October 2021

FDI Policy for Enhanced Value Creation in Ethiopia

Situation Analysis and Policy Proposals

GRIPS Development Forum Report

Foreword

At the request of high Ethiopian leadership, the GRIPS Development Forum (GDF) and the Japan International Cooperation Agency (JICA) have conducted a bilateral industrial policy dialogue with the Ethiopian government since 2008. This compact report is one of its policy research outputs focusing on the FDI policy of Ethiopia. It was produced by the GDF which takes full responsibility for its content. The author greatly appreciates the informational and financial support of JICA. Separately, there is a fuller analysis of FDI policy under preparation jointly by the Policy Studies Institute (PSI), an Ethiopian government think tank, and the GDF. A related study, the Ethiopia Productivity Report of 2020 by the same joint authors, is also available. Interested readers are invited to consult them as well.

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Introduction

Ethiopia is beset with three major challenges that may dampen economic activities and investment inflow. The first is the poor business environment where the acute shortage of foreign currency is the leading problem but there are also other serious inefficiencies and weaknesses. The second is internal political and ethnic instability which accelerated in recent years, obstructing business operations and depressing business confidence. The third is the COVID-19 pandemic which inconveniences businesses and slows down growth. The first two are Ethiopia's internal problems while the last is a global difficulty affecting all countries and sectors but to varying degrees. The pandemic will hopefully be under control and things will become more normal within a few years. But the first two are problems of long-term structural nature whose solutions will require significant national effort and sufficient passage of time.

This document addresses some of these challenges[1]. Discussion is confined to the economic sphere as internal politics and contagious diseases are beyond our purview. Our analyses and recommendations are grounded on Japan's past developmental experience, growth experiences of Asia's latecomer economies, and the ideas exchanged in the Ethiopia-Japan Industrial Policy Dialogue and JICA's industrial projects in Ethiopia since 2008. Our intention is to present thoughts of lasting nature to Ethiopia's policymakers. In particular, we explore ways to revamp Ethiopia's FDI attraction, take full advantage of the presence of FDI for economic growth and realize Ethiopia's developmental potential. Improved FDI policy may or may not resolve the burning issues of this particular moment, but an announcement effect of a credible policy direction will surely turn investor psychology and production trends for the better.

For latecomer countries such as Ethiopia, FDI attraction is one of the policy pillars of economic development. FDI is supposed to bring multiple benefits to the host country including generation of employment and income, better management, labor training, positive spillovers and linkage to domestic firms, knowledge of global marketing, opportunities to participate in global value chains, and so on. But these benefits do not arise automatically (Todo 2008, PSI and GDF forthcoming). They remain potential until the host society and government prepare necessary conditions. Good FDI policy and dynamic domestic labor and enterprises are essential for maximizing the contribution of FDI to the national economy.

In Ethiopia, incoming FDI is still small in both quantity and contribution to the national economy. This can be explained partly by the short history of FDI attraction, which began earnestly in the 2010s with an aggressive attraction campaign and the construction of modern industrial parks. The initial inflow of manufacturing FDI was impressive. However, the subsequent performance has been less than spectacular. The early inflow did not produce an exponential arrival of value-creating FDI. The inflow began to fluctuate before reaching a critical mass. The performance of light manufacturing FDI including garment, footwear and leather products remains limited and stagnant.

[1] For fuller discussions of FDI policy with additional data, analyses and firm surveys, see the FDI report under preparation (PSI and GRIPS, forthcoming). The topics of this report largely overlap with the present paper but they are not identical.

Structural transformation, or shifting sectoral weights from agriculture to manufacturing, is hardly visible in macroeconomic or sectoral data. These problems were largely absent in such Southeast Asian economies as Malaysia, Thailand and Vietnam where FDI-led industrialization swiftly elevated them to the status of emerging industrial economies with middle income, producing a substantive impact on global trade flows.

Ethiopia's slow progress is not just because of its short history. Policy must be improved to increase FDI inflow and its contribution to economic development. Despite past efforts, the quality of Ethiopia's FDI policy remains poor. There are many issues associated with both short-term difficulties and long-term structural problems.

Japan has since 2008 offered many policy proposals and cooperation projects to the Ethiopian government regarding industrial policy and FDI promotion. The current paper updates our past recommendations as well as offers additional perspectives in light of recent events. Part I reviews Ethiopia's current standing (section I-1) and labor advantage which remains untapped (section I-2). Part II analyzes seven specific issues that need improvement and presents policy proposals (sections II-1 to II-7). It should be noted that arguments in this paper are generally consistent with the orientation of the Ten Years Perspective Development Plan 2021-2030 (PDC 2021)[2].

[2] Many topics discussed below coincide with issues raised by the Ten Years Plan. They are, for example, improving productivity and competitiveness (the second Strategic Pillar), productive sectors including manufacturing (the first Focus Area) and enabling factors such as innovation and technology and human capital development.

PART I – Current Status and Future Orientation

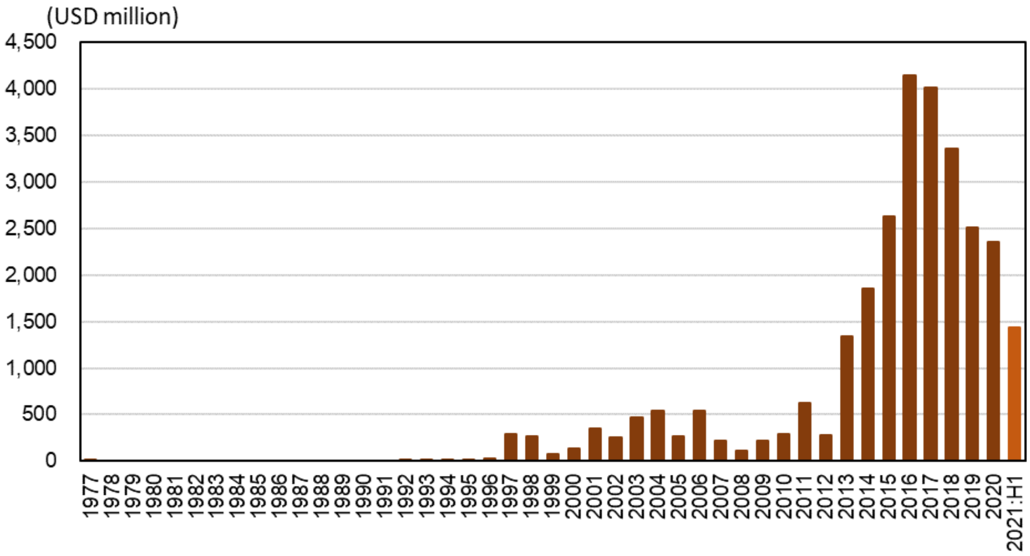
- Ethiopia is in the early stage of FDI attraction and its mobilization for economic growth.
- FDI's impact on skills, productivity and economic transformation has so far been small.
- Labor should be the main source of Ethiopia's comparative advantage.
- Labor quality and productivity must be greatly enhanced as a top policy priority.

I-1 Where Ethiopia stands

We start with the recognition that Ethiopia is in the early stage of FDI-supported industrialization. It must overcome many challenges before using FDI effectively to attain the nation's full development potential.

The historical FDI inflow into Ethiopia, as reported by World Bank up to 2019 and updated by NBE data, is presented in Figure 1. FDI inflow is a recent phenomenon in Ethiopia which began to accelerate in 2013 and peaked in 2016 and 2017, followed by a decline. Meanwhile, in 2019, global FDI net inflows amounted to $1,744 billion (World Bank 2021b). The United States was the largest recipient at $351.6 billion (20.2% of total). Among developing economies, China received $187.2 billion (10.7%), Mexico $29.4 billion (1.7%), Indonesia $25.0 billion (1.4%), Brazil $19.2 billion (1.1%) and Vietnam $16.1 billion (0.9%). In Africa, the largest FDI hosts were South Africa at $5.1 billion (0.29%), Ghana at $3.9 billion (0.22%) and the Republic of the Congo at $3.4 billion (0.19%). Ethiopia was the fourth in Africa at $2.5 billion, occupying 0.14% of the world total.

Figure 1. Net FDI Inflow into Ethiopia



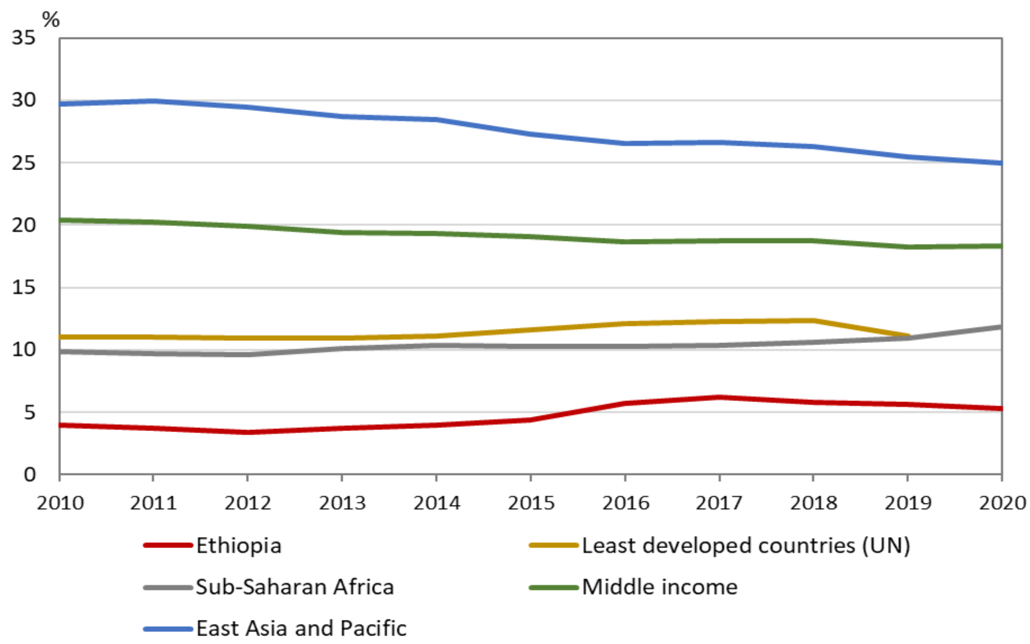
Sources: For 1977-2019, World Bank, *World Development Indicators* (last updated on July 30, 2021, accessed on September 6, 2021); original data come from International Monetary Fund (IMF), *Balance of Payments* database, supplemented by data from the United Nations Conference on Trade and Development (UNCTAD) and official national sources. For 2020 and 2021:H1, National Bank of Ethiopia data as reported in TradingEconomics.com which includes the license fee for foreign participation in the telecom sector amounting to $850 million.

