



Diagnostic Trade Integration Study of Ethiopia

Update, June 2016

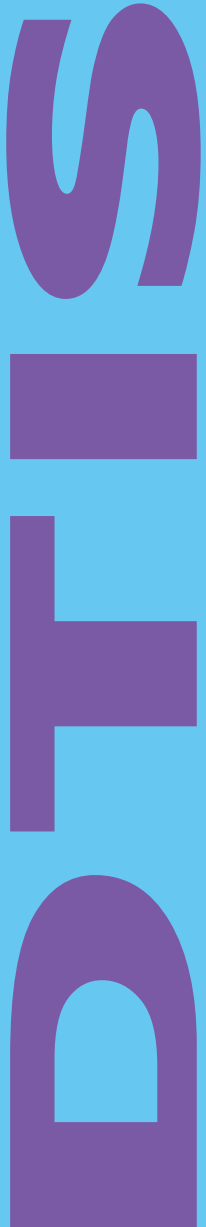


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PART I:
Executive Summary and
Action Matrix

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List of Acronyms

AACCSA	Addis Ababa Chamber of Commerce and Sectoral Associations
ADLI	Agricultural-development-led industrialization
AEO	Authorized Economic Operator
AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
ARSO	African Regional Organization for Standardization
ASYCUDA	Automated System for Customs Data
ATA	Agricultural Transformation Agency
BMEIA	Basic Metal and Engineering Industries Association
CAB	Conformity Assessment Body
CET	Common external tariff
CODEX	Codex Alimentarius Commission
COMESA	Common Market for Eastern and Southern Africa
CRM	Certified Reference Materials
CSA	Central Statistics Agency
CVTFS	COMESA Virtual Trade Facilitation System
DBE	Development Bank of Ethiopia
DTIS	Diagnostic Trade Integration Study
EAC	East African Community
EBA	Everything But Arms
EC	European Commission
ECAE	Ethiopian Conformity Assessment Enterprise
ECTT	European Council for Tourism and Trade
ECQ	Ethiopian Commodity Exchange
ECVS	Ethiopian Customs Valuation System
EIC	Ethiopian Investment Commission
EIIDE	Ethiopian Industrial Inputs Development Enterprise
ELIA	Ethiopian Leather Industries Association
ENAO	Ethiopian National Accreditation Office
EPA	Economic Partnership Agreement
ERCA	Ethiopian Revenue and Customs Authority
ERHSSA	Ethiopian Raw Hides and Skins Suppliers Association
ESA	Ethiopian Standards Agency
ESLSE	Ethiopian Shipping and Logistics Services Enterprise
ESTDP	Ethiopian Sustainable Tourism Development Project
ESW	Electronic Single Window
ETB	Ethiopian Birr
ECX	Ethiopian Commodity Exchange Market
ETTC	Ethiopian Tourism Transformation Council
ETGAMA	Ethiopian Textile and Garment Manufacturers Association
EU	European Union
FDI	Foreign direct investment
FMHACA	Food Medicine and Health Care Administration and Control Authority
FSMS	Food Safety Management System Certification
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GI	Geographical indication

GSP	Generalized System of Preferences
GTP	Growth and Transformation Plan
GVC	Global value chain
GVP	Gross value of output
HACCP	Hazard analysis and critical control points
HS	Harmonized System of Tariff Classification
IAF	International Accreditation Forum
ICD	Inland container depot
ICT	Information and communications technology
IDS	Industrial Development Strategy
IEC	International Electrotechnical Commission
IFC	International Financial Corporation
IGAD	Intergovernmental Authority on Development
ILAC	International Laboratory Accreditation Co-operation
ILO	International labour Organisation
IMF	International Monetary Fund
IPPC	International Plant Protection Convention
ISIC	International Standard Industrial Classification
ISO	International Standards Organisation
LDC	Least Developed Country
LIDI	Leather Industry Development Institute
LLDC	Land-locked developing country
MDGs	Millennium Development Goals
MFN	Most-favoured Nation
MIDI	Metals Industry Development Institute
MoARD	Ministry of Agriculture and Rural Development
MoCT	Ministry of Culture and Tourism
MoFED	Ministry of Finance and Economic Development
MoH	Ministry of Health
MoI	Ministry of Industry
MoST	Ministry of Science and Technology
MoT	Ministry of Trade
NMIE	National Metrology Institute of Ethiopia
NQI	National Quality Infrastructure
NTM	Non-tariff measure
OECD	Organisation for Economic Cooperation and Development
OIE	World Organization on Animal Health
OSBP	One-stop border post
PACA	Partnership for Aflatoxin Control in Africa
PCA	Post clearance audit
PCP	Programme for Country Partnership
PPD	Ethiopian Public-Private Dialogue Forum
PPESA	Privatization and Public Enterprises Supervising Agency
PSI	Pre-shipment inspection
RKC	Revised Kyoto Convention
RTC	Rural Transformation Centre
QMPTL	Quality Monitoring and Pesticide Testing Laboratory
QSAE	Quality and Standards Authority of Ethiopia
S&DT	Special and differential treatment
SADC	Southern African Development Community

SAFE	Standards to Secure and Facilitate Global Trade Framework
SAPRAS	Strengthening of Agricultural Pesticide Residue Analysis System
SITC	Standard International Trade Classification
SLA	Service-level agreements
SME	Small and medium-sized enterprise
SOP	Standard operating procedures
SPS	Sanitary and Phytosanitary Measures
STMP	Sustainable Tourism Master Plan
TBT	Technical Barriers to Trade
TF	Trade Facilitation
TFA	Trade Facilitation Agreement
TIDI	Textile Industry Development Institute
TNC	Transnational corporation
TPCC	Trade Policy Coordinating Council
TRIMS	Trade-Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TVET	Technical vocational and educational training
UCR	Unit cost ratio
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNECE	United Nations Economic Commission for Europe
UNESCO	United Nations Educational Scientific and Cultural Organisation
UNIDO	United Nations Industrial Development Organization
UNWTO	United Nations World Tourism Organisation
US	United States
USAID	United States Agency International Development
VAT	Value-added tax
WCO	World Customs Organization
WTO	World Trade Organization

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EXECUTIVE SUMMARY

Ethiopia's economic performance over the last two decades, and especially since 2004, has raised more optimism about the prospects of the country than at any time in its modern history. Not only has Ethiopia an impressive record of sustained growth, but thanks to a combination of successful growth-oriented policies and well-conceived social policies it has also made significant progress in achieving the Millennium Development Goals, creating millions of jobs, and improving both the material and subjective wellbeing of the population.

Ethiopia's strategy for growth, industrialization and international trade integration is reflected in the Government's Growth and Transformation Plan (GTP) that was launched in 2009/10. With the Second Growth and Transformation Plan (GTP II), covering the period 2016-2020, Ethiopia is set to continue its ambitious development agenda based on its agriculture-based, manufacturing-driven and export-led growth strategy. The main principles of this strategy are to build to the largest possible extent on linkages between manufacturing industries and agriculture, to focus on the development of the most labour-intensive sectors to generate employment, and to concentrate government support on a selected number of strategic sectors.

This Diagnostic Trade Integration Study, which has benefitted from insights obtained from field missions and numerous interviews with stakeholders in the public and the private sector, gives particular attention to six of these sectors. Three of them have a strong export orientation, namely the agro-food industry, the textiles and clothing industry, and the leather and leather goods industry. Two other manufacturing sectors, the metals and engineering sector and the chemical industry, receive priority attention in Ethiopia's industrialization strategy primarily because they can provide important intermediate inputs not only to the three export-oriented sectors, but also to agriculture and the fast-growing construction activities. In addition, further development of tourism is also considered of strategic importance, given that the sector has a strong foreign exchange earning capacity, and an equally strong potential for further expansion.

The main broad findings of this DTIS are that, by and large, current policies and private sector efforts in Ethiopia go into the right direction and are conducive to advance the country's integration into international trade. The policy of targeting strategic sectors and to create sector-specific support institutions has already shown positive results, although these institutions need to be strengthened further, in terms of both the human and financial resources available to them and the functions they assume in policy design, provision of expertise and public-private dialogue. The Study finds that there is an urgent need for putting in place a comprehensive framework for trade and industrial policies to ensure greater coherence between, and better coordination of, various areas of trade-related economic policies. Moreover, it identifies significant shortcomings at the level of policy implementation as a result of insufficient administrative and institutional capacity.

Considerable macroeconomic and social achievements ...

Ethiopia's recent macroeconomic performance has been strong overall, with robust real GDP growth at an annual average of 10.8 percent during 2004-2015, and 10.1 percent during the GTP I period. Sustained growth has brought down measured unemployment from a peak of 26.4 percent in 1999 to a record low of 17.4 percent in 2014 (IMF 2015a).

Real GDP per capita, growing at an average rate of 7.2 percent in the last five years, more than doubled since 2004/05. This has helped to pull 26 percent of the population out of poverty. While this performance is remarkable, per capita income growth has been somewhat below the rate of 8 percent per annum, which would be required every year for Ethiopia to achieve its objective of becoming a middle-income country by 2025.

Despite rapid output and demand growth in recent years, macroeconomic and external imbalances have been avoided: the rate of inflation was significantly brought down and kept within single-digit rates during most of the GTP I period, and fiscal and current-account deficits have remained within manageable limits.

... but disappointing performance of exports and manufacturing

Notwithstanding these impressive macroeconomic outcomes, the performance of the prioritized manufacturing industries sectors has been disappointing. During the GTP I period, Ethiopia's GDP growth was driven primarily by domestic demand, with public investment alone accounting for more than half of GDP growth. The contribution of exports to Ethiopia's otherwise remarkable growth performance was disappointing. In particular, exports of manufactures have been lagging behind targets, and the Ethiopian economy remains vulnerable to the vagaries of international commodities markets, as witnessed by the strong repercussions of the drop of international coffee prices on export earnings.

In spite of their increasing trend, the share of manufacture exports still accounts for only 24 percent of total merchandise exports and 9.6 percent of total export earnings. This reflects the low level of industrialization in Ethiopia, with manufacturing industry contributing just around 5 percent to GDP. Ethiopia's economic structure continues to be dominated by agriculture, which in 2014/15 accounted for more than 40 percent of GDP, 80 percent of employment and 70 percent of export earnings.

Export expansion in those manufacturing sectors prioritized in Ethiopia's industrial development strategy has lagged behind the GTP I objectives. Yet, the three primarily export-oriented sectors offer considerable opportunities for international trade integration given the international market context and Ethiopia's manufacturing capabilities at its current stage of economic development. They are very labour-intensive with a large potential for low-skilled employment, and offer the possibility to develop entire value chains from agricultural production to the manufacturing of final goods. In this context, the domestic availability of agricultural raw materials, including in particular cotton and raw leather, is considered a comparative advantage.

Ethiopia has made significant progress in strengthening the infrastructure needed for accelerated industrialization and trade integration. By contrast, both domestic investment and FDI have grown relatively modestly and remained behind the objectives, in spite of generous incentives in the form of tax and duty exemptions for investment in the prioritized sectors. This explains, in part, why industrial productivity is still low by international standards, notwithstanding considerable advances in recent years. The majority of the producers in the prioritized manufacturing sectors operates at a small scale and has limited access to technology and inputs.

Achievements in the strategic export sectors insufficient to meet ambitious targets

In the agro-food industry, gross value of output increased more than six-fold over the past 10 years, but the share of the agro-processing industry in Ethiopia's GDP has remained low and behind target. Export competitiveness of processed food from agro-industrial activities has improved somewhat but is still very weak. Poor output quality constitutes a major constraint for Ethiopia's agro-industry exports, as evidenced by high rejection rates for some food items. There has been little diversification in Ethiopia's food exports into processed and higher-value-added goods and Ethiopia's trade in food and beverages continues to be highly dominated by raw vegetables, coffee, oils and fats, and meat.

In the textiles, clothing and leather goods sectors, globally operating companies have been driving export growth. Several of these companies, including retailers and brand manufacturers are either setting up their own production facilities in Ethiopia or are showing an increasing interest in sourcing from Ethiopian firms in these two sectors.

Output and export of textiles and clothing rose about threefold during the GTP I period. But product and market diversification has been quite limited, and imports, especially of finished clothes, also rose very fast so that the sector's trade deficit increased. Domestic production at all levels of the value chain is still largely insufficient to meet the fast growing domestic demand.

Over the past five years, the leather and leather goods sectors registered an annual average export growth from that was considerably faster than world export growth in these goods, indicating a gain in market share in world exports. This sector has been the only among the prioritized manufacturing sectors with a positive trade balance. Given its sector-specific comparative advantages, it has a potential to become a world class supplier of high-quality finished leather and leather products, including shoes, garments, gloves and accessories.

Overall, the Ethiopian agro-food processing, textiles and leather industries have been far from fully using their potential. Their existing productive capacity is largely underutilized and the domestic provision of raw materials for these industries can be significantly increased, as and 80 percent of the Ethiopia's country's arable land is still uncultivated. This means that the comparative advantages of a favourable climate and soil for agricultural food and cotton production and a huge cattle population have translated only very partially into competitive advantages for Ethiopian producers.

Remaining strong import dependence in metal and chemical products

Although the development of the metals, engineering and chemical industries has been receiving an impetus from country's industrialization process and the construction boom, the expansion of these industries has been held back by the limited domestic availability of relevant raw materials.

The metals and engineering sector has achieved rapid output growth, albeit with varying performances in the different subsectors. Although this sector's production is primarily geared to the domestic market, exports of a number of metals and engineering products have also risen considerably, albeit from a low level. Yet, an estimated 90 per cent of the domestic demand for base metals as well as metal and engineering products still has to be covered by imports, which in 2014 made up about half of Ethiopia's total merchandise import value. On the positive side, this import growth was less on account of consumer goods than of machinery and equipment, reflecting heavy public investments in transport, power and telecommunication infrastructure as well as private investments in the productive capacities of the prioritized export sectors.

Output growth in the chemical industries has been faster than in the other prioritized sectors, but this growth occurred at a very low level. And, although chemical production in Ethiopia has been almost entirely for the domestic market, this industry has been far from meeting the domestic needs of either basic or intermediate chemicals.

It follows that the prioritized manufacturing industries as well as agriculture and the booming constructing sector have remained highly dependent on imports of intermediate metals, engineering products and chemicals. And the metals and chemical industries are themselves heavily dependent on imports of raw materials. The exploitation of domestic deposits for the production of base metal and chemicals is circumscribed by natural endowments and the relative costs of exploration and exploitation. Still, there is considerably scope for domestic value addition in the production of intermediate and final goods in these sectors as Ethiopia's industrialization advances and per capita incomes rise. As Ethiopian firms develop their supply capacities to meet the growing domestic demand, they could also raise their capacity to gradually become more export-oriented, with a focus on entering the regional market.

The star performer: Tourism

Tourism is the only prioritized sector to have fully attained the targets that were set by GTP I. In 2015, the tourism sector accounted for about 34 per cent of Ethiopia's revenue from exports of goods and services, for 4.2 per cent of its GDP and for 3.8 per cent of its formal employment. Tourist arrivals and revenue from tourist services have grown rapidly, with Ethiopian Airlines alone accounting for more than two thirds of income from tourism in the past few years. Although the Ethiopian tourism sector has been receiving relatively less inflows of FDI than the manufacturing industries, it has considerably increased its overall capacity to host foreign guests in recent years and has also gained in overall competitiveness as a tourist destination. However, it is still lagging behind many other countries, including in Africa, and both the quality of tourism services and their distribution of tourism activities across the country remain to be improved.

Need for a comprehensive strategic framework ...

Research and interviews conducted for this study suggest that one of the reasons for the disappointing manufacturing export performance has been the absence of an all-embracing strategic framework for international trade integration. Considerable efforts have been undertaken in recent years to improve coordination of trade-related policies, but an institutional mechanism to provide strategic leadership in the trade integration process is still missing. Such leadership for policy design and effective policy implementation is needed to respond to three major challenges: First, the institutional deficit to cope with today's world of international supply chains and networks; second, the lack of strong, institutionalized cross-ministry coordination on trade policy issues; and third, the lack of an institutionalized mechanism for serious private-public consultation. A general policy challenge is therefore the design of a comprehensive trade strategy and a framework for better coordination of all trade-related policies that take full account of the nexus between international trade integration, the creation and upgrading of productive capacities for industrial development and the strengthening of domestic supply chains.

... and coordination of all trade-related policies

The design of such a trade strategy must take into account that it is the combined effect of all trade-related policies and the synergies that arise from their coherent and consistent implementation which determines the speed and intensity of structural transformation. Trade is inherently a cross-cutting issue that involves many Government departments, public agencies, private sector operators and trading partners. It encompasses diverse sectors,

including industry, agriculture, services, customs and border management, trade facilitation, logistics, finance, transport and information and communication technology; and it requires consideration of multiple perspectives, including the overall business environment, fiscal aspects and macroeconomic policies, education and vocational training, and upgrading of technical and managerial skills. It is therefore easy for coordination failures among different government agencies to occur, and for opportunities for synergies and complementarities to be missed. Under the existing practice of *ad hoc* inter-ministerial consultations the practice of trade policy tends to become reactive rather than being proactive. And even if policy measures are implemented effectively at the practical level, their results may not always be well reflected in direct impacts at the level of individual firms. It follows that, in addition to policy coordination, regular consultation is necessary with the private sector.

Fiscal and monetary policies matter for trade integration and structural transformation

A central aspect of trade policy coordination is the link between trade, industrial and macroeconomic policies. Trade and industrial policies are inexorably linked with decision-making and planning in budgetary and tax matters. In this regard, Ethiopia's strong dependence on tariff duties for government revenue is a reason for concern. Import duties and other trade taxes still account for more than one third of Ethiopia's total government revenue, but the revenue raising power of import duties is likely to be eroded in the future, especially in connection with accession to WTO. This implies a narrowing of the Government's fiscal space, which needs to be compensated by higher revenues from other sources. In turn, a reform of the public revenue system must take account of its impact on the structure of incentives for private actors, in particular in the corporate sector.

With regard to monetary policy, it is essential that the National Bank of Ethiopia (NBE) be included in the institutionalized coordination of policies in support of industrialization and trade integration. The NBE plays a central role in shaping the macroeconomic environment for investment, structural transformation and growth by determining the interest rate and influencing the exchange rate. Low interest rates are favourable for investment because they mean low credit costs for investors. Therefore, in its efforts to maintain price stability, the Ethiopian Government may be well advised to rely not only on restrictive monetary policy by the NBE, but to also use other instruments for this purpose, such as preventing excessive increases in wage and food prices. Overvaluation of the exchange rate is a reason for concern not only in view of Ethiopia's widening current account deficit, but also in view of the international competitiveness of the still nascent Ethiopian manufacturing industry in a global environment of slow growth. On the other hand, it has to be recognized that an overvalued exchange rate reduces the costs of imported inputs in domestic currency and helps to keep a lid on inflation. In any case, policy coordination between the Ministries of Trade and Industry and the central bank would be essential to identify short- and medium priorities for an exchange rate management that takes account of these conflicting aspects.

Internal constraints on trade expansion are more binding than external ones

With regard to its potential to expand external trade, one of the few advantages that Ethiopia enjoys, as an LDC, is preferential treatment by many of its developed country trading partners. But Ethiopian producers are far from reaping the full benefits from preferential market access, partly because they are unaware or badly informed of the opportunities offered, partly because they lack the required supply capacity or marketing skills. It also appears that there is a considerable unused potential for Ethiopian manufacturers to engage in regional trade.

Hence, internal constraints on output and export growth are more binding than external ones and most of these internal constraints are common for the different prioritized sectors. It is mainly the combined effect of several of these internal constraints behind low average rates of capacity utilization, which make the prioritised sectors unable of to deliver the quantity and quality of goods requested by foreign clients.

Furthermore, the comparative advantage represented by a favourable climate and soil for agricultural food and cotton production and a huge cattle population, have translated only very partially into competitive advantages for Ethiopian producers.

Technological shortcomings and skill shortages

Overall technical efficiency in the domestically-owned manufacturing firms in Ethiopia is compromised by often outdated machinery and production technology and insufficient technical and managerial skills. Technological upgrading is a matter of investment inflows, but in order to be effective it has to be combined with improvements and adaptation of workers' skills, management know-how and entrepreneurial competence. The number of educational and training institutions at all levels has significantly increased in recent years, but a remaining challenge is to better align vocational training and high-school education with the specific requirements of the strategically important sectors. Improved skills will also be necessary in the agricultural sectors slated for supplying inputs to the prioritized export sectors.

Key importance of the domestic supply chain

The most binding constraint for faster growth and trade integration of the prioritized sectors appears to be the insufficient integration of the domestic supply chains, in particular, between the manufacturing sectors and agriculture. Although Ethiopian agriculture has a huge potential to enlarge its output, the provision of agricultural raw materials to the agro-food, textiles and leather industries, which are at the heart of an agriculture-based manufacturing-led development strategy, have been inadequate in terms of quantity and quality. As a result, large amounts of raw materials and intermediate goods have to be imported, and such imports are often rendered complicated by the existence of other constraints, such as shortcomings in customs procedures and inefficiencies in the transport and logistics systems.

The supply chain constraints begin to occur far upstream, with the provision of appropriate inputs to agricultural production and livestock breeding. They continue at the stage of harvesting and slaughtering and the collection and domestic marketing of agriculture output. Finally, within the textiles, clothing and leather sectors, there are frequent problems in the availability of intermediate inputs on a timely basis, such as textiles yarn, textile fabrics and finished leather for further processing into final clothing and leather products. At this stage, insufficient domestic availability of inputs from ancillary industries, such as metal products, chemicals or pulp and paper are also perceived as a constraint, as are weaknesses in transport and other business services.

Successful industrialization begins by raising agricultural output and efficiency

Traditional socio-economic structures in rural areas strongly influence today's value chain and modes of agricultural production. These structures appear to be incompatible with the ambition to develop the Ethiopian agro-food, textiles and leather industries in a way that would raise their international competitiveness and make them a major source of income and employment creation.

Agricultural raw materials for domestic manufacturing mostly come from small farming units with little commercial awareness and low productivity. Small-scale subsistence farmers account for about 97 percent of agricultural production. They rely on rain-fed production, dispose of only very basic production techniques, and have limited access to quality seeds, animal feed, and pest and disease control facilities. They also operate with poor transport and storage facilities, and frequently lack information as to product requirements of processors. Only few farmers are organized into market-oriented farmer associations or cooperatives offering the possibility of pooling resources in order to meet challenges such as access to inputs, storage, transportation, grading and packaging. Yields from agricultural activities are low, the quality of agricultural produce is often insufficient, and there are considerable losses of raw materials on their way from agricultural producers to the manufacturing firms. Agricultural raw material marketing systems are inefficient and often unable to provide adequate services to the manufacturers.

The gap between the actual and potential supply of agricultural raw materials to the growing manufacturing sectors suggests that the market mechanism cannot be relied upon as an instrument to bring Ethiopia's comparative advantages to bear on its industrial development. Government and public support institutions have to assume a strong role in the process of adjusting agricultural production and marketing structures to the needs of manufacturers further down the value chain.

The challenge of meeting international quality standards

Among the reasons why many Ethiopian firms lag behind in international competitiveness, is insufficient compliance with international quality standards, be that in agricultural or manufactured products. One reason is a lack of awareness among operators of the importance to comply with such standards. Another is a delay on the part of the public sectors in establishing product standards and in ensuring compliance through product testing, quality control and certification. Some necessary steps have already been taken by the Ethiopia's National Quality Infrastructure (NQI), with a view to strengthening compliance with standards embodied in the WTO SPS/TBT agreements. But considerable challenges remain in respect of access of producers to comprehensive information about technical standards, product testing equipment and methodologies, access to certification and international accreditation of certifying institutions. The relevant institutions do not dispose of sufficient resources and expertise to provide comprehensive compliance and certification services, and lack accreditation by an international body.

Remaining infrastructure constraints despite heavy investments

Huge infrastructure investments have been a central element in the Ethiopian Government's industrialization strategy. Nevertheless, a number of bottlenecks remain in transport and logistic infrastructure, energy and water utilities as well as telecommunications infrastructure. Constraints in electric power and water provision, together with shortcomings in the transport infrastructure, continue to be responsible for an estimated 50 percent of the productivity handicap faced by Ethiopian firms. These constraints have often contributed to the reluctance of potential exporters to turn to external markets and to make greater international marketing efforts for fear of being unable to meet international contracts. Thus, further public investment

in infrastructure will have secondary effects through improvements in the conditions for private investment, in addition to its primary impact on overall productivity.

Need for more efficient trade logistics and enhanced trade facilitation

Since global supply chains and international production networks demand ever faster cross-border transaction, Ethiopia, as a landlocked country, needs to make special efforts to ensure a maximum of efficiency in transport and trade logistics. Although significant progress has been achieved in recent years, including the design of a comprehensive trade logistics strategy, Ethiopian firms still require more time to reach the destination markets than their competitors in other developing countries. They face considerable operational constraints as a result of very time-consuming and convoluted trade, transit and border clearance procedures, and formalities to obtain import licenses, foreign exchange permits and letters of credit. Moreover, the processing of documentation that is necessary for firms in the prioritized sectors to benefit from privileges like the voucher and duty draw back systems and subsequent reconciliation is often also very slow, causing a drain on the working capital of the companies concerned.

Further improvements in the logistics system and trade facilitation are a key requirement for strengthening the competitiveness of Ethiopian producers. The challenge is to accelerate full implementation of the multimodal system, which can significantly reduce the time, and so the cost, of transit and transport. Harmonization and simplification of documents combined with automation and streamlining of customs procedures would bring significant gains for the Ethiopian economy as a whole in terms of larger trade volumes and lower trade costs. Most of the measures that need to be taken in this area are primarily relevant for import trade, but since the capability of many Ethiopian manufacturing firms to produce and export goods at internationally competitive prices depends on imported intermediate goods, these measures are also of key importance for the success of the export-oriented industrialization strategy.

The current challenge in trade facilitation relates not so much to the design of reforms but primarily to their efficient coordination and effective implementation. Establishing a single Government entity to take the lead on trade facilitation and logistics would greatly facilitate the coordinated implementation of a holistic trade facilitation reform.

Higher investment in productive capacity indispensable ...

A more substantial shift of productive resources from lower- to higher-productivity sectors will be necessary to accelerate the transformation of the Ethiopian economy in the coming years. GTP II aims at an accelerated shift in the production and export structure towards products with a higher value-added content. For these reasons, considerable challenges remain for Ethiopia with regard to raising investment for upgrading and expanding productive capacities, not only in its manufacturing sector, but also in agriculture and the sectors providing industrial services. In the clothing and leather goods industries, FDI can be expected to make an even greater contribution than in the past to productive capacity building. But this will not be enough. What is also required is a greater engagement of domestic entrepreneurs to undertake such investments. The motivation to invest in export-related manufacturing activities, on the part of both domestic and foreign firms, is being stimulated through attractive fiscal incentives. On the other hand, this motivation is compromised by insufficient or unreliable availability of adequate labour skills, raw material supplies and infrastructure and logistic services, as well as by bureaucratic hurdles to “doing business”.

... but impossible without better access to finance

With regards to the ability to invest, financing constraints have been among the main obstacles for Ethiopian firms in their efforts to expand and upgrade their production and increase exports. Such constraints are also a hindrance to the modernization of the agricultural sector. They are being felt both in short-term financing of current activities and in long-term financing of investment for extension and technological upgrading of productive capacity.

An increase in the rate of private investment from around 17 per cent in 2013/14 to more than 20 per cent in the coming years, as envisaged in GTP II, will not be possible without facilitating the access of firms to finance. Retained profits are the most important source of investment financing (about 85 percent) and higher profits generated by greater overall efficiency would bear on both the propensity of entrepreneurs to invest and the possibilities of self-financing of their investment projects. However, at the early stages of a manufacturing activity, profit margins are typically small and insufficient to allow for higher self-financed investments. Bank lending as a complementary source of corporate finance is therefore of particular importance to allow for the required jump in the rate of private investment. It is in particular SMEs and new market entrants that are frequently suffering from inadequate access to finance. This constraint appears to be a greater problem in Ethiopia than in other developing countries, including many in Sub-Saharan Africa, and it seems to have become tighter in recent years, as the ratios of credit to the private sector to total bank credit and to GDP have consistently been declining since 2007.

