.8%	18.4%	21.6%	20.1%	…
Sum of above four (% of GDP)	0.8%	1.0%	1.2%	1.3%	1.1%	…

Source: Ministry of Trade and Industry.

5-2. Democratic Developmentalism

5-2-1. Democracy in a poor country

By adopting DD and ADLI, Ethiopia intends to radically transform the state management paradigm, politically and economically, from the system in which *rent seeking* is the dominant behavioral pattern to the system in which *value creation* is central. This reflects Ethiopian leaders' deep disappointment with the previous ruling paradigms: the paradigm of a predatory state, which was the root cause of rent seeking in Africa, as well as the neo-liberal paradigm that was introduced from outside in the 1980s and 90s with the purpose of eradicating such rent seeking but, according to Ethiopian leaders, failed miserably. Based on the rejection of both paradigms, an alternative development paradigm is proposed. The remainder of this chapter will describe and assess DD and ADLI as the models of political regime and policy principle for development. Our intention is not to offer a comprehensive review of the current developmental situation of Ethiopia, of which DD and ADLI constitute only one, albeit very important, component.[3] It should also be noted that DD and ADLI go beyond theory or thought experiments to serve as pragmatic and action-oriented principles for establishing legitimacy and guiding policy formulation and implementation of the Ethiopian government. In particular, ADLI provides a set of ideas that govern concrete policies such as five-year development plans and industrial master plans as well as Ethiopia's relationship with donors and foreign businesses.

DD can be defined as a political regime in which a developmental party remains in power for a long time by consecutively winning multi-party elections and under which policies that punish rent seeking and encourage productive investment are implemented with strong state guidance. This should be construed as a model which Ethiopia is trying to attain rather than an already-established and well-functioning political regime.

The transformation of development strategy must begin with politics because, in the recognition of Ethiopian leaders, the developmental failure of Africa comes not only from the technical shortcomings of economic policy but also, more fundamentally, from political factors such as the lack of leaders, political will, and a regime that can resist private profiteering and promote national development. For this reason, a political regime consistent with national development must be installed before the

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[3] To review the political and economic situations of Ethiopia more comprehensively, the analytical scope should be enlarged to include the concept of Revolutionary Democracy, ethnic balance, federalism, opposition parties and anti-government groups, NGOs and CSOs, the Diaspora, foreign relations, international organizations, and donors (including emerging donors such as China, India, and Turkey).

formulation of concrete policy measures. The developmental state must prepare conditions for mobilizing available resources to create institutions, policies, and incentive systems to stimulate domestic value creation. Moreover, this endeavor must be undertaken under the rules of democracy rather than dictatorship.

The DD model aims to build a political regime unique to Ethiopia. DD is different from East Asia's Authoritarian Developmentalism (AD) which postponed democracy for the sake of development (section 5-2-4) or the Western style "good governance" that requires an early adoption of advanced governing principles in latecomer countries. The kind of democracy that can be adopted in a poor country is not an ideal type equipped with full conditions and features. Democracy is not an all-or-nothing choice; it comes with variations that reflect the history and structure of each society. The development of democracy must be supported by the creation of appropriate mindsets and institutions, which take time to be installed, just as a market economy must be supported by an array of suitable mindsets and institutions. In this sense, DD is a variation of democracy which is realistic, manageable, and consistent with the developmental goals of a poor country that faces many constraints and problems. The core element of this democracy is the election-based transition mechanism with the existence of opposition parties. But even this limited aspect of democracy is subject to many challenges which prevent its smooth operation (section 5-2-2).

Why should a country in an early stage of development adopt democracy instead of authoritarianism? One reason is the inherent and universal values of democracy itself such as freedom, human rights, empowerment, and participation. Another reason, from the perspective of the ruling authority, would be to use democratic procedure to secure legitimacy, maintain national unity, and gain popular support for developmental policies. Additionally, it must be noted that no country at present, regardless of its development stage, can be admitted as a valid member of the international community and receive aid and cooperation unless it embraces a democratic form of government. This is an international environment sharply different from the one which, for instance, Taiwan or Korea faced during the Cold War era.

5-2-2. Instability of developing country politics

In developing countries, politics is often characterized by radicalism and instability even if democracy is formally in place. Based on extensive qualitative research, Prof. Paul Collier of Oxford University concludes that democracy has not yet produced accountable and legitimate governments and has rather increased political violence in many developing countries, especially in the societies of the "Bottom Billion" (Collier, 2009). This occurs because governing rules are yet to be institutionalized and authority has not been firmly established and accepted. If there is no consensus regarding how democratic procedure should be applied in practice, the incumbent government can exercise much discretion in such matters as election, human rights, budgetary allocation, and relationship with the parliament. Equally, opposition groups can easily criticize and challenge any action by the government. Such a confrontational situation is fairly common in developing countries.

On the basis of extensive qualitative research, Paul Collier, Professor at the Oxford University and the author of *The Bottom Billion*, argues that in many developing countries (especially in the societies of the bottom billion), democracy has not yet produced accountable and legitimate governments and has rather increased political violence.

As a result, politics becomes violent. This may partly reflect a serious schism in social structure associated with ethnicity, religion, region, income gaps, or urban-rural disparity. Nevertheless, political instability often goes far beyond what these social problems can explain. Potential areas of agreement are rejected, conflicts become entrenched, and policies swing from one extreme to the other. Vendetta politics is repeated as former leaders are prosecuted and their policies are reversed by incoming governments. Each time the government and those who oppose it exchange emotional volleys, radicalism is amplified.

Under such circumstances, elections may not go smoothly or peacefully. Those in power rarely intend to lose the next election and mobilize all political and economic means, many of which are not permitted in advanced democracies, to ensure a favorable outcome. Meanwhile, the announced victory of the ruling party, whether by a landslide or a slim margin, is routinely challenged by the opposition. The election itself becomes a complicated political game, and victory in it can hardly confer full legitimacy. If the angered opposition resorts to violence and the government responds in kind, an election may even further destabilize politics. In Ethiopia, the events following the 2005 national election showed that the country was not free from the risks associated with developing country politics. In the 2010 national election, however, the ruling party won a landslide victory and regained urban votes without major violence.

To reduce such instability, it is necessary to install a mechanism to find areas of possible agreement in concrete policy issues between the government and the (moderate) opposition. Even if the two parties totally disagree on some issues, there may be other issues on which they can come to partial or full agreement. In Ethiopia, meaningful discussion may be held on such topics as the upgrading of agricultural or industrial strategy, training of human resources, and macroeconomic analysis.[4] Establishment of a public-private forum to debate these issues would greatly reduce the emotional tension and policy gaps between the two parties, and may help to avoid extreme policy swings even when governments change. Such dialogue and policy stability are mutually reinforcing. The success of policy dialogue depends on the existence of constructive attitudes on both sides, but policy dialogue can also serve as the means to foster such attitudes.