Let us turn to the export performance of the garment sector which is prioritized by the Ethiopian government with generous policy support. According to WTO (2020), in 2019, global trade in textile (SITC 65) and garment (SITC 84) was $305 billion and $492 billion, respectively, while global retail apparel sale was $1,438 billion. This implies that an additional large value of $946 billion was created in consuming countries after finished garment was shipped from producing countries. Ethiopia's garment export stood at $143 million in 2019 (UNCTAD 2021), which was a tiny proportion (0.03%) of global garment trade in comparison with China's $151.6 billion (30.8%), Bangladesh's $33.6 billion (6.8%) and Vietnam's $30.6 billion (6.2%). Moreover, virtually all garment exports from Ethiopia are by FDI firms rather than by domestic producers.

Every latecomer starts small, thus insignificant size in the early stage should not be a cause of alarm. However, sustained healthy growth of domestic industries requires not just passage of time but also appropriate policy in support of the private sector. If the policy is ineffective, that should be a serious concern in realizing the nation's comparative advantage in the future. In Ethiopia, industrial policy in general and FDI policy in particular have not produced satisfactory results in output or export of targeted sectors relative to expectation or plan targets. After the initial FDI attraction, subsequent industrial performance fell short of the historical experiences of East Asia's successful economies. Questions are being raised about the cost-effectiveness of incentive policies in the past. Weaknesses are observed in the following five areas.

First, the share of manufacturing in GDP or export remains small and stagnant despite continued policy effort. It hardly shows any sign of picking up. Figure 2 illustrates the manufacturing share of GDP for Ethiopia and selected groups of economies during the last decade. Ethiopia, hovering around 5%, is way below the average of Sub-Saharan Africa or least developed countries (UN definition), let alone middle income countries or East Asian and Pacific developing countries. We normally expect this ratio to rise to around 20-30% of GDP, or even higher, for economies in

Figure 2. Manufacturing Share of GDP

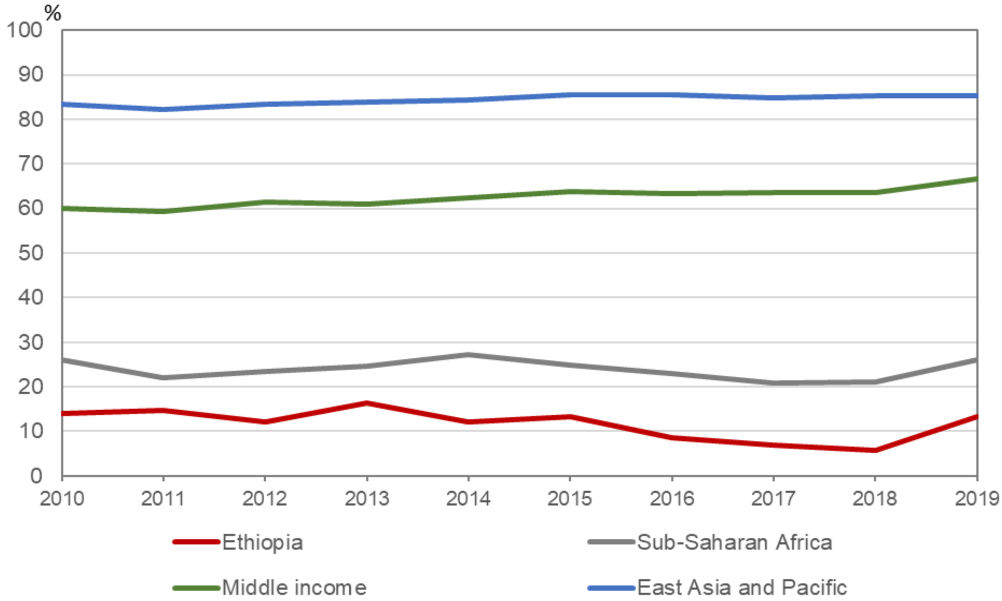


Source: World Bank (2021c). East Asia and Pacific excludes high-income economies in the region.

the process of rapid catching-up industrialization[3]. Figure 3 gives manufactured export as a share of merchandise export. This share for Ethiopia is not only below the average of Sub-Saharan Africa but also declined to below 10% during 2016-18.

Second, labor quality and productivity are low. According to the Ethiopia Productivity Report (PSI and GRIPS 2020), Ethiopia's labor productivity grew 4.9% per year during 2000-2016, but its absolute level remains below those of such competitors as Vietnam, Myanmar, Cambodia and Tanzania whose labor productivity levels were 1.7 to 3.4 times higher than Ethiopia. Ethiopian wage is low, but low labor productivity more than offsets this advantage. Based on interviews with garment factory managers, the same Report also finds that Ethiopian workers are trainable in technical skills but have problems in mindset and discipline. They are particularly weak in prior knowledge of modern factory, motivation to work, enthusiasm about the job, keeping time without delay and finishing tasks on time. Absenteeism is high and job-hopping is frequent. One of the reasons for this is because most Ethiopian workers come directly from villages where city life and modern factories are unknown, a problem that passage of time may solve provided that proper training and incentives are given (section II-1). In interviews, some FDI managers bitterly complained about the low quality of Ethiopian workers, while others stated that they were as good as workers they knew in other, more developed countries. This points to the possibility that Ethiopian workers are unpolished gems, who will shine when good guidance and appropriate incentives are provided (PSI and GRIPS 2020).

Figure 3. Manufacturing Share in Merchandise Export



Source: Manufactures exports (% of merchandise exports) in World Bank (2021c). Ethiopian data for 2019 is unavailable in the World Bank database as of September 2021, for which the national data for 2019/2020 (13.3%) is instead shown.

[3] According to the Ten Years Plan (PDC 2021), the manufacturing-to-GDP ratio was 6.9% and the manufacturing export-to-total export ratio was 13.3% in 2019/20. These numbers are used as historical baselines for projection in the Plan. They are targeted to reach 17.2% and 48.4%, respectively, by 2029/30.

Third, the participation of domestic firms in global value chains is very limited. Most Ethiopian producers are content with domestic sales (because domestic prices are better and the procedure is easier) or unable to export due to low technology or weak management, or both. Moreover, they receive only low value even when they export. In Bangladesh, domestic firms dominate garment exports (98%). In Vietnam, domestic and FDI firms compete in garment exports. In both countries, over 60% of the export value of garment is domestically generated (contributed by domestic labor and domestic material inputs) with the rest being the cost of imported materials. In both, garment production is shifting from simple CMT to more value-creating FOB[4], with Bangladesh moving faster than Vietnam. In Ethiopia, FDI firms conduct almost all export of garment to the Western markets, and they select CMT or FOB based on their global strategy. Most domestic garment firms are non-exporters and have not reached the stage where the choice of CMT and FOB becomes relevant[5] (Ohno 2021b).

Fourth, industrial park operation needs enhancement. Ethiopia's modern industrial parks have a short history of only a decade or so, but they were initially quite successful in attracting foreign investors wanting to come to Ethiopia but hitherto found no industrial land with proper support and services. Industrial parks were built by both private and public developers but the latter, backed by state policy and budget, were more speedy and aggressive. Hawassa Industrial Park, the state-owned flagship park specializing in garment production, was quickly constructed and fully occupied. However, industrial parks are a real estate business with inevitable ups and downs. A swarm of FDI arrivals may not continue when previously suppressed demand for industrial land is filled or when global FDI flows slow down. In comparison with industrial parks in Southeast Asia which are fiercely competing among themselves for tenant firms, the current policy and service levels of Ethiopian industrial parks need further upgrading to attract high-value FDI firms in greater numbers. This issue is highlighted in section II-3.

Fifth, the business climate is poor, and shows little improvement despite the government's effort to address the issue with the support of the World Bank. Ethiopia's Ease of Doing Business ranking has remained low and virtually unchanged in recent years. From 2015 to 2019, Ethiopia was 159th, 159th, 161st, 159th and 159th among 190 economies. It must be noted that the World Bank's Doing Business score covers only a subset of local investors' concern as they concentrate on the simplicity and speed of ten regulatory procedures, namely, "starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency" (World Bank 2021a). Apart from receiving licenses and permits quickly, there are other elements of business climate such as shortage of foreign currency, inefficient and costly logistics, unreliable power supply and unstable policy which are not evaluated in Doing Business scores but are vitally

[4] CMT (cut-make-trim) means that the producer is given all materials by the buyer and produces finished apparel, receiving the processing fee only. FOB (free-on-board) means that the producer buys materials, produces, exports finished apparel, and receives the entire shipment value of products. For garment exporters, the transition from CMT, which is easy but low value, to FOB, which is more difficult but with higher value addition, is considered desirable and necessary. See Ohno (2021b).