Need for innovative policies to increase bank lending

The lending capacity of the Ethiopian commercial banks is based primarily on the amount of savings and time deposits it receives. In addition, long-term commercial bank lending to private firms is constrained by the obligation of banks to hold a minimum proportion of their assets in government bills and to hold 40 percent of their loans in short-term credits, as well as credit ceilings. Moreover, a large part of bank financing is absorbed by the financing of large infrastructure projects. Even within this limited lending capacity, banks are reluctant to extend long-term investment loans, and if they do, such lending is mostly subject to restrictive collateral requirements, which potential investors are often unable to provide. This is due to the fact that the risk assessment of such loans is often difficult in the Ethiopian manufacturing sector, as it often concerns new firms or innovative projects, which however are key to the dynamics of any growing industrial sector.

The challenge for the Government is therefore to combine sectoral support policies with a more pro-active approach to designing an overall financial system that facilitates access of firms to short-term and long-term finance at reasonable terms. For the banking system in Ethiopia to assume a stronger developmental role than in the past, its lending capacity of the commercial banks must be enlarged by strengthening their possibilities for refinancing at the NBE. Moreover, through their own lending, the Development Bank of Ethiopia (DBE) and the NBE could directly or indirectly provide the needed investment financing; they could also play a stronger intermediating role to access foreign currency loans for the financing of capital goods imports, where this is in line with trade and industrialization strategy.

Refining Ethiopia's marketing strategies

Strengthened international marketing efforts will be required to enhance the integration of Ethiopia's manufacturing sectors as well as tourism in international trade. Such marketing efforts must be undertaken for strategically important product groups to showcase Ethiopia as a production location, with a view to attract foreign investors and leading firms in international production networks to source from Ethiopia.

Individual domestic manufacturers in Ethiopia are unlikely to be able to successfully undertake international marketing efforts individually, especially at the global level. For most of Ethiopia's export items, especially clothing and leather products, the structure of the global markets is such that buyers typically have considerably larger market power and a much clearer picture of global sourcing possibilities than most Ethiopian firms have of their possibilities to sell their products abroad. Attempts of integrating Ethiopia's light manufacturing industries into global trade have to take account of the fact that at the core of the global trading system is the expansion of Global Value Chains (GVCs), which are dominated by large transnational corporations (TNCs). This makes it extremely difficult for domestically-owned firms, particularly in the clothing and leather sectors, to market their products directly to retailers in the largest foreign markets, except perhaps for certain niche products. Efforts to increase the visibility of these firms may therefore primarily be geared to market Ethiopian firms, rather than their products, as part of a GVC.

Still, the picture that potential international buyers have of the advantages of sourcing from Ethiopia can be influenced by enhancing the visibility of the Ethiopian export sectors through improved internet presence, including of the sectoral institutes and private sector associations, and through well prepared and targeted participation in international trade fairs. Presentations and dissemination of information have to become much more client-friendly than they have been hitherto.

The markets of neighbouring countries and the wider African and Middle Eastern region, may deserve heightened attention in the orientation of Ethiopia's overall export marketing strategy for all prioritized sectors. Efforts to access global markets should not lead to neglecting opportunities in the regional markets, and for that matter, in the domestic market. Especially in the clothing sector, marketing tools should be used better to increase the share of Ethiopian companies in the domestic market, which would help to reduce the worrisome trade deficit in in these goods.

Ambitious objectives and targets for the GTP II period

In its GTP II for the period 2016-2020, the Ethiopian Government has again set the objectives very high, including export targets. Further structural change is to be linked even more closely than in the past to the country's gradual integration into international trade for this to occur. The investigations undertaken for this DITS confirm the considerable industrial and trade development potential of the Ethiopian economy, but also the need for raising the effectiveness of public policies in support of selected private economic activities. The outcomes will, however, also depend in large measure, on the external economic environment, including the evolution of global demand for the goods that Ethiopia can export, the willingness of the country's development partners to continue with their generous technical and financial cooperation, and the extent to which the policy adjustments needed for accession to WTO can be reconciled with Ethiopia's agriculture-based manufacturing-led development strategy.

ACTION MATRIX

OBJECTIVES	ACTIONS TO BE UNDERTAKEN	REQUIREMENTS			PARTY RESPONSIBLE	TIMING	LINKS WITH GTP II's Pillars
		Policy Implementation	Policy Change	Tech. & Finan. Assist.			
Trade Policy							
Coherence in Trade Policy-making	<ul style="list-style-type: none"> • Design a comprehensive Trade Policy and set up a Trade Policy Coordinating Council (TPCC), chaired by the Higher Authority to coherently link all trade-related policies and regulatory measures <ul style="list-style-type: none"> ○ Set up a TPCC Secretariat responsible to set the agenda and consult with all national stakeholders • Ensure policy coordination to promote prioritized sectors across Ministries, including National Bank of Ethiopia (NBE) and public finance agencies • Ensure adequate training and preparatory work is undertaken in the context of the country's WTO accession 		X		PMO(*), MoFA(*), MoT, MoFEC, ECCSA	ST	Pillar a) Sustaining the rapid economic growth Pillar g) Continue to build democratic and developmental good governance
			X		PMO(*), MoT, Mol, MoFEC, NBE, DBE, Chamber of Commerce	ST	
			X		MoT(*), MoFA	ST	
Regional trade policy	<ul style="list-style-type: none"> • To enhance access to regional market, accelerate accession to the COMESA FTA • Actively participate in the Tripartite and Continental Free Trade Area negotiations • Identify and strive to maximize the possible national benefits from the integration and trade relation • Strengthen cross border trade relations and initiatives 	X	X	X	MoT(*), MoFA, Mol, MOFEC, ERCA, donors	ST	Pillar a) Sustaining rapid, broad based growth
			X	X		ST	
		X		X		ST	
		X		X		ST	
Focus on quality	• Ensure coordinated implementation of all	X	X	X	NQI(*), donors	ST	Pillar b)

enhancement for export promotion	<p>elements of the NQI Strategy, including establishment of Technical Regulation Coordinating Office (TRO) and strengthening of the National Quality Forum (NQIF) and the National Quality Infrastructure Technical Committee (NQITC)</p> <ul style="list-style-type: none"> • Foster greater proximity with stakeholders by including them in the Coordinating entities • Strengthen institutional capacity, mainly on infrastructure, equipment, accreditation and international recognition • Design an outreach strategy for the provision of relevant information on regulations, quality promotion to private sector and the general public • Improve test procedures with better equipment and calibration facilities and trained experts • Set up and strengthen SPS and TBT enquiry points 		X	X	<p>MST(*)</p> <p>NQI(*), NMI, ESA, ECAE, donors</p> <p>NQI(*), ESA, ECAE, NMI</p> <p>NQI(*), ESA(*), ECAE, NMI, MOARD, donors</p>	ST	Increase productive capacity and efficiency
Trade Facilitation							
Accelerate the reform programme	<ul style="list-style-type: none"> • Modernize the customs system in line with proclamation customs law of 2014: adopt Customs automation, electronic processing of transactions and payments and, replace paper documents with electronic ones, while providing accurate and timely metrics on clearance and logistics time to the stakeholders • Fully implement multimodal transport, including the facilitation of cargo transport with non-ESLSE companies • Upgrade dry ports to facilitate the supply of raw materials for export manufacturers, strengthen capacity of the private sector operators 	X	X	X	<p>ERCA(*), MoTR, EMAA, MoT, Mol, donors, MOFA</p> <p>MoTR (*),MOFA</p> <p>EMAA, MoT, Mol, donors</p> <p>MoTR(*), MoT, donors</p>	ST	Pillar b) increase productive capacity and efficiency

	<ul style="list-style-type: none"> Align trade facilitation measures with those agreed by COMESA Enhance international competitiveness at the international level, develop and upgrade institutions for product standardization (quality, certification and accreditation) and sensitize domestic producers on international technical and quality standards 		X	X	MoT(*), EMAA	ST	
			X	X	MoA, MoT(*), ESA(*), ECAE, NQI, LIDI, donors	ST	
Ethiopia-Djibouti Customs Coordination and better regional infrastructure	<ul style="list-style-type: none"> Accelerate the implementation of the new of Ethiopian customs computerized system eCMS (TradeWorldManager) and ensure its compatibility with ASYCUDAWorld System in Djibouti and other neighboring countries. 	X	X	X	ERCA(*), MoTR, MoT, donors	ST	Pillar b) increase productive capacity and efficiency
	<ul style="list-style-type: none"> Enhance the efficiency of customs procedures at the border and other neighboring countries, provide the physical and legal infrastructure to set up a one-stop border post 		X	X		MT	
	<ul style="list-style-type: none"> Strengthen the efficiency and the mandate of the Permanent Committee on Transit and create and technically equip a joint Ethiopia -Djibouti Corridor Management Authority 	X	X			MT	
	<ul style="list-style-type: none"> Ensure efficient, direct links and connections between the port of Djibouti and the container terminal in Modjo and crease a joint railway regulatory authority 	X	X	X		ST	
Enhance domestic infrastructure	<ul style="list-style-type: none"> Create synergies, agglomeration effects and facilitate technology transfers in the existing industrial parks <ul style="list-style-type: none"> Link them to the railway, road networks and provide the parks with power and water utilities 		X	X	MoWUD(*), MoFED(*), MoTR (*), donors	ST	Pillar a) Sustaining the rapid, broad based economic growth
			X			ST	
	<ul style="list-style-type: none"> Improve the rural road network for transport of 	X	X	X	MoTR(*), MoA, donors	ST	

	<p>agricultural inputs to production sites</p> <ul style="list-style-type: none"> Strengthen ICT for both public and private use Strengthen the combined electricity and water utilities expansion focused on improved water and irrigation facilities for cotton production 		X	X	MoCIT(*), donors	ST	c) Enhance the transformation of the domestic private sector
			X	X	MoWUD(*), MoA(*), MoFED(*), MOFA, donors	ST	
Education							
Target skill formation and innovation capacity	<ul style="list-style-type: none"> Better align vocational training with the labour and managerial skill requirements in the prioritized sectors <ul style="list-style-type: none"> Expand enrolment capacity of TVET and increase teachers' competences Promote on-the-job skills training and intra-industry collaboration in technical and managerial training in both private and public institutions Ensure technology and know-how transfer 	X	X		MoE(*), MoT, MoFEC, MOST, Universities, MOFA, MoLSA	MT	Pillar b) increase productive capacities Pillar f) Accelerate human development and technological capacity building
			X			ST	
			X			MT	
			X			ST	
Supply chains							
To strengthen domestic supply chains	<ul style="list-style-type: none"> To increase the cultivated land area, promote commercialized farming, the creation of larger agricultural operating units, and the necessary related infrastructure To raise agricultural output and farm productivity, expand agricultural extension services to the prioritized export sectors, including improved farming and harvesting practices and pest/disease control Establish a greater number of Rural Transformation Centers, preferably linked to 	X	X		MoA(*), ESA, MoWUD, MoT, NQI, donors	ST	Pillar b) increase productive capacity and efficiency
			X	X		ST	
			X	X		MT	

	<p>industrial zones</p> <ul style="list-style-type: none"> Fully implement existing legislation aimed at strengthening the domestic supply chain and enhance quality-related price incentives 	X				ST	
To enhance links with international chains	<ul style="list-style-type: none"> Target support to those firms that are participating in GVC with the aim of upgrading them on the chain and support firms that have a potential to succeed in niche markets, outside of GVC, in view of enhancing market access for domestic products Develop a concrete action plan that would enable the implementation of the Ethiopia's National AGOA Response Strategy and create a one-stop consultation service for exporters and potential exporters Enhance the visibility of Ethiopian export companies and sectoral associations, including through participation in international trade fairs 		X	X	MoI(*), MoFED(*), MoT, MoFA, donors	ST	<p>Pillar a) sustaining the rapid, broad based economic growth</p> <p>Pillar b) increase productive capacity and efficiency</p>
		X	X	X		ST	
		X	X	X		ST	
Finance and Investment							
To strengthen domestic finance necessary to increase liquid working capital	<ul style="list-style-type: none"> Enhance local and rural presence: new branches of commercial banks should be opened in rural areas Finance investment projects of viable small and medium-sized firms, reduce the official rate for long-term bank lending and adapt collateral requirements to the realistic capacity of firms NBE should assume a stronger developmental role and provide targeted and selective liquidity to commercial banks 		X		MoFED(*), NBE(*), EIC	MT	<p>Pillar b) increase productive capacity and efficiency</p> <p>Pillar c) Enhance the transformation of the domestic</p>
			X			MT	
			X			MT	

							private sector
To enhance investment for productive capacity	<ul style="list-style-type: none"> To establish a closer link between profits from exports and productive capacity investment, introduce a temporary corporate profit tax exemptions for exporting firms Develop further the one-stop-services of the EIC, improve data collection and project evaluation To mobilize FDI sources and facilitate linkage with domestic sector ministries 		X		MoFED(*), EIC, MOFA, donors	MT	Pillar c) Enhance the transformation of the domestic private sector
			X	X		ST	
SECTOR-RELATED RECOMMENDATIONS							
<i>I. Agro-food processing</i>							
I.1 Improve policy consistency and coordination between stakeholders	<ul style="list-style-type: none"> Create a specific agro-food industry dedicated to the development of the entire value chain Identify areas of intervention, improve availability of up-to-date and reliable agricultural, food processing, trade statistics Help firms become internationally competitive, create a Manufacturing Efficiency and Response Unit (MERU) to identify and rapidly address operational constraints arising in day-to-day practices 	X	X		MoA(*), MoFED, MOI, MoT	ST	b) Increase productive capacity and efficiency
			X	X	MoA(*), donors	ST	
		X	X	X	Mol(*), MoT, MoFEC, MERU, MoA, MoH, MoST	ST	
I.2 Enhance vertical integration between agriculture and industry	<ul style="list-style-type: none"> Overcome raw material supply and quality constraints, strengthen rural transformation centers, preferably within agro-industrial parks to enable farmers to sell their outputs and receive production inputs, access to cold/dry storage facilities Facilitate the coordination of private industrial parks with the agricultural input providers To access value chains, introduce contract farming between farmers and processors to 	X	X	X	Mol(*), MoA, MoWUD, MoT	MT	c) Enhance the transformation of the domestic private sector
			X		Mol(*), MoT	ST	
			X		MoA(*), Mol, MoT	ST	

	adequately identify quantity and quality of raw material, production methods, prices, financial support		X		MoI(*), MoT, MoA	ST	
	<ul style="list-style-type: none"> To create scale economies and facilitating post-harvest handling, create producer associations and/or cooperatives To enhance development of key export sectors, expand water utilities and water supply for agriculture. Increased power generating capacity to be aligned with water supply for irrigation in agriculture and industrial use. 		X	X	MoA(*), donors	ST	
I.3 Enforce quality standards to enhance competitiveness	<ul style="list-style-type: none"> To ensure product conformity, introduce a food safety and quality control and standardization system to implement standards, regulations and certification schemes As NTMs are becoming significant, provide industry-specific testing and standard equipment and related training 		X	X	MoST(*), MoT(*), MoA, donors	ST	c) Enhance the transformation of the domestic private sector
			X	X	MoA, MoST(*), MoT(*), donors		
II. Leather and Leather Products							
II.1 Strengthen the domestic supply chain of leather to raise the quantity and improve the quality of raw hides and skins	<ul style="list-style-type: none"> Strengthen and rationalize the domestic value chain through the creation and implementation of a strategic action plan to enhance outreach programmes and extension services to increase the quantity and quality of raw hides and skins, to include: <ul style="list-style-type: none"> Increase the off-take flock and reproduction rates and improve animal husbandry Discourage the export of live animals and punish illegal trade Design outreach and extension sensitization programmes Introduce systematic control of 	X	X	X	MoI(*), MoLF(*), MoT(*), LIDI, donors	MT	Pillar b) increase productive capacity and efficiency
			X			ST	Pillar c) enhance the transformation of the domestic private
		X	X			LT	
			X			MT	
		X		X		ST	

	<ul style="list-style-type: none"> ○ cattle/sheep diseases ○ Full implementation of regulations regarding pre- and post-slaughter management of hides and skins ○ Introduce official quality standards that would enable a premium-quality-based pricing mechanism ○ Training for traders and operators to increase skin and hide preservation ○ Create rural cooperatives to have larger units for livestock breeding ○ Enforce proclamations 457/2005 and 819/214 ○ Establish an institution responsible for the system of collection, coordination, quality-control of raw hides and skins, in coordination with meat production process 	X				ST	sector
			X			MT	
			X	X		ST	
			X	X		MT	
		X			MoI(*)	ST	
		X					
	<ul style="list-style-type: none"> ● Improve technical efficiency of domestic producers through training and advisory services, particularly for tanneries <ul style="list-style-type: none"> ○ LIDI and private sector associations should enhance their direct deployment of expertise, particularly regarding quality control, and compliance with quality standards targeting those companies that have the highest degree to succeed in international markets ○ To generate multiplier effect, provide financial support to firms that temporarily employ foreign experts to advance technical know how 		X	X	LIDI(*), ELIA, ERHSSA, donors	ST	
			X			MT	
			X	X		ST	
	<ul style="list-style-type: none"> ● Set up public input supply enterprises that 		X		MoA(*), MoT, EIC	ST	

	intermediate with foreign suppliers to facilitate the import of raw hides and skins and other inputs from neighbouring countries						
II.2 Expand export markets for leather goods with a higher value added and increase marketing efforts	<ul style="list-style-type: none"> To penetrate into regional markets and use favorable access into EU and USA markets, introduce one-stop consultation services about market access, and technical standards for leather products, in particular for SMEs Support participation of Ethiopian producers in international leather fairs To strengthen capacity for innovation in product design and manufacturing process, develop strategies aimed at identifying niche markets, product specialization and specific client groups To enhance marketing of locally produced goods, create of a specific Ethiopian brand for high-quality products To create economies of scale, promote subcontracting between larger and smaller firms to create larger footwear factories that could carry out large export orders To increase productive capacities, develop a strategy to attract FDI in high value-added segments of the leather industries 		X	X	MOT(*), MoA, MoI, EIC	ST	Pillar b) increase productive capacity and efficiency
			X	X	Donors, MoT(*), MoA, MoI	ST	
		X	X	X	ERHSSA, ECCSA, ELIA	MT	Pillar c) enhance the transformation of the domestic private sector
		X	X	X	MoT(*), MoA(*), donors	ST	
			X		MoT(*), MoA, LIDI	ST	
		X	X		Donors, MoT(*), MoA	ST	
III. Textiles and Clothing							
III.1 Trade policy direction	<ul style="list-style-type: none"> To strengthen domestic supply chain, shift the focus of support from export promotion to the promotion of the overall production capacity at all level so as to substitute imported raw materials with domestically produced cotton and textile fabrics To enable the development of the textile and 		X	X	MoI(*), MoT, MoFED, MoA, TIDI, ETGAMA, donors	MT	Pillar c) enhance the transformation of the domestic private
			X		MoT(*), MoA, MoFED,	ST	

	garment industry, protect domestic industry against import competition, while building up domestic production capacity				TIDI		sector
III.2 Strengthen domestic supply chain	<ul style="list-style-type: none"> • To remove input shortages, set up input supply public enterprises aimed at closing the gap between demand for and supply of intermediate <ul style="list-style-type: none"> ○ Strongly increase domestic cotton production by extending land cultivation and irrigation ○ Identify input fabric from other AGOA privileged countries to observe the RoO in international agreements ○ Elaborate a strategy aimed to accelerate the commercialization of domestic cotton farming 	X	X		MoA(*), MoT(*), TIDI, MoFED	MT ST ST LT	Pillar b) increase productive capacity and efficiency Pillar c) enhance the transformation of the domestic private sector
III.3 Increase Productivity and total production	<ul style="list-style-type: none"> • To increase productivity and create economies of scale in production: <ul style="list-style-type: none"> ○ Promote subcontracting from larger to smaller domestic firms and mergers of smaller firms into bigger ones ○ Develop metrics to monitor the extent to which foreign firms are integrating with the domestic economy through backward linkages ○ Enhance financing schemes to raise the productive capacity of existing firms ○ Develop national capacity to innovate in product design and manufacturing, including through technical vocational training 	X	X		MoA(*), MoT(*), MoE, MoI, ITFT, TGRC, EIC, Universities, donors	ST ST ST ST	

III.4 Strengthen integration in international marketing and global value chains	<ul style="list-style-type: none"> • To facilitate trade expansion in the North American and European markets: <ul style="list-style-type: none"> ○ Raise awareness among producers of the advantages offered and on existing rules of origin ○ Strengthen the implementation of the National AGOA Response Strategy ○ Simplify the national rules concerning the export of 837 textiles and apparel products that are subject to prior specific official authorization and archiving information pertaining to export exclusively to the USA market • Raise awareness on the trade opportunities in African and Middle Eastern markets 	X	X	X	MoA(*), MoI(*), MoT(*), ESA, MoFED, donors	ST LT ST ST	Pillar a) Sustaining the rapid, broad based and equitable economic growth
IV. Other prioritized sectors: Chemicals, Metal industries and Tourism							
IV. 1 Enhance the domestic chemical industry's capacity	<ul style="list-style-type: none"> • In order to substitute imported chemicals with domestically produced ones: <ul style="list-style-type: none"> ○ Mobilize exploration and exploitation of local deposits of raw materials for base chemicals ○ Accelerate exchange of technological capability and upgrade technical skills ○ Promote FDI in the chemical sector ○ Improving logistics and border administration will make indispensable imports of chemicals cheaper 	X	X	X	MoFED, MoT, MoME, MoI, CIDD, ECIC, donors	MT ST ST ST	Pillar b) Increase productive capacity Pillar d) Build the capacity of the domestic construction industry
IV. 2 Raise demand and supply of domestically produced metals	<ul style="list-style-type: none"> • Strengthen the role of the MIDI: <ul style="list-style-type: none"> ○ Improve coordination with METEC ○ Support the design, product development and manufacturing process 	X	X	X	MIDI(*), MoFED(*), MoT(*), MoA, METEC, EABME	MT	Pillar b) Increase productive capacity

	<ul style="list-style-type: none"> ○ Make it responsible for strengthening the linkages between industrial activities and research, including technical and managerial know how ● To enhance and enlarge the currently low domestic assembly industry, reduce duty on imports of unfinished metals and engineering items and account for grater contingency stocks ● To foster domestic metal industry, public procurement for construction projects should give priority to locally produced metal and engineering products. ● Incentivizing private purchase or repair of metal products for investment in production equipment in agriculture and manufacturing: <ul style="list-style-type: none"> ○ Offer tax privileges linked to the purchase of construction material or machinery from local metal firms ○ Introduce an advantageous loan facility for the purchase of domestically produced/assembled agricultural machinery brilliantly 		X					Pillar d) Build the capacity of the domestic construction industry	
			X					ST	
			X					ST	
			X					ST	
IV. 3 Foster tourism as source of employment and growth	<ul style="list-style-type: none"> ● Finalize and implement the tourism master plan and design a tourism promotion strategy ● Provide greater support and additional incentives to private (domestic and foreign) investors ● Enhance training in hospitality through the installation of vocational schools ● To increase tourism arrivals, ease visa policy and scale up e-visas or visa on arrival ● Elaborate combined tourist circuits with East African countries 	X	X		MoCT(*), MoFA, MoFED, ETO, donors			ST	Pillar a) Sustaining the rapid, broad based and equitable economic growth and development
		X							
			X						
			X	X					

	<ul style="list-style-type: none"> To finance a tourism masterplan, enforce a tourism taxes collection and redistribution mechanism 		X				
--	--	--	---	--	--	--	--

Note: Short Term (ST) indicates 0-3 years, Medium Term (MT) indicates 4-7 years, Long Term (LT) above 7 years.

An (*) placed next to an Agency indicates that it is the Lead Agency to ensure the implementation of the given action.

PART II:

Ethiopia's international trade integration and its agriculture-based export-led industrialization strategy

This DTIS comes at a time when Ethiopia embarks on its second five-year Growth and Transformation Plan (GTP II), covering the period 2016 to 2020. This gives an opportunity to take stock of the outcomes of the implementation of Ethiopia's industrial development under GTP I in terms of advancing the integration of the Ethiopian economy into international trade and to draw lessons for the challenges that have to be tackled by the Ethiopian authorities and private sector stakeholders in the next five-year phase of Ethiopia's structural transformation. This is the subject of Chapter I.

While some policy measures may need to be adjusted in light of the recent experience, it is mainly the level of implementation and coordination of trade policy in the narrow sense with other areas of public policy that deserves special attention. In order for Ethiopia to attain its ambitious trade objectives it is essential that all trade-related policies are coordinated and implemented in a coherent and consistent manner. Learning from recent experience, it is critical that in the course of implementing GTP II, Ethiopia elaborates a comprehensive Trade Strategy that provides clarity on the institutions entrusted with different tasks in policy implementation. It must also create a nexus between trade and all other trade-related policies. These aspects will be discussed in chapter II.

The macroeconomic context limits the extent of public policies in support of industrialization and trade integration due to the function of maintaining fiscal sustainability and ensuring macroeconomic stability. The right choice and use of macroeconomic policy instruments can make a difference in achieving the desired rapid structural transformation and trade integration. Chapter III addresses the macroeconomic policy constraints and challenges that arise in the context of implementing the export-oriented trade and industrialization strategy.

Ethiopia's potential to expand its external trade is also strongly influenced by international trade agreements. One of the few advantages that Ethiopia enjoys as an LDC is preferential treatment of its exports by many of its developed country trading partners. Still, the "market access agenda" is an important dimension of Ethiopia's trade strategy for two reasons: first, as the country is moving towards becoming a middle-income country, it will eventually lose its LDC status and will have to adjust to WTO rules and regulations; and second, trade agreements at the regional level and with emerging-market economies may contribute to boosting export growth and to diversifying the foreign market options for its products. Issues arising in these areas will be addressed in chapter IV.

Chapter I:

From GTP I to GTP II: Progress and remaining challenges for Ethiopia's trade integration and structural transformation

1. Trade integration as part of the Ethiopian development strategy

Ethiopia's trade integration policy is part of the Government's broader vision of economic development that builds on the potential of Ethiopia's large agricultural sector, but focusses on strengthening an export-oriented manufacturing sector. Based on this vision, Ethiopia's agricultural development led industrialization strategy (ADLI) was brought under way in the mid-1990s and subsequently elaborated. Within this framework, a comprehensive longer-term industrial development strategy was formulated in 2002/3. This strategy is reflected in Ethiopia's Growth and Transformation Plan that was launched in 2009/10 with the intention to lift Ethiopia from an LDC to a middle-income country by 2025.

Ethiopia's national Industrial Development Strategy (IDS) document¹ provides a guide for the development of Ethiopia's manufacturing industry. It emphasizes that the private sector must be the engine of industrial development. This requires an overall environment in which entrepreneurs are enabled and motivated to bring in their initiative and venture their capital.² Beyond this, the main principles of the IDS are to build to the largest possible extent on linkages between manufacturing industries and agriculture, to focus on the development of the most labour-intensive sectors to generate employment, and to concentrate industrialization efforts on a selected number of sectors that have the largest potential for export growth. The Industrial Development Strategy is envisaged to extend over three phases (MoI 2014):

Phase 1: Enhancing the productivity of major industries (2013-2015)

Phase 2: Diversifying and emerging new key industries (2016-2020)

Phase 3: Building up high-tech industries (2021 -2025)

Clearly, the three years envisaged for phase 1 must be considered as much too short for bringing industrial productivity up to the international average. As Part Two and Three of this DITS will show, this remains a task for many years to come and will require considerable Government support into the future. For this strategy, the Government sees its role not only in creating a conducive environment for private economic activities. While relying on market forces wherever they are conducive the process of development, the Government also assumes a key developmental role in guiding and coordinating economic activity in those areas that potentially have the greatest benefit for the development of the economy as a whole. This includes the provision of direct and targeted support to selected sectors, with emphasis on micro, small and medium-sized enterprises.

