

INDUSTRIAL POLICIES IN ETHIOPIA: Building capacities for private sector development and structural transformation

*From the African Community of Practice on Managing for Development
Results at the African Capacity Building Foundation (ACBF)*



Case Study
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SYNOPSIS

The first Ethiopian Growth and Transformation Plan (GTP), for 2011–2014, had a strong focus on industrial development. The second, for 2016–2020, aims to increase exports from industry and agriculture. This link between industrialization and agriculture is not recent, having been formulated in the early 2000s. Ethiopia is one of the few African countries to have experimented and implemented, for more than a decade, a full-fledged industrial development strategy (IDS). An integral component of the government's agenda in linking agriculture to industrialization revolves around agricultural development-led industrialization (ADLI).

The study finds that five to 10 years after the enactment of the 1995 constitution and related agricultural policies, agricultural growth, poverty, and food security had not shown any significant gains. Forward and backward production linkages remained weak, in part due to lack of demand as extra income in Ethiopian households was generally directed to buying food rather than agricultural inputs. Moreover, the impact of the land certification program on smallholder tenure security was stunted by lingering tenure concerns. While the program's resulting certificates had some positive effects on tenure security (land rental and leasing are legal), and on other outcomes such as land-related investment, land insecurity persisted.

The study concludes that for an agriculture-led industrialization strategy to succeed, Ethiopia would need a “double” green revolution, combining new agricultural technologies mindful of climate change consequences with adaptation to the wide diversity of ecosystems.

As a key recommendation, regular review of policies and instruments is needed in order to identify bottlenecks and capacity gaps. Policies have to be framed to address skills development for increasing firm (and agricultural) productivity as well as capacity needs and constraints for an agricultural-led industrialisation.

Introduction: Industrial policies in Africa

The economic growth that many African countries have experienced in recent years has been principally driven by natural resource discovery and exploitation, coupled with a primary commodity price boom. But it is not a sustainable path. Such growth is tied to external conditions (such as the oil price) that African countries cannot control, entailing risk and presenting an unpredictable economic future.

Industrial development is a powerful tool to promote structural transformation of African economies, allowing them to fully benefit from their natural resources, and ensuring long-term development through private sector growth. Agenda 2063 of the African Union underlines this pan-African vision of giving a central role to industrialization. Specifically, the Action Plan for the Accelerated Industrial Development of Africa is a central strategy of the Agenda, aimed at mobilizing financial and non-financial resources to enhance Africa's industrial performance.

"Africa needs an active industrial policy to sustain its growth" (Chang 2012). This might seem obvious, but marks attitudinal shifts in the debate on development policies in Africa. It is recognized that structural adjustment plans and the "Washington consensus" policies implemented in Africa during the 1990s failed to achieve their intended results.

In privatizing state-owned enterprises and liberalizing international trade and foreign investment, African countries experienced economic crises, as their nonexistent or underdeveloped private sectors were unable to participate in the marketplace, while facing vastly stronger import competition. At that time, national industrial policies were not an option, because the World Bank and the International Monetary Fund monitoring African economic reforms remained opposed to industrial policy. According to the neoliberal policies they promoted, industrialization would have diverted efforts from the focus on

exports and integration of African countries into the global market, which they considered the solution.

To take one example: The World Bank and International Monetary Fund structural adjustment prescriptions in Uganda did not include any industrial policy development, focusing instead on achieving macroeconomic stability, reducing inflation, reviving traditional exports, and liberalizing the economy (Whitfield and others 2015). Across most of Africa, the era of structural adjustment was one of deindustrialization. As the Executive Secretary of the Economic Commission for Africa once stated, "today, the weak African industrial structure still has to move out of the shadow of those interventions (e.g. structural adjustment)" (Lopes 2013b: 2).

For this reason, and inspired by the East Asian "miracles" of, for example, Japan and Korea between the 1950s and the 1980s, and by the economic success achieved by most western countries and China through industrialization, African countries are progressively becoming more interested in industrial development through active industrial policies. East Asian industrialization was in fact strongly criticized at the end of the 1980s and during the 1990s, while industrial policy has been one of the most controversial issues in development economics (Jerven 2011).

But more recently, critiques have been theoretically nuanced in developed and developing countries, while experiences of industrial policies in Sub-Saharan Africa in the 1960s and 1970s are also nowadays revisited (Jerven 2011). It is in fact recognized that Western Europe has become what it is through industrialization; it is also acknowledged that countries like China have achieved development results through a clear focus on industrialization. Further, the 2007–2008 global financial crisis has enhanced the legitimacy and importance of industrial policy, including in Africa, where the lessons learned by countries like Germany, China, and Brazil, which have used industrial policy for domestic growth, are being

reconsidered for their positive effects on African economies (Chang 2013).