[5] The only exception was MAA Garment and Textiles Factory, a member of MIDROC Ethiopia Group owned by an Ethiopian-Saudi billionaire. This firm is usually counted as "domestic." No other Ethiopian firm exports garment to the EU or US market regularly and in large volume. However, MAA was damaged by the recent conflict in Tigray.

important for investors[6]. Improvement in the business climate must embrace all these aspects, not just the ten regulatory procedures highlighted by the Doing Business score (section II-6).

While Ethiopian policies made good progress in the last two decades, the nation needs even more learning for staying on a solid path to lower middle income and higher. This will require additional policy research, analysis and discussion, pragmatic and concrete benchmarking, and the creation of the Ethiopian model by selectively adopting foreign practices with appropriate modification for local reality.

I-2 Realization of dynamic comparative advantage

Labor should be the main source of Ethiopia's comparative advantage in the foreseeable future. Availability of skilled labor at a reasonable cost and in abundant supply should be the driver of Ethiopian industrialization in the coming decades. Ethiopian workers have the potential to become highly productive if proper guidance, incentives and opportunities are offered. However, due to the lack of these conditions, Ethiopian labor advantage remains underdeveloped and latent. Some FDI firms confirm the satisfactory quality of Ethiopian workers after training them with globally common corporate programs and providing them with decent career paths, but such cases are not many (PSI and GRIPS 2020). Full development of dynamic labor advantage should be at the heart of Ethiopia's industrial policy, and FDI attraction should be one of its main instruments. Ethiopia is among the few countries in Africa that can take up this challenge because most other African countries already have high wages relative to labor productivity, a condition unfit for labor-intensive manufacturing.

Improving the business climate is highly desirable but not enough to attract high-quality FDI in great numbers. A good business climate raises the efficiency of factory operation *after* foreigners invest in Ethiopia, but that alone will not make Ethiopia a compelling FDI destination for potential investors in the global and regional competition for high-quality FDI. Other host countries are also removing business barriers, often more quickly and decisively than Ethiopia.

To be a favored FDI destination continuously, a host country must offer a unique, differentiating national feature that contributes greatly to the profitability and business expansion of incoming firms. Such features include (i) large domestic demand, (ii) natural resources, (iii) labor advantage, and (iv) trade privilege (Ohno 2021a). These are compelling attractions for FDI. As argued above, Ethiopia's main attraction should be labor advantage, which contributes greatly to the generation of economic growth, but whose potential remains largely untapped. Another important advantage Ethiopia already enjoys is a zero-tariff privilege with the EU and the US (EBA and AGOA, respectively), an artificially created advantage Ethiopia should not lose[7]. As to large domestic demand, the current demand size of Ethiopia is generally small. Given its large population, however,

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[6] A recent EIC-JICA survey finds the following problems as reported by firms operating in industrial parks (EIC and JICA, 2021): reduced demand; logistic costs and delays; power, internet and water; foreign currency; customs; theft; labor shortage, high turnover and absenteeism; inconsistent promotion policy; and security in Mekelle. Many overlap with the problems mentioned in the text above.

[7] On August 25, 2021, U.S. Trade Representative Katherine Tai warned Ethiopia's Chief Trade Negotiator Mamo Mihretu that ongoing human rights issues and humanitarian crisis in northern Ethiopia "could affect Ethiopia's future AGOA eligibility if unaddressed."

this advantage will automatically emerge if and when Ethiopia attains middle or higher income[8]. Meanwhile, Ethiopia's natural resource endowment per capita is relatively small, and therefore cannot be the main driver of foreign investment. Moreover, being too rich in oil, copper, diamond, etc. is an obstacle to industrialization. As economics and historical experiences teach us, there are both economic and political reasons why resource richness prevents industrialization. Technically, this problem is called the Dutch Disease or the Curse of Natural Resources (Ohno 2012).

To build a strong labor advantage, the improvement of labor productivity is vital. In the next few decades, the attainment of high labor productivity should be among Ethiopia's top priorities. Concrete and time-bound national targets for labor productivity should be set, and maximum policy effort should be made to achieve them[9]. Policy instruments and international cooperation should be actively mobilized for this purpose.

To improve labor productivity and promote effective FDI mobilization, seven mutually related policy areas are presented in Part II below, one by one, for official attention and intervention.

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[8] Thailand and Vietnam were initially considered as export bases of labor-intensive products thanks to their low wage. As their income rose to middle income, growing domestic demand became an additional attraction which drew import-substituting FDI in industrial materials and components, consumer goods and services.

[9] In Vietnam, the Central Executive Committee of the ruling Communist Party in 2016 set productivity targets for the next five years as follows (Resolution No. 05/NQ-TW 2016): (i) annual labor productivity growth of 5.5% or higher; (ii) within-industry productivity growth contributing 60% or more to overall labor productivity growth; (iii) TFP growth contributing 30-35% to labor productivity growth during 2016-2020; and (iv) narrowing the competitiveness gap between Vietnam and ASEAN4 (Malaysia, Thailand, Indonesia and Philippines). In the following year, the Vietnamese government issued the Action Program to concretize this policy (Resolution No. 27/NQ-CP 2017).

Part II – Policy Challenges and Recommended Actions

Proposed FDI policy priorities are as follows.

1. Strengthening domestic labor and enterprises with many measures in proper sequence.
2. Revamping policies for FDI attraction and FDI-local firm linkage.
3. A reform of Industrial park management.
4. A minimum wage-setting mechanism linked to labor productivity performance.
5. Quick removal of business barriers, both procedural and substantive.
6. Policy benchmarking with mobilization of experienced foreign experts.
7. Confidence rebuilding targeted at the international business community.

Part II discusses seven issues that should be considered for FDI policy reform in a broad sense. Coping with the challenges below will each require careful analysis, intensive stakeholder discussion, a concrete action plan and appropriate legal and institutional frameworks. All this usually takes several years of detailed planning and effective execution for which hard work and patience are needed. A quick and haphazard implementation is not advisable.

II-1 Upgrading Ethiopian labor and enterprises

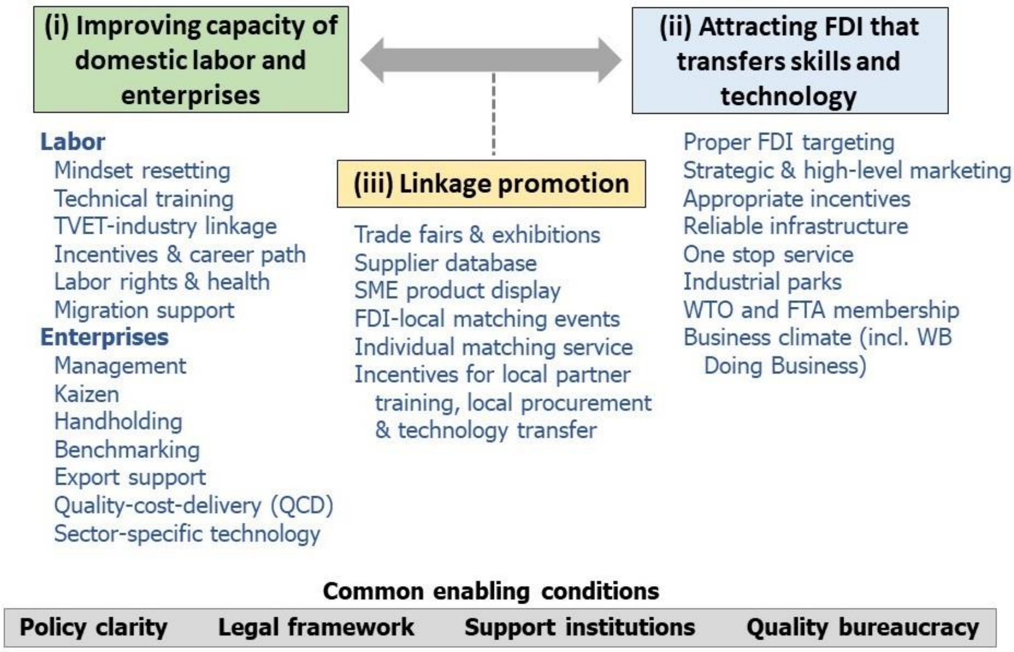
In countries receiving a large amount of FDI, a three-part strategy is essential for increased value creation and avoidance of FDI enclave formation. The strategy consists of (i) domestic capacity building; (ii) attraction of high-quality FDI; and (iii) linkage promotion between FDI and domestic firms (Figure 4). These components must be implemented simultaneously and in a close-knit way to obtain the desired result. This section discusses the first component (domestic capacity building).

In many developing countries, foreign firms are often located in Special Economic Zones (SEZs), Export Processing Zones (EPZs) or similar confined areas. They tend to form an enclave with little interaction with domestic suppliers or service providers. GDP and export may rise on account of their presence, but domestic capacity remains underdeveloped and unused, and the nation's true participation in global value chains is close to nil. The purpose of the three-part strategy is to break this impasse.

An alternative way to reinforce domestic value creation is to foster domestic firms that can export and compete globally without the help of FDI. This is attained by policy component (i) alone. Some Ethiopian agro-product sectors such as cut flowers, coffee and pulses already export directly. However, in most other sectors including garment, mechanical engineering, electronics, chemicals and pharmaceuticals, the direct approach is more difficult than joining the global market indirectly in partnership with foreign firms, when domestic firms are weak.

Capacity building of domestic workers and enterprises is the very core of industrial policy, and there are many well-known and widely practiced policy instruments for this purpose in Asia and elsewhere (Ohno 2012). Some are suitable for countries in the early stages of development while others become important at middle or high income. Some require higher policy capability than

Figure 4. Three-part Strategy for Ethiopia



Source: the author. Blue policy instruments are those that may be suitable in the Ethiopian context. They must be introduced selectively and in proper sequence since simultaneous execution of all measures is not feasible.

others. In Figure 4, policy instruments that may fit the current development stage and circumstances of Ethiopia are listed in small blue letters under each pillar, with a total of 27 instruments. Some of them, such as kaizen, one stop service and industrial parks, are already introduced in Ethiopia while most others remain unknown or implemented only in a limited way. Even those instruments already in place must be deepened and broadened before they can make a visible impact on the national economy.