The list of priority sectors has been updated over time. In 2014, these prioritized manufacturing sectors were (MoI 2014):

- textiles and garments,
- leather and leather products,

¹ Federal Democratic Republic of Ethiopia (2002). Ethiopian Industrial Development Strategy. Addis Ababa (in Amharic).

² The IDS identified a number of concrete elements for the creation of a conducive business environment: maintaining macroeconomic stability; building a functioning and well-regulated financial sector; creating dependable infrastructure services; developing skilled and effective human resources; creating an efficient civil service and legal framework; developing industrial zones in major locations with all required infrastructure facilities (Gebreyesus 2013a).

- the agro-processing industry,
- the chemical and pharmaceutical industry,
- the metals and engineering sector,
- electronic products,
- petro-chemicals,
- biotechnology, and
- packaging materials.

The Ethiopian Government's first Growth and Transformation Plan (GTP I) covered the period until 2014/15. The document covering the GTP II for the period 2015/16 to 2019/20 was finalized in September 2015 (National Planning Commission 2015). This DTIS is therefore an opportunity to take stock of the outcomes of IDS and GTP I in terms of advancing the integration of the Ethiopian economy into international trade and to draw lessons for the challenges that have to be tackled by the Ethiopian authorities and private sector stakeholders in the next five-year phase of Ethiopia's structural transformation.

This chapter will next review the main elements of Ethiopia's efforts to achieve structural transformation of its economy and the role that international trade integration is playing in this context. It will then take stock of the achievements of Ethiopia's trade and development policy during the past few years and the structural changes that are underway. Section 4 will then outline the broad economic challenges for the Government in the coming years, with a focus on trade-related policies.

2. Trade-related elements of GTP I

Over 2010–2015, GTP I has served as a medium-term road map for policymakers in all areas of economic, social and human development (MoFeD 2010). It aimed at an average annual GDP growth of over 11 percent and achieving the Millennium Development Goals (MDGs). Raising agricultural output and productivity, promoting industrialization, and investing heavily in economic, social and administrative infrastructure are GTP I's main pillars. External trade was considered an important driving force in Ethiopia's efforts to promote sustained economic growth, create employment opportunities and reduce poverty.

Large-scale public investment in infrastructure has been supporting structural transformation and growth. The infrastructure programme includes the construction of about 2,400 km of new electrified railway lines, which will lower the costs of transportation of exported and imported goods; extensive road construction, both urban and rural; the construction of industrial parks; and various investments in the logistics and trading infrastructure. Major hydropower projects (including the Grand Ethiopia Renaissance Dam, which will be the largest in Africa) will triple Ethiopia's power generation capacity, enough to meet domestic demand and generate significant export earnings.

The Ethiopian Government has also sought to improve the business environment for the private sector and to enter into public-private partnerships. However, coordination and cooperation in planning and decision-making between public and private players appear to have been suboptimal. In addition, reportedly erratic regulations with regards to prices, licensing, business registration, land administration, customs administration and commercial banking, have contributed to discourage investment, industrial upgrading and international marketing efforts. The negative impact on the business environment is reflected in the World Bank's Doing Business ranking (World Bank 2015a). While up to 2010 there had been some improvements in the indicators underlying this ranking, these could not be sustained. It followed that that Ethiopia's ranking fell from 104th (2010) to 132nd out of 189 countries

(2015).³ The country performed particularly poorly in “starting a business” and “trading across borders” (both 168th) and getting credit (165th).⁴

The Government has encouraged private investment, both domestic and foreign, by providing incentives such as tax holidays and duty-free imports of capital goods in a range of sectors, and given particular emphasis on support for the development of micro, small and medium-sized enterprises.⁵ Besides aiming at improving the quality of, and enable broad access to, general primary and secondary education, the public policy efforts have included technical and vocational training as well as management and professional training in public and private institutions, including for staff in public administration and law enforcement institutions.

GTP I identified five sectors - agro processing, textile and garments, leather and leather products, chemicals and metal industries – as having the greatest potential to boost the growth of the economy.⁶ While the promotion of exports from the agro-processing, textiles, clothing and leather goods industries has been a central element of Ethiopia’s economic policy under GTP I, there was no clear definition of the country’s trade regime or a unified national trade strategy that links in a coherent manner all trade-related policies and regulatory measures, something that will need to be corrected in the GTP II phase (see chapter II).

3. Recent economic performance and structural change

3.1 Macroeconomic performance

Ethiopia’s recent macroeconomic performance has continued to be strong, with robust real GDP growth at an annual average of 10.8 percent during 2004-2014, and 10.1 percent during the GTP I period (table 1.1). Real GDP per capita⁷ grew at an average rate of 7.2 percent in the last five years, so that it has more than doubled since 2004/05.

Sustained growth has brought down measured unemployment from a peak of 26.4 percent in 1999 to an average of 20.2 percent between 1999 and 2013 and to a record low of 17.4 percent in 2014 (IMF 2015a). Ethiopia has also made significant progress in achieving the Millennium Development Goals. The share of the population living below the poverty line⁸ fell from more than 44 percent in 2000 to around 30 percent in 2010, and during the GTP I period further to 23.4 percent in 2014/15 (National Planning Commission 2015).⁹ While this performance is remarkable, per capita income growth has been somewhat below the rate of 8 percent per annum, which would be required every year for Ethiopia to achieve its objective of becoming a middle-income country by 2025 (World Bank 2015b).

³ For various other business climate assessments, e.g. Global Competitiveness Index by the World Economic Forum; UNCTAD’s Investment Compass, Global Investments Prospects Assessment and Inward FDI Performance Index; the OECD’s Policy Framework for Investments; the World Bank’s Investment Climate Surveys; and other governance indices, see Christy et al. (2009).

⁴ The ranking for starting a business in Ethiopia was even considerably lower than the regional average for SSA (129).

⁵ GTP I also had a renewed focus on extractive industries such as gold, oil, gas, potash, and gemstones and on investments in renewable energy projects.

⁶ Progress achieved and remaining challenges in these sectors will be analysed in some detail in Part III of this Study.

⁷ A more appropriate measure for per capita income would be gross national income per capita. However, figures for this measure were not available for the entire period under consideration.

⁸ The poverty line is defined as the percentage of the population living on less than \$1.25 per day, purchasing power parity adjusted.

⁹ Ethiopia has also as one of the lowest levels of inequality, with a Gini coefficient of 0.30 (IMF 2015b).

<i>Table 1.1:</i>						
Selected economic performance indicators, 2009/10 – 2014/15^a						
<i>(Annual rates of change, percent)</i>						
	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13</i>	<i>2013/14</i>	<i>2014/15</i>	<i>2010-2015 Average</i>
Real GDP growth ^b	11.4	8.7	9.9	10.3	10.2	10.1
GDP per capita	8.5	6.1	7.3	7.8	6.2	7.2
Exports of goods	37.2	15.5	-1.9	5.9	-8.5	9.7
Imports of goods	-0.2	34.0	3.6	19.6	20.0	15.4
<i>Sources:</i> National Planning Commission, Federal Democratic Republic of Ethiopia						
<i>Notes:</i> (a) Figures are for the fiscal year ending 7 July and beginning 8 July of the previous year						
(c) GDP at factor prices						

Despite continued rapid growth, the rate of inflation, which had been close to 40 percent in 2010/11, was brought down to below 9 percent during 2012–2014. However, in the first half of 2015 inflation re-accelerated into the double-digit range, due to domestic food price increases, mainly owing to below-average rainfall.

On the supply side, construction and manufacturing industry have been the main drivers of growth in recent years. Overall, the industrial sector grew by 137 percent between 2010/11 and 2014/15, largely due to a construction boom during the latter half of the GTP I period. Services expanded by 68 percent and agriculture by 25 percent, so that the share of agriculture shrunk, indicating progress in the transformation of the Ethiopian economy (World Bank 2015b).

On the demand side, GDP growth during the GTP I period was driven primarily by domestic demand, while exports grew more slowly than GDP (table 1.1, see also section 2.2). Public investment accounted for more than half of GDP growth, and it grew at an annual average rate of 14 percent in 2010/11–2013/14 (World Bank 2015b). The share of fixed investment in GDP rose considerably due to massive public infrastructure investment (table 1.2). Private domestic and foreign investment have also increased during the GTP I phase. In nominal terms, FDI quadrupled since 2010, reaching around \$1.2 billion in 2014, and as a percentage of GDP it rose from 1 percent to 2.2 percent (UNCTAD 2015a).

With government spending for large infrastructure investments increasing considerably faster than government revenue, the public sector deficit widened from 1.3 percent of GDP in 2010/11 to an estimated 2.5 percent of GDP in 2014/15. The deficit was financed primarily from external sources (2.0 percent of GDP). In December 2014, the Government could place its first Eurobond at an advantageous interest rate to finance investment in industrial parks, power transmission infrastructure and support to the sugar industry (IMF 2015a).¹⁰

¹⁰ The \$1 billion 10-year bond could be issued at an interest rate of 6.625 percent, which is lower than the sovereign bond yields of several other African countries. In early 2015 Ethiopia's sovereign rating was "B" by Standard and Poor's and all rating agencies acknowledge Ethiopia's continuing strong growth prospects (World Bank 2015b).

Table 1.2:

Selected macroeconomic indicators, 2009/10 – 2014/15^a
(Percentage of GDP)

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Exports of goods and services	13.6	16.7	13.8	12.5	11.6	9.7
Imports of goods and services	-33.0	-31.5	-31.6	-29.0	-29.1	-27.1
Resource balance	-19.4	-14.8	-17.8	-16.5	-17.5	-17.4
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Fiscal balance (excl. grants)	-4.6	-4.8	-2.8	-3.5	-3.7	-3.5
Fiscal balance (incl. grants)	-1.3	-1.6	-1.2	-1.9	-2.6	-2.5
Total public debt ^c	39.4	37.8	32.7	37.0	41.2	50.2
External public debt ^c	18.3	22.2	17.9	20.3	22.1	26.2
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Gross fixed investment	22.3	31.4	30.6	29.8	40.3	39.3
Public investment ^b	13.9	22.4	23.3	13.1	22.0	16.1
Private investment ^b	8.4	9.0	7.3	16.7	18.3	23.2
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<i>Sources:</i> National Planning Commission, Federal Democratic Republic of Ethiopia; IMF (2013, 2014, 2015a), World Bank (2015b), and UNCTAD secretariat calculations based on these sources.						
<i>Notes:</i> (a) Figures are for the fiscal year ending 7 July and beginning 8 July of the previous year						
(b) Estimates						
(c) End of fiscal year; including State-owned enterprises (excl. Ethiopian Airlines)						

3.2. Trade performance

Both exports and imports of goods and services increased substantially during the GTP I period. The value of imports grew faster than exports. The \$3.2 billion worth of exports in 2014 fell significantly short of the \$5-8 billion targets of GTP I. While the deficit in Ethiopia's resource balance rose from around 15 percent to around 17.5 percent of GDP over the past five years, the current account deficit also increased, from less than one to more than 12 percent of GDP, partly as a result of lower official and private transfers (IMF 2015a). In addition to higher public borrowing from abroad, the rise of FDI inflows helped finance the growing current account deficit.

The contribution of the export sector to Ethiopia's otherwise remarkable growth performance was disappointing. In 2014/15 the value of exports of goods and services was more than 5 percent below its level in 2011/12. At the same time, the value of imports of goods continued to grow rapidly (table 1.1), as growing public investment involved high imports of capital goods and the dependence on imports of intermediate goods could not be reduced.

The decline in export earnings after 2011/12 reflects unfavourable international price developments for primary goods, which account for the bulk of Ethiopia's exports. The sharp increases in primary commodity prices, notably coffee, vegetable oils and gold in 2010 and 2011 boosted export earnings, but they were followed by a slump after 2012. Even a substantial export volume growth could not compensate for this slowdown. This strong impact of international commodity price swings on Ethiopia's export earnings and GDP growth reflects the continuing high dependence of the economy on a few export commodities.

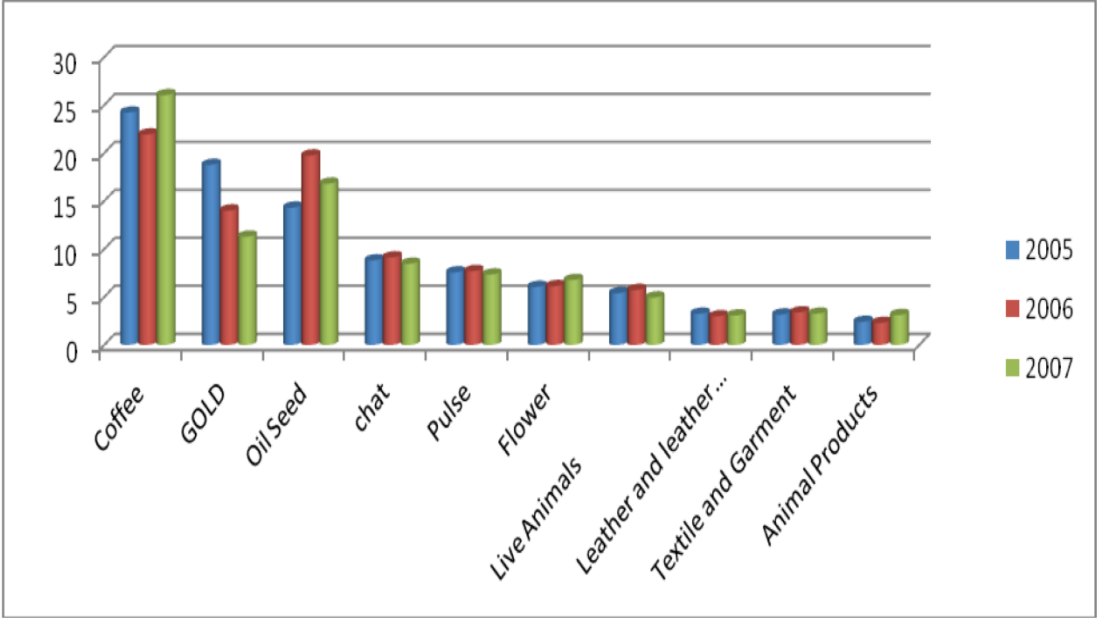
Ethiopia’s development path thus remains vulnerable to the vagaries of international commodities markets.

It has to be recognized, though that compared to the 1990s, export diversification in the primary commodity sectors has shown an encouraging trend. Some higher-value agricultural products, such as cut flowers, oilseeds and pulses, gained in importance. The way Ethiopia has created and nurtured a high-value horticulture exports is particularly remarkable.¹¹

By contrast, vertical diversification into manufactured exports and within the manufacturing sector has been quite limited. Although the export of non-primary commodities has shown an increasing trend, its share is still small, accounting for only 24 percent of total merchandise exports and 9.6 percent of total exports. Export expansion in the prioritized export sectors has lagged, behind the GTP I objectives. A recent evaluation of manufacturing export performance by the Ministry of Industry shows that the overall export performance of the manufacturing industries during GTP I period (2011-2015) is roughly half of the plan target.

Figure 1.1:

Share of top ten merchandise exports, 2012/13 to 2014/2015
(Percent of total merchandise exports)



Source: Ethiopian Revenue and Customs Authority

A sectoral breakdown reveals that textiles and garments, chemicals and pharmaceuticals have shown better performance than agro-processing products, and leather and leather products (Chaudhuri, 2015). But even the performance of the textiles sector is considered unsatisfactory in the Ethiopian Government’s own assessment of the outcomes of GTP I (National Planning Commission, 2015).

¹¹ The share of flowers in total merchandise exports increased from 0.03 percent in 1997/98 to 7.4 percent in 2011/12 and 6 percent in 2013/2014. The sector has grown from one single firm in 2000 to 100 firms in 2014, generating \$200 million per annum in export earnings and employing 50,000 people. Some have described the performance of the horticulture sector an encouraging example of “self-discovery” (World Bank 2014; Oqubay 2015).

The low base of industrialization in Ethiopia has also resulted in an increased import bill for products that could be produced domestically. This holds for both consumer goods and intermediate goods for the prioritized sectors, for example: cereals, sugar, vegetable fats and oils, pulp and paper products, furniture or textile yarns and fabrics.

Among services exports, transport accounts for around 75 percent and travel for around 20 percent. On the import side, transport services made up 64 percent of the total, whereas the second largest item has been construction services (10.6 percent). Overall net services make a positive contribution to the current account but only a small contribution to GDP (around 0.7 percent). There is certainly scope for an expansion of this contribution, notably through growth in incoming tourism (NBE 2014).

3.3. Structural change in the Ethiopian economy

Ethiopia's economic structure continues to be dominated by agriculture, which in 2014/15 still accounted for more than 40 percent of GDP, 80 percent of employment and 70 percent of export earnings. Yet, most agricultural activities are performed by small-scale and family entities marked by low productivity and output.

The share of the entire industrial sector, including construction and mining, reached an estimated 15 percent in GDP in 2015 (table 1.3). This is a considerable increase compared to 2010, but less than the objective of GTP I. It also has to be noted that almost the entire increase of the share of industrial output in total GDP results from the expansion of the construction sector. The share of manufacturing industry has almost stagnated, in the order 4.5 percent despite a rapid increase of exports of manufactures in absolute terms (World Bank 2015b).

Table 1.3:

Sectoral shares in GDP: GTP targets and actual performance, 2010-2015

	2010/11	2013/14		2014/15	
	<i>Actual</i>	<i>GTP I target</i>	<i>Actual</i>	<i>GTP I target</i>	<i>Actual</i>
Agriculture	44.7	37.8	40.1	36.9	38.5
Industry	10.5	16.9	13.8	18.8	15.1
Services	45.5	45.3	46.6	44.3	46.3

Source: National Planning Commission, Federal Republic of Ethiopia

Yet, the contribution of manufacturing exports to GDP remains very small and in international comparison, Ethiopia appears to under-export goods and services by over 10 percentage points of GDP. Thus, although important gains have been made, with signs of successful employment creation and structural changes, the pace and quality of transformation has not been deep, largely because of the failure to achieve a more substantial shift of productive resources from lower- to higher-productivity sectors. The reasons why the targets of structural change in general, and the specific output, export and employment targets for the prioritized sectors in particular, have been reached only partially, appear to be threefold. The first reason is simple, namely that the targets may have been set too high, expressing more the admirable ambition of the Government than a realistic assessment of the potential. The second is that the impact of public investments and support measures on production and export growth are taking longer to materialize than expected, and the third is that the constraints for economic actors on the way to reaching the set targets were underestimated. These

constraints, and the resulting policy challenges for the GTP II period, will be examined in the subsequent chapters of this DTIS.

4. Trade-related challenges for the next phase of structural transformation

4.1 The overall setting for further trade integration and structural transformation

If Ethiopia's middle-income ambition is to be met, the speed of growth and structural transformation will need to be accelerated during the GTP II period. The international environment will considerably influence the growth of Ethiopia's export earnings, public revenue and GDP. Except from the recent fall in oil prices, this external environment is not favourable at the outset. International prices for Ethiopia's export commodities are weak and the outlook for global demand growth in the coming years is highly uncertain, with tepid recovery from the financial crisis in the developed countries and a slowdown of growth in major emerging-market economies, including China (UNCTAD 2015b).

By contrast, the domestic setting for continued fast growth in Ethiopia is broadly favourable. Recent and ongoing large public infrastructure investments, apart from their direct demand effect on GDP, will make a considerable indirect medium- and long-term contribution to GDP and future export growth. Macroeconomic policies have been cautious in recent years, and fiscal and current-account deficits have remained within manageable limits (IMF 2015a). The economic outlook for the coming years also remains favourable because the providers of official external financing in the form of concessional loans and grants are honouring Ethiopia's serious development efforts and the progress already achieved. Moreover, the country's significant potential is also reflected in a strong upward trend in FDI.

The broad objectives of GTP II are the consolidation of achievements to date through the completion of unfinished major infrastructure projects; maintaining the leading role of public investment in infrastructure development; and enhancing the rural development agenda, with a focus on investment and productivity improvement and an expansion of both agricultural and non-farm rural activities. The new plan also stresses the development of a dynamic domestic manufacturing sector and a sharp rise in exports of manufactured goods.

GTP II targets for the prioritized sectors are again very ambitious. In order to meet them it will be necessary to catch up the delays in reaching GTP I targets and to reinforce all the measures that can be identified as having the strongest impact on the expansion of production and exports in these sectors. It is equally important to learn from experience about what has not led to the desired results and to adjust policies and/or strengthen their implementation accordingly.

4.2 Macroeconomic perspectives

The Ethiopian Government's outlook is for a new acceleration of annual GDP growth to an average of 11 percent during the GTP II phase, underpinned by strong growth of manufacturing output and an annual average export growth of more than 36 percent (table 1.4). IMF and World Bank also expect sustained GDP and export growth in the coming years, but are more conservative in their medium-term outlook for the Ethiopian economy (IMF 2015a; World Bank 2015b). The IMF projection for GDP growth, in the order of 7.5 to 8 percent, is based on the assumption that private investment will increase only gradually, due to: (i) the existing constraints on access to credit and foreign exchange, (ii) public investment in infrastructure will need to be scaled down for budgetary reasons (table 1.3), and (iii) considerable competitiveness challenges remain.¹² These lower projections assume the

¹² The IMF figures referred to in this section are those published in the IMF Staff Report of Ethiopia's most recent Consultations with the Fund under Article IV of the IMF's Articles of Agreement, in October 2015 (IMF

implementation of the IMF’s policy recommendations for tightening monetary and fiscal policy, which may, however, be debatable (see also chapters III and VIII).¹³

There is agreement among IMF and World Bank that the relative high “cost of doing business” is the main obstacle to foster export expansion (World Bank 2015a,b; IMF 2015a). While this may be one factor, the analysis in the subsequent chapters will show that weaknesses in the domestic supply chain and financing bottlenecks are at least of equal importance, and major challenges also remain in terms of availability of skilled labour, public utilities and efficient transport and trade logistics.

<i>Table 1.4:</i>		
GTP II targets and IMF projections for Ethiopia, 2015/16 – 2019/20		
<i>(Percent)</i>		
	<i>GTP II target</i>	<i>IMF projection</i>
Real GDP (<i>average annual growth rate</i>)	11.0	7.7
Exports of goods ^a (<i>average annual growth rate</i>)	36.3	15.2
Gross fixed investment (<i>share of GDP</i>)	41.3	32.9
Tax revenue (<i>share of GDP</i>)	17.2	14.4
<i>Sources:</i> National Planning Commission; IMF (2015a)		
<i>(a) including electricity</i>		

Given these remaining constraints, GTP II envisages public expenditures, especially for investment, that are considerably higher than the assumptions underlying IMF projections (table 1.4). The financial needs for the implementation of this Plan, including its trade-related elements, are therefore likely to lead to a higher public sector deficit and an increase in the public debt-to-GDP ratio. The medium-term budget targets of the Ethiopian authorities envisage a general government deficit of less than 3 percent of GDP, which remains in line with IMF projections. Nevertheless, both the total and external public debt-to-GDP ratios are expected to increase until 2017/18, implying that a growing part of government revenue will be absorbed by interest payments (IMF 2015a). This heightens the need to accelerate reforms in the public revenue system, to allocate public spending in the socially and economically most efficient manner and to improve tax collection.

2015a; see also <https://www.imf.org/external/about/econsurv.htm>). It should be noted that projections published in earlier Staff Reports were mostly below Ethiopia’s actual performance.

¹³ The most recent policy recommendations of the IMF for Ethiopia include: tight monetary policy to contain inflation and increasing real interest rates to promote saving; strengthening tax administration to bolster revenue and slowing public investment to safeguard debt sustainability; enhancing competitiveness, through a more flexible exchange rate, reducing the cost of doing business, and easier access to credit for the private sector; and (vi) attracting more private capital flows, by opening key sectors to foreign investors (IMF 2015a).

<i>Table 1.5:</i>						
IMF projections for 2015/16 to 2019/20						
	2014/15 <i>actual^a</i>	2015/16	2016/17	2017/18	2018/19	2019/20
<i>Projections</i>						
<i>Annual rate of change</i>						
Real GDP growth	10.2	8.1	7.6	7.5	7.5	7.5
Exports of goods and services ^b	-8.5	15.4	16.0	15.9	15.1	12.9
Imports of goods and services ^c	20.0	1.7	7.2	7.5	7.2	6.8
<i>Shares in GDP</i>						
Gross domestic investment	39.3	37.1	35.9	34.8	33.8	32.9
Public investment	16.1	19.0	17.5	16.2	15.0	14.1
Private investment	23.2	18.1	18.4	18.6	18.8	18.8
Fiscal balance (excl. grants)	-3.5	-3.9	-3.7	-3.6	-3.4	-3.2
Fiscal balance (incl. grants)	-2.5	-2.8	-2.6	-2.7	-2.6	-2.5
Total public debt	50.2	57.1	61.3	63.6	62.9	61.6
External public debt	26.2	28.8	31.0	31.8	30.3	28.7
Current account balance	-12.8	-9.4	-8.5	-7.6	-6.9	-6.3
<i>Source:</i> IMF (2015a)						
(a) Data from National Planning Commission, Federal Democratic Republic of Ethiopia and UNCTAD secretariat estimates.						
(b) in dollars, f.o.b.						
(c) in dollars, c.i.f.						

4.3 Overcoming internal constraints with a comprehensive trade and industrial strategy

Merchandise exports are planned to double in value during the next five years. The fundamental challenge of increasing trade and export competitiveness that results from this objective is inseparable from the imperative of increasing productive capacities through capital accumulation and technological progress, and of changing domestic production and marketing structures. Conversely, export orientation contributes dynamically to productive capacity development by earning the foreign exchange required for the import of capital goods, equipment and intermediate goods that cannot (yet) be produced domestically.

Overcoming internal constraints requires greater coherence between trade and industrial policies. The importance of industrial policies for economic development and structural transformation has received renewed attention in recent years (Stiglitz et al., 2013), partly based on the recognition that at an infant stage manufacturing activities are not immediately profitable. It follows that government support is necessary for the initiation and extension of entrepreneurial ventures, for reducing total production costs, the creation of synergies within and across sectors and for opening up international marketing opportunities. In the coming five years, Ethiopia's industrial policy must be geared to upgrading productive capacities, based on a systematic assessment of those actions necessary to fill the missing links in the domestic value chain, and to address other binding constraints that have been hindering Ethiopia's economy to move up the quality ladder. This requires a strategic approach to lifting the immediate and most binding constraints on production and trading capacity, by improving the provision and coordination of public inputs for private productive activities, with a view to

raising productivity and quality, as well as increasing and upgrading the output of those goods that are already produced. This approach is often referred to as “industrial policy in the small”, and Ethiopia has a lot to gain from such an approach.

At the same time, Ethiopia’s objective of reaching middle-income status within the coming decade may also require an industrial policy “in the large”, which focuses on sectors where capabilities and actors are still weak or may not yet exist, but which can be crucial for a sustained output growth and employment growth. This would involve supporting private entrepreneurs in starting activities with higher levels of value-added, such as agricultural machinery, transport equipment, metals or chemicals which will boost local content by strengthening backward and forward linkages. An integrated trade and industrial strategy has to operate at both levels, promoting and facilitating exports where possible and promoting import substitution, especially of intermediate goods but also of certain final goods, to reduce the economy’s import dependence.

Ethiopia’s structural transformation and trade integration strategy is rightly focussing on developing its manufacturing sector and increasing its contribution to domestic income and employment. However, an effective strategy for trade integration of Ethiopia’s manufacturing industries sector has to start with reforms in the agricultural sector and its links to the industrial sector in order to better use Ethiopia’s specific comparative advantages.