Industrial policies are today even more complex than in the past, as their scope is broadening to include environmental, social, and sometimes urban dimensions. Africa's regional economic communities, like the East African Community, include industrial policies in their economic integration strategies.

There is clear and documented awareness that Africa needs inclusive sustainable and growth-oriented industrialization: The United Nations Economic Commission for Africa (UNECA) puts a strong emphasis on it (for example UNECA 2014) and even the World Bank recognizes its importance (Chang 2012). But achieving it is only possible if industrial policies are well formulated and implemented at all relevant levels.

Case study: Industrial policies in Ethiopia

Ethiopia has an underdeveloped industrial sector, which goes beyond manufacturing to cover construction and mining, despite significant potential. It has therefore put in place industrial policies to enhance its contribution to domestic structural economic transformation and job creation. The goal is to move workers from poorly productive agriculture to industries and services, with higher productivity and better-paying jobs.

Despite its strong and consistent economic growth in 2004–2014, Ethiopia remains a low-income country and has been unable to foster structural transformation. The share in gross domestic product of its manufacturing sector is slightly higher than 4 percent, and the share of employment in manufacturing was 4.7 percent in 2013, having climbed a little from 4.4 percent in 1999. Industry's 18.5 percent growth in 2013–2014 was driven by construction and mining (World Bank 2015).

For Ethiopia therefore, expanding its manufacturing subsector is essential to secure the long-term and

sustainable growth of its industrial sector. Industrialization would bring better and more diversified jobs, helping to reduce poverty and narrow inequality.

Ethiopia is one of the few African countries that has formulated and implemented for a decade and a half a full-fledged IDS (Federal Democratic Republic of Ethiopia 2002). Approved in 2002, the IDS was the country's first comprehensive IDS. It was not promoted by international financial institutions but designed by the Ethiopian government and based on ADLI. This focus on agriculture is intended to encourage rural development, while increasing the productivity of a large but archaic agricultural sector. It fundamentally attempts to remedy low sectoral productivity gains, as farming and livestock management systems remain underdeveloped, while highly-specialized farms producing high-value cash crops like flowers, fruit, and vegetables, and investments in the agro-industrial sector, remain limited (Altenburg 2010).

The IDS concentrates on the mechanisms through which the government should engage and promote the private sector, creating a conducive environment for private sector development to tackle macroeconomic instability and build a well-functioning and well-regulated financial sector (Gebreyesus 2013). It gives priority to the export sector: This choice is based on the assessment of the limited size of the local market and on the need to generate foreign exchange. Export industries benefit from advantages including better land lease rates, tax incentives, and subsidies for attending trade fairs. Labor-intensive industries are preferred to capital-intensive segments.

As a landlocked country, Ethiopia strives to attract resource-based investments, using its cheap labor as an incentive (Fortin 2014). The IDS identified four industries: textiles and garments, leather, agro-processing, and construction. It has promoted high entry of firms into manufacturing, but these firms are predominantly small enterprises and domestically oriented, meaning that the export sector underperforms (Yewondwossen 2015). These

small enterprises often lack the innovative drive, financial capital, and technical and managerial capacities required to scale up.

The first Ethiopian GTP, for 2010–2014 had a strong focus on industrial development, with its third pillar devoted to enabling industry to play a key role in the economy. The GTP promoted rapid economic growth and support for, among other issues, entrepreneurship, private sector development, and jobs. The fourth pillar is enhancing expansion and quality of infrastructure, at the core of which is the effort to promote domestic capacity building for job creation.

The GTP's attention to capacity building is in phase with the efforts made toward institutional reform and institutional capacity building (Markos 2013). This has been done through the Civil Service Reform Program, as well as the restructuring of some public agencies, such as the Ministry of Trade and Industry and the Ministry of Education, to make them more flexible and responsive to the needs of the private sector.

The reform of the Ministry of Trade and Industry was extremely successful and has rectified the problems ingrained over a long period of time. [...] However, the problem of a lack of institutional capacity in Ethiopia remains, which may cast doubts on the country's ability to broaden and sustain civil service reforms (Mengesha and Common 2006: 18).

More widely, institutional and capacity challenges constrain design and implementation of policy, and progress in fostering industrialization (Gebreeyesus 2013).

GTP2, for 2016–2020, aims to increase industrial and agricultural exports. It gives priority to capacity building, higher education, and specialized technology. Dedicated technology and training centers (such as the Adama Science and Technology University) are to support industries such as leather, dairy, meat, and sugar.