All of the policy instruments in Figure 4 are highly desirable, but each requires serious learning, careful planning and competent execution and monitoring. Given the limited financial and human resources, all cannot be introduced at once. Ethiopia has spent more than two decades to spread kaizen to the current level but there is still room for additional learning and upgrading. Similarly, Ethiopia's poor business climate has been noted for long but improvement has been a slow process. The best strategy, therefore, is to be selective with clear prioritization. After reviewing past achievements and the burning issues of the day, a small number of policy goals and instruments should be chosen initially and introduced with great policy attention and sufficient resources until they produce expected results, rather than trying to implement many policies superficially and without visible impact. Special sector- or issue-specific policy documents are needed to guide such focused policy actions, supplementing the Ten Years Perspective Development Plan. Policy learning occurs precisely by managing such a process. The current plan documents are highly comprehensive with many ambitious targets but, apart from the listing of projects, without sufficiently concrete details to achieve them.

Details of the recommended 27 policy instruments cannot be explained or discussed here partly because each requires enormous time and information to analyze and deliberate, and partly because appropriate design differs from country to country and must be discovered by the policymakers of each country. They are not given as a universal package applicable to all countries[10]. The policy capacity of government is enhanced by going through such a process involving policy learning with trials and errors. Below, we just mention four cross-cutting issues that may be relevant to the policy formulation process of Ethiopia.

First, as a precondition for all policy actions, the mindset of all Ethiopians must be renovated for growth acceleration and economic transformation. The national mindset does not change easily, but it is not immutable. Features such as long-term vision, upward mobility, teamwork, perseverance, honesty, sincerity, etc. can be inculcated by a proper national movement whose ingredients are known from past international experiences[11]. In Ethiopia, the concept of kaizen was introduced in 2008 and JICA's support started in the following year. It produced many achievements including the Ethiopian Kaizen Institute (EKI) as a hub organization; training of local consultants; annual kaizen activities and awards; Ethiopianization of kaizen; spreading kaizen movement to cities, public bodies and educational institutions; master and doctoral programs in kaizen; and cooperation with the rest of Africa. But much more can be expected, as the impact of kaizen is yet to be seen in macroeconomic and sectoral data. Kaizen should be deepened and broadened as a main pillar of the national productivity movement in Ethiopia.

Second, the incentivization of all stakeholders is necessary. Some people are driven by passion and selfless devotion, but most need financial or other rewards to sustain any effort. In strengthening Ethiopian labor and enterprises, key stakeholders are workers, technicians, CEOs, FDI firms, consultants and government officials in charge. Policies must be designed to encourage all into positive actions via monetary awards, non-monetary benefits, bright career paths, etc. In Ethiopia, workers at one large factory that won a kaizen award complained that this honor did not augment their salaries or bonuses. Many EKI consultants used to quit because of low salaries (this problem was later corrected by increased remuneration). These are incidents where stakeholder incentivization matters greatly for the success of a project.

Third, public assistance—be it subsidies, soft loans, special privileges or ODA projects—should be provided conditionally and temporarily. Policy benefits should be performance-based and time-bound to avoid helping inactive firms that demand endless support. Proper design and knowledge are essential in identifying firms that make a productive effort.

Fourth, good results are often obtained when foreign firms seriously interested in buying Ethiopian products give guidance and instructions (and sometimes even assistance) as the prerequisite for business transaction. This is usually better than purposeless and buyer-less effort in upgrading quality, productivity or product design assisted by government or ODA, because

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[10] The Viet Nam Productivity Report (Ohno et al. 2021c) recommends several productivity tools including 5S and kaizen, TVET-industry linkage, FDI-local matching, SME technical support, and so on, to Vietnam which may be supported by Japanese cooperation with proper local modification. These tools are considered suitable for Vietnam but they may not fit the reality of other developing countries including Ethiopia.

[11] Cases of successful national movements include Japan's kaizen since the late 1950s, Korea's Saemaul Undong (new village movement) during the 1970s, and Singapore's productivity drive in the 1980s. Common success factors are a strong personal commitment of the top leader; establishment of a core organization, supporting institutions and mechanisms; national campaign with mass participation; standardized training programs and materials; and promotion of private-sector consultants (JICA and GDF 2011).

changes demanded by foreign buyers are more concrete and specific to the satisfaction of ultimate consumers (i.e., superfluous improvement is avoided) and because markets are already assured when corrections are properly made. H&M, together with the Swedish International Development Cooperation (SIDA), supported Ethiopian garment firms to comply with international labor codes. Itochu, together with the Japanese Ministry of Economy, Trade and Industry (METI), assisted an integrated Ethiopian garment factory to meet Japanese quality and cost standards. Similar cases of foreign firms assisting local exporting firms are observable in other light manufacturing countries including Vietnam, Bangladesh and Myanmar.

II-2 FDI attraction and linkage formation

This section discusses the remaining two components of the three-part strategy in Figure 4, that is, the attraction of high-quality FDI and linkage promotion between FDI and domestic firms (industrial parks are separately considered in section II-3).

Regarding FDI attraction, Ethiopia has made significant improvements with a series of policy reforms during the last decade. However, the policy needs further refinement to compete effectively in the global FDI attraction competition. Four mutually related principles must be fulfilled.

First, the entire FDI policy—marketing, incentives, investor support and monitoring—must be re-directed to value-creating projects rather than sheer investment size, number of employees or gross export. Quantitative targets need not be abandoned, and in fact, must continue to be stressed until Ethiopia reaches a stage where unemployment is no longer a problem. Nevertheless, more weight should gradually be given from quantitative gain to value creation. For this, simple and transparent criteria on what constitutes value creation should be announced. Some of the globally common eligible actions are the implementation of R&D, the introduction of new products and methods, high-level staff training, adoption of ICT, linkage creation, environment-friendly and energy-saving technology, and development of remote regions. Value creators should be rewarded regardless of whether they export or sell in the domestic market. However, not all host countries formulate the policy the right way. One common mistake is to force FDI firms to contribute to technology transfer, product development, localization of components and other national objectives without offering necessary domestic conditions. Another mistake is to incentivize activities that are not truly value-augmenting due to inappropriate policy design or monitoring. Still another problem is a failure to upgrade FDI policy from quantity to quality after the initial stage of industrialization is attained. Identification of value-creating projects that fit the reality of the host country is a delicate task that requires deep knowledge and experience.

Second, foreign investors of all sizes, not just large ones, should be invited. Large standard rental sheds are useful and even necessary in the early industrialization stage when labor-intensive production is dominant. But high-tech firms and firms that bring new technology and products do not usually go to large standardized sheds. They require workspaces that have the right location, size, facilities, support services and amenities to accommodate professional staff. In upper middle income countries such as Malaysia and Thailand, investment authorities discourage large labor-intensive projects and target smaller investors from advanced countries. Many ready-made and built-to-order rental factories of small size, say 250m^2 to 1,000m^2, are available in industrial parks all over Southeast Asia. In Ethiopia, Japanese firms are often told that their investment is too small. Instead of rejection, a red carpet should be rolled out for foreign high-tech SMEs.

Third, not only physical facilities but also support services must respond to the needs of value-creating FDI firms. Because their needs are highly varied, this requires a mechanism to listen to their requirements carefully and implement solutions promptly. One-size-fits-all services supplied by ill-informed authorities must be avoided. Frequent interaction with key investors, both formal and informal, is desirable. Investors' concerns may range from safety, security and life amenities to problems related to workers, logistics, power, ICT and administrative procedure. A telephone hotline where investors can call at any time to report any problem is very useful, which is faster and more cost-effective than a row of one stop service counters that operate during normal working hours only. It is also customary for an investment promotion agency to establish country-specific “desks” for important source countries where a person well-versed in the language and business culture of each source country is assigned. In Southeast Asia, Japan Desk, Korea Desk and China Desk are common. In Ethiopia, the Ethiopian Investment Commission (EIC) may consider China, India, EU, and Japan Desks.

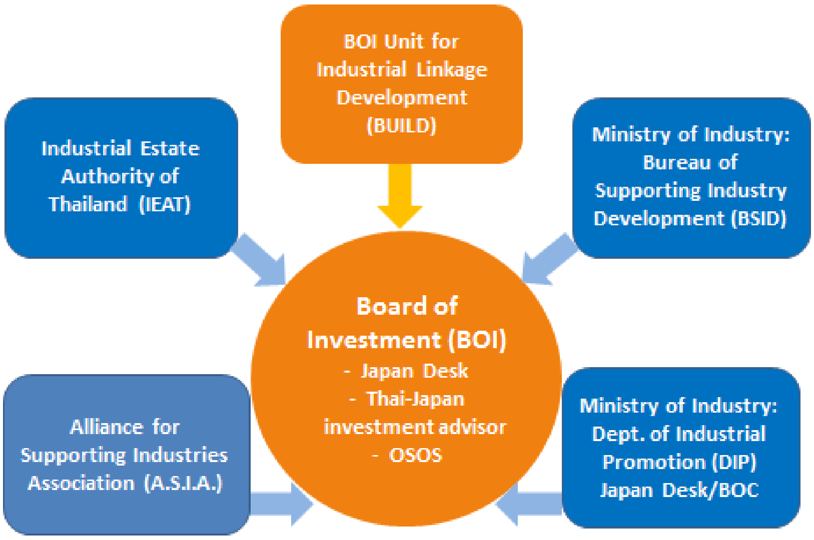
Fourth, FDI policy must be stable and predictable for the foreseeable future. An unstable policy may not be an obstacle for speculators or firms interested in short-term gains, but it is critical for non-adventurous firms that want to stay long and invest in domestic capacity. Even though policy must sometimes be revised, the change should be announced well in advance, the opinions of stakeholders must be heard, and sufficient lead-time should be given for businesses to adapt to the change. When Thailand's FDI policy was drastically revised in 2015, the Thai Board of Investment (BOI) took more than a year to publicize it to investors in advance at home and abroad. By contrast, in Indonesia, domestic and foreign investors bitterly complain about ministerial regulations that abruptly change rules without explanation or lead-time. At present, the FDI policy in Ethiopia is highly changeable. Ethiopia adopts the trial-and-error approach in which policies are drafted relatively quickly and any problems arising from them are dealt with by subsequent revisions. This speed-first approach is understandable, but it should be balanced with investors' need to be assured of a stable business environment before making a strategic investment. Many Japanese firms are interested in Ethiopia and investment seminars in Tokyo have always been full. However, very few actually invest. Foreign currency shortage in Ethiopia and the inherently slow nature of Japanese FDI are undoubtedly two major reasons. But another reason is disenchantment and the lack of trust caused by many recent incidents of policy instability.