Under DD, a legal procedure for political transition through election is installed, while the ruling party is often determined to stay in power for a long time. It may be argued that these requirements are in conflict with each other. If the possibility of power change is a real one, it is highly unthinkable that one party will consistently win elections for a number of decades. Every time a new government comes into power, previous policies will be cancelled or at least greatly modified, and long-term consistency of development policies will be lost. By contrast, if DD has a hidden mechanism which effectively prevents the opposition from winning, there is no real political competition and the opposition and anti-government groups

[4] On the other hand, debate over land policy or liberalization of the financial and telecom sectors may be too difficult to launch between the government and the opposition in the present circumstances of Ethiopia.

will certainly cry foul. This is a real challenge that must be clearly recognized and eventually overcome for DD to work as an effective regime to accelerate national development. The existence of this challenge does not discredit the notion of DD but it requires the Ethiopian government to stay in power by successful execution of development policies successfully rather than through income re-distribution or political suppression.

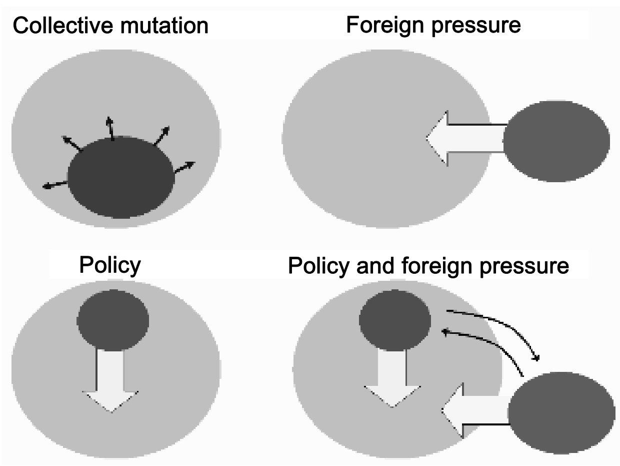
EPRDF, the developmental party of Ethiopia, hopes to stay in power to implement development policies continuously and consistently. It wants to stay in power by persuading the people of the need to launch a new developmental paradigm and by achieving initial successes in its implementation. This is expected to foster a domestic political coalition supportive of developmentalism and to allow the government to execute more development policies. This virtuous circle will ensure victory in coming elections. In this scenario, the main political base of the ruling party is the smallholder farmers that account for 80% of the population (section 5-2-4). Small entrepreneurs in urban areas are also considered to be part of the support base although their number is not large at this moment. This is a political regime called "dominant party democracy" led by EPRDF or, alternatively, "dominant coalition democracy" if political coalition between the government and smallholder farmers is emphasized.

In a sense, the dominant party democracy aspired to by the Ethiopian government is akin to the Japanese political regime under the dominance of the Liberal Democratic Party (LDP) from 1955 to 2009. Equipped with highly developed democratic institutions and continuously winning elections, the LDP stayed in power alone or by forming coalitions with other parties for more than half a century (except for a short interruption). Its power base was also rural. However, Ethiopian DD has one crucial difference from the LDP regime in Japan: the LDP miserably failed to improve the productivity of agriculture and managed to stay in power by transferring income from industry to agriculture and from urban to rural residents through subsidies, protectionism, and allocation of public works. Japan, with high income and advanced industries, may have the luxury of pampering farmers but Ethiopia cannot follow such a model. The combined DD and ADLI will never succeed unless there is a significant breakthrough in agricultural productivity. This is a very important point to which we will return (section 5-2-4).

5-2-3. Government as an agent of systemic change

According to Comparative Institutional Analysis, which studies the diversity and dynamics of institution, it is not easy to transform a "system" (a collection of institutions) which has been installed and already solidified (Aoki, 1995a; Aoki, 2001). Different types of inertia work to defend the existing system such as *institutional complementarity* (mutual dependence of institutions in which removal of only one institution hardly changes the system), *strategic complementarity* (strong incentive for individuals to follow existing rules and play the existing game), and *path dependency* (difficulty of deviating from the system which was chosen first and subsequently solidified). At the same time, there are also patterns in which systemic transformation can occur even under such inertia (Figure 5-1).

Figure 5-1. Patterns of Systemic Transformation



The first is collective mutation. This occurs when a sufficiently large number of people change their behavior spontaneously without external guidance or directives. In the context of developing countries, this may happen when a resistance movement arises against suppression or deprivation or, conversely, when a sustained rise in income and living standard changes the values and wants of the majority of the population. The second is policy launched by the government. The government is one of the insiders of a society but can become a dynamic actor (as *deus ex machina*, a god who appears out of context to solve confusion in an ancient Greek play) to force a change on other members of the society. The third is foreign pressure. For better or worse, foreigners and foreign organizations are not bound by domestic rules and can become an agent for systemic change in that society. Finally, there is a possibility of effective cooperation between the government and foreign pressure. This does not mean that the government and foreigners are always on good terms. But when the government as a leader initiates a clear direction for change and the foreigner as a follower supports it, the probability of systemic transformation will rise significantly.

Using this framework, what the Ethiopian government is trying to do can be interpreted as using policies as a primary driver to install developmentalism (i.e., to replace rent seeking with value creation) and additionally soliciting foreign investors, bilateral donors and international organizations to enhance this effort. This endeavor must achieve the two tasks of destroying selfish motives, patronage, zero-sum games, and dependency culture associated with the old system on the one hand, and building institutions, human resources, technology and incentive structure to support the new system on the other. Both will require enormous social energy to surmount political resistance.

The most critical element of state-led systemic transformation is *leadership*. This includes both the quality and capability of the top leader as well as the appropriateness of the visions and principles that guide national transformation. The importance of leadership can hardly be overstated. Even in the high performing economies of East Asia, the value creation system was not in place when they entered the period of high growth. Before 1960, South Korea was a basket case with rampant corruption, administrative inefficiency, and high dependency on US aid for survival (World Bank, 1993). Similarly, in 1959, the World Bank report on Thailand lamented the absence of public investment management and the severe shortage of trained or experienced bureaucrats (World Bank, 1959). These situations were turned around by President Park Chung-hee (in power 1961–79) in South Korea and the governments of Prime Minister Sarit (in power 1958–63) and Prime Minister Prem (in power 1980–88) in Thailand. Similar systemic breaks occurred when strong and economically literate leaders emerged in Taiwan (President Chiang Kai-shek), Singapore (Prime Minister Lee Kuan Yew) and Malaysia (Prime Minister Dr. Mahathir).

The Ethiopian leaders explain the failure of the neo-liberal paradigm as follows. The neo-liberal paradigm failed to uproot the rent seeking system because it denied the role of government as a dynamic agent of systemic change. The naïve view of "market is good, government is bad," which preached a minimalist government, could not create an agent powerful enough to launch a systemic change in a latecomer developing country. The policy package consisting of liberalization, privatization, decentralization, and international integration generated a horde of new domestic and foreign rent seekers such as non governmental organizations (NGOs), voluntary organizations, mining companies, foreign firms, and ODA contractors and consultants who rallied for budgets and subsidies without producing a systemic change. The idea of "Trickle Up Democracy," which was intended to eradicate rent seekers by giving power to people and local communities, did not succeed in installing developmentalism in Africa.