The government has also targeted private sector capacity building in industries identified by the IDS. In 2005, for example, it launched the Engineering Capacity Building Programme. The government has thus shown commitment to the industrialization process that stands out in Africa. But despite such ownership, outcomes thus far appear mixed. If progress in some industrial sectors like leather and textiles is acknowledged, constraints in, for example, infrastructure have checked industrial development. In short, industrialization has not for the moment structurally transformed Ethiopia, which means that poverty and inequalities are still high.

The limits of agriculture in supporting industrialization

ADLI has been the government's policy response to the country's food security and agricultural productivity challenges. The focus areas are to commercialize smallholder agriculture through product diversification; to shift to higher-valued crops, promoting niche high-value export crops; to support development of large-scale commercial agriculture; to integrate farmers with domestic and external markets; and to tailor interventions to the specific needs of the country's varied agro-ecological zones (Haberli 2013).

The government has pursued complementary agricultural development policies to support smallholders. Its ADLI strategy asserted that, since Ethiopia was a labor-rich and capital-poor country, the government should cater to and support non-mechanized agricultural production. By strengthening its most labor-intensive industry, through inputs such as irrigation, fertilizer, improved seeds, credit services, and capacity development programs, the government posited that it could generate economic growth while improving national food security and stimulating downstream and upstream agricultural linkages. One of the key pillars of this strategy has been the continued guarantee of usufruct land rights to smallholders, for the government believes that

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these rights prevent land transfers, which in the case of the poor, are often done during times of distress.

Ethiopia's land tenure policy is also key to understanding the country's economic and agricultural development patterns. Land is a major asset for Ethiopians, especially for rural communities. From a government viewpoint, land has many key economic and non-economic roles, such as maintaining social and political stability and has, in turn, been controlled by successive governments as an asset under state ownership. As a consequence, this land tenure system does not allow farmers to use the land as collateral to secure credit from banks, serving to alienate poor operators and owners from formal credit supplies. As a result, a farmer's ability to increase productivity through enhancing inputs and technologies on their small plot of land is dismissed.

Some five to 10 years after the enactment of the 1995 constitution and related agricultural policies, agricultural growth, poverty, and food security had not shown any significant gains. Forward and backward production linkages remained weak, in part due to lack of demand as extra income in Ethiopian households was generally directed to buying food rather than agricultural inputs. On the supply side, a lack of public funds and capital accumulation in the private sector also held back the larger investments needed to facilitate these linkages. Consequently, the economic arguments outlined in the ADLI in favor of expanding smallholder agriculture were discredited.¹

These new land and agricultural policies have also often failed to protect vulnerable groups. For instance, despite the legal recognition of ethnic equality through federalism, the country's lowland regions remained politically marginalized and gained a lesser degree of autonomy due to their lack of capacity in running state-led systems (Lavers

2012). Thus the central government continued to act on these regions' behalf, undermining any meaningful form of regional representation there.

At the same time, pastoralists and shifting cultivators within these regions were denied "their right not to be displaced from their own land" (Article 40 (5)) by the central government. The state was expropriating their land under the guise of it being "unused," despite such land's crucial role in the nomadic nature of pastoralism and shifting agriculture. While the country's land certification program would have aided in solidifying these two groups' land rights, the central government did not attempt land registration in the lowland regions. Combined with the State Minister's comment, "we are not really appreciating pastoralists remaining as they are [...] pastoralism, as it is, is not sustainable" (Butler 2010), the rights of pastoralists seem unlikely to be upheld.

The impact of the land certification program on smallholder tenure security was stunted by lingering tenure concerns. While the program's resulting certificates had some positive effects on tenure security (land rental and leasing are legal), and on other outcomes such as land-related investment, land insecurity persisted, as landholders were worried that further land redistributions would occur, affecting household investment decisions and limiting long-term investments (Ali and others 2007). This anxiety was caused, in part, by growing landlessness in some regions, which Ethiopian landholders suspected would precipitate future rearrangements of land ownership to accommodate new claimants' needs.

Ethiopia's "gender-sensitive" land certification program had varying impacts on strengthening women's rights. For instance, although the Tigray region had only 8.6 percent "husband-only" certificates, the Amhara region had 70.5 percent of them. There were also complications in Southern Ethiopia where gender equality was undermined on a more fundamental level by the continued practice of polygamy (Makki 2012).

¹ Some researchers have highlighted the fundamental structural barriers that undermine a smallholder agricultural strategy like ADLI, while others have attributed the failure to poor implementation (Lavers 2012).