Besides strengthening domestic firms and attracting sufficient FDI, there must be a national strategy to link productive activities between the two. This includes FDI’s procurement of materials, components and services from domestic sources as well as the formation of long-term business partnerships through joint ventures, production cooperation, technical support and so on. In Figure 4, six instruments for this purpose are listed: trade fairs and exhibitions; supplier database; SME product display; FDI-local matching events; individual matching service; and incentives for local partner training, local procurement and technology transfer.

Government can facilitate linkage in two ways: first, by the government itself offering matching services, events and databases as well as support for product exhibition, trade fair participation and other global marketing (direct support), and second, by subsidizing or incentivizing FDI firms that improve domestic partner firms with a view to using the latter's products or services, or domestic firms that seriously acquire the capacity for such linkage (indirect support). Either way, actions of FDI and local firms must be spontaneous, with linkage formed willingly by partner firms without the government's order or coercion. Some countries such as China or past Malaysia require input localization or technology transfer as a condition for market access or business operation. However, such imposed obligation without additional profit opportunities is disliked by firms and often protested by source countries[12]. Compulsory methods are therefore not advisable.

Thailand has reasonably good (though not perfect) linkage promotion measures. The Thai Board of Investment (BOI, an investment agency under the prime minister) and the Ministry of Industry (MOI) are the key official actors. They coordinate activities of their affiliated agencies as well as private bodies including the Alliance for Supporting Industries Association (A.S.I.A.) that comprises 12 Thai industrial associations. Figure 5 illustrates this assistance network for Thai-Japanese firm linkage formation (Japan is the largest source country for manufacturing FDI in Thailand). This network is a loose one without formal instruction or explicit rules. Each member organization performs its tasks separately and refers client firms to other organizations for services not rendered by itself. Personal relations among officials and experts at various organizations ensure the quality and speed of collective services. A loose working style such as this is universally observed in the Thai government, not just linkage promotion.

Figure 5. Thailand: Policy Network for Linking Thai and Japanese Firms



Source: Thai Board of Investment slide presentation in May 2013.
Note: this policy network was created when BOI was placed under MOI at the time of Prime Minister Yingluck Shinawatra. OSOS is short for the One Start One Stop Investment Center. BOC stands for the Business Opportunity Center under MOI.

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[12] China has been able to force FDI to transfer technology because foreign investors often accept unreasonable demands for the privilege of entering China's huge market. This advantage is unique to China, and countries with smaller domestic markets cannot avail themselves of this bargaining strategy. The US government severely criticizes this Chinese practice, which has become one of the disputed issues in the US-China trade war.

Within BOI, the BOI Unit for Industrial Linkage Development (BUILD) specializes in matching between FDI and Thai firms. Its functions include:

(i) Sourcing service—locating local suppliers in response to individual requests from FDI or large domestic firms through website solicitation, one-on-one meetings, etc.

(ii) Partnering service—finding appropriate partners of a joint venture, OEM, patent use or production contracts.

(iii) SUBCON Thailand—hosting a large subcontracting exhibition in Southeast Asia for industrial components and business matchmaking, organized annually in Bangkok.

(iv) ASEAN Supporting Industry Database—managing a large database of component suppliers in Southeast Asia accessible globally via the internet.

(v) Vendors-Meet-Customers Roadshow—providing subsidies to Thai component suppliers that participate in overseas trade fairs.

These functions can be studied and selectively introduced to Ethiopia with proper local adjustments when it launches a similar linkage program under EIC or any other appropriate body.

II-3 Industrial park management

Industrial parks offer a relatively good environment for factory operation in a country where business conditions are generally poor. Ethiopia has built many industrial parks and attracted FDI to them. However, given the short history of modern industrial parks, there is much room for improvement. The FDI Report currently under preparation (PSI and GRIPS forthcoming) gives six concrete suggestions which are summarized below. The key idea is that industrial parks are a customer-oriented real estate business and that they should be managed for long-term profitability and cost-effectiveness in providing facilities and services. Resilience must also be ensured against business ups and downs which are inevitable in any property business.

First, industrial park developers must have multiple revenue sources, not just rents from land and factory sheds. The presence of alternative revenue sources lowers such rents and strengthens the financial viability of the park. This can be done by offering various fee-based services such as management consultation; support for accounting, tax or environmental documentation; labor recruitment and management; linkage creation with buyers or suppliers; ICT installation and maintenance; and offices, meeting rooms, incubation space, equipment, vehicles, etc. for rent. Another way to raise revenue is to provide basic infrastructure services (especially power) reliably but with an additional charge by investing in a substation, round-the-clock engineers, etc. These constitute the main revenue sources of Japanese industrial parks in Southeast Asia. Most tenant firms highly appreciate these services even at additional costs.

Second, park developers should offer supporting services selectively and strategically. Frontline technology and generous services should not be provided at any cost. The cost here includes not just an initial investment but also future operation, maintenance and replacement. A cautious cost-benefit analysis must be done to decide which facilities and services are worth offering. The tightfisted approach is necessary for business survival under severe competition among host countries and parks. Financial viability must be carefully checked when building a grandiose park management office, non-standard waste treatment, apartments and dormitories, restaurants, shops, schools, clinics, banks, golf courses, beautiful landscaping, and so on. These services, even when offered, may be outsourced to private providers. The normal practice at Japanese industrial parks in Asia is to offer only basics—safety, security, reliable power, water supply, standard wastewater treatment, internal roads, etc.—with high quality but not frills and add-ons which tenant firms do not strongly want or for which they are unwilling to pay extra. In Ethiopia, the effectiveness of Zero Liquid Discharge (ZLD) should be revisited. JICA experts recommend standard two-step wastewater treatment for light water users such as garment and footwear firms instead of installing centralized ZLD for the entire park.

Third, one stop service should be introduced functionally rather than physically. The existence of one trusted official at the end of a telephone hotline, who can connect distressed tenant firms to any office and service to solve any problem at any time, is more valuable than installing many desks manned with seconded officials. The matter is more of a soft support mechanism than the physical installation of desks and counters. At Thilawa SEZ, Myanmar, Mr. Yoichi Matsui, head of the One Stop Service Center, takes care of any issue immediately and professionally. At Kizuna Industrial Park, Vietnam, Ms. Satoko Shirakawa handles all matters raised by Japanese investors and Mr. Nam Kyoung Wan does the same for Korean investors. One stop services are adopted at virtually all industrial parks around the globe but some of them are just by name; investors still face bureaucratic hassles and delays. In Ethiopia, some investment-related services are slow, irregular, or entirely missing such as visa and work permits, certificate of country origin, residence permit, post-investment services and follow-up, and claim and complaint procedure by an investing firm.

Fourth, industrial parks must have contingency plans for low times. Property business has both good times and bad ones, and good times never last forever. The speed of tenant firm arrival (and departure) depends on many factors, most of which are beyond the control of a host country or a park developer. Ethiopia's state-owned industrial parks were initially very popular among foreign investors, but the COVID pandemic, global demand decline and political instability in Ethiopia are taking a toll on investor arrival. Future demand for industrial park space is difficult to forecast. New construction, expansion and borrowing must be paced judiciously to avoid unrented land or sheds.

Fifth, industrial parks should invite all sectors, especially in the early stage of their development. The Ethiopian government specifies sectors to each industrial park rather than leaving the matter to the choice of investors. Some argue that the geographical concentration of firms of the same sector creates synergy and sharing of resources such as skilled engineers and specialized waste treatment. This is theoretically plausible but does not always happen in reality. Firms in the same sector are often rivals who are wary of labor poaching and information leakage to others. It is better to let firms decide where to invest, including whether they prefer concentration or dispersion. In Asia, most industrial parks welcome investors of any kind as long as they comply with national laws and park regulations and pay dues on time. Sector indifference is a natural consequence of severe competition among industrial parks to attract as many good tenants as possible.

Six, diverse choices should be available for renting land and sheds. As noted above, Ethiopia has built many same-size, large-capacity rental sheds. These standardized sheds are suitable for labor-intensive export-oriented light manufacturing such as garment and footwear in the early stage of FDI-led industrialization. However, to attract more sophisticated manufacturing now and in the future, customized industrial space should also be offered. When Japanese manufacturers invest abroad, they typically start with small and made-to-order industrial space of about 250-1,000m^2, or even smaller incubation space with only one machine. If successful, they move to bigger rental space or build their own factories. Some European and American firms behave similarly.