Many studies confirm that economic liberalism does not necessarily generate development in low-income countries. Ishikawa (1990) presented evidence from China on the failure of liberalization policies to produce production incentives in an economy with underdeveloped markets; Nishimura (1994) and Aoki (1995b) showed that rapid privatization in Russia created new gigantic rents and their seekers; Khan (2008) argued that capability to direct rents to productive purposes such as investment and technology absorption, rather than to eliminate rents, was needed in a country that lacked market supporting institutions; and Ohno (2009) contended that Washington Consensus policies could take a country to middle income but climbing further would require a combination of more proactive policies and private dynamism.

In Ethiopia, a strong state is guiding the other members of society for development. A government led by a strong leader is giving incentives (carrots) and disincentives (sticks) to economic actors such as farmers, workers, merchants, entrepreneurs, and foreign investors to adopt behavioral patterns based on value creation rather than rent seeking. Donor assistance must also align closely with the development strategy of the Ethiopian government in order to be accepted. Even with small farmers who are the main partners in political coalition, the government offers top-down directives and incentives for productivity improvement rather than responding to their voices in a bottom-up fashion. In this sense, the role of small farmers in political coalition remains a passive one.

The strategy of combining carrots and sticks is most clearly seen in the leather and leather product industry. The goal of this industry set by the Ethiopian government is to supply finished leather or finished leather products for export and domestic sales by acquiring management and technology capabilities to process what has hitherto been sold as raw or semi-finished leather. As sticks, a ban on raw material export and a high tax on semi-finished leather have been introduced. As carrots, a large number of supporting measures have been offered to the industry including (i) establishment of the Leather and Leather Product Technology Institute (LLPTI) to provide training, quality tests, and some production processes; (ii) donor assistance, foreign advisors, and twinning with a foreign institution for strengthening LLPTI; (iii) preference in finance and foreign currency allocation; (iv) business matching between domestic shoe producers and European firms; and (v) monthly government-business meetings to monitor the industry and solve its problems.

What will guarantee that DD will not repeat the same mistake as the neo-liberal paradigm—that it will not become a new playground for rent seekers? Experiences of other developing countries show that there is no magic formula to ensure that a strong state will generate long-term growth. On the contrary, it could easily fall pray to patronage and collusion among politicians, bureaucrats, and businesses. Although institutions and pressures for policing rent seekers should be built, this will take a long time in a country in the early stage of development. At present, Ethiopia is led by a strong and intelligent leader who is determined to avoid such political capture. This is a source of strength for the moment but may become a source of weakness when the time for power transition arrives.

5-2-4. Political and economic potential of small farmers

It is natural that a developmental party intending to win an election every five years would choose small farmers, which occupy 80% of the Ethiopian population, as its support base. In addition, small and medium size entrepreneurs in the urban areas are also counted as its future support base, although their number is still small.

Generally speaking, poor farmers are characterized by conservatism, low levels of education and knowledge, and submissiveness to authority. Although disgruntled farmers may resort to uprising and violence, it was rich farmers, village leaders, or landlords equipped with education, judgment, and material wealth who became constructive political partners in the early days of democracy in developing countries—as observed in Meiji Japan in the late 19th century. Even if small farmers are elevated to the position of principal political partners, it is difficult to mobilize them on a national scale unless they are given orders from above—as seen in Mao Tse-tung's mass mobilization of Chinese peasants for the Great Leap Forward in the late 1950s. In the early years of development, small farmers are often passive followers rather than mature and independent partners of national politics. This is a point which is entirely different from the validity of autonomy, participation, empowerment, and other grass-roots activities in rural communities. The question therefore is what incentive small farmers have for accepting such a position.

The minimum condition for small farmers to accept the government's lead is the perception that the latter will not suppress them or drive them into despair. A better incentive is the receipt of official aid for the improvement of their livelihood such as famine relief, food aid, and education and health services. Better still, they will more willingly follow if the government provides productive assistance such as technology, fertilizer, seeds, irrigation, and finance. It will be ideal if farmers raise productivity and income thanks to such productive assistance and become commercial producers.

In Ethiopia, at least some of the above conditions are satisfied because a considerable number of rural assistance programs are already in place. A nationwide food aid program with a large amount of donor assistance has been established to improve food security. Expenditure on agriculture and rural development is relatively high in Ethiopia.[5] Productive support has also been consistently prioritized towards the agricultural sector in national development plans such as SDPRP 2002/03–2004/05 and PASDEP 2005/06–2009/10.

Besides these programs, agricultural extension services have been greatly strengthened in the last several years (Tables 5-3 and 5-4). Ethiopia has completed the process of assigning three agricultural extension workers in charge of agricultural technology, livestock management, and resource utilization respectively, and establishing a Farmers Training Center, in every village (*kebele*) of the country. Additionally, two female health workers are being stationed in every village. Nationwide extension services such as the ones Ethiopia has built are still rare in Africa. The next challenge for Ethiopia is to fully utilize this network to improve the agricultural productivity and livelihood of rural residents.

Table 5-3. Numbers of Farmers Training Centers and Agricultural Extension Workers

	Established or trained in each year						Cumulative as of Jan. 2010
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	
Farmers Training Centers		1,500	2,200	2,000	1,782	…	9,265
Agricultural extension workers	9,368	13,899	13,383	15,095	9,404	636	61,785

Source: Agricultural Extension Department, Ministry of Agriculture and Rural Development.
Note: As of January 2010 the number of trained agricultural extension workers exceeded the official target of 60,000. However, the number of actually allocated extension workers was less than those trained (Table 2-4). The number of operational Farmers Training Centers as of January 2010 was 6,543.

Table 5-4. Numbers of Extension Workers and Service Delivery Stations (Allocated or Established)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Agricultural extension workers		9,434	23,359	34,446	49,435	…
Health Centers	451	519	600	635	690	826
Heath Posts	1,432	2,899	4,211	5,955	9,914	11,446
Health Workers			2,737	8,901	17,653	24,571
Primary schools		10,394	11,780	19,412	20,660	23,235
Primary school teachers		105,788	121,077	203,040	225,319	253,586

Sources: Education Management Information System; Health Management Information System; Ministry of Finance and Economic Development, *Annual Performance Review*, various issues; Ministry of Health, *Health Sector Development Plan-III Annual Performance Review*, June 2008; and Agricultural Extension Department, Ministry of Agriculture and Rural Development.

[5] According to the World Bank (2008) estimate, the ratio of agriculture-related expenditure to total government expenditure in Ethiopia is 6.7%, which is higher than the corresponding ratios in Mozambique (2.2%), Kenya (2.0%), Tanzania (2.1%), Vietnam (6.0%), Indonesia (0.2%), and Pakistan (1.2%).

The most fundamental question is whether and how smallholder subsistence farmers, who are the dominant majority as well as the chosen coalition partner of the developmental state, can be commercialized and improve productivity and income. As noted above, political support of small farmers can be secured with a perception that the government is a positive—or at least not negative—factor in their livelihood. But the grand objective of DD and ADLI is to transform the national economic principle from a zero-sum game to a sustained increase of GDP. If the productivity of agriculture does not improve, the state will eventually face fiscal crisis and aid dependency. If developmentalism results only in the buying of rural votes through redistribution of benefits, it must be considered a failure. What is needed is a detailed strategy and a realistic roadmap for commercialization of agriculture based on improved productivity. To meet this challenge, Ethiopia needs more selectivity and concreteness in its agricultural and rural development strategy.