Agriculture is not only the most important economic sector in Ethiopia’s economy, but it is also a way of life for the great majority of the Ethiopian citizens. Thus, while industrialization is primarily a matter of creating new structures, integrating the agricultural sector and the rural economy involves changing existing structures. The challenge is not only to identify and design the most appropriate institutions and to mobilize resources for modernization and commercialization of agricultural activities, but also to adapt traditional behaviour patterns to the exigencies of integrating agriculture with manufacturing activities. In implementing the trade and industrialization strategy, it will be important to recognize that this process is likely to take time and could be associated with social frictions.

The recent setback of Ethiopia’s overall export performance underlines the need to mainstream trade into GTP II and to design all policy measures that affect the economy’s export capabilities in an integrated manner. Learning from recent experience, it is critical that GTP II spells out a Trade Strategy which identifies clearly the Government’s trade policy objectives, strategic goals and directions and the nexus between trade policy in a narrow sense and all other trade-related policies.

Chapter II:

Coordination of trade-related policies: Policy coherence and institutional responsibilities

1. Introduction

The rationale for coordination of all trade-related policies results from the fact that trade is inherently a cross-cutting issue that involves many Government departments, public agencies, private sector operators and trading partners. It encompasses many diverse sectoral areas, including industry, agriculture, services, customs and border management, trade facilitation, logistics, finance, transport, and information and communication technology; and it requires consideration of multiple perspectives, including the overall business environment, taxation and fiscal dimensions, macroeconomic policies, education and vocational training, and upgrading of technical and managerial skills. It is therefore easy for coordination failures to occur, and for opportunities for synergies and complementarities to be missed.

Effective coordination is not only a matter of communication between different ministries and regulatory agencies. It also requires coherence in the definition of objectives and targets, on the one hand, and instruments to reach these targets, on the other. Intelligent and careful choice of instruments therefore needs to be accompanied by effective implementation at the practical level, including the enforcement of rules and standards set by the government. This is because the impact of many measures occurs at the level of the economy as a whole and may not always be well reflected in direct impacts at the microeconomic level. This is also why consultation is necessary with the private actors that are involved or whose involvement is needed in trade activities. Such consultations also help to identify which support measures are most effective.

Trade and industrial promotion policies and strategies are unlikely to be successful unless they are supported by institutions with advanced skills and knowledge in policy coordination and implementation, and by a favorable macroeconomic and financial environment. Therefore, the design of a trade strategy and industrial policies should go beyond laying out goals and include an assessment of whether the prevailing organizational and institutional structure is 'fit for purpose' in delivering the desired objectives. In practice, stronger and more effective internal coordination and cooperation across different parts of Government will be needed to enhance the likelihood that the Government's export targets and strategic objectives can be achieved.

In short, as a cross-cutting issue, trade is not limited to what the Ministry of Trade does. It is increasingly about coordination and policy coherence. Doing this effectively requires a clear strategy to provide a framework. This chapter addresses these issues and proposes an organizational structure for coordination and effective implementation of trade policies in Ethiopia.¹⁴

2. Trade policy Coordination: The need for institutional capacity "fit for purpose"

2.1 Rationale and challenges

¹⁴ A large part of the discussion in this chapter is based on extensive stakeholder consultations, secondary data, and a review of national development policies conducted for larger study on trade mainstreaming in Ethiopia prepared for UNCTAD by Eyob Tekalign.

In the coming five years, as outlined in the Second Growth and Transformation Plan (GTP II), Ethiopia wishes to pursue an *agriculture-based, manufacturing sector-driven and export-led development strategy*. In the course of implementing GTP II, learning from recent experience, it is critical that Ethiopia elaborates a Trade Strategy which identifies clearly the Government's trade policy objectives, strategic goals and directions, and the nexus between trade and trade-related policies. It is clear that international trade will be a key determining factor in the country's ability to attain all the objectives specified in GTP II, including progress towards economic diversification and structural transformation.

The limited progress in the structural transformation of the economy, as evidenced by the weak performance of the manufacturing and export sectors in the last two decades, is a major concern among policy makers in Ethiopia. Despite the vigorous and impressive growth trends recorded over the past several years, the Ethiopian manufacturing sector remains essentially weak. The level of industrialization in Ethiopia is very low, the share of manufacturing in the gross domestic product accounting for barely five percent. The share of manufactured exports is an insignificant half of a percent of GDP and contributes less than ten percent to the total value of merchandise exports. Export performance is also unsatisfactory.

Even though exports have increased sixfold from \$600 million in 1995 to \$3.2 billion in 2014 in 1995 US dollars, the performance of the export sector has shown limited progress in terms of growth and diversification across sectors. The \$3.2 billion of exports in 2014 falls significantly short of the \$5-8 billion targets set in the GTP I plan. The manufacturing and export sectors are beset with a number of constraints that make them uncompetitive. However, the GTP II signals a renewed determination and commitment to make both the manufacturing sector and exports the key drivers of growth, poverty reduction and structural transformation of the economy.

As is the case across many economies in Africa, the leading challenge in Ethiopia now is how to translate growth into sustainable and inclusive development by fundamentally changing the structure of the economy. This requires developing strategies consistent with the needs of the industrial and modern sectors. Based on the underlying assumption that trade can be a powerful tool to promote development, as noted above, this chapter focuses on trade policy coordination and implementation in the Ethiopian economy. The rest of this chapter will assess the current state of affairs in Ethiopia's trade and industrial policy-making process, to indicate a roadmap for effective trade and industrial policy coordination to advance Ethiopia's transformation agenda.

2.2 Current state of Ethiopia's trade policy making: the need for a strategic direction

An assessment of Ethiopia's trade policy making-process reveals mixed results. On the one hand, there is ample evidence that policy makers in Ethiopia have properly recognized the importance of trade as an engine of growth, employment, economic diversification, poverty reduction and sustainable development. Since early 1990s, major policy documents in Ethiopia have consistently referred to trade-related issues and trade policy reform. In the early 1990s, the government adopted an overall development strategy known as the Agricultural Development-Led Development Industrialization (ADLI) strategy in order to stimulate farm output and rural incomes, thereby generating broad-based growth and reducing poverty. The strategy focused on increasing the production and productivity of smallholder agriculture through complementary intervention such as promotion of improved agricultural technologies, provision of credit services, development of infrastructure, and improvement of primary education and health care services (MOFED, 2002, 2005). More recently, from 2011/12 to 2014/15, the Growth and Transformation Plan (GTP) took Ethiopia on a bold journey of growth and transformation. The plan laid strong emphasis on promoting the manufacturing sector, which had received little attention in the previous development

programs. As indicated earlier, however, although the GTP I period was associated with a high level of economic growth, it achieved only limited progress in the structural transformation of the economy, as evidenced by the weak performance of the manufacturing and export sectors. The newly introduced plan, GTP II, is expected to improve on this performance, with a renewed focus on manufacturing, export promotion and agricultural transformation, grounded on an overarching theme of structural transformation.

However, it is not clear whether there is a comprehensive strategic framework that ensures overall coherence between different but interrelated policies to allow a deeper and more lasting transformation of the economy. The absence of such a strategic direction has limited the country's ability to utilize trade effectively as a tool to achieve its national aspirations. The nexus between trade and industry, in particular, is a key issue of concern, on which the achievement of the stated objectives of transforming the structure of the Ethiopian economy and achieving the national vision of becoming a middle-income economy is heavily dependent.

Similarly, it is not clear whether the existing institutional arrangements for trade policy making and negotiations in Ethiopia are effective enough to coordinate and implement trade policies and to create synergy and coherence with other trade-related policies. In fact, research and interviews conducted for this study indicate that these arrangements meet with three specific types of challenges that are commonly found in many least developed countries (LDCs) and lower middle-income countries.

First and foremost is the institutional deficit. Trade policy making in today's world of global supply chains and international production networks requires knowledge and expertise in many domains, ranging from a good understanding of the capacity of domestic enterprises and their competitiveness to having reliable and up-to-date information on trade logistics, rules of origin, technical standards, customs rules and regulations, negotiation skills and a good understanding of the implications of macroeconomic policy for trade and markets. Institutional arrangements in many LDCs, as represented by Ministries of Trade and Ministries of Industry, while drawing on available expertise on demand in an *ad hoc* manner, do not have the depth necessary to formulate and implement policies effectively. The countries that have been able to design and implement successful trade and industrial policies are those where the relevant Ministries have diverse specialized skills, knowledge and expertise. Generalist administrators, however talented, intelligent, and hard-working, can never substitute actual specialized knowledge of specific issues. Neither should such generalists be expected to deal optimally with complex policy issues that require such knowledge.

The second major challenge is the lack of strong, institutionalized cross-ministry coordination on trade policy issues. Again, *ad hoc* inter-ministerial consultation on a particular issue cannot substitute for sustained engagement on trade strategy. Rather, the result is often that trade policy making becomes reactive and defensive rather than proactive. This is the case in Ethiopia, for example, as shown below.

The third major challenge is the lack of an institutionalized mechanism for serious private-public consultation. In most countries, Ministries of Trade and of Industry have periodic consultations with the private sector. A problem with such consultations is that they tend to be *ad hoc*, and are perceived by the private sector as such. This creates negative incentive effects, in terms of a lack of willingness to invest the resources needed to engage seriously with government and other stakeholders. The lack of sustained longer-term between government and industry engagement on strategic trade issues has meant that the culture of joint strategic private-public strategizing is completely lacking in most low-income developing countries.

The *ad hoc* approach also results in such consultations becoming a platform for lobbying by industry for their own short-term interests. As in all lobbying activities, it is often a few influential segments that have short-term interests that show the most interest in such consultations and emerge as the loudest voices, which may unfortunately be mistaken for an industry-wide consensus. In practice, they are often likely to represent firms that compete against imports rather than industries that are export-oriented or stand to benefit from more FDI and access to imported goods, services and knowledge.

This chapter reviews the existing institutional arrangements for trade policy making in Ethiopia, in particular the extent to which trade policy coordination takes place and whether Ethiopia has developed the institutional capacity necessary to conduct stakeholder consultation during trade policy making and implementation. This review addresses four aspects: public sector engagement; private sector engagement; the role of a lead institution; and sector-specific intermediary institutions. The following sections present the key observations and findings across these four areas.¹⁵

2.3 Public sector engagement¹⁶

This section focuses on political will, capacity and coordination issues within the public sector, to gauge the extent to which trade policy formulation and implementation in Ethiopia is well coordinated and the trade agenda is mainstreamed in national policies and strategies. The workings of other institutional coordination mechanisms established for export promotion and competitiveness purposes are discussed under the sector-specific intermediary institutional in section 2.6.

One thing that comes out consistently in interviews with senior officials in Ethiopia is the existence of a strong political will to make trade work. The desire to improve export performance and enhance the competitiveness of the manufacturing sector is expressed strongly, at least at the higher level of government. While there are genuine efforts at the lower level of government to achieve results, these efforts are based on each actor's understanding of its own role, and are limited by institutional capacities. Each player exerts efforts that are confined within its limited understanding of what is required to achieve the national development goals. In the absence of a well-articulated strategy and a robust institutional mechanism to coordinate individual efforts, a far-reaching and transformational result remains elusive.

The problem begins with the lack of a clear understanding and articulation of an overall strategy for trade and what is required to realize it. Swamped in the day-to-day operation of their respective agencies, many institutions lose sight of the larger vision. This makes policies and actions at the level of each institution primarily reactive and *ad hoc*, preventing the opportunity to establish a considered strategy focused on a longer-term vision. Each actor refers to a national vision of becoming a middle-income country, the importance of manufacturing, and the need for strong export performance. However, there is no clarity on the strategic direction needed to achieve these goals, on the specific and impactful contributions of each actor, or on how individual efforts can combine in a coordinated manner to ensure that the overall result is greater than the sum of individual efforts.

¹⁵ The UNCTAD secretariat is grateful to Mr Eyob Tolena for proposing the four dimensions, and for conducting research and interviews on trade policy mainstreaming and coordination.

¹⁶ The findings are based on discussions with key institutions that have direct or indirect dealings with the trade and industry agenda, including key officials in the Ministry of Trade, the Ministry of Foreign Affairs, the Ministry of Finance and Economic Development, the Ministry of Agriculture, the Ministry of Health, the Ethiopian Revenue and Customs Authority, the Ministry of Transport (specifically the Ethiopian Maritime Enterprise), the Ministry of Industry and selected sectoral institutions under the Ministry of Industry.

In some instances, there is clarity on the importance of coordination and alignment, but there is a tendency to assume that it is not the role of that specific institution to initiate coordination and achieve the desired goal. Existing coordination mechanisms at ministerial level, which often take a form of *ad hoc* committees, tend to focus on operational issues and involve proliferation of efforts, resulting in tendencies to view inter-agency and intra-agency coordination as a time-consuming and wasteful activity. Certain institutions such as the Ethiopian Revenue and Customs Authority (ERCA) and the Ministry of Trade that are often involved in such activities particularly feel this burden.

There are also instances of unclear mandates and duplication of efforts leading to substandard results, at both the policy and the implementation level. At the policy level, different institutions deal with different aspects of trade policy, with no clear sign of coordination. In multilateral trade negotiations, for example, different Ministries take a lead in different trade negotiations, and there is no proper coordination mechanism to ensure consistency and coherence in overall policy goals. The Ministry of Trade mainly deals with Economic Partnership Agreements with the European Union, while the Ministry of Finance and Economic Development handles regional trade negotiations, particularly the COMESA Free Trade Agreement (FTA). The Trade Negotiations department of the Ministry of Trade handles WTO negotiations, although the former planning commissioner serves as chief negotiator. It is not clear how consistency is ensured in these efforts. The same is true in bilateral trade negotiations, which are coordinated by the Ministries of Trade, Foreign Affairs, or Finance and Economic Development. There have in the past been incidents of one institution furthering bilateral trade negotiations without the knowledge of another lead institution, indicating a coordination failure. The fact that Ethiopia does not have a comprehensive trade policy framework that serves as a guide further exacerbates the coordination problem.

Coordination failures are also seen at the implementation level. For instance, while the Ministry of Agriculture provides the standard competence certificate for exporting/importing plant products, the Ministry of Trade also performs a similar procedure and undertakes visual inspection of the quality of plant products being exported or imported. This is a waste of both public and private resources. The coffee grading process also illustrates this problem. Both the coffee liquoring unit of the Ministry of Agriculture and the Ethiopian Commodity Exchange Market (ECX) provide coffee-grading services to exporters. Since these two institutions often use different parameters and give divergent grading results, this confuses the private sector and gives rise to unnecessary transaction costs. (EIFTRI/AEMFI, 2014)

There are also cases where different public institutions tend to work on conflicting goals. A case in point is the challenge faced by exporters of roasted coffee. The Ministry of Industry encourages value addition to increase the share and value of export products. This would imply that exports of roasted and ground coffee are strongly encouraged. However, coffee roasting companies have difficulty procuring quality coffee, as the Ministry of Trade is understandably focused on getting top quality coffee beans to the export market, and so does not allow top quality coffees to be sold locally. However, since processed coffee fetches better export prices, denying roasted coffee exporters access to quality coffee works against the very goal the Ministry of Trade is pursuing. The failure of the two ministries to work together and resolve this problem shows the weak link between the “trade” and “industry” agendas.

The general view among the officials and, particularly, among private sector representatives interviewed for this study, is that there is a major gap in effective implementation of policies at the lower levels of government. Incentives designed to encourage manufacturing and exports fail to achieve their desired goals due to implementation problems. For example, the

effectiveness of one of the incentive schemes for imported raw materials and other inputs for the production of export commodities - the voucher system - is reduced by the complication involved in its administration. The bureaucratic inefficiency involved in the calculation of the input-output coefficients that help determine the input requirements, and the delay in reconciliation of voucher books, create a strong disincentive, forcing many potential beneficiaries to refrain from using the mechanism.

The quality of sector-specific policies vary from sector to sector. A recent comprehensive study of industrial policy in Ethiopia (Oqubay, 2015), for example, shows that the results of sectoral policies have been significant in the horticulture and cement industries, but unsatisfactory in the leather sector. The performance of sector-specific institutions established under the Ministry of Industry also varies. Some intermediary or support institutions such as the Horticulture Producers and Exporters Association have established a positive track record in advancing the interest of their members, while the Ethiopian Leather Industry Development Institute (LIDI) and other newer institutions, such as the Pharmaceutical and Chemical Institute, have yet to prove themselves.

It is interesting to observe that the desire to engage with the private sector is showing progress. In recent years, the government has pushed sectoral Ministries and public institutions to engage the private sector in their planning processes. Institutions such as LIDI and the Textile Industry Development Institute (TIDI) have taken further steps by working with each factory on annual production and export targets. Most government institutions also have “public wing” departments that facilitate platforms for regular interactions. However, these forums rarely discuss strategic issues, but rather focus on minor administrative issues or at times on one-way policy lectures that can unfortunately be perceived as mere propaganda exercises. As discussed in section 2.4 below, some in the private sector also feel that the effectiveness of such engagement is undermined by a failure to understand the challenges faced by the private sector. Nonetheless, the genuine interest of the top leadership in engagement with the private sector is undeniable. A noteworthy instance is the decision by the Council of Ministers in 2013 to reject a draft Customs Procedures Law primarily on the grounds that consultation with the private sector had been insufficient (Mihretu and Tolina, 2015).

Overall, assessment of the public dimension shows that there is room for further improvement to ensure effective coordination to advance the trade agenda.

2.4 Private sector engagement

This section assesses the level of engagement of the private sector on trade and industry agenda. In addition to assessing the extent of private sector participation on trade policy issues and its general sense of ownership, this section considers the capacity of the private sector to produce and trade, its ability to innovate, and its capacity to participate in international trade.

Private sector engagement is difficult to assess, largely due to access issues. Understanding the extent of private sector involvement in trade policy formulation and implementation, and the degree to which trade agenda is mainstreamed among members of the private sector, would require a comprehensive survey, which has been infeasible within the time and resource constraints of this study. Discussion with the private sector therefore focused around key sectoral association leaders and selected members of the private sector.¹⁷

¹⁷ A survey of 100 firms is currently underway to gather evidence from the private sector on these issues. This survey will generate better and more comprehensive results. Therefore caution is necessary in interpreting the findings discussed in this section.

The key finding is that there are marked variations in the ability and willingness of the private sector to influence trade policy issues, depending on the strength of associations and the quality of their leadership. Some of the associations, such as the Ethiopian Horticultural Growers and Exporters' Association, tend to have a strong interest in and capacity to influence policy issues affecting their sectors. They maintain closer working relationships with policy makers, and this approach has provided positive results for producers and exporters in these sectors. Other associations, such as the leather industry and spices associations appear to have more limited involvement in policy issues affecting their respective sectors.

On the broader trade policy agenda, however, there are similarities across the board. For example, very few respondents showed any interest in or knowledge about the ongoing WTO negotiations or those on the European Partnership Agreement (EPA) with the EU. Exporters showed a reasonable level of interest on preferential market arrangements such as AGOA, but primarily at the level of overall awareness rather than a strong desire for involvement in the details of the negotiation process. There is an apparent tendency to view trade policy issues, particularly international trade negotiations, as the responsibility of the government. The only exceptions are the Addis Ababa Chamber and the National Chamber, which have reportedly attempted to engage in international trade negotiations (for instance preparing a private sector position paper on WTO accession, and pushing for more open regional trade policy through policy deliberations with government).

The low level of engagement of the private sector in the trade policy agenda could also be explained by the quality of business leaders in the country. Private sector associations, including the Chambers, have failed to attract astute and more dynamic businessmen as members. Chambers have a very low membership base, which also reflects negatively on their organizational capacity. Large and established businesses show little interest in the activities of the sectoral associations and the Chambers. It is reported that part of the problem is the prevailing political economy, which allows individuals privileged access to policy makers, creating disincentives for involvement in and strengthening of Chamber. In recent years, however, the government has made a conscious effort to change this pattern. By establishing the Ethiopian Public Private Consultative Forum, for example, government policy makers hoped to create a more structured and institutionalized mechanism for policy deliberations. Some government institutions, notably the Ministry of Foreign Affairs and the President's office are also making conscious efforts to involve the private sector in all major economic interactions with other nations. The President's office now has a more-or-less established practice of including the private sector, through the national chamber, in official business trips outside the country or when hosting foreign delegations in the country.

The dialogue platform is also helping to improve coordination within the private sector by allowing a more organized way of articulating their policy preferences. Each dialogue platform with the government, for example, is preceded by validation workshops (for the private sector) providing an opportunity to coordinate and align policy preferences. However, these mechanisms are less than perfect. At times, members of the private sector have conflicting agendas and interests resulting in conflicting positions.

There is a widespread agreement among members of the private sector that the business environment in the country remains very difficult. The government is seen as too inclined to exert control, at the cost of burdening the private sector. A telling example is the business-licensing regime, which, in comparison with international best practice and trends in many economies, is described as unduly prescriptive. With more than 1,300 licenses, the regime establishes too many and unnecessarily specific licenses, forcing businesses to obtain multiple

licenses for closely related business activities. This makes business start-up and the general business environment very difficult (bKP Development and Consulting, 2013).

There is also a tendency to view government officials as being inattentive to private sector needs. Lack of transparency in policy making and lack of predictability in policy changes are also mentioned as major disincentives to active engagement in trade and other policy issues.

Another issue examined to assess private sector engagement relates to the capacity of the private sector to innovate and explore new opportunities. This is important because a innovative and business-savvy private sector is better able to engage in the trade agenda. The finding is that, although the enterprise culture in Ethiopia is improving, it is far from being dynamic and innovative. A look across a single product value chain shows the extent of untapped opportunities due to limited interest and capacity to translate existing potential into actual business opportunities. Had there been a strong culture of innovation and entrepreneurship, a garment producer's lack of access to inputs such as zippers or a bottling company's need for corks should have sparked a new business idea for another business. Respondents also mention lack of linkages between FDI and local firms and between the private sector and academic institutions preventing strong knowledge spillovers.

2.5 The role of institutional leadership

This section goes a step further, to look at the leadership issue. It assesses the existence of one or more lead institution(s) with the credibility and expertise to drive the trade and industrialization agenda. The existence of a lead institution is demonstrated by its capacity to lead trade policy making by coordinating the works of other institutions and stakeholders. Such an institution should also have the capacity and legitimacy to break conventional wisdom and effectively push for reforms. If there is more than one lead institution, its strength is measured by the complementarity of the other institutions' initiatives and the level of their coordination.

It is very difficult to identify a lead institution in the Ethiopian trade policy space. As discussed above in the context of regional and international trade negotiations, coordination mechanisms to ensure consistency and coherence in overall policy goals are poor. This is mainly due to the absence of a lead institution or institutional mechanism with strong power and leverage to provide leadership. Examples of policy inconsistency and implementation inefficiencies mentioned above attest to this fact.

The irony is that this problem persists despite considerable efforts made to improve coordination in recent years by putting in place a number of high-level institutional coordination mechanisms. Three high-level institutional setups that deal with issues of export trade and the productive sector are noteworthy. These are the National Export Coordinating Committee (NECC), the National Economic and Business Diplomacy Coordination Committee (NEBDCC), and the National Productive Sector Competitiveness Support Council (NPSCSC). The NECC and NPSCSC focus primarily on solving bottlenecks related to infrastructure, tax, customs, logistics and finance to create a conducive policy environment for the private sector by fostering international market competitiveness (EIFTRI/AEMFI, 2014). These mechanisms are led at the highest level of government. There are also efforts to coordinate at the level of line Ministries in the form of several *ad hoc* committees.

The challenge lies in the coordination and complementarities of the existing institutional setups. The three top-level institutional mechanisms are not institutionally coordinated despite dealing with significantly overlapping activities. This affects the effectiveness and the complementarities of these institutional mechanisms and also creates a leadership vacuum, as it is not clear which mechanism is the "lead" institutional set up.

Equally problematic is the focus of these institutional mechanisms. There is a strong tendency to deal with operational challenges rather than with strategic policy issues. In the case of the NECC, for instance, though “giving assignment to its subcommittees to investigate policy related bottlenecks and bring forth workable solutions” as part of the committee's mandate, in reality, the main focus of the committee has been to “oversee the overall performance of the export sector and troubleshoot observed problems”(EIFTRI/AEMFI, 2014, 12-13). The committee’s dealings over the years have been more with monitoring export targets against set plans. The committee has not been able to deal with strategic policy issues, articulate a trade agenda or overcome coordination failures at the level of line Ministries. The same is true with NPSCSC. Though younger than NECC, NPSCSC was established with a stronger mandate, as it is expected to facilitate and coordinate policy provision to the productive sector and to make the productive sector competitive in the international market in terms of productivity, quality and price. However, the committee has not been as active as the NECC in its deliberation, and tends to deal with routine operational challenges rather than facilitating bold policy provisions. More worrisome is the prevailing notion that NPSCSC deals with manufacturing while NECC deals with export trade, revealing the existence of a “trade” and “industry” dichotomy in Ethiopia’s policy space. The problem is more pronounced, as the two mechanisms are not institutionally coordinated, as indicated earlier.

2.6 Sector-specific intermediary institutions

As mentioned above, there have been efforts in Ethiopia to establish institutional mechanisms for coordinating trade and industrial policies, although most tend to monitor progress in implementation of plans rather than providing strategic direction. This section looks at existing institutional mechanisms, resources and other instruments aimed at promoting trade and enhancing trade and industry linkages. It also evaluates the extent to which key stakeholders are coordinated and how resources are leveraged for effective trade policymaking and implementation.

As discussed above, a number of institutional mechanisms exist for policy coordination. In addition to the three high-level coordination mechanisms discussed earlier, field investigation reveals that there are a number of *ad hoc* committees at technical level that work on different policy or implementation issues. These committees may deal with key trade policy issues such as drafting multilateral trade negotiation positions or providing recommendations to troubleshoot a certain policy implementation challenge. Unfortunately, however, these institutional mechanisms are not very effective. Part of the problem is lack of coordination among the diverse institutions. Duplication of efforts and a large number of committee engagements also create fatigue, leading to diminishing motivation to engage effectively in these coordination mechanisms.

Sector-specific intermediary institutions also exist, allowing members of the private sector to respond to their sectoral needs. These institutions range from membership-based sectoral associations to autonomous government institutions that focus exclusively on issues related to a specific sector. The government has established a number of independent sector-specific institutions including the Leather Industry Development Institute, the Textile industry Development Institute, the Metal Industry Development Institute, the Chemical and Constructions Inputs Industry Development Institute, the Food, Beverage and Pharmaceuticals Industry Development Institute, and the Milk and Meat Products Institute. The oldest and well-established institutions provide comprehensive support to the private sector helping to address challenges across the entire value chain. The more recently established institutions, however, have very limited capacity to respond effectively to the needs of the private sector. The overall view, however, is that the government’s strategy of establishing sector-specific institutions is a useful strategic direction.

There are also a number of donors that operate in the trade and industry policy sphere in Ethiopia. Some of the major donors include USAID, DFID, SNV of the Netherlands, Swedish aid, Canadian aid, the European Union, UNCTAD, UNECA, UNIDO, UNDP and Italian Cooperation. Although most of these institutions are willing to provide support to private and public institutions, there is limited absorption capacity. One donor representative, for instance, complains about lack of response from a government agency despite repeated efforts for more than a year for a project worth tens of millions of dollars. Projects under implementation also suffer from poor execution and coordination, resulting in substandard results. There are no efforts to map out key available donor support. Such an effort would have allowed a more strategic approach to leverage the support offered by donors to achieve maximum impact. Such mapping also ensures more complementarity between different projects allowing a chance to build further on existing achievements.