II-4 The productivity-wage balance and minimum wage setting

The relationship between wage and labor productivity has important implications for economic growth. In reality, they often do not move together. If wages rise faster than labor productivity, production cost increases and competitiveness is eroded. This may damp the inflow of foreign firms and increase their exits. Rapid wage growth unaccompanied by matching labor productivity growth also prompts firms to hire fewer workers and replace them with machines, which goes against job creation. On the other hand, if wages are suppressed below labor productivity growth, the income share and living standard of workers decline, which negatively affects development. It is essential that wages and labor productivity move in tandem.

Given this requirement, a two-part strategy should be adopted to maintain a proper balance between wage and labor productivity. The idea below is a simple one but actual implementation may encounter economic and political complications.

The first part of the strategy is productivity enhancement. This should be elevated to the top national priority. Policy measures for this were already discussed in sections II-1 and II-2 above, as well as in the Ethiopia Productivity Report (PSI and GRIPS 2020). They include:

- A sequence of measures to upgrade labor and enterprise capacity
- FDI policy reform
- Linkage promotion between FDI and Ethiopian firms
- Establishment of a competent productivity organization
- Collection, analysis and publication of relevant data
- Target setting and monitoring
- Restraint on large public investment projects
- Deepening of kaizen
- Effective SME support laws and policy mechanisms
- Observance of labor and environmental codes
- Mindset transformation of workers and management

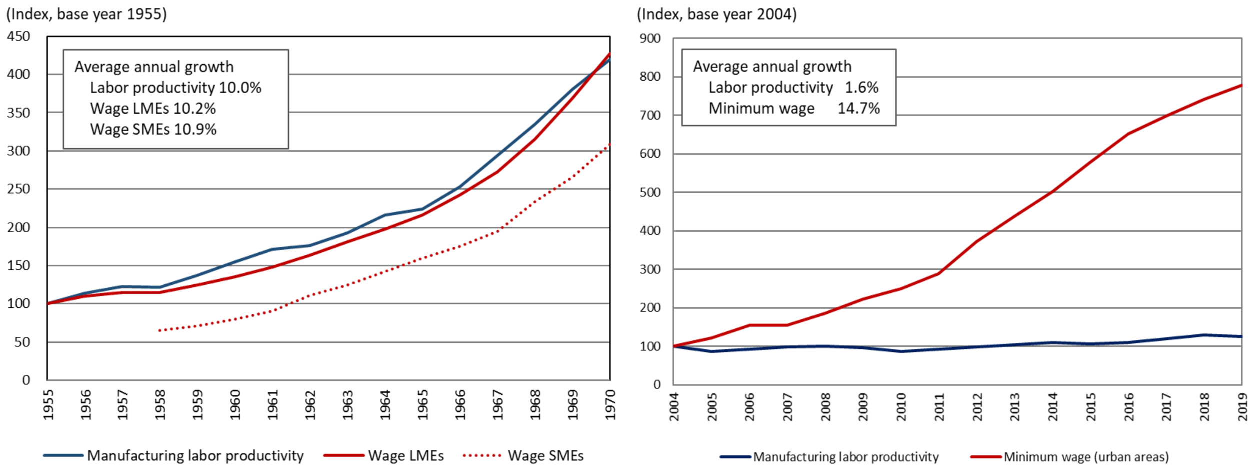
These are the core components of industrial policy. Their implementation requires careful planning and sequencing as well as continuous learning and adjustments. They must form an integrated national productivity movement, not a bag of separate and fragmentary projects. Insights on how these measures should be done can be learned from international experiences including those of Singapore, Taiwan, Malaysia, Thailand, etc. depending on the topic.

The second part of the strategy is to keep wage growth the same rate as labor productivity growth. Although wages are decided by demand and supply in the labor market, minimum wages set by the government exert a strong influence on the entire wage structure of the nation. As Ethiopia begins to institute minimum wages, this consideration becomes particularly important. In any country, minimum wages are driven by two contending forces, namely, demand for higher living standards of workers and demand for maintaining the international competitiveness of enterprises. Wage-labor productivity balance may be lost by the action of various stakeholders. Labor unions and belligerent workers usually press for high wages beyond labor productivity. The government may succumb to their demand, especially before an election. Businesses (including FDI) often complain about such political settlement of minimum wages. This is a battle between politics and economics. The only satisfactory solution to all parties is setting wage growth equal to labor productivity growth *provided* that the latter grows sufficiently, which is ensured by the first part of the strategy.

The virtuous circle of high productivity growth and high wage increase was observed during the high growth periods of Japan, Korea, Taiwan, etc. By contrast, Southeast Asian economies such as Thailand, Indonesia and Vietnam have faced the dilemma of low productivity growth and high wage pressure, resulting in a loss of international competitiveness and protestation by domestic and foreign businesses. Figure 6 compares manufacturing labor productivity and wage of Japan (1955-1970) and Vietnam (2004-2019) when each economy was growing rapidly. Japanese labor productivity and wage rose very fast and in parallel, about 10% per year, while Vietnamese minimum wage increased far faster (14.7%) than manufacturing labor productivity (1.6%). Japan quickly climbed to the global technology frontier but Vietnam seems trapped in middle income and labor-intensive manufacturing. Ethiopia should be mindful of the need to fulfill both parts of the strategy when it sets minimum wages in the coming years.

Figure 6. Manufacturing Labor Productivity and Wage

(a) Japan: 1955-1970 (b) Vietnam: 2004-2019



Sources: Japan Productivity Center, "Productivity Statistics" and Ministry of Labor, "Monthly Labor Survey," various issues; Viet Nam Productivity Report (2021) and the Ministry of Labor, Invalids and Social Affairs.

Note: Japanese Small and medium enterprises (SMEs) are establishments with 5-29 workers while large and medium enterprises (LMEs) are those with 30 or more workers. Vietnam's minimum wage was national minimum wage until 2008 and urban minimum wage thereafter. The minimum wage was subdivided for different regions in 2008. It should be noted that Vietnam's labor productivity grew faster prior to this period, at 5.5% per year during 1991-2003.

II-5 Improving business environment

As already pointed out in section I-1, Ethiopia's business climate is poor by international standards. This is clear when Ethiopia is compared with the high-performing developing economies we researched in Southeast Asia (see below). The Ethiopian government is fully aware of this problem and trying to remedy identified weaknesses in foreign currency supply, power, logistics, banking, customs clearance, bureaucracy, etc. It is also working on the Doing Business score with the cooperation of the World Bank[13]. Corrective actions are thus already in place, and reiteration of this well-known problem may seem superfluous. Nevertheless, we still want to stress three related points below and urge swift actions.

First, as mentioned earlier, the World Bank's annual evaluation of the Ease of Doing Business pertains to the efficiency and speed of business-related procedures such as obtaining licenses and permits, and thus covers only a part of the difficulties enterprises encounter. There are other serious problems, mentioned just above, concerning foreign currency, power, logistics, etc. Non-economic challenges such as politics, ethnic violence and diplomatic relations also matter. The business environment should therefore be interpreted broadly, including not just procedural expediency but also various other barriers that hinder the realization of Ethiopia's full economic potential.

Second, Ethiopia should move from the pattern of removing internal barriers to the creation of positive advantages to compete with other host countries. Current difficulties for businesses are so many and so overwhelming that the private sector clamors mainly for the removal of these negative elements. Overcoming this gloomy situation is only the first step in policy reform. Real competition starts when FDI policy turns to the creation of sources of competitiveness unparalleled by other host countries. Generally speaking, such sources include (i) a large domestic demand, (ii) natural resources, (iii) labor advantage, and (iv) trade privilege. Among these, Ethiopia should develop its labor advantage as a high national priority (section I-2). Only then, Ethiopia can truly rise to the status of a globally popular FDI destination and take full advantage of the presence of FDI for national development.

Third, a clean break from the past is needed. Investment proclamations have been revised many times and Ethiopian business conditions have changed for the better in many areas. However, these improvements were not large enough to offset the remaining problems. The negative perception remains among investors and Ethiopia's position in the Doing Business ranking continues to be low. Investor psychology will not visibly turn around unless a dramatic break from past gradualism is staged and competently executed. This is not likely to happen with another minor revision of the investment proclamation. A new FDI policy should be crafted and announced by the top leader with fanfare, accompanied by concrete objectives, actions and a timeline (as done by Thailand in 2015). For this, we recommend the drafting of an FDI policy master plan (or a national FDI strategy, the name does not matter) with new, realistic and implementable contents. It should be a separate document from the Ten Years Perspective Development Plan but should support the implementation of the latter. International benchmarking is highly useful in producing a convincing

[13] However, this famous annual ranking by the World Bank may be ended due to the political scandal within the Bank.

document (next section). Historically, a remarkable policy shift usually occurs at the time of the inauguration of a new government.

For supplementary information, Table 1 shows the ten largest business problems Japanese firms face abroad in 2019 and 2020 as surveyed by JETRO (2020). Starting in 1988, this survey is conducted annually to monitor Japanese FDI operating in 20 countries and areas in Asia and Oceania. The number of responding firms in 2020 was 5,976.

As many as five problems (2, 3, 4, 6, and 7) are related to market conditions and sectoral competition. These are private sector matters in which governments are not directly involved at least in the short run. Meanwhile, two problems (1 and 5), the cost and quality of labor, are something that the host country should greatly mind as discussed in section II-4. In fact, high wage (relative to labor productivity) is the very top concern of Japanese FDI for consecutive years. Two (8 and 9) are problems related to customs clearance and taxation, which are again policy matters. The last (10), exchange rate fluctuation, is a macroeconomic issue for which government is also responsible. Cited demand problems may also be attributable to the government if they are caused by poor aggregate demand management. Ordering of problems is similar between manufacturing and non-manufacturing firms and between large firms and SMEs. There is no evidence that SMEs suffer more than large firms. However, greater ratios of manufacturing firms tend to report problems than non-manufacturing firms. This table shows aggregate tendencies only, and situations differ from country to country[14].