In Central Highlands where the majority of the Ethiopians reside, small farmers are scattered across vast mountainous terrains with difficult road access. They live on what they produce with little external sale or purchase. The supply of electricity, drinking water, and hygiene is severely limited. Agriculture basically depends on the whims of rainfall. The use of fertilizer is inadequate, and the arable plot of each family is very small and frequently further subdivided under population pressure. Eastern Tigray, Eastern Amhara, and Eastern Oromia are particularly vulnerable to drought due to unstable rainfall and soil erosion. Land division has gone to extremes in some parts of Southern Region such as Gurage and Wolayita. Pastoralists lead nomadic lives in the sparsely populated dry areas in Eastern and Southeastern Ethiopia, especially Somali and Afar Regions. In recent years, the Ethiopian government has made much progress in preparing necessary conditions for agricultural and rural development, including establishment of nationwide extension services mentioned above. Nonetheless, a productivity breakthrough from these unfavorable initial conditions is a task that requires long and concentrated effort.[6]

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[6] After the severe drought of 2003/04, the Ethiopian government introduced the Productive Safety-net Program targeted to the most vulnerable areas and actively mobilized international aid amounting to about USD300 million annually. However, the number of farmers who have graduated from this program is limited. As of 2009, 7.57 million rural residents were in need of continued support from

According to the sample surveys conducted by the Central Statistical Agency, agricultural production has shown an upward trend and land productivity of major crops is also rising (Tables 5-5 and 5-6). This seems inconsistent with the pessimism expressed in the foregoing paragraph, but there are a few catches. First, the periods covered in Tables 5-5 and 5-6 were marked by relatively good weather and an increase in fertilizer use, which cannot be sustained indefinitely in the future. Second, more seriously, Ethiopian agricultural data are unreliable and do not reflect real trends.[7] This is caused partly by inadequate statistical technique and shortage of personnel and partly by the incentive to overstate output relative to targets when local officials report the results. For this reason, it must be concluded that recent agricultural performance is unknown and no basic data on which policy discussion can proceed exists in Ethiopia.

Table 5-5. Agricultural Production

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	Average growth per year
Cereals	90,062	100,308	116,242	128,798	137,170	144,964	10.0%
Edible oil	3,129	5,264	4,866	4,971	6,169	6,557	15.9%
Pulses	10,373	13,496	12,712	15,786	17,827	19,646	13.6%
Vegetables	3,879	4,320	4,502	3,451	4,720	5,989	9.1%
Root crops	16,055	16,152	13,375	14,095	15,309	12,136	-5.4%
Fruits	2,495	2,634	4,283	4,600	4,621	3,513	7.1%
Coffee	1,262	1,562	1,716	2,415	2,734	2,602	15.6%

Source: Ethiopia Central Statistical Agency, agricultural sample surveys.

Table 5-6. Land Productivity of Major Crops

(Quintal/ha)

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Barley	11.7	12.1	2.7	13.3	13.8	15.5
Maize	18.6	17.2	21.9	22.3	21.2	22.2
Teff	8.4	9.5	9.7	10.1	11.7	12.2
Wheat	14.7	15.6	15.2	16.7	16.3	17.5
Sesame	6.7	8.5	7.3	7.1	10.1	7.8
Broad beans	11.2	1.9	11.2	12.6	13.2	12.9

Source: Ethiopia Central Statistical Agency, agricultural sample surveys.

this program (World Bank, 2009).

7 Dercon, et.al. (2009), as well as many donors, stress the need to check data reliability on agricultural production and land productivity.

The problem faced by small farmers is not only a supply-side problem of agricultural production but also a demand-side problem of finding markets. In addition, they face a quality-of-life problem that requires poverty reduction and empowerment. The policy package for small farmers must therefore have a broad perspective and pursue multiple objectives. In addition to the existing PASDEP and five-year agricultural development strategy containing a large list of supply-side targets and measures, proper re-organization of targets and measures in agricultural and rural strategy, including demand-side and livelihood issues, is in order.

On the demand side, the current strategy of commercializing smallholder agriculture targets export markets. For such products as coffee, leather products, and cut flowers, this seems a reasonable direction. However, marketing should be flexible enough to reflect different potentials of individual products and localities. For some agro products, penetrating a global (or even urban) market, which demands high quality and hygiene standards, stable supply in large quantity, and on-time delivery, may be too difficult initially. The policy menu should be broadened to include "closer" markets such as (i) expansion and diversification of agro and livestock products for nearby cities, towns, and villages; (ii) promotion of tourism; (iii) creation of local specialty products; (iv) the "one-village-one-product" approach; and (v) establishment of *michi-no-eki* (roadside stores to sell local products and serve local food). The newly created agricultural extension service network should be used fully to implement these options.

As for quality-of-life improvement, many programs are being carried out with government budget and donor support to realize the Millennium Development Goals (MDGs). However, the *rural life improvement movement*, which emphasizes improvement of concrete mundane activities at the grass-roots level and combines both top-down and bottom-up approaches, should also be considered. Mizuno (2008) warns that the mainstream strategy for rural development underestimates the importance of multi-faceted improvements of rural life aspects such as meals, clothing, housing, hygiene, and social relations. Rural development from a very low level must embrace production, marketing, and quality-of-life aspects simultaneously. Mizuno cites the experience of Japan immediately after WW2 as one of the most successful cases of a rural life improvement movement.[8] Similar movements have also been implemented in many other Asian countries including Korea, India, Indonesia, Thailand, and Vietnam with different scales and degrees of success (Cruz, 2002).

5-2-5. A comparison with East Asian Authoritarian Developmentalism (AD)

How does DD of Ethiopia compare with the AD which was popular in East Asia in the late 20th century? Let us first note that developmental regimes in East Asia have been quite diverse. The typical AD regimes were Taiwan and South Korea in the past. China after Deng Xiaoping, Singapore, and Malaysia can also be regarded as AD. On the other hand, Indonesia under Suharto and the Philippines under Marcos failed to solve structural problems in politics or economics (or both) to be counted as AD despite certain initial achievements in income and growth. Thailand, which has attained middle income despite frequent political and economic crises, is located between these two groups. Vietnam has sustained high growth under one-party rule since the early 1990s, but its policy formulation capability remains low. Besides these, East Asia also contains very poor countries such as Laos and Cambodia, and non-developmental dictatorships such as Myanmar and North Korea. Therefore, AD to be analyzed here for the purpose of comparison with DD is an ideal type which is most closely represented by Taiwan and South Korea before their transition to democracy.

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8 Under the direction of the US occupation forces, the Japanese Ministry of Agriculture launched the "Life Improvement and Dissemination Movement" in 1948. Many local governments also introduced similar programs with great enthusiasm. This movement, though originally started with a top-down structure, encouraged grass-roots activities with strong participation at the village level. Life improvement dissemination staff consisting of rural women were organized. They took the lead in improving cooking, nutrition and meals; clothing, bedding and footwear; cleaning, washing, water carrying, and other domestic chores; child raising and training; wedding, funeral and other ceremonies; public morals; and elimination of superstition and feudal habits. Regular meetings were held with the participation of all village households where issues were debated and consensus was formed. Government officials and village staff jointly solved problems arising from complex social relations in rural communities such as the increase of absenteeism during planting and harvesting seasons, the feudal concept of family, and the lack of cooperation from husbands and mothers-in-law (Mizuno, 2008; Ikeno, 2008).