3. Improving coordination in trade policy design and implementation

The discussion so far indicates clearly the deep-rooted problem of poor coordination among different public institutions, the private sector and other stakeholders in Ethiopia's trade policy making. Most worrying in the coming years will be the disconnect between the "trade" and "industrialization" agendas, especially given the focus of GTP II on promoting manufacturing sector-based and export-led growth and development. Meaningful transformation of the structure of the country's economy, a major focus of the national plan, can only be realized when the lead role of trade is recognized and trade and other policies are made to work together. The coordination failure at different levels of government and between public agencies and other stakeholders is also a major area of concern.

Overcoming the coordination failure and ensuring coherence between different policy instruments requires putting in place a robust and effective coordination mechanism. There are many different models that have been adopted by countries to inform policy formulation and to act as coordination mechanisms. It is difficult to copy and apply any of these models without taking into consideration the specificity and starting position of countries. What works in Singapore may not work for Ghana or Chile or Ethiopia. However, effective policy coordination models have a number of common characteristics that could be used to guide countries in establishing coordinating mechanisms suitable for their specific conditions and needs. These characteristics include:

- I. high-level political support – reporting to the highest level in the government structure such as the Prime Minister;
- II. an institutional mandate to undertake high-level coordination of responsible public agencies (for example, Trade Team Canada comprises 21 federal government departments, the US Export Cabinet comprises 14 public agency heads, while the US Trade Promotion Coordinating Committee comprises 20 agencies); and
- III. a formal private sector consultative structure both to ensure transparency and to provide a mechanism for business and other stakeholders to provide inputs and feedback to government.

A first step in the coordination of trade-related policies is to identify the key institutions and allocate the responsibilities for both the formulation and implementation of trade-related policies. As already noted, given the cross-cutting nature of trade, it is necessary that many stakeholders and parts of government are involved in both the design and implementation. For this to work, however, it is necessary that leadership of this process is not left vague, but instead a lead coordinating body - a Trade Policy Coordinating Council (TPCC) - is established and given the authority and a coordinating role. The TPCC should be given a clear

mandate from the highest level of country's leadership to consult with stakeholders and ensure policy consistency and coherence. However, the TPCC cannot be solely responsible for implementation as that will by necessity involve many players in and outside of government. Instead, its role in the implementation phase is to act as a coordinator and convener, and to have the responsibility (mandate) to monitor and assess implementation by the relevant agencies within the government.

Ideally, all stakeholders will have "ownership" of the policies adopted and implemented. They must perceive that what is being pursued is for the benefit of all and will help the country compete in the international market place and support better jobs and economic growth. It is possible that, in practice, specific policy actions that are needed for the promotion of trade may negatively affect some groups, both in and outside of government. Moreover, prevailing policies in a given area may be inconsistent with the realization of the overall trade strategy. To address such political economy realities it is necessary that the TPCC reports directly to the head of government and has the mandate to point out where specific policies are not consistent with the overall trade strategy. Conversely, it is important that those that are affected by trade policy actions have a voice – including those that are negatively affected. This also calls for a cross-cutting institutional arrangement – both to ensure accountability and transparency.

Thus, the key and primary function of the TPCC is coordination and ensuring that all agencies that are responsible for trade-related policies – line ministries, regulatory bodies, regional or provincial governments – know what their goals are, are fully informed and aware of the priorities that are defined by the national plan or development strategy, and use this as a framework that guides their activities. In other words, the TPCC provides executive sponsorship and oversight, vision and strategic direction. It leads the process of trade policy-making and facilitates stakeholder-wide communication. It oversees the country's overall trade performance, including the performance and efficiency of all sectors that have direct impacts on trade, and updates the trade policy objectives when required based on feedback and impact assessments. The TPCC also engages with stakeholders and agencies as needed to ensure organizational alignment on trade priorities; resolves conflicts and disputes between agencies, including issues related to ensuring that required funding is allocated for implementation; and regularly reviews progress in implementation of trade policies.

The TPCC should be chaired by the Prime Minister. The Council should include the heads of all relevant ministries and regulatory agencies. It should have the mandate and authority to create technical committees if and when deemed necessary, to bring together sectoral or issue-specific experts to provide inputs on the design, implementation and adjustment of specific aspects of trade policies.

The TPCC can only be effective if its work is supported by a strong and independent secretariat. Therefore, it is desirable that a full-fledged secretariat is established and tasked with organizing meetings and managing consultative and deliberative bodies interacting with the business/investor community; and monitoring and evaluating the implementation and effectiveness of national trade policies. Specific activities of the TPCC secretariat could include assistance in the development of key performance indicators and milestones; review and monitoring of progress towards meeting the export objectives; support to line agencies with analysis and benchmarking studies; ensuring information sharing among stakeholders; undertaking analysis of outcomes and impacts; and outreach activities, including regular public reports on progress made in trade promotion. The key question is what should be the composition of the secretariat and where should it be located? An ideal option is to have a stand-alone secretariat located in the Prime Minister's office and managed by someone with a

Ministerial rank reporting to the Prime Minister and with experience and in-depth understanding of the nexus between trade and other policies.

The TPCC should hold quarterly meetings, twice a year with representatives of the private sector and chambers of commerce and industry and chaired by the Prime Minister. At the end of these consultations, an action plan should be prepared with responsibilities assigned to the respective line ministries which should monitor and report progress at the next TPCC meeting.

3.1 Organizational framework for the TPCC

What follows presents a proposal for the organizational structure of the Trade Policy Coordinating Council (TPCC) that will oversee the implementation of country's trade policies and its vision of making trade an engine of economic growth, industrialization and a key instrument for job creation, poverty reduction and development financing. Central to this process is an institutional design that separates the strategic aspect of managing global economic engagement from the more administrative and policy implementation related functions (figures 2.1 to 2.3).

In order to separate the strategic decision-making process related to trade and industrial policy from day-to-day operational issues, the secretariat of the Trade Policy Coordinating Council (TPCC) should be housed administratively within the ambit of the Prime Minister's Office. This will give the council the status of coordinating and monitoring the implementation of trade-related policies at a higher level.

Such a high-profile Coordinating Council is needed to provide a framework for:

- I. policies related to domestic regulatory reform in various sectors to reduce the costs of doing business domestically - especially for inputs required by sectors targeted for export-promotion - and strategic policy making more generally to improve the country's competitiveness;
- II. policies related to trade facilitation and improving the country's logistical capacity and connectivity with the rest of the world;
- III. market access policies and strategy – spanning unilateral, multilateral, bilateral, and regional trade policy initiatives, including policy related to FDI;
- IV. integrating private sector input into policy and strategy formulation;
- V. interacting with donors and development agencies more effectively in identifying priority areas for action and allocation of aid for trade; and
- VI. holding all stakeholders accountable for implementation of the trade policies and the country's vision of making trade contribute to graduation into middle-income country within the next decade.

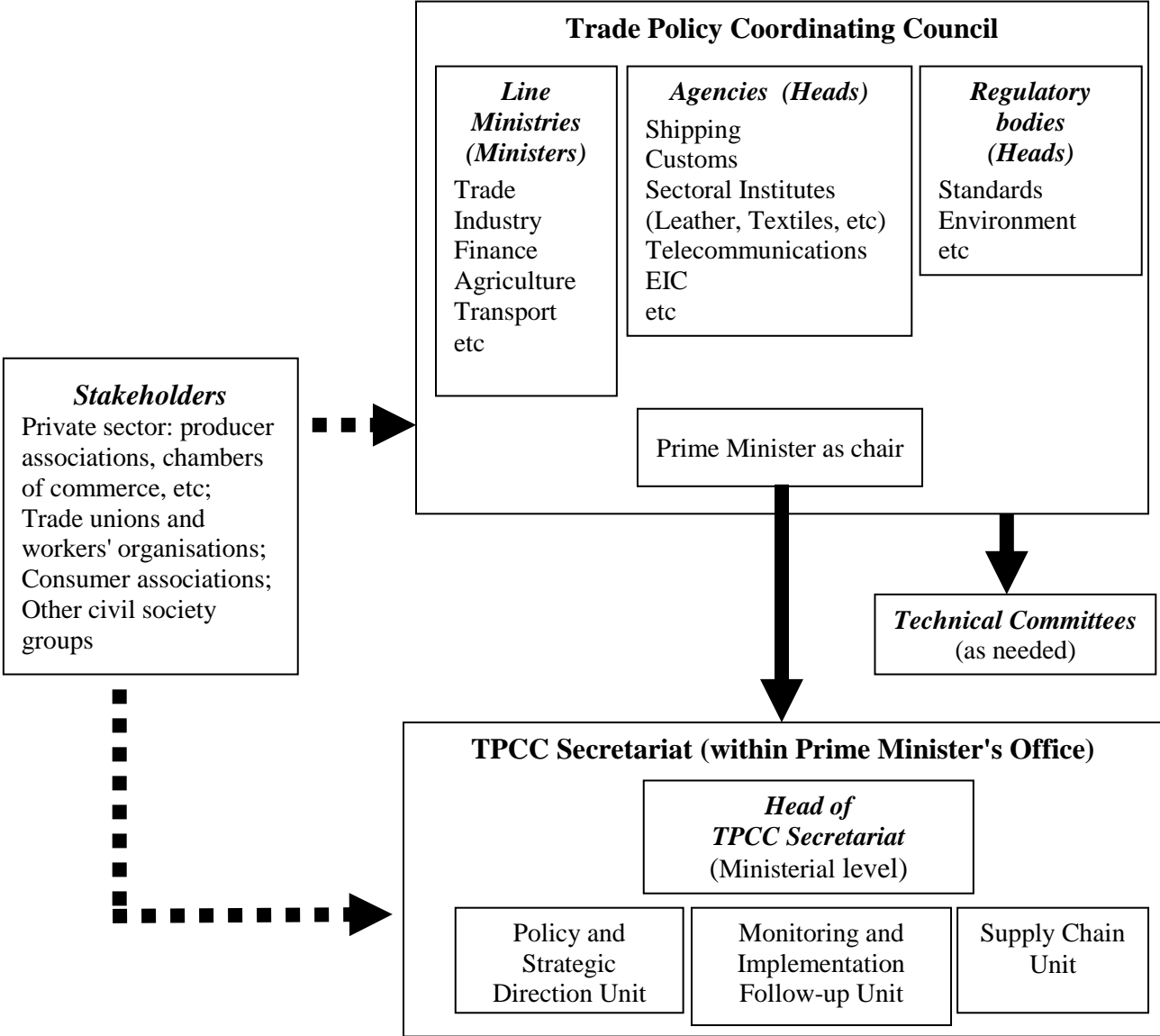
Figure 2.1 provides a schematic of the proposed TPCC. The goal of the TPCC and its subsidiary bodies is not to replicate the administrative functions of line-ministries that deal with sectoral policy, but to develop specific trade and trade-related policy initiatives for different sectors in conjunction with private players, and ensure the implementation of such policies across ministries.

The TPCC, supported by the secretariat, would include the senior officials from Customs office, line Ministries (transport, industry, finance, planning, etc.) and representatives of other departments and regulatory agencies that have a role to play in the movement of goods and services in and out of the country. The TPCC should have a mandate to meet at least on a

quarterly basis to monitor trade performance across various parameters, informed by reports prepared by its secretariat.

Ideally, the secretariat of TPCC should be staffed with competent experts, meritocratically appointed based on their understanding of the complexity of the multilateral trading system, the importance of establishing synergy between key macro and micro-policies (including macroeconomic policies, industrial and agricultural policies) and the intricacy of the domestic value chain. The secretariat as such serves as “think-tank” and depository of knowledge ensuring institutional memory and consistency in policy making and implementation, at times thinking outside the box. The secretariat should also be tasked with ensuring that the TPCC makes informed decisions after thorough considerations of alternative scenarios. The secretariat should also oversee the operational aspects by ensuring that the decisions made the TPCC are properly implemented.

Figure 2.1: Structure of Trade Policy Coordinating Council¹⁸



¹⁸ This organizational structure is a preliminary suggestion intended to stimulate discussion, therefore, it should not be read as a final proposal. Ethiopia has several different coordinating bodies or structures, including a Ministerial coordinating council. However, the authors of this report believe that given the significant importance given to trade, in particular export-led growth during the GTP II period, it may be necessary to establish a high-level coordinating council focused on the formulation, implementation and monitoring of trade-related policies.

Figure 2.2: Functions of a Trade Policy Coordination Council

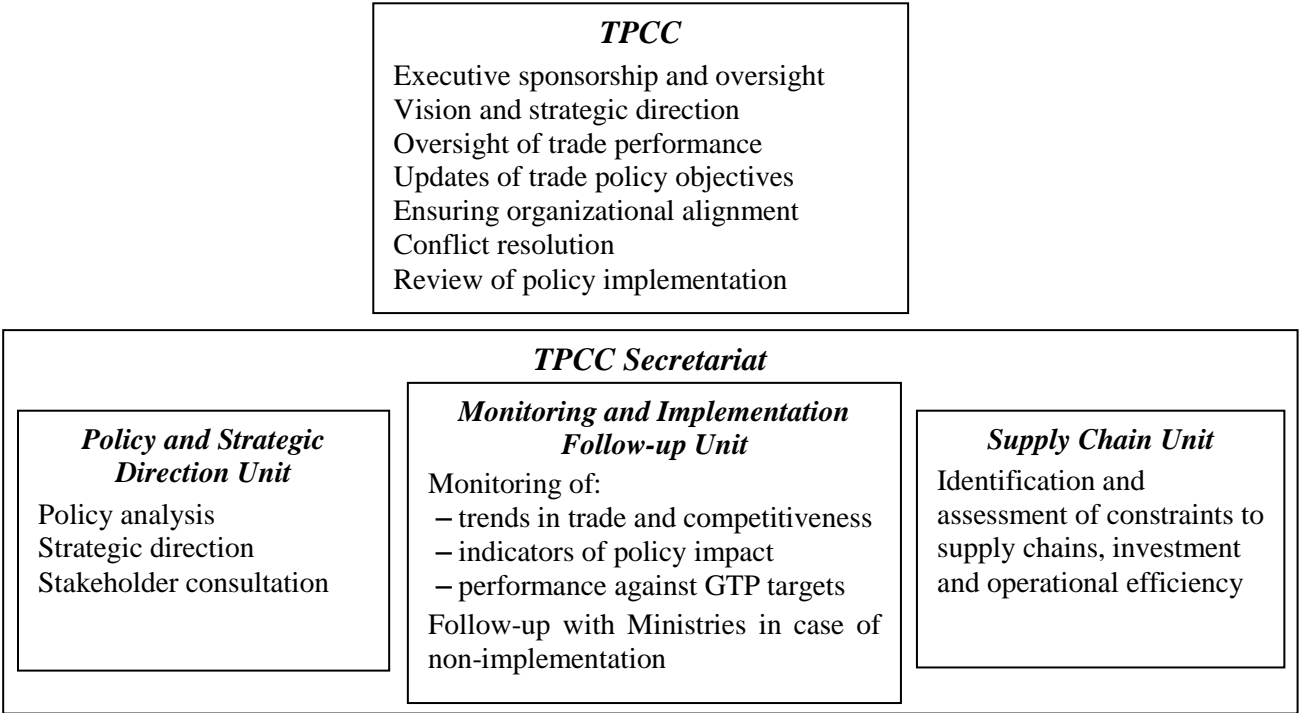
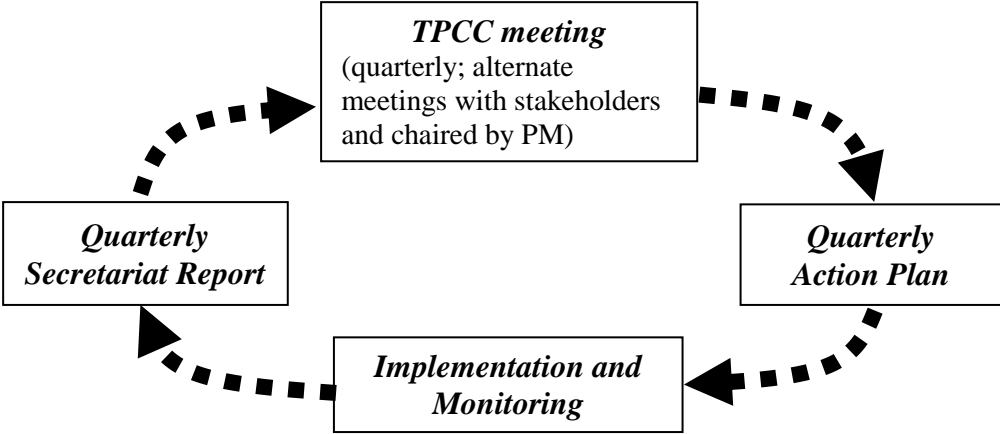


Figure 2.3: Work Cycle of a Trade Policy Coordinating Council



To fulfill these tasks efficiently, the work of the secretariat should be supported by at least three functional subsidiary bodies reporting directly to the Minister responsible for the work of the secretariat. These subsidiary bodies need not necessarily be large entities but must be staffed with competent and experienced economists and specialists capable of understanding the importance of the integrated approach to trade policy and the need to ensure that all other macro and sectoral policies are in line with the trade vision and the overall objectives of the GTP II. The functions of the three subsidiary bodies could be defined as follows:

- I. Providing a 'Knowledge Platform' for policy analysis and strategic direction through research and analysis and close consultations with key stakeholders and government departments and regulatory agencies;
- II. Identifying supply chain-related constraints and providing solutions for consideration by the Council. The secretariat will have the mandate to identify and assess specific constraints and factors that impede investments or the efficient operation of value chains;
- III. Monitoring, assessing and reporting on trends in trade competitiveness and attainment of the various indicators needed to measure the impact of trade-related policies and the attainment of trade and industrial development objectives of GTP II. Obviously, this function requires the secretariat to acquire the capacity to conduct economic analysis, ideally under the supervision of a chief trade economist, and regularly assess the country's trade competitiveness and trade performance.

It should be noted that the implementation of trade and trade-related policies and actions that are needed to boost the country's export capacity and the GTP II objectives is the responsibility of the relevant line ministries and regulatory agencies; the role of the TPCC is to act as a coordination, support and accountability mechanism and provide strategic direction when necessary. The proposed Policy and Strategic Direction Unit and Supply Chain Unit are two instruments that are intended to support both the process of designing the overall trade objective and assist line ministries and regulatory agencies in implementing it. A key role that both instruments play is to bring in the business community and other stakeholders – e.g., workers associations, consumer organizations – to identify priority areas for actions and suggest options for addressing them, including through the allocation of public investment where necessary.

In this connection, what will be the role of the Ministry of Trade? As noted above, the TPCC's role is strategic and to provide policy direction and to oversee/support and coordinate the implementation of trade-related policies. The Ministry of Trade plays a central role in this process. The responsibility for implementation of the national trade policy as narrowly defined, including trade promotion, managing domestic trade rules and regulations, taking the lead in trade negotiations and implementation of trade agreements, administering trade disputes, and participating in the collection of information on NTMs and strategic commercial intelligence in key markets and working with key sectoral line ministries to improve the regulatory and business environment in different sectors of the economy will continue to rest with the Ministry of Trade. Effective gathering of commercial intelligence to help industry to improve access to key markets, including regional and global value chains, is one of factors behind the international success of manufacturing sectors in emerging economies. This task is better performed by the Ministry of Trade.

The three important subsidiary bodies under the responsibility of the secretariat identified in the proposed organizational structure namely, the Policy and Strategic Direction Unit, the Supply Chain Unit and the Monitoring and Implementation Follow-up Unit (figures 2.1 and 2.2) will require diverse and advanced knowledge and skills that are currently lacking in the

Ministry of Trade and other mainline Ministries. The Policy and Strategic Direction Unit will serve as a forum aimed at fostering a substantive, evidence/analysis-based discussion of the impacts of sector-specific regulatory policies. It could help build a common understanding of where there are large potential gains from opening markets to greater competition, the preconditions for realizing such gains and options to address possible negative distributional consequences of policy reforms. Better information on what are the applicable NTMs and service sector policies and how these impact on operating costs and the ability to engage in trade would help facilitate broad based discussion on what priority sectors/issues are and where the key regulatory problems lie. Furthermore, the Policy and Strategic Direction Unit can be a useful mechanism to bring in expertise from the rest of the world to discuss and learn about alternative approaches that have been pursued to improve regulatory policies while reducing barriers against foreign providers of goods and services. To be effective and relevant for the implementation of the trade policies, the knowledge platform unit must be action oriented.

The proposal for the establishment of a Supply Chain Unit is based on two inter-related factors, one inward looking and the other external trade motivated. The first relates to the recognition of the current serious domestic input supply constraints faced by export-oriented firms in the three export priority sectors namely, textiles; leather and leather products and agro-processing; and the need to tackle the binding constraints through coordinated policy actions; and the second is to identify and provide policy support to domestic firms that are in a position to specialize and become part of the regional and global value chains. Participating in regional and global value chains requires more than trade facilitation and reducing domestic trade costs, although that is likely to be a critical element. In practice a broad range of potential policies that are implemented by different government agencies will impact on the operational efficiency of a value chain. This requires efficient policy coordination across line ministries and relevant trade-related regulatory bodies to be performed by the secretariat of the TPCC.

The third subsidiary body under the responsibility of the TPCC secretariat is the Monitoring and Implementation Follow-up Unit. The unit should be by an experienced trade economist reporting to the Chair of the TPCC and working closely with the knowledge platform unit, the supply chain unit and the Ministry of Trade. The unit will have substantive staff with in-depth knowledge of trade, economics and statistics-related issues. The primary role of the unit will be to provide the information and data needed to establish baseline performance for the various indicators that are chosen to assess progress in achieving the country's export targets and overall trade strategy as specified in GTP II. Therefore, the overarching goal of the unit is to monitor performance and results. This is a task that goes beyond collection and compilation of the requisite data. Another important task of the Monitoring and Implementation Follow-up Unit should be to assess the consistency between what has been identified as priority areas and goals in GTP II and what comes out of implementing the trade objectives of the plan.

3.2 Conclusions

Over the last two decades, there is more optimism about the prospects of the Ethiopian Economy than any time in its modern history. Not only has the country managed to register impressive growth records averaging 11 percent for more than a decade, but it did so while also achieving a much broader set of socio economic development goals. Pulling 26 percent of the population out of poverty, sending 95 percent of school age children to school, creating millions of jobs, improving both the material and subjective wellbeing of the population, to mention a few, is a truly remarkable achievement by any standard. With the formulation of the Second Growth and Transformation Plan, Ethiopia is embarking on even more ambitious

development agenda based on agricultural-based, manufacturing sector-driven and export-led growth strategy.

In the next five years, GTP II is expected to shift the country's structural base from agriculture to manufacturing and enable it to initiate the momentum necessary for eradicating poverty in line with the objectives of the 2030 Agenda for sustainable development and prepare the country for graduation from the LDC status by 2025. The success or failure of GTP II will depend on how the country performs on its export objective, which is expected to triple within the next five years and the composition of exports to shift to light manufacturing goods. Whether the country will achieve these objectives will very much depend on the attention given to trade policy coordination and whether the government appreciates the fact that trade is inherently a cross-cutting issue that involves many government departments, public agencies, private sector operators and trading partners and encompasses many diverse sectoral areas and policies, including industry, agriculture, services, customs, transport, standards, communication, transport and logistics, etc. Therefore, coordinating trade-related policies to achieve the central objectives of GTP II will enable the government to create synergy across all major policy areas. It is recommended, therefore, that the government reviews the functions and performance of existing policy coordinating mechanisms with a view to creating a single and an overarching high-level coordinating council revolving around trade-related policies and operating under the direct responsibility of the prime Minister and serviced by independent secretariat with specialized subsidiary bodies to provide reliable and up-to-date information necessary for making informed decisions and providing strategic direction.

Chapter III:

The macroeconomic policy context

1. Coordination of the trade strategy with fiscal policy

Fiscal policy always has multiple purposes. First, it has an impact on overall growth in the economy as the public sector is levying taxes, customs duties and other charges and channeling its revenue back into the economy, thereby influencing economic activity. Since different types of public revenue and different types of public expenditure have different effects on aggregate demand and supply, fiscal policy is not only influencing the level but also the structure of economic activity. It is from this perspective that the challenge of coordination with trade and industrial policy arises. This challenge is complicated by the fact that fiscal action, on both the revenue and the expenditure side, also influences income distribution. This aspect is of particular importance in a poor country like Ethiopia in its efforts to reduce poverty. Moreover, apart from the crucial impact public finances have on growth and development in the longer run, fiscal policy, especially with regards to the variation of public expenditure and its financing, is also a key instrument for macroeconomic stabilization.

Given the distinct federal structures of Ethiopia, fiscal policy needs to be coordinated with the trade strategy not only across the different public authorities at the federal level, but also between them and the regional and municipal authorities. The importance of such coordination is evident from the fact that the share of total regional expenditure in total public expenditure is about 40 percent.

1.1. Public revenue and trade and industrial policy

Taxation and the collection of other public revenue has to secure a share of national income that is sufficiently large to enable public spending for infrastructure and public services for the corporate sector, as well as for the society as a whole, and thus to sustain a sound fiscal position. On the other hand, taxation is a key instrument to direct economic activity at both the demand and the supply side into the strategically desired direction.

This aspect is of particular importance not only because upgrading public infrastructure and support services requires high government expenditure, but also because trade and industrial policies tend to have a strong impact on the revenue side of the budget for two reasons. First, trade policy (e.g., lowering tariffs) implies a reduction of import duties and other trade taxes. Second, many incentives that aim at directing the private sector into a direction that is deemed desirable from a growth and development perspective are either reducing revenue as certain firms or activities are taxed at lower rates or entirely exempted from taxation, or increasing spending when incentives are provided in the form of subsidies or guarantees. For these reasons decision-making and planning in budgetary and tax matters are inexorably linked with trade and industrial policy.

Ethiopia has a level of tariff dependence for government revenue that is far above average. Customs duties and trade taxes accounted for 30 percent of Ethiopian government revenue in 2014/15, a share exceeded only by very few countries in the world. The revenue raising power of import duties is likely to be eroded in the years to come, particularly in connection with WTO accession. This implies a narrowing of the Government's fiscal space, which needs to be compensated by higher revenue from other sources. This is not an easy task as shown by an IMF study on 100 countries over 25 years, which found that low-income countries could recover only 30 cents for every lost dollar from tariff reduction (Braunsgaard and Keen 2005).

The composition of tax collection matters not only for its distributive implications but also because of its role in generating incentives and disincentives for different elements of demand and supply. For example, the structure of income taxation and specific indirect taxes on certain types of consumption influences the pattern of domestic demand, which has possible repercussions on the trade balance. Even more important from the point of view of coordinating taxation with the trade and industrialization strategy is the design of corporate taxation. On the one hand, applying differential tax rates to particular sectors is one instrument of industrial policy. The design of corporate taxation can be geared towards strengthening the link between corporate profits and investment at the firm level, for example by allowing specific systems of fiscally relevant depreciation allowances, or loss allocation, or preferential treatment of reinvested profits (see also chapter VIII). On the other hand, fiscal incentives in the form of tax holidays for foreign investors, reduced statutory rates for particular sectors or regions and direct tax breaks for exporters, can significantly reduce the total yield from corporate taxes as has been the case in many developing countries in recent years (UNCTAD 2014).

Direct income and corporate taxes tend to rise faster as the economy grows, provided that the pattern on tax rates is progressive and that such taxes are effectively applied collected. It is therefore essential that the influence of interest groups, including foreign investors, is not getting the upper hand in corporate tax governance, as has frequently been the case in poorer countries that compete with other countries to attract FDI (Keen and Simone 2004). In terms of attracting more investment, the results of such tax incentives to corporations have often been disappointing. The focus on the provision of tax advantages for foreign investors is often driven by media and other corporate assessments that identify taxes as an important variable, even though these may not always be the most important determinant of FDI. This consideration is especially valid for Ethiopia, whose agriculture-based industrialization strategy can count on significant other advantages, especially lower wages compared with other countries and a large raw material base.