It is interesting to note that the problems of foreign currency, power, logistics, banking, etc., which are real headaches in Ethiopia, do not show up among the top 10 worries in Table 1. Only one problem (customs clearance) is directly related to the World Bank's Doing Business ranking, confirming that procedural irregularities are only a small part of business challenges for Japanese

Table 1. Top Ten Problems Reported by Japanese FDI in Asia and Oceania (Multiple Answers)

Problem		2019	2020	Change	By sector 2020		By firm size 2020	
					Manufact-uring	Other	Large	SMEs
1	Wage increase of workers	65.8%	56.4%	-9.4%	66.7%	48.2%	57.4%	54.7%
2	Reduced orders from buyers	31.7%	48.2%	16.5%	53.0%	44.2%	44.7%	53.6%
3	Sluggish market demand	35.1%	42.7%	7.6%	44.7%	41.0%	44.9%	39.3%
4	Difficulty in securing new customers	38.9%	41.9%	3.0%	43.8%	37.7%	39.8%	41.5%
5	Quality of employees	43.5%	40.4%	-3.1%	36.4%	46.6%	39.4%	45.8%
6	Emergence of low-cost competitors	47.8%	33.4%	-14.4%	37.6%	29.9%	36.1%	29.3%
7	Price cutting pressure from buyers	32.8%	28.7%	-4.1%	34.3%	23.9%	28.1%	29.5%
8	Complicated customs procedure	26.6%	25.8%	-0.8%	32.7%	20.3%	25.8%	25.9%
9	Tax-related burdens	27.1%	25.7%	-1.4%	29.6%	22.6%	27.7%	22.4%
10	Exchange rate fluctuation	27.8%	24.2%	-3.6%	30.3%	19.4%	26.9%	19.8%

Source: JETRO (2020).

[14] For example, the lack of supporting industries (domestic component supply) is among the greatest problems in Vietnam, Sri Lanka, Bangladesh, Cambodia and Myanmar but not in Malaysia or Thailand. Sluggish demand and scarcity of new customers are reported in such high income economies as Singapore, Taiwan, Hong Kong, Australia and New Zealand. Power supply problems are serious in Myanmar and Bangladesh but not in others.

FDI in Asia. This JETRO information may be referenced when Ethiopia expands the scope of business conditions that need to be reformed.

II-6 Benchmarking and mobilization of competent foreign experts

During the last two decades, Ethiopia introduced a series of productivity-enhancing methods including Business Process Re-engineering (BPR), twinning between foreign and domestic institutes, benchmarking and kaizen. Some were adopted enthusiastically but soon forgotten. Others were mobilized only on small scale without generating a nationwide impact. Kaizen, with JICA support, was sustained and expanded with many achievements, but it too has so far failed to produce visible results in national productivity statistics (IPE Global 2017). Kaizen needs to be promoted with more vigor and a broader scope. Twinning should be continued for strengthening selected public institutions. As for benchmarking, we recommend its increased use with more intensity and appropriate selectivity.

Benchmarking means learning from external good practices by quantifying your inefficiency and gaps that need to be filled. It consists of a concrete measurement of performance and practices of a domestic firm or industry and comparing them with those of exemplary performer(s). When properly done, this facilitates the setting of numerical goals to be attained. However, countries or firms to be benchmarked must be chosen with great care. Because situations and development stages differ from country to country, the wrong choice of a benchmark will not produce desired results. Multinational corporations with global management capacity and frontline technology are often too difficult to copy for an average firm in low income countries. Good practices may also depend on socio-economic conditions which vary significantly across countries. The "best" practice is therefore not one but many, and each learning country and firm must find one that most fits its circumstances. Another concern is that benchmarking does not itself tell us how—by which technique and instruments—identified gaps should be filled. That is a separate task requiring additional study and effort. In sum, good benchmarking requires a judicious selection of models and an appropriate choice of correcting methods in addition to numerical comparison of your practice and the practice of others.

In Ethiopia, benchmarking has typically been applied to specific production processes such as cutting or stitching of leather shoes, often with donor support. The speed and accuracy of such works are measured and compared with those in more advanced countries, gaps are identified, and a foreign expert is dispatched to improve the process. This is an appropriate use of benchmarking at the level of individual manufacturing firms, and such benchmarking should be continued in the future. However, benchmarking is also useful in upgrading the government and its policies. The scope of benchmarking should be expanded to include the drafting of policies and the strengthening of ministries, sectoral institutions and other public bodies (along with twinning).

In applying benchmarks to the policy arena, two cautions are in order. First, the foreign model must always be adjusted to the reality of the home society and economy. This is a general principle that must be observed in importing any foreign system, which Japanese economic anthropologist Maegawa Keiji calls *translative adaptation* (Maegawa 1998). No benchmark should be copied and pasted to the home country without respect for different conditions at home and abroad. Second, benchmarking—and reforms and improvements instructed by benchmarking—are easier to perform when appropriate international assistance is available. If possible, benchmarking should be executed with international cooperation, provided that such cooperation mobilizes top foreign experts and properly recognizes the need to adjust the original model to local circumstances.

Let us look at several examples of learning from foreign models and experts.

In the 1860s and 70s when Japan ended the feudal rule and established a new Western-style government, it hired several hundred Western advisors in any year at very high salaries to execute many government turnkey projects. State-of-the-art factories and infrastructure were rapidly built including the Tokyo-Yokohama railroad, the Institute of Technology, lighthouses, land survey (by British experts); modern army, silk spinning, shipyards (French), medicine, law, geological survey (German); farming, Hokkaido development (American); and so on. But after a decade of doing these projects intensively, the government began to replace expensive foreign advisors with trained Japanese engineers who had been dispatched to European and American universities to absorb the latest knowledge. Design, construction and management of new projects were now handled by the Japanese with local adjustments. Import substitution of engineers proceeded very rapidly in Japan in the late 19th century.

In the post-WW2 era, many Asian economies copied Japanese policy institutions. Industrial policy, economic laws, banking, SME promotion and kaizen were some of the items copied. Japanese FDI, ODA and private technology transfer often played a key role there. Taiwan adopted Japan’s deliberation council, a policymaking mechanism with private and academic participation, as well as the shinkansen (bullet train) system. The Korean banking system was structured very much like the Japanese. Malaysia even copied Japan's Ministry of International Trade and Industry (MITI) and named it the Malaysian MITI, with a similar organizational structure of vertical and horizontal bureaus. Kaizen is practiced in many parts of Asia, often with different names. When these models were adopted, their scope and operation usually deviated from the Japanese original.

Tan Thuan EPZ, Vietnam’s first export processing zone, was established in 1989 by a joint venture between Vietnam and Taiwan. Taiwanese experts who built Taiwan’s Kaohsiung EPZ in 1966 guided the construction, marketing and operation, Tan Thuan EPZ offered high-quality investor services in the heart of Ho Chi Minh City along the Saigon River. It was an immediate success, fully occupied by Japanese, Taiwanese, Korean, Vietnamese and other investors. When our mission visited the management office of Tan Thuan EPZ without an appointment, officials were more than happy to receive us, offered tea, explained the EPZ, and asked us to email them for any additional questions.

Prior to the establishment of the Rwanda Development Board (RDB) in 2008, the Rwandan government dispatched many study missions to Singapore to adopt the Economic Development Board (EDB) model that offered one stop service, investment incentives and logistic and trade support. Dr. Rama Sithanen, Former Vice Prime Minister and Minister of Finance and Economic Development of Mauritius, was invited to assume the first chairmanship of RDB (Mauritius also learned from Singapore’s EDB). RDB became a leading economic body in Rwanda responsible for many functions including FDI promotion and national marketing.

The government of Zambia was inspired by the lecture and advice of Dato’ J. Jegathesan, a high Malaysian official with 30 years of hands-on experience in investment promotion and industrial park management. In 2004, Mr. Jegathesan began preaching his policy philosophy to the Zambian cabinet, stressing the importance of strong political will as well as efficiency and integrity of civil service and the public sector. To concretize this, he urged Zambia to create 12 task forces to improve business conditions and develop targeted sectors. He also advised the creation of multi-facility economic zones. Proposed actions were strictly monitored. His recommendations were executed with the support of JICA which mediated this Malaysia-Zambia policy learning (Jegathesan and Ono 2013).

Kenya and Myanmar are in the same early stage of automotive development as Ethiopia (SKD assembly). We sent missions to these countries in 2018 and 2019 to study their automotive policy formulation. It was discovered that Kenya's automotive policy was drafted by local private-sector automotive experts at the Kenya Association of Manufacturers, and approved by the Ministry of Industrialization with minor modifications. In Myanmar, the Ministry of Industry worked closely with Japanese carmakers to draft its first automotive policy (Japanese cars dominate Myanmar streets). It accepted most of the contents proposed by the foreign experts. In both countries, the produced policy was simple and effective. Isuzu has a large truck factory in Nairobi. In Myanmar, Suzuki has assembled cars for many years. With the announcement of the new automotive policy, more foreign carmakers, including Toyota, decided to invest in Myanmar[15].

Ethiopia also learned from other countries when it established state-run industrial parks, drafted SME development plans, revised investment proclamations and restricted used car imports. The Japanese policy dialogue team had the privilege of witnessing these processes. However, the major difference between Ethiopia's policy learning and the six cases cited above is the use of foreign experts in setting the initial concrete details of a new policy. Ethiopia studies foreign models but does not usually allow foreigners to draft a policy or set up a new institution whereas other countries are more willing to let experienced foreigners do the first detailed design, leaving local adjustments and expansion for later when experience is gained and local capacity improves. The Ethiopian way, based on quick research of a few countries through short visits or web search, lacks depth and ground experience, and often encounters inconsistencies in the implementation stage[16].