With these caveats in mind, let us enumerate the outstanding features of East Asian AD: (i) emergence of the regime in response to a domestic or regional crisis (communist threat was the most common external crisis in East Asia); (ii) strong leadership exercised by one charismatic leader; (iii) an elite technocrat group carrying out the leader's vision; (iv) prioritization of developmental ideology (i.e., postponement of political reform); (v) legitimacy through economic performance rather than democratic procedure; (vi) continuation of the same regime for two to three decades and social transformation that it generates (Watanabe, 1995; Ohno and Sakurai, 1997; Banno and Ohno, 2010). The AD regime has the following sharp differences from the DD model which Ethiopia aspires to adopt (Figures 5-2 and 5-3).

Figure 5-2. Democratic Developmentalism of Ethiopia

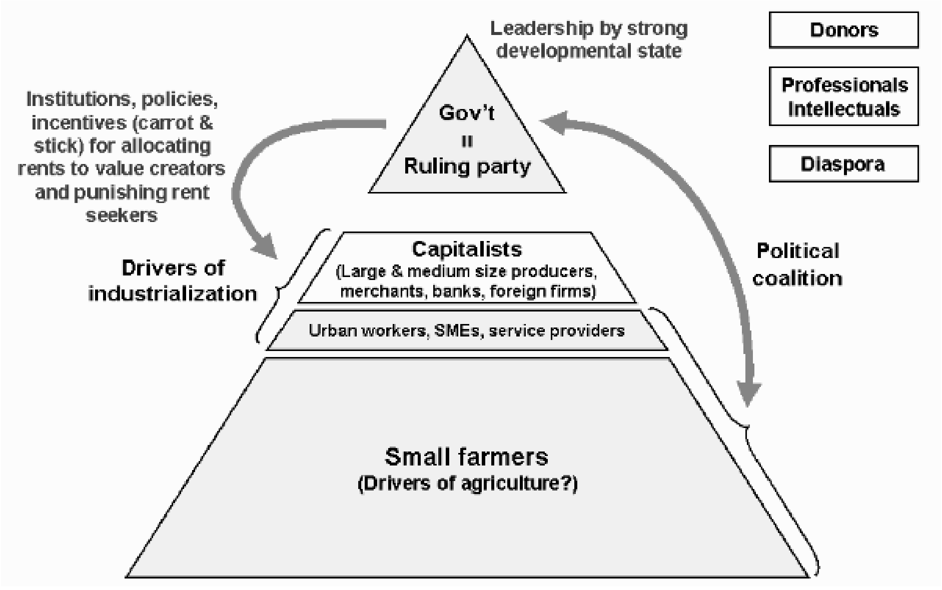
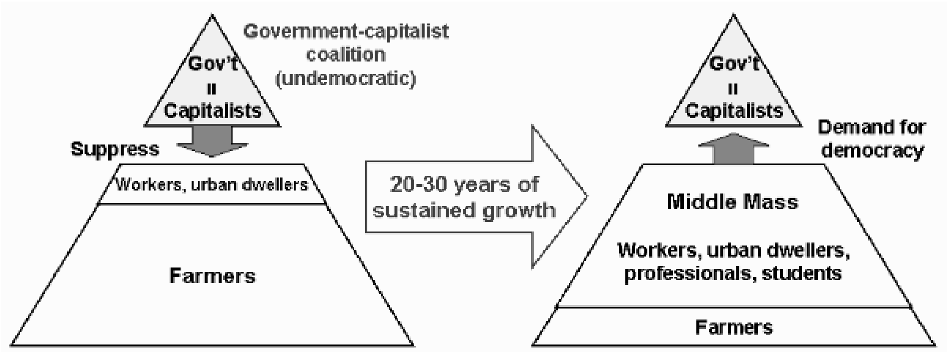


Figure 5-3. Dynamic Transition of East Asian Authoritarian Developmentalism



First, East Asian AD is a proven model that has been adopted in many countries with remarkable achievements in income generation and structural transformation in at least some of them. In this sense, the validity of AD is indisputable under certain historical circumstances. By contrast, Ethiopian DD remains a plan to be fully implemented in the future. Its advocates ought to convince the skeptics of the feasibility of DD in the social context of latecomer developing countries in general and in Ethiopia in particular.

Second, East Asian developmental states from the outset formed political coalitions with domestic capitalists—large businesses, conglomerates, banks, and so on—who were the executers of industrialization while effectively refusing to adopt the multi-party system with free elections. By contrast, the DD model of Ethiopia adopts the latter as one of the key ingredients at the starting point. The legitimacy of AD depended solely on its economic performance whereas that of DD will depend on both economic performance and democratic procedure. This is a vital difference between the two.

Third, dynamic social transformation was observed in East Asian high performing economies. AD achieved economic results over time which transformed the social structure, mindsets, and demands of the people. This social change accompanied a rise of a middle mass who demanded democratization. Their increasing pressure eventually toppled the AD regime. This pattern has already run its course in

Taiwan and South Korea while it is in progress in a number of other countries in East Asia. Watanabe (1995) calls this a "successful dissolution" of the authoritarian regime through the very success of its development. Meanwhile, what dynamic course the DD regime will trace if it is successfully implemented remains uncertain. It will probably take long for a strong middle class to emerge in Ethiopia. A government document states that Rural Democracy will eventually transform itself into Urban Democracy, but its concrete content or mechanism is unclear.

5-3. Agricultural Development Led Industrialization

5-3-1. Core ADLI

ADLI is defined as a development strategy which aims to achieve initial industrialization through robust agricultural growth and close linkage between domestic agriculture and domestic industry. This strategy was formulated in the early 1990s and has been implemented in stages, especially from the early 2000s, in Ethiopia. ADLI is considered to be an evolving strategy subject to pragmatic experimentation and adjustments rather than an immutable principle. The revisions made from SDPRP 2002/03–2004/05 to PASDEP 2005/06–2009/10 (section 5-1-2) as well as the currently proposed expansion of policy space, discussed below, reflect the evolving nature of ADLI that enables it to respond to changing circumstances, evaluation of past policies, and rising policy capability of the Ethiopian government.

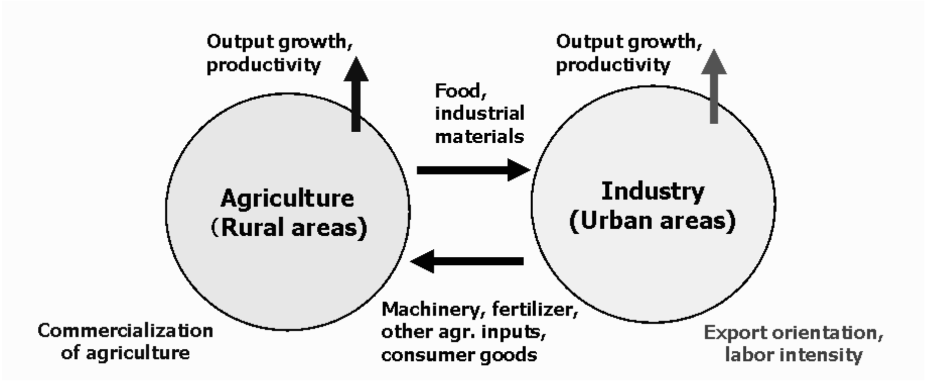
An early exposition of ADLI was given in *An Economic Development Strategy for Ethiopia* in 1994 as follows.