1.2 Public expenditure and trade and industrial policy

On the expenditure side, an important matter for coordination with trade and industrial policies is focussing infrastructure investment to the specific needs of the priority sectors. For example, investment in public infrastructure is likely to be more effective in raising the efficiency of production and inducing new private investment when it is coordinated with the creation and management of industrial zones, in which activities of prioritized sectors are concentrated. Another aspect of coordination arises from the fact that not all elements of infrastructure can be improved at the same time, so that there is a need for sequencing and setting priorities. For example, in mobilizing and deploying financial resources for infrastructure development, competition is likely to arise between improving the transport, power and water infrastructure for the prioritized manufacturing sectors and the necessary upgrading of other types infrastructure in support of developing the social or tourism sector.

Furthermore, in setting priorities for fiscal spending, the public provision of education and vocational training and financial support for institutions helping to upgrade technical and managerial skills must be considered. This is not only a matter of the overall level of public spending for these purposes but also one of coordinating such spending with the concrete needs of the prioritized sectors. Learning-by-doing can go a long way in upgrading the professional competences required in these sectors, in particular for the low- and semi-skilled groups of the workforce. Developing a dual system of professional training that combines school learning with the acquisition of experience on the job may not only be the most effective way to upgrade professional skills but also the most efficient allocation of public education expenditure.

Public procurement can also play a key role for the expansion and upgrading of domestic industries, especially in connection with construction. Giving priority in public procurement to locally produced inputs, especially from the prioritized chemical and metals industries, can make a significant contribution to the development of these sectors.

2. Monetary policy and the role of the central bank in the context of trade

In the area of monetary and financial policies, there is already a degree of coordination with the industrialization strategy inasmuch as in recent years the monetary and regulatory policy of the National Bank of Ethiopia (NBE) has aimed at supporting capital accumulation by avoiding high interest rates. There are provisions that facilitate access of firms in the prioritized sectors to foreign currency.

The central bank's interest policy is an important element in the policy mix in support of Ethiopia's integration into international trade, as it influences the cost of financing of both investment and working capital in the export sectors. In addition, central bank policy also bears on the provision of liquidity and refinancing facilities for the banking system, which determines the capacity of the latter to lend to the non-financial sector. Another macroeconomic policy instrument in the purview of the central bank, which has direct bearing on Ethiopia's external trade performance, is the exchange rate. The levels of interest rates and the exchange rate are co-determinant of the ability of Ethiopian manufacturers to compete with their exports internationally and with imports on the domestic market.

2.1 Management of the exchange-rate and foreign exchange

2.1.1 Exchange-rate management

The most obvious interaction between monetary and trade policy is via the exchange rate, which affects a country's competitive position in international trade. The NBE practices a system of managed floating, meaning that it regularly intervenes to reduce exchange rate volatility and to follow a stable path of nominal exchange rate depreciation.

The impact of market access privileges for Ethiopian products and the success of export promotion measures can be compromised when the exchange rate is overvalued, as presently seems to be the case for the Ethiopian currency (IMF 2015a). From the perspective of exporters, currency overvaluation has the same effect as tariffs. At any given level of production cost in domestic currency, an appreciation of the exchange rate will either cause an increase in foreign currency prices of exports, with attendant effects on the international competitiveness of domestic production, or reduce the profitability of exporting firms with implications for their willingness to invest and capability to finance such investment. Therefore, appropriate exchange-rate management, and its close coordination with trade policy, is crucial for any export-oriented industrialization strategy to succeed.

The challenges for effective coordination between exchange-rate, trade and industrial policy are then to determine the "right" exchange rate and to attain it. In a country like Ethiopia that is not (yet) fully integrated into international capital markets and therefore less likely than many emerging-market economies to be subject to speculative capital inflows (Martins 2013), exchange-rate management may best aim at an exchange rate that reflects the level and movements in unit labour costs relative to those in its trading partners or competitors in international markets. The effect on the real exchange rate that results from higher inflation would then be offset by a devaluation of the nominal exchange rate (UNCTAD 2011: ch. VI).

When domestic inflation is higher than that of the trading partners, the nominal exchange rate needs to be depreciated by the same amount as the inflation differential in order to maintain a stable real exchange rate. With regard to international competitiveness of the prioritized sectors, the issue of the appropriate exchange rate relates to the inflation differential between

Ethiopia and its trading partners, i.e. the countries to which it exports and from whom it imports. But it also relates to the differential in unit labour costs compared to countries whose producers compete with the Ethiopian producers.

According to IMF estimates, Ethiopia's real effective exchange rate is currently overvalued by around 30 percent, a major reason for the widening of the current account deficit (IMF 2015a). The NBE is concerned that a devaluation could lead to higher inflation as prices for imports in domestic currency would rise. With regard to the impact that the exchange rate has on Ethiopian exports, the NBE relies on productivity gains in the prioritized sectors and, thus, the possibility for exporters of manufactures to reduce their production costs and the prices of their products in domestic currency.¹⁹ In other words, it expects efforts to enhance efficiency and productivity in these sectors to compensate for the negative effects of currency overvaluation. This is just the opposite of an exchange rate policy, which aims to support trade and industrial policy by avoiding currency overvaluation, or achieve a certain degree of undervaluation to increase the international competitiveness of domestic producers.

On the other hand, potential inflationary pressure arising from nominal currency devaluation is a valid concern. At the current ratio of imports to GDP, a 10-percent devaluation could push the inflation rate up by 3 percentage points, provided the entire exchange rate change is passed through to domestic prices. Another aspect that highlights the interaction of exchange-rate management and the trade and industrialization strategy is that the overvalued exchange rate is supportive to the prioritized sectors inasmuch as it lowers the domestic currency cost of their imported inputs. These effects may need to be weighed against the disadvantage for the exports of these sectors. At a time where Ethiopian exporters are eager to gain market shares in the international markets for processed food, textiles, clothing and leather products and to achieve efficiency gains from economies of scale, exchange rate overvaluation on exports negatively impacts on these sectors' medium-term perspectives, which may deserve priority attention.

In any case, due to the above considerations there is a strong case for strengthened coordination between the Ministries of Trade and Industry and the central bank to identify short- and medium term priorities. Another consideration to be taken into account is that a developing country like Ethiopia, which aims at accelerating the development of its manufacturing industry, may aim not only at preventing currency overvaluation but even at keeping its currency slightly undervalued (UNCTAD 2008).²⁰

2.1.2 Management of foreign exchange and external borrowing

Controls over the use of foreign exchange are essential for Ethiopia, as they are for any country with a severe shortage of hard currency. In particular, it is essential to rigorously restrict the use of the available foreign exchange for unproductive purposes, such as imports of luxury consumer goods or for goods that can be produced locally with similar quality. In certain cases, for example, when nascent industries deserve strategic support, it may even be justified to restrict the allocation of foreign exchange for imports of goods whose domestic

¹⁹ This can be read from the statement made by the Executive Director for Ethiopia at the IMF in connection with Ethiopia's 2014 consultations with the IMF: "[The Ethiopian] Authorities acknowledge that a competitive exchange rate is important but consider too rapid an adjustment to be counter-productive due to feedback effects on inflation. They preferred to effect the real effective exchange rate adjustment through a combination of gradual nominal exchange rate depreciation, further reduction in inflation and improved productivity of exports. Efforts to promote non-traditional exports and exports of services along with those to attract fresh financing from abroad were expected to help in this regard." (IMF 2014)

²⁰ In the successful cases of late industrialization in East and South-East Asia, undervalued exchange rates for many years accompanied low central bank interest rates and accommodative and stimulating monetary policies.

production is more costly than importing them. Clearly, in such cases the advantages that can be found from raising domestic production must be carefully weighed against the disadvantages that are likely to arise from reduced competition.

Yet, while the rationale for foreign exchange controls is obvious, it appears that, in practice, controlled foreign exchange allocation in Ethiopia has not always been consistent with the priorities of structural transformation. In particular, overly bureaucratic and lengthy procedures to obtain authorization for payments in foreign currencies appear to frequently cause problems for the procurement of essential inputs for production in the prioritized sectors. These can severely affect the competitiveness of exporting firms. It is therefore essential to better coordinate the principles and procedures of foreign exchange allocation with the import requirements of these sectors.

While strict foreign exchange controls are also essential for controlling capital outflows, the problems that domestic firms may encounter from borrowing in foreign currency is a less important issue for Ethiopia than for other developing countries because only few domestically owned firms, if any, have access to international lending. However, to the extent that such access exists or will be gained as firms grow in the coming years, it will also be essential that such borrowing is restricted to the financing of capital or intermediate goods imports in the prioritized sectors.

2.2 Coordination of inflation control and credit expansion

2.2.1 Inflation control versus support for capital accumulation

The main mandate of the NBE is to control inflation, which is considered essential for economic growth. There can be no doubt that a stable macroeconomic environment conducive to investment in productive capacity must include relative price stability.

However, there are instances where there is a trade-off between inflation control and the objective of raising productive investment. This arises in situations when inflation control requires restrictive monetary policy and rising interest rates, whereas low interest rates are a key policy factor contributing to the dynamics of investment in productive capital. A monetary policy that is permanently and exclusively geared to keep a lid on inflation *a priori* hampers capital accumulation. In all cases of successful industrialization, monetary policy has been accommodating (expansionary) with low interest rates.

A comparison of the experiences of countries with different priorities in the conduct of monetary policies shows that in countries where monetary policy was tight and interest rates were high, structural change was slow or absent and capital accumulation was low. This was the case in the past in many African and Latin American countries. By contrast, in countries where monetary policy was accommodating or expansionary, capital accumulation was strong and structural change, output growth and employment creation were fast, as in East and South-East Asia. Distinct from many countries in Africa and Latin America, both nominal and real lending interest rates in East and South-East Asia over the past 20 years have been consistently lower than the GDP growth rate.²¹ As a result, monetary policy has acted as a driver of the strong investment dynamics in those two sub-regions (UNCTAD 2010).

The NBE pursues a restrictive monetary policy, which has been successful in recent years in keeping inflation in the single digit range. While at present bank lending rates are rather low (11.9 percent on average, equivalent to 2 to 3 percent in real terms),²² it is essential that the desirable objective of keeping inflation low will not lead to higher interest rates that would

²¹ An exception was the episode of the Asian financial crisis.

²² In the first quarter of 2015, the minimum and maximum lending set by the central bank stood at 7.5 and 16.25 percent (National Bank of Ethiopia, 2015).

raise financing costs or to a sharp tightening of bank liquidity with negative effects on bank lending for productive purposes. The risk of this happening is high as long as the sole focus of the central bank is on inflation control, and as long as inflation control is pursued only with monetary policy instruments.

It may be useful to establish a mechanism for coordination of central bank policy geared to inflation control, on the one hand, and the need to enable the banking system to provide additional long-term investment credit at low interest rates to actors in the prioritized sectors, on the other. In situations where a trade-off between these two objectives occurs, it will be necessary to find the right balance between accepting a slightly higher rate of inflation and limiting the provision of credit. This coordination challenge has two aspects. The first is related to the relationship between inflation and investment, the second to the way in which inflationary pressures are addressed.

Under the first aspect, it may be worthwhile considering that inflation may not necessarily be detrimental to investment and growth as long as it is kept within a certain range. In developing countries, a higher rate of inflation than often assumed may be acceptable when central banks provide favourable financing conditions for productive investment. Empirical research suggests that in developing countries with underutilized capacities, as is the case in Ethiopia, growth can be compatible with – or even supported by – a moderate rate of inflation (Muqtada, 2010). While it is difficult to specify a rate of inflation that might be tolerable in Ethiopia, it has been estimated that the threshold rate of inflation for developing countries (i.e. the rate above which real GDP growth could be compromised) is 11–13 percent (Khan and Senhadji 2001).

Under the second aspect, the question arises to what extent inflation can be controlled with non-monetary instruments. It appears that the coordination of anti-inflation policies with the export-oriented industrialization strategy, and avoiding a trade-off between these two, could be greatly facilitated if additional policy instruments were considered to effectively dampen inflationary pressure that may occur in the growth process. This is all the more relevant as the source of inflation is often not excessive monetary expansion, but has to be sought elsewhere, especially excessive wage increases and rising food prices. If inflationary pressures result from such sources, restrictive monetary policy may not be the most appropriate response.

2.2.2 Non-monetary options for inflation control

Resort to additional policy instruments for preventing or countering inflationary pressures would facilitate the task of the central bank to effectively address inflationary pressures. Depending on the sources of such pressures and the dynamics underlying its acceleration a variety of options may be considered.

To the extent that inflationary pressure results from domestic demand in an overheating economy, shifting to a more restrictive stance in fiscal policy, especially a variation of public sector demand for domestically produced goods, is a first option.

Although problematic in a market economy, interventions in the price setting process are another non-monetary option that may be considered as a temporary instrument. These may take the form of direct price controls on goods with relatively low price elasticity of demand,²³ for example electricity and transportation as practiced in 2004 in China (Flassbeck et al 2005),²⁴ or temporary price moderation agreements with associations of producers and

²³ When applied to goods and services with a high price elasticity of demand, price controls prevent the market mechanism to play its stabilizing role, i.e. to reduce demand as prices rise, so that supply bottlenecks arise.

²⁴ It has been estimated that Chinese price controls introduced in 2004 when the economy was overheating kept inflation at almost half of the level without controls (Qu 2004; Flassbeck et al 2005).

wholesale and retail distributors as in Argentina in 2006 (UNCTAD 2006). Such measures have been found to be successful even in Ethiopia in moderating price expectations and to moderate inflation.

Another instrument, the use of which has been key to combining high rates of productive investment and fast growth with a high degree of price stability in a number of Asian economies in the past, is wage policy (UNCTAD 2010). Here it will be important that wage increases in the economy as a whole do not exceed the productivity gains, so as to avoid a price increases as a result of higher unit labour costs. This measure also dampens the expansion of domestic demand in excess of the supply potential.

In a low-income country like Ethiopia agricultural policy can be instrumental in preventing inflationary pressures. In Ethiopia, food represents a large share of consumer expenditure, so that changes in food prices can have a strong impact on the overall rate of inflation, as witnessed in the first half of 2015 (see chapter I). In addition to population growth, the increase in per capita income that is expected to result from fast export-oriented industrialization will cause food demand to rise further. At the same time, food production for the domestic market is likely to increasingly compete with the production of agricultural inputs for the prioritized export sectors, causing a risk that agricultural space available for domestic food production is reduced in favour of the production of such inputs. If the emergence of inflationary pressures from this source could be avoided, then another reason for restrictive monetary policy would, at least partly, be eliminated. The inflationary pressures would be tackled at their source, whereas monetary policy instruments would slowdown investment without being able to reduce the inflationary pressure.

Chapter IV:

The international framework: Trade agreements and legal market access

1. Overview

Trade performance is significantly influenced by multilateral trade rules and the policies and regulations of other countries. Efforts to boost export growth must, therefore, go hand-in-hand with policies aiming at improving access to foreign markets by actively pursuing international trade cooperation, through both preferential market access programmes and reciprocal trade agreements, particularly in emerging economies. The 'market access agenda' is thus an important dimension of a trade strategy.

One of the few advantages that Ethiopia enjoys as a least developed country (LDC) is the preferential treatment by many of its trading partners. LDCs are granted duty-free, quota-free access to the largest foreign markets for virtually all of their exports, extended through such initiatives as the European Union's Everything But Arms (EBA) program and the United States' African Growth and Opportunity Act (AGOA). Ethiopia also enjoys tariff preferences under the Generalized System of Preferences (GSP) in Australia, Canada, Japan, New Zealand, Norway, and Switzerland. It also has preferential access to the markets of China, India, Russia, the Republic of Korea, and Turkey. These ensure that Ethiopia's exports face almost no barriers to the major markets, and these advantages are independent of the country's status vis-à-vis WTO.

However, this is not the case in many other fast-growing developing countries, where tariffs are generally higher than in the advanced economies. In the latter, however, non-tariff measures (NTMs) and regulatory requirements can still constitute prohibitive trade barriers. Furthermore, ancillary policies such those regarding rules of origin may substantially reduce the benefits of preferential market access. Such considerations make it essential that Ethiopia gives higher priority than in the past to trade agreements, both multilateral (for example, in the accession to WTO) and with specific trading partners that are of the greatest importance for Ethiopia (for example, COMESA FTA and EPA).

At present, Ethiopia's trade is conducted principally with partners outside of its own region. Over half of all exports are still sent to high-income countries (especially in Europe), and for textiles, clothing and leather products this share is even higher. On the other hand, the share of imports originating from these same countries has declined over the past decade, as imports from China have increased. The share of other African countries remains well below 10 percent for both imports and exports.

Ethiopia is now engaged in numerous trade negotiations at the regional, extra-regional, and multilateral levels. The circles formed by these multiple initiatives are not precisely concentric, however, as WTO membership is not yet universal, and some countries are members of more than one of the many groups and sub-groups within the continent. Ethiopia has been a member of the Common Market for Eastern and Southern Africa (COMESA) since its foundation in 1993, but has only recently decided to negotiate for its accession to the COMESA Free Trade Agreement - a necessary step towards full participation in the proposed Tripartite Free Trade Agreement among COMESA, the East African Community (EAC), and the Southern African Development Community (SADC). The Tripartite Free Trade Agreement would create a market of 26 countries with a population of 625 million and a gross domestic product of more than \$1 trillion. It would also be a stepping-stone towards the

eventual establishment of the Continental Free Trade Area among all the members of the Africa Union. Ethiopia already has a bilateral trade agreement with Sudan which uses the COMESA Rules of Origin and other COMESA FTA instruments such as the COMESA Safeguard Mechanism (which has already been used in relation to imports of steel reinforcing bars from Sudan). It is also a member of the Intergovernmental Authority on Development (IGAD) and, as such, is negotiating an IGAD minimum integration programme, which is a sort of Free Trade Agreement. It should be noted, however, that with exception of Eritrea and Somalia, all IGAD members are also members of COMESA.

These regional initiatives are being undertaken at the same time as Ethiopia, together with other African countries, is engaged in negotiations with the European Union for an Economic Partnership Agreement (EPA). The net effect of these multiple negotiations on the regional distribution of Ethiopian trade may be difficult to assess, especially as it remains uncertain which of them will ultimately produce agreements, when and in what sequence, and what items may be excluded or otherwise subject to less than full free trade. Views on the relative importance of South-South and North-South trade agreements also differ. One commentator anticipates a greater impact from the former, because developing countries have “retained relatively high rates of protection”. Others expect that the regional initiatives will expand Ethiopian trade with its African partners, but that the regionalizing effect might be blunted if the EPA negotiations are fruitful. At the other extreme, some see limited potential for regional trade because of the high level of similarity both of exports and imports and of the relative competitive position of African suppliers.

Nonetheless, given its vision of making international trade the main source of growth, employment, economic diversification and sustainable development, the Government of Ethiopia has little choice but to pursue the market access agenda aggressively, to consolidate existing preferential market access offers and to diversify the foreign market options for its products.

2. Preferences under the United States’ African Growth and Opportunity Act (AGOA) and the EU’s Everything-But-Arms Initiative (EBA)

So far, Ethiopian producers have captured the AGOA preferences to a much lesser extent than some other AGOA eligible countries. Although the Government has put in place an AGOA Response Strategy and support is also offered by the United Nations Economic Commission for Africa as well as USAID, there still appears to be lack of awareness of AGOA opportunities. Most eligible enterprises in Ethiopia do not take full advantage of AGOA because they lack information about market opportunities in United States and face supply capacity constraints. Yet, AGOA appears to have helped attract considerable FDI and to establish linkages of Ethiopian firms with large international distribution chains in the clothing and footwear sectors. After its recent extension to 2025, AGOA will continue to provide advantageous market access to exporters from Ethiopia and allow for a rapid expansion of Ethiopia’s manufacturing exports to the United States.

The non-reciprocal EBA initiative has been introduced by the EU for an unlimited period of time and, in principle, is not subject to periodic review and renewal.²⁵ The EBA initiative also provides for a transition period of three years after LDC graduation (EC 2013).

²⁵ One common criticism of GSP schemes and other non-binding unilateral preferential schemes for developing countries has been the uncertainty of such trade regimes stemming from their annual renewal. Donor countries can exclude countries and products or alter the procedures at any time when such preferential schemes are reviewed. Not being subject to periodic renewal, the EBA initiative reduces the uncertainty of preferential market access. However, being adopted within the GSP framework, the EBA arrangements can be modified

In some cases, however, restrictive Rules of Origin can act as a constraint on exports (Cernat et al. 2003). This is of particular relevance for the clothing sector, where many inputs to production in Ethiopia still have to be imported.

3. Accession to the COMESA FTA and the IGAD Minimum Integration Programme

The most immediate challenge is to complete accession to the COMESA FTA. This appears to have the greatest economic potential, and negotiations are the most advanced. Following a *Study on Competitiveness of Ethiopian Firms for Participation in the COMESA FTA*, funded by the COMESA Secretariat and completed in the last quarter of 2013, the Government of Ethiopia has made a decision to join the COMESA FTA in a phased manner.

The Study mentioned used the unit cost ratios (UCRs) methodology to compare production costs of Ethiopian manufacturing industries with those of other COMESA FTA members. On this basis, it divided the Ethiopian manufacturing sector into four broad categories:

- (a) Only eight manufacturing activities (18% of the total) were found to be competitive, with UCRs of less than one. These were: prepared animal feeds; sugar and sugar confectionary; paper and paper products; pharmaceuticals, medicinal chemicals and botanical products; chemical products; cement, lime and plaster; ovens, furnaces and furnace burners; and other general purpose machinery.
- (b) Three manufacturing activities (7%) had UCRs greater than 1.5, and were therefore considered to have little hope of being competitive, leading the report to recommend that these should immediately be subjected to competition. These are: knitting mills; wood and products of wood and cork, except furniture; and other fabricated metal products. The Study proposed that tariffs on products in these two categories (representing 25% of manufacturing activities in all) should be fully abolished as soon as Ethiopia joined the COMESA FTA.
- (c) Eleven (24%) of manufacturing activities had UCRs between 1.0 and 1.1, implying that they would be marginally uncompetitive if tariffs were to be removed. Tariffs on these items could be phased out over time as part of the FTA with relatively low intervention requirements.
- (d) 51 percent of manufacturing activities had UCRs were between 1.1 and 1.5, indicating that they were lagging behind the competitive threshold by a margin of 10 to 50 percent. The authors of the Study considered that strong competition-enhancing capacity-building interventions were required to allow tariffs on these goods to be phased out gradually.

Based on these findings and recommendations, Ethiopia has drawn up a roadmap for joining the COMESA FTA in a phased approach as follows:

- Goods in categories (a) and (b) would have their tariffs eliminated in 2014-15, when Ethiopia joins the FTA.
- Goods in categories (c) and (d) would have their tariffs reduced by 30 percentage points in three equal annual instalments, starting in 2019.
- Ethiopia would thus become a full member of the FTA in 2021.

unilaterally by the EU. Preferences for developing (LDC and non-LDC) countries under the GSP scheme are subject to periodic renewal (Cernat et al. 2003).

- Between 2014 and 2019 the Government and the Ethiopian private sector are expected to undertake competitiveness enhancements in the form of capacity building activities to prepare firms for the tariff elimination that will start in 2019.

While understandable, this cautious and gradual approach does not take full account of the improvement in the price competitiveness of Ethiopian industries which may be expected from implementation of the Logistics Strategy as part of GTP II, through reduced costs for transport and imported inputs and shorter delays.

Preliminary information suggests that some manufacturing sectors, such as textiles and clothing, footwear and other leather products, are already highly competitive, both in the region and internationally, despite the high costs and inefficiency of trade logistics; and that there may be significant potential regional markets for others, such as vegetable oils and other agro-processed goods; chemicals and light engineering. If these findings are confirmed, there may be a case for considering an acceleration of tariff reduction in these sectors in the context of accession to the COMESA FTA.

While Ethiopia has also agreed to implement the recently proposed IGAD Minimum Integration Programme, this will provide little or no additional benefit, as all members of IGAD are also members of COMESA (except Somalia, which is eligible to join COMESA if it so wishes, and Eritrea). Thus, if the IGAD Minimum Integration Programme uses the COMESA FTA rules and regulations, it will add no value; but if it uses different procedures and Rules of Origin, it will merely add to the “spaghetti-bowl” of regional integration and trade arrangements in Eastern and Southern Africa. Ethiopia should therefore give the highest priority to the COMESA FTA negotiations.

4. The Economic Partnership Agreement

Another area which requires urgent attention and monitoring is the negotiations for an Economic Partnership Agreement (EPA) with the European Union. Ethiopia is among the proponents of including a “development benchmark” in such Agreements, providing that market-opening commitments should be adopted by developing countries only to the extent that they are justified by these countries’ development needs. Conversely, the European Union prefers any concessions to the development needs of its partners to take the form of specific exceptions or extended phase-in periods for their commitments. The partners to the EPA negotiations are also split over several other issues, including rules of origin, export taxes, the extension of MFN treatment to other regions, and intellectual property rights.

For African LDCs, including Ethiopia, the perceived need to finalize the EPA negotiations is reduced by their already favorable access to the EU market through EBA preferences. Nevertheless, Ethiopia should monitor developments in EPA negotiations closely, and assess the potential impact of any Agreements concluded on Ethiopia’s capacity to export to the region and its competitiveness.

5. Accession to WTO

5.1 The rationale for WTO membership

For Ethiopia, the implications of accession to WTO arise primarily at the international political level, and in relation to Ethiopian economic policies, rather than to any improvements in access to foreign markets, although these will become more relevant once Ethiopia has achieved its objective to become a middle-income country and its exports will no longer benefit from LDC preferences. Moreover, only WTO members enjoy access to the facilities of the institution. The most important of these facilities is the WTO dispute-settlement process, under which even the smallest countries may challenge other WTO

members' measures that may violate their rights. Considering the fact that there has never yet been a complaint brought to the Dispute Settlement Body by any African country, however, dispute settlement may be much less important in practice than it is in principle.

On the other hand, joining WTO would imply commitments by Ethiopia regarding access of foreign firms to its own markets for goods and services. It would also require numerous other changes in its legislation to comply with WTO norms.

WTO accession will also require the country to adopt significant changes in some of its economic policies. Commitments made in this context imply concessions that could reduce Ethiopia's policy autonomy, as is the case for all other WTO members and for all other international agreements which the Government is engaged in. On the other hand, the accession package may also offer opportunities in the implementation of policy reforms.

Regarding these opportunities there is a broader tension between the principles of the WTO system and the economic policy approach that Ethiopia has taken in recent years, beyond the challenges that arise from specific commitments (see section 5.2). Ethiopia has been following a "developmental state" model, reserving a strong role for the Government in many sectors of the economy. Some of the more notable aspects of the Ethiopian development model are high levels of public investment in infrastructure and a series of controls on the operations of both domestic and foreign firms, as well as an egalitarian approach to growth and distribution.

The overall tenor of WTO rules and norms tends to discourage state intervention in the economy. This point is especially strong with respect to any laws or policies that discriminate against foreign traders and investors. If the Government believes that the economic achievements of the country have now reached a point where the role of the state might be scaled back, the commitments that have to be made in the WTO-accession process may be seen as a vehicle to undertake potentially useful reforms.

It remains an open question as to how far the incumbent WTO members will go in accommodating Ethiopia's special challenges as an LDC. The formal procedures by which the negotiations are conducted might appear to favor LDCs, with the WTO having adopted guidelines in 2002 and again in 2012 that are intended to facilitate and accelerate the accession of these countries. There are some differences here among the incumbent members: Whereas the European Union generally supports the principle that the demands on LDCs should be limited, the United States has long taken a more demanding position. Acceding countries have sometimes found their accessions delayed by disagreements that erupt between the transatlantic powers over how the general principles of the trading system ought to be translated into precise terms.

5.2 Current state of negotiations

Ethiopia has made some progress in its negotiations on WTO accession since its formal application in 2003. At the time of preparation of this DTIS, the working party on Ethiopian accession had met three times, most recently in March 2012 (following its initial offer on goods), and it is expected to schedule a fourth meeting after the Government of Ethiopia submits its initial services offer. This step could take place soon, as the offer is at an advanced stage of drafting and approval.