Ethiopia should involve outstanding foreign experts more substantially in benchmarking to establish new policies or institutions or reform old ones. This should be done, for example, for strengthening domestic enterprises (especially SMEs), inviting value-creating FDI, linkage formation between FDI and domestic firms, the capacity building of EIC and IPDC, renovating industrial park management, improving the business climate, organizing a national productivity movement, setting minimum wages and the drafting of an automotive policy, among others. When details are fully set and mastered, hopefully in a relatively short time, foreign advisors can be sent home. As long as Ethiopia is the initiator, supervisor and final decision maker in policy learning and formulation, it will not lose country ownership in development. It will emerge as a competent policy maker when the learning is complete and everything is decided by Ethiopians.

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[15] The military coup in 2021 may change the situation in Myanmar. However, the new automotive policy was already producing remarkable results before this political shock.

[16] There were exceptions to this rule. America's TWA greatly assisted the birth of Ethiopian Airlines in 1946 (Oqubay and Tesfachew 2019). The idea of the Ethiopia Commodity Exchange (ECX) was proposed and put into practice in 2008 by Eleni Gabre-Madhin, an Ethiopian economist of Swiss nationality.

II-7 Rebuilding and augmenting confidence

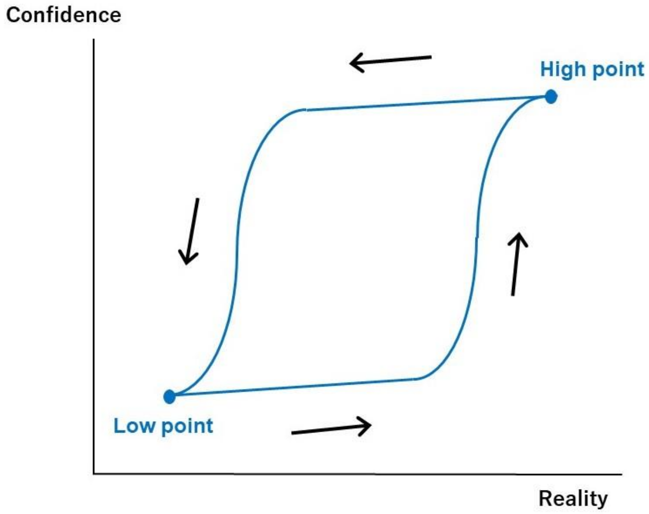
Ethiopia needs to rebuild and augment confidence from the current level vis-à-vis domestic and international investors to fully realize its economic potential. FDI may continue to arrive but its quality and volume have much room for improvement. FDI flows are influenced not just by concrete facts but also by investors' psychology and perception. When problems in political and public health areas, which are beyond this document, are stabilized or about to become stable, Ethiopia should start a confidence-enhancing campaign working on both Ethiopian reality and investors' psychology. Successful execution of this campaign will make reform efforts and economic policies more convincing and effective.

It must be stressed that lost international confidence is always recoverable, and can even be lifted to a new height, if proper policy actions are adopted after a war, ethnic conflict, economic crisis or other devastating events. Cambodia and Rwanda have regained confidence after a horrendous massacre, each now being a favored investment destination in selected sectors. Vietnam fought long wars of independence against France and the United States during the 1950s, 60s and part of the 70s which ravaged its people and land, but is now the most popular business destination in Southeast Asia. Sri Lanka, after a debilitating civil war, has restored its international standing. Ethiopia itself, in the aftermath of economic mismanagement of the Derg, was able to gain high esteem among investors. However, restoration of international confidence may take a long time. Cases cited above often took a decade, or more, to achieve success. It is vitally important that Ethiopia's confidence reinforcement should take a much shorter time. This requires good policy planning and execution.

Facts and investor's perceptions are not the same, but they are mutually related and develop interactively. Psychology must be backed by reality, and reality must be accelerated by positive psychology. Communication with current and potential investors must be done with a full understanding of this mechanism. Ethiopia must build a favorable national image backed by visible substance.

Social psychology is not a linear function of reality but exhibits hysteresis (Figure 7). This means that perception rises and falls on different paths. There is a critical level of facts that triggers massive change. When confidence rises from low to high, it hardly changes as reality gradually improves but suddenly jumps upward when a critical mass of favorable facts is attained. Ethiopia's initial actions to improve confidence may not seem to produce results, but the effort must be continued until a critical point—which is difficult to forecast with precision—is reached. After that point, improvement is easy and fast. When things deteriorate, high confidence is sustained for a while then it suddenly drops. Government must introduce remedial policies quickly or otherwise, it will be too late. Patience is required on the climb and promptness is required on the decline.

Figure 7. Hysteresis in Gaining and Losing Confidence: An Illustration



Besides the basic nature of hysteresis, it is important to realize the unique characteristics of investor psychology and FDI's decision-making.

First, investors evaluate credible future policies highly even if the status quo is far from satisfactory. Investment is a long-term commitment that is accelerated when a bright future—large demand, ample skilled labor, promotion of targeted sectors, trade advantage, etc.—is presented with high probability. The more credible is the policy, the more accelerated is the FDI inflow. The announcement of a convincing policy can partly reverse the slowness of investment response even amid a pitiable reality.

Second, a big perception shift occurs when investors are convinced of a policy regime change in the host country, as explained above. To shed the image of gradualism and impress a regime change, policy presentation becomes very important. Various policy components, even if they are prepared by different ministries and commissions, should be offered not piecemeal but in a coherent package with high visibility and clamor, featuring common objectives and synergy among policy components.

Third, investor psychology also responds positively to small but visible early results. Initial results increase policy credibility and justify an investment decision. When kaizen is introduced in any sector or country, cost reduction and productivity increase in the first three months dispel any doubt about this new method. Policies should be so designed to produce visible results in the early stage, instead of waiting till the end of the project period to achieve a spectacular result.

Fourth, despite these common features, there are also differences in investor behavior from one source country to another. Chinese and Korean investors arrive quickly and take bold risks for grabbing new opportunities while Japanese and Europeans are generally more cautious. Japanese investors usually arrive last in frontier markets but stay longer even if unfavorable events—military coup, ethnic instability, floods, terrorism, etc.—unfold. In this sense, Japanese and Europeans are more "hysteretic" (require more energy and time to move) than Chinese or Koreans.

Under these circumstances, let us sum up what Ethiopia needs to do when the political and pandemic difficulties are overcome. It is of paramount importance to stage and impress a policy regime change indicating a clean break from the past. The top national leader should declare new policy philosophy and measures. A document should be issued with ambitious but attainable goals and a credible action timeline. The precise content of this document must be decided much in advance with national ownership and utmost care. Ideas suggested by the current paper—measures for domestic enterprise, FDI and their linkage, industrial park management, benchmarking, productivity-based wage setting, etc.—should be considered. The quality of this document determines the degree to which the world will turn to Ethiopia as a place to invest with a fresh eye. The document should be compact and well-focused on a few selected issues unlike past plan documents (PASDEP, GTP I and GTP II) or the current Ten Years Plan which are larger and more comprehensive. The path-breaking policy statement must be backed by performance. Proposed actions must be implemented immediately and competently to produce small but quick results.

The policy needs a break from the past not only in content but also in method and form. Past procedures and constraints should not bind the drafting of this document; otherwise, the perception of business-as-usual will prevail. Such a document will require serious learning and preparation. Work must begin now, preferably with the help of experienced foreign experts and international cooperation, so the new orientation and document will be ready by the time the current crisis ends.

When the preparation is complete and the time is ripe, a new national marketing campaign must be launched. All functionaries including top leaders, economic and foreign ministers and state ministers, relevant commissions and NPOs, and overseas diplomatic missions must be mobilized with the support and coordination of EIC. Past investment seminars were not sufficiently targeted or cost-effective. Instead of addressing potential investors generally, the new campaign should target certain sectors, countries and even specific multinational corporations. This was also done before but must be continued with even more zest and planning. In this regard, it is regrettable to see the size of Ethiopian diplomatic missions shrink under the current fiscal stringency. When the fiscal crisis is over, Ethiopia should restore embassies abroad because they play an indispensable role in national economic marketing.

A concluding remark

Since 2008 when Japanese researchers were invited to an intensive and continuous industrial policy dialogue with the Ethiopian leaders, there have been many improvements in the Ethiopian policy, institution and dataset related to FDI. We duly recognize these achievements and applause the efforts that went into them. At the same time, we must also acknowledge that the road ahead is long and far. Ethiopia's current FDI policy and performance fall short of what the nation aspires or can attain, and are well below the average of fast-growing economies of Southeast Asia with which we are familiar. We know that the Ethiopian people and government are not content with the result so far, and it is in this spirit that this policy paper was written. Candor rather than courtesy rules, as has always been in our policy dialogue. It is hoped that the reader will detect our passion for Ethiopia beneath our critical assessments.

The Ethiopians are a proud people and the Ethiopian government does not jump to foreign advice easily. When advice is accepted, the policy is drafted by assigned Ethiopian officials (relatively quickly), which is good for country ownership but details and implementability often suffer. We suggest that pride and ownership be set aside initially, letting best practices be introduced by highly skilled and experienced foreign experts. Local adjustments are necessary but after the foreign model is fully understood. This is what Japan—and many other latecomers—did in the past to catch up. Pride and ownership can be easily regained when Ethiopians have learned how to manage, modify and improve the foreign model by themselves. In Meiji Japan, this transition from student to competence took about ten years.

This paper identified problems and suggested new policy directions. Concretizing these policy directions into implementable plans will require additional effort as well as deep policy skill and knowledge. That will be a process of learning by doing. We would like to see Ethiopia move from the analysis stage to the implementation stage while taking advantage of international cooperation.

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