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These factors combined to convince senior policy makers that new initiatives were required. Landlocked and with few natural resources, growth in agriculture was still essential to economic growth and poverty reduction. Consequently, in the early 2000s, the government began to expand its focus on smallholder production and internal production linkages to include large-scale commercial agriculture, trade, and foreign investment. The ADLI strategy was thus superseded by the Comprehensive Africa Agriculture Development Program² (Interview, Addis Ababa Chamber of Commerce, April 18, 2014). This policy shift occurred mainly in 2002 and 2003 with the enactment of investment proclamations, and new regulations governing incentives for foreign and domestic investors (Rahmato 2011).

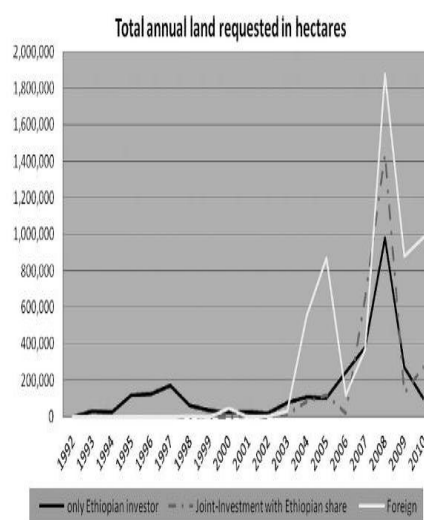
These new legislative tools are notably generous to foreign investors who, though typically prohibited from leasing land in Ethiopia for more than 25–50 years, are now largely exempt from taxes on imports of capital goods and from taxes on repatriated profits (Bossio and others 2012). Additionally, Ethiopian land is leased for very low rents with the lowest fees available in the remote and sparsely populated lowland regions.

As the Ministry of Agriculture has stated, Ethiopia offers “immaterial” lease rates compared with the surrounding countries (Makki 2012). Consequently, these “over-the-top” incentives, combined with a superficial approval process for investment proposals in many cases, have been criticized by foreign and Ethiopian experts for the lack of advantages and economic return they create for Ethiopians and for the opportunities they create for land grabbing.

Domestic returns aside, this shift in policy has had a dramatic and immediate impact on foreign demand. The area solicited annually by foreign investors, which did not exceed 50,000 ha before 2003,

surpassed 500,000 ha by 2004 (figure 1). Although there were short drops after the national elections in 2005 and after the food price crisis of 2008, there has been an increasing share of foreign investments in Ethiopian land since the early 2000s. A growing literature documents land grabbing and forced displacement of tens of thousands of people from their ancestral land to accommodate foreign investors (The Oakland Institute 2015).

Figure 1. Total land area requested annually by investor category, 1992–2010



Source: Author’s own calculations based on internal documents provided by the Ethiopian Agricultural Investment Land Administration Agency under the Ministry of Agriculture in April 17, 2014.

The government’s policy shift was codified and refined through policy documents later in the 2000s. One such document was the 2009 Proclamation, which established the federal government’s authority over land transfers to foreign entities involving 5,000 ha or more. Thus, despite past claims of ensuring ethnic self-determination through the empowerment of regional governments, one of the most significant land administration functions was recentralized within the state. The government’s stated motivation for this change was to eliminate red tape and lengthy processes investors faced in acquiring land at the regional level.

² This was a framework on which African governments had agreed. It embraced agriculture-led growth as a focal strategy to achieve the Millennium Development Goal of halving hunger and poverty by end-2015.

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The government created the Agriculture Investment Support Directorate—later to be the Agricultural Investment Land Administration Agency—to manage and streamline these functions at the federal level. One of the directorate’s first tasks, with the help of the regional governments, was to create a land bank of all “unused” agricultural land to more easily identify suitable land for foreign investment proposals.

The government established the Agricultural Transformation Agency as a means of increasing food production (ATA 2013). By 2013 the agency had taken measures on reversal of soil depletion; fertilizer production and optimization; productivity programs for the basic staple cereal teff; pilot credit schemes; biotech studies; and farmers’ (re) organization (ATA 2013).

But for an agriculture-led industrialization strategy to succeed, Ethiopia would need a “double” green revolution, combining new agricultural technologies mindful of climate change consequences with adaptation to the wide diversity of ecosystems. “Rather than leading industrial development, it is essential that productivity growth and greater market integration in agriculture proceed together with industrialization” (Page 2013: 256). In fact, agricultural-led industrialization still seems an unsustainable path for Ethiopia (Page 2013).