As some observers have noted, it is possible that Ethiopian policymakers may have underestimated the complexity of the WTO accession process: they originally aimed to complete the process in 2009 but later extended this timeline to 2013. GTP I was based on the expectation that the accession negotiations would be completed in 2015.

But even this latter timeline has proved to be too ambitious. For GTP II, the primary consideration is the substantive content of the negotiations, especially the need to pursue clear and well-reasoned negotiating objectives that are consistent with the country's development strategy. WTO accession is not an end in itself. Delayed accession with an agreement favorable to Ethiopia is preferable to accelerating accession at the expense of less favorable terms. More than a decade has already been spent in pursuit of that end, and it may require several more years of negotiations. However, it is clear that there must be an end-point for the negotiations, and unnecessarily delayed accession may also have a cost.

During the GTP II period, the main attention of the Ethiopian Government should be on identifying potentially contentious issues that may be raised in the accession negotiations and considering how to deal with them.

5.3 Contentious issues

5.3.1 Intellectual property rights

Perhaps the most controversial aspect of WTO accessions is the negotiation of commitments considered as "WTO-plus".²⁶ The area where this has particular relevance is intellectual property rights, such as patents, trademarks, and copyrights. Of all the issues in WTO accession negotiations, this is perhaps the most frequent area of friction between developing applicants and the developed countries that take the lead in these talks. The concern is not just whether the acceding country's current regime complies with the norms of the Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement), but also whether incumbent WTO members will seek TRIPS-plus commitments. Opinions differ on the extent of adjustment that may be required in order to bring Ethiopia into compliance with TRIPS.

The accession process has already encouraged reform of the Ethiopian intellectual property regime through revisions of existing laws (particularly with respect to patents) as well as the enactment of laws in areas where little or no legislation existed before. There may nevertheless remain some significant sticking points. Hindeya (2011: 109) argues that "the plant varieties protection regime of Ethiopia as it stands now is compatible with the TRIPS Agreement," thus requiring no changes, but also observes that incumbent members of the WTO "may push Ethiopia into joining the UPOV Convention 1991 or agreeing to abide by TRIPS Plus obligations." Birhanu (2011: 137) reaches a contingent conclusion regarding the impact of TRIPS compliance on the availability of pharmaceuticals, noting that in order to make effective use of the flexibilities available under the WTO regime "it is absolutely important for the country to build its own capacity in the pharmaceutical sector through a range of incentives and other policy measures." Gereyo (2011: 164) similarly concludes that adoption of TRIPS will require a more active government policy, including the enactment of "[d]etailed guidelines on the application of compulsory licenses" as well as stricter regulation of pharmaceutical imports. In any case, the Government of Ethiopia needs to examine requests in this area very carefully, and with a view to maintaining Ethiopia's special status as an LDC.

Another issue is the possibility that intellectual property protection may offer opportunities for the promotion and protection of some products unique to Ethiopia, through *Geographical Indications* (GIs) or other forms of protection (see also chapter X). This has already been the subject of some high-profile cases, such as the recent experience with the Ethiopian Coffee Trademarking and Licensing Initiative, which emerged from a dispute between Ethiopian growers and Starbucks. The issue of GIs has not been given due attention in Ethiopia, and

²⁶ The term "WTO-plus" refers to commitments made by applicants for WTO membership that exceed those of the original WTO members.

draft legislation has only recently been prepared. Given the substantial potential contribution of GI for exports of products unique to Ethiopia, it is essential that consultations on the draft legislation are carried out without delay, and that ratification and the establishment of legal and institutional structures and enforcement mechanisms proceed expeditiously.

5.3.2 Trade in services

Negotiations over Ethiopia's services schedule will be especially critical, and the financial and telecommunications services sectors are likely to be the most sensitive. Other sectors, including distribution and transport services, may also be problematic.

Ethiopia imposes restrictions on telecommunications and financial services²⁷ for several reasons. First, there is a concern that, if FDI were permitted in these sectors, it would lead to a concentration of services in the urban areas where they can most profitably be provided, at the expense of rural areas, where an expansion of such services are crucial, in view of strengthening agriculture-based domestic supply chains. Second, there are worries about the possibility that opening-up for foreign service providers could lead to higher costs for domestic firms or lower levels of service in these two important sectors. Yet, several studies have argued that it would be in Ethiopia's own interests to allow for more competition in these sectors (see, for example, Yimer 2011; Kiyota, Peitsch, and Stern 2007; Belete 2009).

The most immediate challenge for the Ethiopian Government is to submit an initial offer on trade in services. One option is to exclude the particularly sensitive financial and telecommunications sectors from such a proposal. It can be anticipated, however, that major WTO members will insist on offers on these sectors. If the Ethiopian Government wishes to advance its accession, it should consider what commitments and reforms it is prepared to make in the financial and telecommunications sectors that are consistent with its own goals and those of its foreign partners.

5.3.3 Trading rights, government procurement and state trading

The topic of "trading rights" may also be among the most contentious items in the negotiations over Ethiopia's accession. At issue here is the question of whether foreign firms in Ethiopia will be permitted to engage in import and export activities on more or less the same terms as domestic firms.²⁸ Trading rights are currently restricted in Ethiopia. Foreign firms are permitted to import raw materials and intermediaries that are used as inputs in their production processes, but are not permitted to sell any such imported items in those same conditions in the Ethiopian market. Export activities are somewhat more open to foreign investors for goods produced by their own company, but export of several raw materials, minerals, livestock, and hides and skins are reserved for domestic firms.

Some incumbent WTO members maintain that any conditions attached to the right to trade (beyond simple and automatic registration) would violate GATT Article III (national treatment), and argue that the right of foreign-owned businesses to trade should not be restricted to importation for production purposes and exportation. They have also stated that limitations should not be imposed on foreign firms who wish to be the importers of record,

²⁷ See World Bank data at <http://iresearch.worldbank.org/ServiceTrade/default.htm>.

²⁸ The Investment Proclamation and its Regulation, both dating from 2012, did not explicitly place import trade on the list of reserved sectors, but neither did this activity appear within the definition of sectors where foreign investment is explicitly permitted. These areas are provided for in Article 4 of the regulation, as supplemented by an attached schedule that lists both the permitted areas and the duration of any income tax exemptions that may be provided as incentives for investment. One of the sectors on this positive list is "[i]mportation of LPG and bitumen." No other import activities are listed, and Ethiopian investment officials affirm that this means that the importation of any other finished product falls within the scope of activities that are reserved for domestic investors.

and have asked acceding countries to confirm that importers of record are not subject to limitations on equity and are not required to invest in the acceding country.

Several other countries that have acceded to WTO have made commitments on this issue, even though some analysts view these demands as WTO-plus. The typical commitment is one in which the acceding country confirms that upon accession “all of its laws and regulations relating to the right to trade in goods, and all fees, charges or taxes levied on such rights would be in full conformity with its WTO obligations, including Articles VIII:1(a), XI:1 and III:2 and 4 of the GATT 1994 and that it would also implement such laws and regulations in full conformity with these obligations.” The incumbent members may also make additional demands, such as a commitment that any registered entity could be an importer or exporter of record. Sometimes, transition periods of months or even years are allowed so as to permit adjustment to the new regime.²⁹ This subject needs careful examination, based on a review of the costs and benefits of alternative approaches available to the Government of Ethiopia.

Issues may also arise concerning requirements that may be imposed upon foreign investors in their contracts with government entities such as the Privatization and Public Enterprises Supervising Agency (PPESA). Some such arrangements reportedly require investors to achieve certain levels of domestic content or exports, raising questions regarding their compatibility with the requirements of the Agreement on Trade-Related Investment Measures (TRIMs).³⁰ Ethiopia should determine in advance whether any agreements that investors reach with the PPESA include commitments that may be inconsistent with these provisions.

The TRIMs Agreement does not ban export performance requirements (i.e., requirements that investors export some specified percentage or value of their production). However, some acceding countries have made TRIMs-plus commitments regarding export performance requirements; and some obligations that foreign investors in Ethiopia are reportedly asked to undertake might be inconsistent with such commitments. Ethiopia should therefore examine whether these issues are likely to arise in the negotiations and which options may be available.

Finally, State trading may also be at issue in the negotiations. The Ministry of Industry is in the process of establishing an enterprise dedicated to the purchase of imported supplies for the leather and cotton industries. While this initiative is intended to address the recurrent problems encountered by these and other industries in the management of their supply chains, the operation of the enterprise may also raise questions on the part of certain incumbent WTO members for whom state trading is a persistent source of concern. Related issues that may be raised by some countries include allegations that some government procurement does not occur through a tendering process, and the establishment of state monopolies in some sectors.

These issues, as well as others that may arise in the Ethiopia’s WTO accession negotiations (e.g. export taxes on hides and skins), should be clearly spelt out in Ethiopia’s trade strategy, the key elements of which should be aligned with Ethiopia’s overall vision and incorporated in GTP II.

²⁹ More details on the standard and extended commitments that applicants have made on trading rights can be seen by examining, among others, the working party reports on the accessions of Oman (2000), Cambodia (2004), Saudi Arabia (2005), and Viet Nam (2007).

³⁰ Article 2.1 of the Agreement generally bans “any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.” The prohibited TRIMs are further defined in an Illustrative List that forms an annex to the Agreement, which includes (among others) any requirement concerning “the purchase or use by an enterprise of products of domestic origin or from any domestic source” or that restrict “the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise.”

PART III:

Enhancing the efficiency and trade competitiveness of domestic firms

Successful integration of Ethiopia's economy into international trade largely depends on the efficiency and competitiveness of its private firms, on international markets with a view to increase their exports, and on the domestic markets with a view to compete with imports. At the firm level, the efficiency of production and management matters greatly for international competitiveness. At the sectoral level, the functioning of the supply chain is a key element for overall efficiency; and at the national level, the provision of education and vocational training, infrastructure and trade facilitation, as well as access to financial services, determine the extent and speed of Ethiopia's international trade integration.

Focussing on the sectors that are receiving priority attention in Ethiopia's agriculture-based export-led industrialization strategy, Part Two of this DITS aims at providing a comprehensive picture of past policies, the current situation and the remaining challenges in these different areas.

Considerable challenges remain for Ethiopia with regard to accelerating investment for upgrading the production capacities. These challenges are related partly to the willingness of domestic entrepreneurs and foreign companies to make such investments, partly to the possibility of financing them.

However, even improvements in all these areas would not automatically lead to better integration of the prioritized sectors in international markets. An important additional element is the way in which Ethiopian producers approach the international marketing of their products, including through integration into global supply chains, and how the Government can support them in this regard.

The analyses in Part Two, based on insights gained from field missions and numerous interviews with stakeholders, as well as on comparisons with successful experiences in other countries, show that current policies and private sector efforts in Ethiopia mostly go into the right direction. They also indicate that some elements of the development policy need to be adjusted or refined, and its implementation improved. Accordingly, the recommendations derived from these analyses are aimed partly at indicating areas where current policies should be strengthened, partly at suggesting innovative measures.

Chapter V:

Increasing efficiency by enhancing professional skills and domestic supply chains

1. Introduction

In recent years, technical inefficiencies and inadequate domestic supply of raw material inputs have been constraining firms operating in the prioritized export sectors (Abegaz 2013, Mezgebe et al 2013; World Bank 2012) and are responsible in large part for the failure of the underperformance of these sectors relative to the strategic targets of GTP I. These constraints are reflected in low capacity utilization and frequent inability to deliver the quantity and quality of goods requested by foreign clients. Other reasons for suboptimal efficiency are a lack of suitable skills among the work force, of know-how and sense for entrepreneurs among factory owners and managers, and outdated and badly maintained equipment.

The inadequate availability of agricultural raw materials, especially cotton and raw hides and skins, contrasts with the large domestic supply potential for such goods. The gap between the actual and potential supply in these areas indicates a lack of capacity among agricultural operators to raise the quantity and quality of their output in line with the needs of the fast growing manufacturing sectors, but also shortcomings in the management of the domestic supply chain.

This chapter will first address the problems and challenges related to insufficient human resource capacities before turning those that are related to supply-chain management.

2. Upgrading skills and managerial know-how

2.1 Challenges arising from the current situation in the prioritized sectors

Currently there is a general shortage of adequately trained manpower and qualified personnel in the prioritized sectors, including at the various levels of management. Apart from significant weaknesses in machinery and information and communication technology (ICT) compared to competing producers in other countries, the way in which the existing equipment is handled is often sub-optimal, and there is also a lack of qualified personnel for maintenance and repair of the old machinery. Moreover, there is a big gap in aptitudes to use whatever is available in computer-assisted production technologies. The problem arising from skill shortages is exacerbated by high labour turnover and absenteeism, especially in the clothing sector, where the requirement for incoming skills is relatively low but learning on-the-job and experience matter for productivity. At the managerial level, insufficient competences in factory layout and material flow management have often caused a sub-optimal allocation of resources and inputs. Even though the Government has been putting considerable efforts to expand technical and vocational education and training vocational (TVET) institutions and universities, the capacity of these institutions to produce the required quality of manpower in the prioritized sectors is still insufficient.

2.1.1 Vocational education and training

It appears that technical vocational and educational training (TVET) has not intensified in line with the need of sector-specific labour skills in the prioritized industries. In 2012/13 there were 437 TVET institutions in Ethiopia, compared to 458 five years before. Surprisingly,

TVET enrolment also declined from 308,501 students in 2008/09 to 237,877 in 2012/13.³¹ This past trend is inconsistent with the objective of developing a vocationally trained workforce that is necessary in order for the export-oriented trade industrialization strategy to succeed. According to a draft ‘Human Resource Requirement Plan for Selected Manufacturing Industry 2015-25’ prepared by the Adama Science and Technology University, the manufacturing sector would need 2 million technicians in order to increase the share of manufacturing in GDP from 4.5 percent in 2014 to 18 percent by 2025. It is unlikely that this projected demand can be met without a strategic approach that includes a steep increase in the number and quality of TVETs graduates as well as the setting up of manufacturing-focused technical institutions.

2.1.2 Higher education and universities

Capabilities for entrepreneurship and business management can sometimes emerge from work experience at the lower operational levels, but most likely they are acquired through higher education. Ethiopia is well equipped with high schools. Currently there are about 32 public universities and a good number of private universities. Thirty of the public and all private universities were opened in the last twenty years. Currently around 500,000 students are enrolled in the public universities alone and the number is planned to rise to 600,000 by the end of GTP II. Overall, the trend in public and private higher education enrolment is in the order of the human resources required at this level. Moreover, the distribution of students in the public universities between the scientific and technological faculties (around 70 percent) and the social and arts faculties (around 30 percent) is consistent with Ethiopia’s industrialisation agenda. In the public universities, about half of the science and technology graduates are in the fields of civil and survey engineering as well as architecture, which bodes well with the current boom in construction and infrastructure development. What is also needed is a much larger enrolment of electrical, mechanical, materials and chemical engineers, as well as a greater number of undergraduates in higher education in ICT that could sustain the manufacturing growth phase.

The role of universities in supporting integration of the Ethiopian manufacturing sector into international trade goes beyond education, and extends to the development of research centres of excellence in relevant industrial vocations that collaborate with sectoral institutions in the areas of product and process design and development. Research institutions that could play enhanced roles in this context include the Institute of Textile and Fashion Technology and the Textile Garment Research Centre of Bahir Dar University, the Addis Ababa and Adama Science and Technology Universities and the Institute of Technology of Mekelle University.

2.1.3 On-the-job training

It is true that higher secondary and high school enrolment is not necessarily correlated with export success. This depends on whether the instruction in these educational establishments meets the competence requirement in the export sectors. It is also true that many of the required skills for the workforce at the lower levels can be acquired through on-the-job learning. In any case, the absence of a sufficient amount of qualified graduates coming from the public educational institutions, additional training requirements arise at the practical level and within manufacturing firms.

Most of the larger companies in Ethiopia have effective systems for in-house staff training and development, whereas the smaller ones rely on external support for such training. Therefore, the industry co-ordinating institutes and sector support associations must assume

³¹ Regrettably, more recent data was not available at the time this Study was prepared. Although enrolment is likely to have increased in the past two years, these figures suggest that increasing TVET capacity and enrolment remains a major challenge in Ethiopia.

an important role in workforce training and in the development of managerial skills through tailor-made technical, supervisory and managerial training and associated support packages.

2.2 Skill-related challenges in the agricultural sector

Insufficient quantity and poor quality of raw material inputs result, to a large extent, from inappropriate cultivation and harvesting techniques as well as from poor animal husbandry (see also section 3). This is owed in part to insufficient financial possibilities among small agricultural enterprises to invest in modern equipment, but in part also to insufficient knowledge of smallholder farmers.

There is no doubt that many skills acquired and developed over generations in agricultural activities may well merit to be preserved, not least because of the rapidly increasing demand in export markets for products based on organic agriculture. However, these skills have to be refined further and be complemented by modern farming techniques and equipments. In this area, better production know-how is already disseminated through the State's extension system. However, business, managerial and technical skills are rather limited in Ethiopia's agricultural sector, although they are key elements in efforts to strengthen the domestic supply chain and to use Ethiopia's comparative advantages to much larger extent than in the past.

A large part of the raw material for the agro-industries, and the textiles and leather sectors is still provided by small enterprises, often cottage and micro-scale farms operated by a family or one or two employees. Therefore, strengthening rural cooperatives can contribute to an improvement, if these can offer training programmes for productivity enhancement and animal husbandry. Cooperatives or producer associations also offer possibilities for sharing modern farming equipment among their members and commercialising the relationship between agricultural operators and the manufacturers at the subsequent stage of the supply chain.

2.3 Recommendations to strengthen human resources and innovation capacity

Measures to advancing the skills and competences of managers and workers in the manufacturing sector and farmers should include the following:

- The number and enrolment capacity of TVETs should be increased, and young people, especially young women, should be encouraged to enroll in these institutions. The promotion of on-the-job skills training as well as sustained and comprehensive intra-industry collaboration in the areas of technical and managerial training is critical in the effort to raise efficiency in the prioritized sectors.
- Expanding the training of existing sectoral institutions and associations requires that their own capacity to deliver such services is reinforced. Government-sponsored expert support from corresponding firms in other countries should be expanded.
- Training the trainers programmes are essential for enhancing targeted professional education in TVETs as well as for training provided by sectoral support institutions. Setting up a centre that continuously provides such training should be considered.
- It is vitally important to align the curriculum and instruction of TVETs with the specific workforce and skill requirements of the prioritized sectors, through greater cooperation between public education and training institutions, on the one hand, and private firms and their sectoral associations, on the other.
- Agricultural extension work should be intensified further, with a focus on capacity building among farmers and agricultural enterprises to better meet the raw material quality requirements of manufacturers in the prioritized export sectors.

3. Strengthening the supply chains in the prioritized export sectors

3.1. The importance of the domestic supply chains for Ethiopia

The Ethiopian Government's prioritization of the textiles, leather and agro-processing sectors is appropriately founded on the country's comparative advantage in the provision of raw material inputs to these sectors. Due to Ethiopia's landlockedness, there is a strong case for focusing on sectors which offer the greatest potential for domestic forward and backward linkages. However, such an approach is critically dependent on a clear trade strategy and logical sequencing of policy implementation.

Achieving the objective of export promotion relies heavily on local sourcing of inputs by the producers of finished products. In order to enhance its export markets, Ethiopia must be prepared to meet the expectations of these markets regarding quality, safety, productivity and timeliness (see chapters VI to VIII). This requires domestic supply chains to meet the same standards. Offering incentives to potential investors, whether domestic or foreign, to build the capacity to add value to local primary production and to produce finished products for export will serve little purpose if these investors find they cannot source inputs of adequate quality from local suppliers and at a competitive price.

From the point of view of Ethiopia's agriculture-based export-oriented industrialization strategy, domestic value chain integration has two aspects. On the one hand, domestically available raw materials should be used, to the largest extent possible, by domestic manufacturers for further processing, i.e. value addition, instead of being exported at the pre-manufacturing stage. From this perspective, bottleneck exists at the processing stages, i.e. insufficient capacity and capability to process existing agricultural output, as, for example, in the case of coffee and live animals. On the other hand, it is important to ensure that manufacturing firms in the export sectors can draw to the largest extent possible on domestically-produced agricultural inputs. Here, bottlenecks have arisen from insufficient quantity and quality of raw material inputs to the export industries, despite the fact that there is huge, hitherto unused, domestic supply capacity for such raw material inputs. This is the case of some other agricultural food products, raw hides and skins and, especially, cotton.

Due to these supply chain bottlenecks, Ethiopia has exploited its comparative advantages, of a favourable climate and soil for agricultural food and cotton production and a huge cattle population, only to a very limited extent and continues to rely on imports of raw materials and intermediate goods that could be produced in much larger quantities domestically.

3.2 Current supply chain problems

During the GTP I phase, the shortage, unreliability and cost of inputs have represented critical and binding constraints for the export industries. They have significantly slowed the expansion of these industries and their ability to compete successfully with producers from other countries. These constraints are being felt at several stages of the supply chain. First, at the level where raw materials are provided for further processing in the agro-industry or the textiles and leather sector. Second, at the stage where intermediate products enter processing further down the value chain, such as textile yarn into textile fabrics and the latter further into the manufacturing of garments, or leather into footwear, gloves and other leather goods. At this level, products of other industries, especially chemicals but also tool making and accessories, also enter the respective value chains. At the final manufacturing stage, packaging and labelling materials also become parts of the value chains of Ethiopia's three prioritized export sectors. In all these areas serious constraint have been felt in recent years.

The domestic value chains in the export industries are not well integrated and most participants in the supply chain operate independently instead of interdependently. Especially

for small and medium-sized enterprises (SMEs) this has resulted in a significant under-utilization of the existing capacity which in turn is reflected in higher unit production costs.

The supply chain of the agro-food processing sector overlaps with that of the textiles, clothing and leather industries insofar as the supply of cotton partly faces constraints that are similar to those in the supply of food crops, and as the supply of raw hides and skins is closely connected with local meat production and consumption.

3.2.1 Agricultural raw material production and marketing

Increasing the volume of raw material inputs to the prioritized sectors needs a better use of Ethiopia's natural endowments as well as a productivity increase in the agricultural sector.

Commercial agriculture³² accounts for a small share of Ethiopia's agricultural output. An estimated 97 percent of agricultural production comes from small-scale subsistence farmers. Their traditional farming and harvesting practices often compromise product quality. Small-sized farms dispose of only very basic production techniques, have poor storage facilities and lack adequate information as to processors' product requirements. Only few smallholder farmers are organized into market-oriented farmer associations and cooperatives, thus limiting the possibility of pooling resources with a view to meet challenges such as access to seeds, fertilizers, storage, transportation, grading and packaging. An expansion of commercial cotton farming would be instrumental in raising agricultural output and improve its quality. Although a few large agricultural producers already exist, there has been no comprehensive strategy so far to support the transition from smallholder to commercial farming.

Since irrigation is rare, both the quality and quantity of output is constrained by the strong dependence on rainfall, which is very irregular. For example, the productivity of large-scale irrigated cotton farming is about twice that of small-scale rain-fed farming.

The quality of agricultural food items and cotton is affected by inappropriate cultivation, harvesting, transport and storage practices. In addition, many plantations are seriously attacked by pests, as the availability of measures and products to prevent or fight such pests is very limited in the rural areas. While the large commercial farms use chemicals to protect their plantations and achieve a higher yield per hectare, the small farms do not have sufficient financial resources to do so.

Similarly, poor animal husbandry and animal slaughtering practices are a major cause for insufficient supply of raw hides and skins and for their inferior quality. Most Ethiopian livestock owners are not oriented towards good quality or unable to practice better feeding, watering and breeding. The problem is compounded by the inadequacy of disease control, veterinary services and slaughtering practices, as well as by –frequently illegal – export of live animals.

Whereas the rapid expansion of processed vegetables exports is an indication of the success of Ethiopia's efforts to develop a specific sub-sectoral value chain, the performance of the processed coffee sector has been surprisingly poor. Coffee is one of the emblematic products of Ethiopia, but the country has only specialized in the production and export of unroasted coffee, rather than taking advantage of the dynamic world demand for roasted coffee and coffee preparations.

Insufficient domestic supply of agricultural inputs in the presence of rising domestic demand also results from considerable inefficiencies in the collection and marketing of agricultural products. Supply chain management is rendered particularly difficult by the large number of

³² Unless otherwise indicated, the terms "agriculture" and "agricultural products", as they are used in this section, include livestock breeding and raw hides and skins, respectively.

actors involved. Moreover, domestic marketing systems are largely informal. They consist of small and medium scale private traders, who are unable to benefit from economies of scale, lack access to capital and packaging technology, and have only limited marketing skills. Long handling chains between farmers in rural areas and processors in urban areas contribute to high post-harvest losses, quality deterioration and contamination. In leather and cotton, in particular, the domestic supply chains involve an excessively large number of intermediaries and lack appropriate standards for the collection and quality classification and thus, sufficient price incentives to act as premium for superior quality. Schemes that aim at linking the production and processing parts of the value chain, such as the Ethiopia Commodity Exchange, are still in the early stages.

3.2.2 Intermediate goods

Increasing the volume and quality of inputs of domestic origin also represents a challenge further down the value chains, i.e. the production of garments from textile fabrics and the production of leather goods from finished leather. The number of actors is much smaller, relationships between suppliers and users are commercialized and a number of firms are vertically integrated inside. The bottlenecks, at this stage, mostly result from those at the preceding stage of the supply chain. Ethiopia's producers of textiles and clothing must import a large share of their textile inputs, because potential domestic suppliers fail to produce sufficient quantities of intermediate goods of the type and quality required. It is also the weakness of ancillary industries in providing the required chemicals, tools, accessories, labels and package material that affects the domestic supply chains, especially in the textiles, clothing, leather and leather goods industries. In the leather industry, almost all non-leather inputs have to be imported due to the impossibility of sourcing them locally.

3.3 Strengthening the domestic supply chains

3.3.1 Agricultural production

Further development of the prioritized export industries must focus on the linkages between agricultural production and agro-food processing, as well as textiles and leather manufacturing. With a view to meeting the most binding constraint for producers in these sectors, there is need for a coherent strategy to raise the quantity and improve the quality of agricultural inputs.

Efforts to exploit Ethiopia's comparative advantages in the prioritized export sectors – and for that matter in the tourism sector – have to begin at the level of agricultural production and its marketing in the rural areas. The challenge for the Government in this context is to promote a substantial increase in agricultural production by extending the cultivated land area and to support increased vertical integration of the domestic supply chains. This will require close coordination of actions by the different Ministries involved, especially the Ministry of Agriculture and Rural Development, the Ministry of Industry and the Ministry of Trade, as well as cooperation with industry support agencies at the different levels of production.

In order to increase raw material inputs to the agro-food and textiles industry, substantial financial resources have to be mobilized to improve rural infrastructures, including water utilities, irrigation systems and transport facilities. Another challenge is to lead the private actors to create greater production and marketing units.

Farmers have to be made more aware of the critical importance of reliable supplies and better quality, as well as of the advantages of long-term commercial arrangements with actors in the agro-processing, textiles and leather industries, and in tourism hospitality services. In combination with this, improving horizontal linkages between farmers, for example via

market-oriented farmer associations or cooperatives, would be beneficial for creating economies of scale and facilitating post-harvest handling.

Agricultural extension services so far have had some success in improving farming and harvesting practices, as well as in raising productivity and controlling for diseases. These practices are important not only for the individual farm or rural community, but for the system as a whole. The challenge is therefore to combine strengthened extension services with a coherent, medium-term strategy to accelerate the commercialization of agriculture. Serious attempts have been made at the institutional level to address the challenge of quality assurance. Institutions like the National Metrological Institute, the Ethiopian Standards Agency and sectoral institutions, such as the Textiles Industry development Institute and the Leather Industry Development Institute, are key to improving quality and to disseminate a sense for the compliance with product standards (see also chapter VI).