> The long term objective of development in Ethiopia is structural transformation of the economy in which the relative weight of agriculture, industry and service changes significantly towards the latter two. Especially, the objective is to raise appreciably the share of the industrial sector in the economy both in output and employment. This structural

> transformation is envisaged to occur with a high growth of agriculture which is superseded by growth of industry and services.
>
> In essence the development strategy revolves around productivity improvement of smallholder agriculture and industrialization based on utilization of domestic raw materials with labor-intensive technology. The strategy is akin to what is known in economic literature as agricultural-development-led industrialization (ADLI), framed into the Ethiopian context. It visualizes export-led growth which feeds into an interdependent agricultural and industrial development. Exports, be it agricultural and mineral, initiates growth thereby creating space for a process of an interdependent agricultural and industrial development (or ADLI), which increasingly becomes a self-generating process of development. Here the strategy has two layers; an outer crust of export-led growth and an inner core of ADLI…
>
> The strategy of ADLI in Ethiopia focuses primarily on agricultural development. This is to be attained through improvement of productivity in smallholdings and expansion of large-scale farms, particularly in the lowlands. The contribution of agriculture to economic development is conceived in two ways. On one side, agriculture will supply commodities for exports, domestic food market and industrial output, and on the other side, it will expand the market for domestic manufacture. At present, the importance of agriculture lies as a source of supply rather than demand. As industrialization picks up pace, over the long term the significance of agriculture as a source of demand will also rise. (FDRE, 1994, pp.8–9)

If ADLI is interpreted narrowly and strictly as a strategy to achieve early industrialization through direct material interaction between domestic agriculture and domestic industry as the main engine of growth with exports providing initial markets (with the implication that agricultural or industrial development without such interaction receives less attention), the situation can be depicted as in Figure 5-4. Let us call this domestic input-output dependency *Core ADLI*. In this interdependence, highlighted industrial sectors are agro processing (including leather products), which uses domestic agricultural inputs, as well as sectors that produce goods for rural communities such as agricultural tools and machinery, chemical fertilizers and pesticides, construction materials, and basic consumer goods such as processed food and beverages, clothes, and simple household goods demanded by the rural population.

Figure 5-4. Linkages in Core ADLI



The *Industrial Development Strategy* (2002) additionally lists the following conditions under which industrialization must proceed: (i) the leading role of the private sector; (ii) parallel development of agriculture and industry through mutual dependence (i.e., Core ADLI); (iii) export orientation; (iv) focus on labor-intensive industries; (v) proper roles of local and foreign direct investment (FDI) enterprises; (vi) strong state guidance; and (vii) mobilization of all social relations such as government-capitalists, capitalists-small farmers, and labor-management. The requirements of export orientation and labor-intensiveness should be underscored. Moreover, the second condition (Core ADLI) can be re-interpreted as the requirement for the maximum use of domestic resources. These three conditions are the main requirements for industry in establishing bi-sectoral interdependence. As noted above, this linkage is not a permanent one but something that can evolve into a new pattern in which industry will take the main lead once the initial stage of industrialization is realized. The *Industrial Development Strategy* clearly states that "[w]hen we say that we follow agriculture development led industrialization this does not mean that it will be so forever... if agricultural development led industrialization strategy is successfully applied it will be changed to industry led development strategy” (Eng. p.8).

The question concerning Core ADLI is whether this strategy is powerful enough to significantly propel early industrialization in Ethiopia. We do have historical examples in which agriculture grew relatively strongly prior to the period of full-scale industrialization and provided resources for industrialization through taxation and foreign exchange earnings (for example, silk and tea exports in late 19th century Japan, rice and sugar production in Taiwan up to the 1960s, and the rice export tax of Thailand up to the 1980s). There are also cases in which robust agro and fishery exports ameliorated the immiserization of rural communities often associated with globalization (for example, fish and shrimp exports of Southeast Asia). Agro and fishery products may even become leading exports (for example, Chilean wine and salmon). Agriculture can also serve as an income and employment buffer at times of economic crisis (for example, Japan immediately after WW2, and absorption of laid-off workers caused by state-owned enterprise (SOE) privatization in Vietnam in the early 1990s).

Despite all this, a historical example in which an industry using domestic materials as its main input has expanded dramatically to become the industrial pillar of that nation and contributed greatly to structural transformation is difficult to find. Agricultural development and industrial development are usually more distinct and separable than envisaged in Core ADLI. Japanese industrialization was not based on silk and tea, and neither the Taiwanese electronics industry nor the Thai automotive industry relied heavily on the domestic supply of rice.

In Ethiopia, the implementation of Core ADLI is most clearly seen in the leather and leather product industry in which domestic animal hides and skins are procured by tanneries and manufacturers to produce finished leather or final products such as leather jackets and shoes for domestic sales and export. However, even with significant expansion in recent years, this industry still remains small. In 2008/09, the export value of leather and leather products was USD76 million amounting to 5.2% of total export or 0.2% of GDP (Table 5-2). Whether this industry will grow robustly to lead broader Ethiopian industrialization is an open question.

5-3-2. Enhanced ADLI and policy learning

Although the early formulation of ADLI emphasized the direct linkage between domestic agriculture and industry, the current thinking of Ethiopian leaders is no longer confined to the framework of Core ADLI. While continuing to attach importance to Core ADLI, other strategic options and relations are also explored to promote industrialization. The first clear step in this direction was seen in PASDEP 2005/06–2009/10 in which growth acceleration through commercialization of agriculture and private sector development were highlighted. Policy targets in this Enhanced ADLI were not limited to smallholder farmers in rural areas. Large-scale commercial agriculture[9] (including flower farms), urban micro and small producers, medium and large manufacturers, and foreign-invested firms all came within the purview of Ethiopian industrial policy. Politically, expansion of policy scope to encompass urban producers can be understood as the government's response to include them in the democratic developmental state in the aftermath of disturbances following the national election in 2005, which revealed the lack of support of urban dwellers for the ruling party.