Other areas of industrial policy

Ethiopia’s industrial policy focuses not only on agriculture but also on urban planning and transformation and on infrastructure development. The links and benefits of coherent development planning—enhancing and supporting industrial policy—have been demonstrated outside Africa.

In Africa, an increasing number of countries have been focusing on urban planning for industrial development, building industrial parks and clusters (Monga 2011), maximizing industrial policy interventions and benefiting from multiplier and spillover effects. Successful industrial parks (based on the East Asian model) need to be in an urban or

peri-urban location if they are to exploit the concentration of infrastructure and services, including international ports and airports.

This is the case in Ethiopia, where the leather industry is concentrated in a special economic zone on the outskirts of Addis Ababa and benefits from large Chinese investments. It has produced about 25,000 jobs directly and indirectly countrywide (Lopes 2013a). Nevertheless, this zone also raises labor rights concerns for workers, given Ethiopia’s low labor standards (Rohne 2013).

Beyond national infrastructure initiatives, the Lamu Port–South Sudan–Ethiopia Transport Development Corridor Project aims to foster economic connections between the three countries. It aims to increase their international trade competitiveness, with a positive effect on input through benefits to transport infrastructure (port, highway, and airport facilities) and energy infrastructure (a crude oil pipeline and an electric power supply system), as well as resort cities (which means more industrial clusters and related services).

Lessons learned and policy implications

It is difficult to evaluate the extent to which the Ethiopian industrial strategy has been implemented and to determine its positive and negative effects, direct and indirect. Industrial policies have not yet been systematically and independently evaluated: monitoring and evaluation capacities are seriously limited in Ethiopia, and not only for industrial policy.

Despite a growing awareness of the need for monitoring and evaluation, fully independent third-party evaluations are rare (Altenburg 2010). A regular review of policies and instruments needs to be instituted to identify bottlenecks and capacity gaps. Policies have to be framed to address capacity needs and constraints. If this had been done in Ethiopia, the evaluation would have shown, as suggested above, that agriculture cannot lead industrialization in Ethiopia. It is recommended that deep and independent evaluation be undertaken

soon to review and as necessary revise the national industrialization strategy.

It is critical that the government be able to identify and address capacity gaps, in government and other institutions (UNECA 2014). Other key needs relate to skills development for increasing firm (and agricultural) productivity.

As other examples around the world have shown, a sound industrial policy requires close government–private sector collaboration, to ensure its relevance and effectiveness: Too limited involvement of private investors in manufacturing can condemn it to fail, despite initial goodwill and solid strategic choices (Chang 2012; Yong 2014). The Ethiopian private sector does not meet the requirements to make it effective and to allow it to participate in implementation. Nor has industrial policy been able to develop the sector, as the focus on foreign investment has been too acute to ensure sizable results.

As Gebreeyesus (2013: 35) concludes:

“What form of relationship should be instituted between the state and business? How to create an environment that maximizes the social benefits and limits rent seeking? [...] There is also emerging concern that the public investment expansion is increasingly dwarfing the private sector, for example in relation to credit and foreign exchange availability. A vibrant private sector is critical for the effectiveness of industrial policy.”

Current industrial policy, despite a clear focus on growth-oriented entrepreneurship, has failed to create additional markets to make this entrepreneurship competitive. One approach should be to reward innovative businesses with coaching from experienced business people, and with ad hoc programs helping small firms to connect with larger ones. Others include public procurement programs, and improved provision of business services and service delivery. Measures to

boost technological skills and access to markets are also strategic (as clear in the GTP2 and the IDS).

Sectors with high growth potential and related constraints have to be identified with the stakeholders concerned. Subsequently, the list of industrial priority sectors must be flexible and allow for changes. Consultation with the private sector should help identify potentially strategic emerging industries, as with the wine industry.

Outcomes of industrial policy vary by sector: leather, textiles, and construction have proven successful. But what matters for the long term and beyond individual sectors is to build the country's industrial structure, and tighten its linkages with the industrial value chain. Ethiopia has so far been unable to do this because of a divergent focus on agriculture. Periodic revisions of strategic priority sectors for the industrial strategy should be included in the policy to facilitate implementation.

Despite all the limitations, Ethiopia may provide a lesson from its industrial parks: “Ethiopia’s relative success has come from its focused policy. [...] Rather than electrify the whole country, Ethiopia has concentrated on providing power and transport links to its industrial parks” (The Economist 2015). The country needs now to ease binding constraints nationally.

Oqubay (2015) demonstrates that industrial policy can work in Africa, including in low-income countries like Ethiopia. But it remains a work in progress, facing development problems and capacity gaps.

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