The current scope of Ethiopian industrial policy is sufficiently flexible that all policy options for industrial development, including those not compatible with Core ADLI, are freely studied and implemented. For instance, the agricultural sector can offer surplus labor, agricultural or land taxes, cheap food (wage goods), and foreign exchange and export earnings for the promotion of industrialization. The urban industrial sector in turn can transfer resources and technology through production support, food and service delivery, agricultural protection, or public investment (Figure 5-5). These transfers may be made directly as well as through fiscal and financial mechanisms. Furthermore, industrialization measures unrelated to agriculture, such as production of steel, cement, and other construction materials, FDI attraction, and establishment of industrial estates, have also been promoted.[10]

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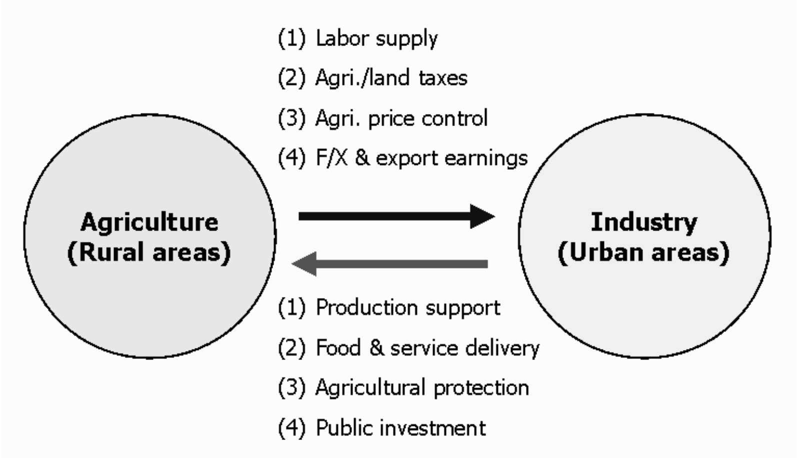
9 *An Economic Development Strategy for Ethiopia* discussed policies for large-scale commercial agriculture separately from policies for small farms (FDRE, 1994). However, concrete policies for the former were not activated until the early 2000s.

10 In the previous version of this paper, the GRIPS team recommended the broadening of policy scope

Although the policy scope was thus broadened and became more flexible, at least conceptually and in theory, the Ethiopian government could not immediately introduce a large number of additional measures to carry out all available policy options. Due to the lack of policy capability and experience, industrial measures had to be introduced in steps and through trial-and-error. In practice, during the period of PASDEP 2005/06-2009/10, what the Ethiopian government did mainly was to select a few export-oriented sectors and provided them with generous policy attention and financial incentives. The *Industrial Development Strategy* (2002) chose meat, leather, and leather products; agro processing; and textile and garment as three export-oriented priority sectors (in addition to the promotion of construction and micro and small enterprises). Later, floriculture (large-scale production of cut rose for export), an industry which emerged autonomously from the private sector, was added to the list.

Figure 5-5. Resource Transfers between Agriculture and Industry

(Other than Linkages in Core ADLI)



Note: These transfers may be carried out directly, through fiscal mechanisms, or through the financial sector.

beyond Core ADLI. However, Prime Minister Meles assured us that the Ethiopian policy scope was already much wider and that all possible contributions of agriculture to industrialization were being considered. He also remarked that the interpretation of ADLI as input-output relations between the two domestic sectors only was a caricature of this strategy which was in reality broader and more dynamic.

For promoting these priority sectors, the government has adopted a number of policy tools, measures, and organizational arrangements through self-learning, dispatch of students abroad, consultation with foreign experts, and technical and financial assistance of donors. They included compilation of policy documents; the monthly export steering committee chaired by the prime minister; productivity enhancing tools such as benchmarking, business process re-engineering, and kaizen; establishment of centers and institutes for priority sectors; creation of new science and engineering universities and TVET institutions; installation of federal and local public-private dialogue mechanisms; public administration reform; building of key power and transport infrastructure; and strategic mobilization of ODA and FDI for these purposes. Some of the policy innovations were learned from East Asia, especially South Korea and Taiwan. Thus, the last several years was a period of vigorous policy learning and experimentation by the Ethiopian government (details of these efforts are discussed in chapter 8).

One remaining question, perhaps a rhetorical one, is regarding the significance of ADLI when its policy scope is enlarged this much. The current policy scope is no different from that of any developing country in Africa or elsewhere. What is the meaning of ADLI, a concept which is supposed to guide the unique developmental path of Ethiopia? One possibility is that ADLI is a statement of political assurance that the interests of farmers and rural communities will never be sacrificed or forgotten no matter what industrial strategy may be adopted by the government. This may be similar to the use of the slogan of the "Socialist Market Economy" by the Chinese government, in which capitalism and globalization are embraced economically while communist power monopoly and effort to improve the livelihood of workers are firmly maintained politically.

5-3-3. Further expansion of policy scope and measures

At present, the expansion of industrial policy scope and measures is entering a new stage beyond what was envisaged in Enhanced ADLI. Specifically, there is an emerging interest in promoting import substitution industries such as construction materials (steel, cement, and so on), metal processing and engineering, and chemicals and pharmaceuticals in addition to a selected number of export-oriented sectors in the past. This policy shift is clearly observable in discussions within the government as well as among development partners. The Ethiopian government regards this as a "shift in emphasis within the same fundamental policy" whereas some call this a directional change in development policy. At this moment, however, this movement points only to a general direction without concrete principles, roadmaps, or action plans. Specifying these will be the task in the implementation period of PASDEP II.

One high official of the Ethiopian government stated that the introduction of import substitution policy had been discussed within the government for about two years. Others say that this change was advocated by Prof. Joseph Stiglitz of Columbia University who regularly advised Prime Minister Meles, Prof. Dani Rodrik of Harvard University who visited Ethiopia at the invitation of the World Bank, and Dr. Justin Lin, the chief economist of the World Bank. Some speculate that this policy shift was forced by the need to reduce imports to ameliorate the foreign exchange shortage that Ethiopia has been facing since 2008. Thus, there may have been multiple causes that jointly pushed the industry policy towards the inclusion of import substitution. What is important about this broadening of policy scope, however, is the fact that it is proposed on the basis of policy learning and experimentation of the Ethiopian government in the last several years. It is also interesting to note that import substitution, whose validity used to be summarily discredited by the Washington institutions, is now strongly recommended to Ethiopia by the World Bank and American economists.[11]

In the note prepared for the Ethiopian government, Rodrik (2008) argues that, while Ethiopia's "first-generation" industrial policies had achieved some success, especially in flower export, there is a need to move towards "second-generation"

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[11] The World Bank Executive Board approved the Protection of Basic Services (PBS) II, a budget support type program, for Ethiopia in May 2009 with the condition that the implementation of "directional change" mentioned above be implemented and monitored properly. The PBS I (2006–08), the precursor to this program, was initiated by re-organizing existing general budget support. PBS II will strengthen the delivery of basic services of local governments through budget support in the three year period of 2009–11. The International Development Association (IDA) will provide a total of USD540 million (USD309.78 million of grants and USD230.22 million of loans) and 12 other donors will supplement it with an additional USD737 million.

industrial policies aiming at both home and export markets. The existing industrial policy of Ethiopia consists of a short list of priority sectors which receive a variety of incentives. According to Rodrik, this narrow approach to industrialization has two limits:

> One is that many potentially successful sectors are almost certainly not on the list. There are potentially hundreds of different products in which Ethiopia can be competitive; yet it is hard to think of all of them ex ante. The most successful sector to date, floriculture, is a case in point. This is a sector that was brought to the government's attention—and made the priority list—only after private entrepreneurs had done the initial discovery and had come to the government for assistance. It is easy to imagine that there are many such industries that government policy fails to target simply because they are not in its list. At present, there is no mechanism in place to actively solicit "new" investment projects that may lie outside the priority list.
>
> Second, the assistance needed by investors may be highly specific to the needs of the project in a way that makes it impossible to specify ex ante. Cheap land and holidays on profits taxes may suit some investors just fine; but others may have different needs. One firm may need relief on payroll taxes, another from tariffs on inputs, and a third may want the relaxation of some regulation or legislation. In at least one instance, the prime minister has helped a large pioneer investor by agreeing to change a regulation (on qualification for DBE [Development Bank of Ethiopia] loans). But problems such as these are common at all levels, and it is unrealistic to expect that the PM himself can attend to them all. There is currently no mechanism in place to respond to such needs systematically. (Rodrik, 2008, pp.5–6)

For these reasons, Rodrik proposes the following six revisions to Ethiopian industrialization strategy: (i) broadening policy scope to include more sectors; (ii) supporting "new" activities for Ethiopia rather than exports; (iii) recognition that mistakes are both unavoidable and necessary; (iv) broadening the list of policy instruments; (v) giving incentives and subsidies to "pioneers" only and not emulators; and (vi) enhancement of lines of communication and coordination with the private sector. He also adds that success depends on the change in mindset in which industrial policy is regarded as a process of collaboration and problem-solving with the private sector rather than increasing the number of incentives or the volume of exports.

Most of Prof. Rodrik's recommendations are appropriate and supportable.[12] However, it is important to recognize the fact that the proper timing of policy expansion depends critically on the amount of policy learning. The proposed shift from the "first-generation" to "second-generation" industrial policies was hardly possible around 2003 when the Ethiopian government had just begun to promote industries with limited policy capability. At that time, selecting only a few export-oriented sectors and using simple measures such as cheap land, tax holidays, and preferential finance was reasonable because the government did not have sufficient knowledge or resources to conduct full-fledged industrial policies. By now, many policy tools and insights have been acquired through hands-on experimentation and donor support. Some initial achievements have also been made in the export of fresh flowers and leather products. With these records, Ethiopia is now set to go to the next stage of industrial promotion.

5-4. Concluding remarks

While the Ethiopian pursuit of DD and ADLI is in the early stage of implementation and their details may not be directly applicable to other countries, there are some general points of interest for all latecomer countries to observe. Three remarks are in order.

First, the Ethiopian effort at industrial policy innovation can be understood as an adaptation of political and economic regimes to the international reality of the early

[12] The GRIPS policy dialogue team does not agree with the idea that only pioneer firms should be provided with incentives and subsidies and not emulators (recommendation (v)) on the grounds that such selectivity is both impractical and unfair. See chapter 6 (section 6-3) for more discussion.

21st century. For developing countries, the basic menu for development policy is mostly the same. Any country must promote education and training, skills and technology, domestic enterprises and industries, agriculture and rural development, and power and transport infrastructure. It must also build institutions, laws and regulations, and monetary and fiscal mechanisms that enable these policies. In addition, revenues from natural resources must be properly managed and invested, and problems associated with growth such as inequality, urbanization, traffic congestion, and the environment must be dealt with. On the other hand, the international environment surrounding developing countries changes over time. The collapse of the Soviet Union in 1991 brought a particularly large shift in external conditions. During the Cold War era, a developing country belonging to one of the two ideological camps could receive a large amount of economic and military aid without intervention in the management of domestic politics or economy. But today, all countries are required to embrace democracy, markets, and globalization. Without doing so, financial cooperation or full membership in the international community is not granted.

The Ethiopian development regime of DD and ADLI is different from the authoritarian developmentalism of South Korea or Taiwan in the 1960s or the FDI-led industrialization of Southeast Asia in the 1980s and 90s. This difference comes mainly from the different international environment in which development must be pursued and not from different policy goals that Ethiopia has set for itself. The broad goals of development remain the same across ages and countries, but Ethiopia has to adjust to the reality of the 21st century so that it can secure a respectable position in the world and sufficient cooperation from donors and international organizations. The combination of DD and ADLI is innovative in the sense that it is a proactive attempt to ignite development with the rejection of the Washington Consensus and without counting on a large inflow of manufacturing FDI as in Southeast Asia. As a poor, landlocked, and resource-less country, Ethiopia's initial conditions are unfavorable. But policy innovation and learning initiated by Ethiopia—and its outcome—may offer important inspiration for other countries in Africa.

Second, the success of DD and ADLI critically depends on the concrete steps that

Ethiopia will take in attaining the common policy goals mentioned above. Among these, the two real-sector goals of productivity breakthrough and commercialization of smallholder farmers, on the one hand, and emergence of a strong and broad manufacturing base not confined to a few export sectors, on the other, are crucial. The adjustment of political and economic forms to changing global reality alone is not sufficient to achieve the substance of development, especially a vibrant and competitive private sector. For this, pragmatic policy effort featuring speed, flexibility, and attention to detail must be maintained for years.

Two factors are required for real-sector promotion. One is decisive and effective leadership, which Ethiopia seems to possess at the moment. However, a developmental state heavily dependent on one top leader will become vulnerable at the time of power transition. Good policies and policy processes should be institutionalized as much as possible to diminish this problem. The second requirement is the accumulation of practical knowledge by the ministries and agencies in charge of industrial policy formulation. Proactive industrial policy calls for far greater knowledge than either laissez-faire or socialist planning. To interact successfully with the private sector, officials must share with producers and investors up-to-date information on the industries in question. They must also be well informed about the pros and cons of concrete measures adopted in other countries. Effective channels of public-private dialogue must be established and concrete international cases must be studied with zeal, with the help of foreign experts if necessary.

Third, policy learning and expansion of policy scope are dynamically linked in Ethiopia. This is a highly laudable feature which we call *dynamic capacity development* (Ohno and Ohno, 2008). In a typical developing country, problems are many while policy capability is limited. This makes it difficult to decide where to start development efforts, and in which sequence and at what speed various policies should be introduced. International financial institutions used to demand a long list of difficult policy actions to be implemented before a short-term rescue package was released. Meanwhile, some experts argued against trying any of the so-called “industrial policies” because the risks of policy mistakes and political capture were too great. However, neither type of advice proved to be very constructive in breaking the poverty trap.

In recognition of limited policy capability in developing countries, the World Bank's 1997 *World Development Report proposed a two-part strategy* that called for constant effort to be made to improve policy capability while increasingly difficult policies were to be adopted over time to match the acquired policy capability. Ethiopia is practicing exactly what this World Bank report proposed. The only difference is that the World Bank emphasized general improvements in "rules and restraints," "competitive pressure," and "voice and participation," while Ethiopia prefers to improve its policy capability through problem-solving on such concrete matters as export promotion of leather products and proper selection of import-substitution sub-sectors for promotion. This approach is closer to the dynamic capacity development frequently seen in East Asia.

With the understanding and endorsement of the Ethiopian strategy that policy scope should be expanded gradually in line with policy learning, the GRIPS Development Forum hopes to provide specific, practical, and concrete information to support the planned policy expansion through the ongoing three channels of policy dialogue: Prime Minister, concerned Ministers and State Ministers, and operational levels.