3.3.2 Marketing of raw materials and intermediate inputs

The Government has recognized that some challenges exist in production and marketing of agricultural output. A number of Proclamations and Directives have been passed to strengthen supply chains, and the challenge now is to set up a strategic actions plan to rigorously implement this legislation. The Government has also initiated setting up of industrial input supply enterprises to address shortages of intermediate goods, such as cotton and leather. If operated effectively, this could be one element of enhanced supply management. In any case, at the stage of raw material collection and marketing, it is essential to develop the markets in a way that they transmit incentives to produce more and better quality raw materials.

The Government is also supporting the creation of cooperatives and the organization of producer groups. Yet, due to lack of management and organizational know-how, these institutions may also lack business orientation and their dependability is thus limited. In order to improve the consistency and reliability of input supply to the prioritized export industries, dealing with such organizational shortcomings should receive priority attention.

To strengthen vertical integration within the value chain, the contract farming and livestock breeding should be extended to enable agricultural producers to enter into legally binding agreements with the processors. Such contracts could benefit both sides: processors would have greater security in their access to crops or livestock products, while agricultural producers would be enabled, and also obliged, to employ specific production methods and to deliver a certain output quantity and quality. In return, they would have stable and secure outlets for their production, and could be provided with better access to inputs, such as equipment, seeds and fertilizers or animal feed, and technical and financing support.

With higher productivity in agriculture and livestock breeding and slaughtering, the prices, agreed contractually before the actual production takes place, could be lower than the imports' prices of imports, but they should be high enough to prevent agricultural producers from seeking to export their raw products directly, including through informal channels. The possibility for contract farming depends, however, on two factors. One is the sense for contractual obligations on the side of the agricultural producers, which is not yet well developed. The other is the structures on the processing side; smaller firms at the first stage of processing, such as tanneries, are likely to be less able to enter into such longer term contractual obligations vis-à-vis agricultural producers than larger ones that are themselves already better integrated further down the value chain.

Another possible avenue to help address the export industries' raw material supply and quality constraint is establishing a great number of Rural Transformation Centres in combination with industrial parks, as recommended by UNIDO's Programme for Country Partnership Ethiopia. Farmers should be encouraged to sell their output at such centres, including by improving

access to inputs to agricultural production, such as fertilizers, seeds, or animal feed and medication. This could contribute to a less fragmented and more organized, demand-driven and quality-oriented agricultural supply.

3.4 Imported inputs in the supply chain

There is an increasing gap between the fast growth of actual and projected demand for inputs of raw material and intermediate goods by firms in the prioritized sectors, on the one hand, and of the slow growth in the domestic production of these inputs, on the other. This gap is currently being filled by additional imports. If this situation persists, the Government will need to facilitate the import of such inputs to firms in the prioritized sectors, by removing the remaining restrictions to the largest extent possible.

Producers observe that import restrictions in Ethiopia tend to raise the cost of critical intermediate goods and inputs, for example textile fabrics, leather and accessories, thereby influencing the international cost competitiveness of exporting firms. Vouchers, duty drawback and bonded warehouse schemes, while mitigating some of the cost disadvantages, tend to lead to additional administrative costs and burden. It is therefore important to review and evaluate the costs and benefits of imposing import restrictions.

New institutional arrangements may help to reduce the costs of imported inputs. One possible initiative that could help facilitate access to imported inputs is the introduction of an intermediary import enterprise that could improve access to, and lower the costs of, imported inputs. The institution could support domestic firms by identifying the most suitable suppliers for each input on the world market. Moreover, since it would purchase significantly larger volumes than any individual firm, it would have stronger bargaining power in price negotiations. It might also be helpful in accelerating the management of import transactions and customs services (see chapters VII and VIII).

3.5 Recommendations for strengthening supply chains

- A coherent policy to strengthen domestic supply chains must include:
 - a sound institutional framework that coordinates support across all government and non-government institutions and development partners
 - a dedicated support organization that acts as a focal point for the development of the entire value chains in the prioritized export sectors.
- In order to increase the cultivated land area, the Government should lay the necessary infrastructure and promote commercialised farming and the creation of larger agricultural operating units.
- A further expansion of comprehensive agricultural extension services is required to raise agricultural output and farm productivity and ensure better quality of raw material inputs to the prioritized export sectors, through improved farming and harvesting practices, and pest and animal disease control.
- The Government should develop a strategy aimed at a transition from primarily smallholder farming to commercial farming in larger production units. Stronger promotion of the creation and expansion of rural cooperatives may be useful in this regard.
- Priority should be given to foster agricultural cooperatives and producer associations to improve the consistency and reliability of input supply to the prioritized export industries, to strengthen their business orientation, and to help remedy existing organizational gaps.

- In line with UNIDO recommendations, a greater number of Rural Transformation Centres (RTCs) should be established, preferably linked to industrial zones. These centres should also provide appropriate storage facilities and help improve the rural-urban improve logistics.
- Contract farming should be promoted, while ensuring, through monitoring by public bodies at the sectoral level, that buyers will not misuse their probably better negotiating position and greater bargaining power at the expense of producers.
- In the absence of an efficient domestic market for raw materials and intermediate products, the establishment of a well-functioning national input supply enterprise, or several ones at the sectoral levels, should be accelerated. Such an entity could also play an intermediary role for the arrangement of bulk imports of other essential inputs, such as chemicals, that are not domestically available.
- A strategic actions plan should be set up for the implementation of existing legislation directed at strengthening the domestic supply chain and for enhancing quality-related price incentives. The actions plan should be carried out in close cooperation with the private sector and with standard-setting agencies.

Chapter VI:

Upgrading to international quality standards

1. Introduction

One of the reasons why Ethiopian manufacturers lag behind in international competitiveness, is the difficulty they face to produce and market their products at international quality standards. In order to take advantage of its trading opportunities, Ethiopia must be prepared to meet the standards and quality expectations of importers and consumers abroad. This holds true for the direct export of agricultural produce, such as coffee, cereals, nuts, oilseeds and sesame, where there is a considerable potential to augment value per unit through better processing, packaging, testing and application of international quality standards. Likewise for flowers, a recently successful sector, enhanced handling and packaging can assist exporters in moving up the quality chain. Similarly, the development of the tourism industry depends in part on the adoption of high quality standards by tour operators, hotels, restaurants, and other actors.

Section 2 of this chapter will provide an overview of the main issues in the area of quality management in the context of Ethiopia's agriculture-led export-oriented industrialization strategy, including national and international aspects. Section 3 will then present the institutional structure for national quality management and compliance with international quality standards as they are laid down in the Agreements on Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT) of the World Trade Organization (WTO). Section 4 will provide an assessment of the remaining challenges for enhancing this infrastructure and for private sector quality management in the prioritized sectors. Section 5 will derive a number of recommendations emerging from this assessment. Sector-specific issues related to quality management in individual sectors will be taken up in Part III of this Study.

2. Key issues in national quality management

The quality of the final export goods is determined by the skills and the technology available, and by the effective quality control at the final stage of the domestic value chain. Product quality at the export stage is also highly dependent on the quality of inputs from the preceding stages of the production chain, i.e. raw materials, such as cotton, raw agricultural food items and raw hides and skins, or intermediate goods, such as textile yarn, fabrics and leather. Quality management is therefore closely connected to the management of the domestic supply chain (chapter V).

In terms of compliance with international standards, Ethiopia is lagging considerably behind other countries. Adhering to certification by the International Standards Organization (ISO)³³ provides a structure for efforts to raise product and process quality and allows for verification and measurement of product and service quality. Certification to ISO standards aims at enforcing a consistent quality of products, services, processes and management systems. It requires compliance with certain minimum quality requirements, which only a minority of Ethiopian producers is in a position to meet.

For Ethiopia's manufacturing sector, particularly in the prioritized export sectors, achieving compliance with international quality standards is therefore a major challenge on the way of

³³ Mainly relevant in this context are ISO standards 9001, 14001 and 22000.

integrating into international trade and value chains. Such requirements may result from contractual obligations vis-à-vis individual buyers, or may be legally imposed by the authorities of importing countries in accordance with international agreements, such as the WTO SPS and TBT Agreements.

Upgrading product quality to international standards is particularly difficult for small local firms or smallholder farmers. They may have little or no experience with systems in which production is dedicated to formal marketing channels, contracts are precise and enforced, proper handling is essential, and accidental or deliberate adulteration of products is unacceptable. While these considerations apply even to the most basic commodities, they become progressively more challenging as Ethiopia seeks to move its exports up the value chain from raw materials to processed and finished goods.

Foreign investment in the manufacturing sectors, and the knowledge and experience in international markets that come with it, may help to upgrade average product quality. However, this will not be sufficient to sustain competitiveness in the long run: the cost, quality and reliability of the inputs required to produce high quality finished products for export are equally important. The experience of other developing countries shows that public institutions play a central role in quality upgrading, *inter alia* by fostering and supporting sectoral producer associations. The latter are the best suited to identify sector-specific quality problems, to facilitate the spread of skills and technologies among producers, and to share quality-related market information.

Rejection of Ethiopian exports in developed countries' markets is mainly due to pesticide residue, mycotoxin content, insufficient hygienic condition and inappropriate labeling. To a large extent, these rejections concern agricultural products, which still represent more than 80 percent of Ethiopia's total merchandise exports, and agriculture-based processed food products,³⁴ but they are also indicative of quality problems in other sectors (see also chapters XI to XIV).

The reasons for rejection vary from market to market and have to be addressed primarily through reforms at the sectoral level. Such reforms need to take place in the framework of a broader National Quality Infrastructure (NQI) for testing, inspection and certification of product quality. An NQI must also include institutions and mechanisms that raise the awareness and sensitivity among producers for the crucial importance of meeting international product standards and enable them to comply with them. A strong NQI can ensure that

- the risk of import rejection at the border is minimized;
- conformity assessment certificates in Ethiopia and the importing countries are harmonized;
- goods pass through borders more quickly because they carry an internationally recognized quality certification; and
- exporters can build a reputation that benefits the economy as a whole.

With Ethiopia's accession to WTO the standards set by the SPS and TBT Agreements will determine access to the markets of other WTO members. Compliance with these standards is not only necessary as a basis for Ethiopian-based companies to successfully compete in global markets, but it is also a precondition for attracting additional FDI by companies that are

³⁴ To address the threat of agricultural product contamination due to pesticide residue, the Ethiopian Ministry of Agriculture launched the Project for Strengthening of Agricultural Pesticide Residue Analysis System (SAPRAS) in cooperation with the Japan International Cooperation Agency in 2011. The goal of the project, scheduled to end in 2015 but with a chance of being extended, has been to increase the number of agricultural products that undergo a pesticide residue analysis through the Quality Monitoring and Pesticide Testing Laboratory (QMPTL) of the Ministry of Agriculture. The SAPRAS-project has achieved remarkable results.

willing to source raw materials or intermediate goods of Ethiopian origin. SPS standards are of greater relevance for the agricultural and the agro-processing sectors, as the relevant regulations are more numerous and also because food is subject to greater scrutiny for its possible implications on health. Technical standards as regulated in the WTO-TBT agreement are of crucial importance for the competitiveness of producers in the textiles and clothing and the leather and leather goods industries.

Ethiopia has already begun to adjust to the requirements of the WTO SPS/TBT Agreements. The NQI has been reformed and serious attempts are made, even in the absence of a comprehensive legal framework, to develop technical solutions and to implement them. Steps have also been taken to provide for more comprehensive and better testing, inspection and certification services, and accreditation. There are also initiatives to strengthen and broaden training and capacity building to help the private sector to comply and conform.

3. The National Quality Infrastructure in Ethiopia

3.1 The role of a National Quality Infrastructure

A NQI is generally understood to be the totality of the policy, legal, regulatory and administrative frameworks and the institutional arrangements that are required to establish and implement standardization, accreditation and conformity assessment services. This should involve international accreditation of domestic entities, public or private.

In the context of Ethiopia's NQI-Strategy the following institutions were created in 2011: the National Metrology Institute of Ethiopia; the Ethiopian National Accreditation Office; the Ethiopian Standards Agency; and the Ethiopian Conformity Assessment Enterprise under the leadership of the Ministry of Science and Technology. Moreover, in order to implement the NQI-Strategy, the Government in January 2015 launched the NQI Forum and the NQI Technical Committee. These institutions are tasked to monitor, coordinate and support quality and standards-related issues. The Technical Committee is also charged to monitor further development of the NQI, including the establishment of uniform standards across the country, and to identify problems within the system that need to be addressed immediately.

The priority areas for the institutional framework of the NQI are the introduction of:

- a national metrology system that ensures correct and consistent measurements and tests required for production, quality control, and certification; it includes operational laboratories for primary and secondary physical standards as well as certified reference materials for chemical and microbiological purposes;
- a conformity assessment and certification system, including internationally recognized testing facilities, as a basis for certification that products and production processes comply with international standards; and
- an accreditation system which evaluates calibration and testing laboratories and other bodies involved in the certification of products, systems and processes, with a view to ensuring that testing facilities and methodologies, and thereby the certification activities, satisfy international standards.

The NQI can only function properly as a whole; lack of competence or absence of any one of the constituents will compromise the effectiveness of the whole system, with attendant negative effects on the business environment. Due to the importance of the various elements of the NQI, it is imperative that the Government plays an active and continuous role in the establishment and sustainability of these institutions, not least because they provide services which typically are not targeted at a specific beneficiary. At present, the adjustment of Ethiopia's NQI to the needs of complying with international products standards, as they are embodied in the WTO SPS/TBT agreements, is still work in progress.

3.2 The National Metrology Institute

The National Metrology Institute (NMI) oversees Ethiopia's industrial and scientific metrology. It is responsible for the maintenance of Ethiopian National Measurement Standards and Certified Reference Materials. The Institute's objectives are to:

- develop a modern national metrology system based on international accepted practices, compatible with international systems and supported by metrology-related technology transfer;
- establish and implement a system that allows for a comparison of Ethiopian National Measurement Standards and Certified Reference Materials with international Measurement Standards;
- build national capacity for maintenance of scientific instruments and provide maintenance services;
- support education and research activities in the field of metrology; and
- provide technical training, consultancy and information services on scientific equipment.

3.3 The Ethiopian National Accreditation Office

The Ethiopian National Accreditation Office (ENAO) was established only recently and is still in the process of building its operational structure and resources. It is mandated to accredit Conformity Assessment Bodies to perform specific activities, such as tests, calibrations, certifications or inspections. The ENAO Council under the Ministry of Science and Technology governs the strategic direction of ENAO.

ENAO is to provide an internationally recognized national accreditation service aimed at:

- supporting the credibility of Ethiopia's NQI;
- enhancing the protection of consumers; and
- improving the competitiveness of Ethiopian products and services, in terms of both compliance with publicly regulated standards and reaching voluntary quality objectives.

ENAO aims to assure trading partners that the accredited Ethiopian Conformity Assessment Bodies are competent to test, calibrate, inspect and certify according to their requirements. Consequently, one of ENAO's current medium-term goals is to gain full international recognition, by peer-evaluation of the International Laboratory Accreditation Co-operation and the International Accreditation Forum.

3.4 The Ethiopian Standards Agency

The Ethiopian Standards Agency (ESA) was established as the national standards body of the Ministry of Science and Technology. It is governed by the Standards Council whose members are appointed by the Government. The mission of ESA is to enable Ethiopian manufacturers and service providers to be competitive in internationally accepted management systems. The Agency determines the design and content of the National Standards mark and authorizes its use. ESA services and activities include:

- the development of Ethiopian standards and national standardization strategies;
- the development of standardization implementation mechanisms and following up on quality control, productivity enhancement and competitiveness of Ethiopian industries;
- the provision of training, consultation services and technical support on standards implementation to industry, businesses, government and consumers;

- the dissemination of information about standards and raising public awareness of the relevance of standards;
- collaboration with the relevant national and international institutions to ensure that technical regulations are developed in line with legal provisions governing world trade, including the establishment of WTO-TBT enquiry points.

ESA is a member of the International Electrotechnical Commission (IEC) and a participating member of the *Codex Alimentarius* Commission. It also contributes to regional standards harmonization activities of COMESA, is a council member of the African Regional Organization for Standardization, and can enter agreements on behalf of the Government.

3.5 The Ethiopian Conformity Assessment Enterprise

The Ethiopian Conformity Assessment Enterprise (ECAE), established in 2011, is a State-owned Enterprise, governed by the Ministry of Science and Technology. It is, at present, the only conformity assessment organization in Ethiopia providing certification services. Its main laboratory facilities are located in Addis Ababa and an additional nine branch offices are operational in various parts of the country.

The task of ECAE is to provide, against payment, internationally accepted and recognized certification, inspection and testing services for exporters, producers, service providers, regulatory bodies, importers and consumers. The Enterprise has six laboratories, and it is able to test some 65 parameters:

- (1) The Chemical Laboratory tests food, agricultural products, chemicals and soils. It is the major laboratory. Since it requires very sophisticated equipment the cost of this laboratory is relatively high.
- (2) The Microbiology Laboratory is well equipped but has not been used as it is not yet well known. The ECAE is planning to market the laboratory to potential customers.
- (3) The Mechanical Laboratory tests construction materials, cement, ceramics, hollow blocks and similar products. Its main task is to test the products of the 18 Ethiopian cement manufacturing companies every three months.
- (4) The Leather and Textile Laboratory tests packaging material and stationery and has been accredited for testing cotton yarn.
- (5) The Electrical Laboratory has a good capacity to test wires, cables, circuit breakers, sockets, switches, luminaires, dry cell batteries and solar equipment. Ten experts of this laboratory have been trained in India in order to strengthen its capacity.
- (6) The Radiation Laboratories test for radioactive materials in different food items, cement and fertilizers.

ECAE does not initiate inspections. It enforces standards, if it is requested to do so by the exporters, producers, service provider, importers or regulatory bodies. It also performs third-party inspection for entities that look for an independent evaluation, such as factory inspection, pre-production or production inspection, pre-shipment inspection and supervision of loading. Based on a Memorandum of Understanding with the Ministry of Agriculture, ECAE also performs inspection services at Djibouti for agricultural products destined for exports.

ECAE provides certification services for both management system and product certification. Its product certification services are based on “mandatory” and “voluntary” Ethiopian Standards as per ISO/IEC 17065. Its auditing and certification services include ISO 9001 (Quality Management System). So far, ECAE has certified 50 companies. It is planned that ECAE provides Food Safety Management System Certification (FSMS), for which there are already 4,000 applications.

According to ECAE, the main problems of conformity assessment in Ethiopia are the general lack of modern testing instruments and qualified manpower to operate laboratory equipment. Owing to these constraints, ECAE is currently not in a position to test and analyze most of the relevant parameters for drinking and waste water, food (infant food, packed food, flour, beverages) and agricultural products (honey, oil seeds, cereals, pulses and vegetables).³⁵ Nor is the current capacity of ECAE laboratories convenient for the analysis of environmental, health and safety conditions.³⁶

Currently, ECAE is incurring significant costs of outsourcing tests it cannot perform within its own capacity to Europe and other African countries. This reduces the financial resources available for the acquisition of analytical instruments that are necessary to test food, water and agricultural samples and for training experts. On the other hand, the existing capacities of ECAE laboratories are underutilized, owing to the lack of awareness among producers and low demand for quality management services in general, and testing services in particular.

4. Challenges for the National Quality Infrastructure

4.1 Implementation of quality standards and compliance control capacity

While some adjustments have already been made in Ethiopia's NQI with a view to strengthening compliance with international products standards as they are embodied in the WTO SPS/TBT agreements, the compliance services that can be provided by the different NQI institutions are currently not sufficient. There are parameters for which no testing is available in the country and there are certificates that none of these institutions is accredited to provide. NQI compliance service providers lack capacity in terms of human resources, expertise and equipment (especially in the still nascent laboratory capacity to test for pesticide residues) and suffer from insufficient coordination and limited outreach to the private sector.

Foreign investors may be in a position to comply with the standards and requirements of the international/export markets without much facilitation by NQI institutions. This requires them, however, to make substantive investments into their own facilities and expertise, and acquiring certification from accredited entities in other countries. Domestically-owned companies aiming at strengthening their efficiency and international competitiveness, especially the smaller ones, do not have the financial means and expertise to make such investments and therefore depend on the public institutions for the full range of compliance services.

A critical element of the trade promotion challenge remains the accelerated development and upgrading of the standardization, quality assurance and accreditation architecture in accordance with international standards. However, according to ECAE, a major problem is also the insufficient sensitivity for quality issues among Ethiopian producers and the public at large. Ongoing awareness-building activities for SPS compliance, especially in rural areas, do not appear sufficient.³⁷

Many producers are unaware of the existence of sanitary standards, leave alone the need to comply with them. There is no SPS notification authority or an SPS enquiry point. Eventually, the SPS notification authority is expected to be established under the

³⁵ Such parameters are pesticide residues, heavy metals, mycotoxines, vitamins, phenolic compounds, organo-chlorine compounds, and microbiological parameters.

³⁶ In this area ECAE filed a project proposal in December 2014 on "Food, Water and Agricultural Product Quality Development".

³⁷ Such activities are carried out in particular by the Ministry of Agriculture and the Partnership for Aflatoxin Control in Africa (PACA) under the leadership of the African Union. Agricultural extension workers – over the past years hailed for their strength in number and capacity and for transforming agriculture in Ethiopia – also play a key role in raising awareness, providing advice and capacity building.

responsibility of the Ministry of Trade, and the SPS enquiry point under that of the Ministry of Agriculture. However, the legal process of setting up an SPS enquiry and an SPS notification body has been stalled, since Ethiopia's standing Technical Committee on WTO accession and the SPS Committee have not been active in 2014-15. Nevertheless, the Ministry of Agriculture has undertaken further steps, at the technical level, by participating in the establishment of the IGAD voluntary SPS Committee. But even for firms in the agro-food processing sector that are willing to comply with quality standards and seeking certification services it is difficult to identify a Government agency that would have the information and capacity to issue such a certification or to advise on compliance requirements. Even the existence of the laboratory services of ECAE is not well known.

As for the promotion of TBT standards, ESA has already set up a TBT Enquiry Point, which mainly receives requests for information about Ethiopian standards, including from foreign investors that want to learn about the standards of their host country. Only a limited number of exporters are interested in destination-country standards.

Yet, a key challenge for the textiles, clothing and leather sectors is compliance with environmental standards. The costs of installations for material treatment are very high and prior to the establishment of the industrial zones, textile and garment manufacturers were spread wide geographically and would not opt for a treatment plant as a joint investment. Industrial zones may contribute to alleviate this problem but many local companies consider locating to one of the industrial zones as too expensive (see also chapter VII).

It follows that the textiles, clothing and leather sectors continue to face challenges in the following areas:³⁸

- (1) *Certification:* There is limited knowledge and information of, and access to product certifications based on international standards and importers' requirements, especially for finished products. Since there is no accredited certifying body at the national level, if certification has to be obtained from abroad. This is expensive and places an extra burden on the domestic companies that try to upgrade from textiles to clothing manufacturing. The sectoral institutes such as the Textiles Industry Development Institute and the Leather Industry Development Institute, could play a key role in filling this gap, but they seem to grossly lack capacities and expertise. Additional financial resources would thus be necessary for upgrading these institutes' human resources and technological capacities to fulfil these functions. They would also need accreditation by an international body.
- (2) *Access to comprehensive information about technical standards:* Whereas access to information on national standards is easy, promotional work to ensure their application is still necessary. Information on standards in export destination countries is normally available from importers or local embassies. However, access to important information on packaging and labelling standards is not well developed even for finished products. In order to acquire knowledge and information on standards, companies have to rely on their own research or that of producer associations in their respective sector. Although this information should be available electronically and in a sustainable manner, the

³⁸ See also USAID/Agricultural Growth Project; Livestock Market Development; Value Chain Analysis for Ethiopia: Meat and Live Animals; Hides, Skins and Leather; Dairy - Expanding Livestock Markets for the Small-holder Producers (2013); and USAID/Agricultural Growth Program; Livestock Market Development: End Market Analysis for Meat/Live Animals, Leather and Leather Products, Dairy Products Value Chains - Expanding Livestock Markets for the Small-Holder Producers (2013).

currently limited connectivity and the scant availability of skilled manpower in information technology in relevant government agencies, restricts its implementation.³⁹

- (3) *Product testing*: Local testing for exports is mandatory. The respective regulatory authorities conduct such testing regularly. But, none of them has been accredited and therefore may not be recognized by the foreign importers. For exporters seeking such recognition, product testing and analysis has to be done abroad at high costs. Furthermore, the knowledge about the existence of such services may not be widespread. In the case of finished leather products chemical residues testing based on regulation, directives and standards of the importing countries is a particular challenge.
- (4) *Compliance with system standards*: Although there are some requests by exporters on management system certification, such as ISO 9001 or ISO 14001 including traceability, exporters generally have limited knowledge on system management, and traceability issues in particular, and the impact that such certification has for their competitiveness.

4.2 Private sector awareness and sensitivity

Foreign investor's level of awareness on standards compliance is high, but that of the local companies is very limited. Only a few larger operators in the private sector comply with generally accepted SPS requirements and national rules and regulations. The Ethiopian private sector is not sufficiently aware of the need and benefits of quality management, standards and conformity assessment. It also appears to be insufficiently informed about the availability of guidance, advisory services and training offered by NQI institutions or of their conformity assessment services. It follows that there is strong need for awareness-building in the agriculture-based export industries. Compliance skills, benchmarking and market intelligence also need to be developed.

Raising the sensitivity for quality and awareness of the fact that non-compliance with international quality standards can be a serious obstacle to export success is a major challenge for the Government. At the early stage of the value chain, the current pricing system provides insufficient incentives for quality enhancement. At the level of production of intermediate goods, such as textile yarns and fabrics and finished leather, producers often have limited knowledge on how to improve the quality of their products.

4.3 Problems of coordination in implementation

Although there are a number of agencies to regulate and enforce international quality standards, especially as they are related to food, the regulatory capacity is highly fragmented and the enforcement capacity weak (USAID 2012). With the recent changes in the Ethiopian NQI, and the establishment of sectoral institutes and other support-providing institutions, the system of standards regulation and implementation has become more complex. As a result, there appears to be some confusion, among the institutions and the producers, on the respective mandates and roles, as well as the division of labour.

This confusion relates in particular to the way in which the standards set by ESA should be implemented and monitored. For example, the Ministry of Agriculture requests a standard to be established. ESA then sets up a multi-institutional committee to develop the standard. The emerging standard is then approved by the Standards Committee and becomes mandatory. At the next stage, however, it is unclear who is responsible for the implementation of the new standard, the Ministry of Trade, the Ministry of Agriculture or the Ministry of Industry. This

³⁹ Most governmental agencies do not have official websites on which to publish information, and those that do only publish partial information which, in many cases, is outdated (Kassahun, 2014).

situation seems to arise in part from the fact that the issues of SPS/TBT, standards and compliance may not always be well enough understood in the NQI institutions themselves.

Since the implementation and enforcement of quality standards is a multi-institutional area of interest, there is a need for a strong coordination mechanism which is currently missing in Ethiopia. For example, at the federal level the Ministry of Agriculture claims responsibility for animal health, but certain issues in this area, such as livestock disease, fall under the responsibility of the Ministry of Health. The attribution of responsibilities is even more complicated at the level of the Regions, where there is very little awareness, among both private operators and public agencies, of issues related to quality standards.

A fragmented regulatory framework also poses problems for proper risk management. Some regulatory stakeholders already apply risk management to ensure the proportionality of safety measures to risks.⁴⁰ But a consistent and systematic application of risk management tools requires the participation of all parties involved in the regulatory system, including not only the regulatory authorities, standardization bodies, conformity assessment bodies and market surveillance authorities, but also economic operators (UNECE 2012).

Thus, it is of key importance to strengthen the capacities of the NQI Forum and NQI Technical Committee to lead and coordinate, and the ability of all entities in the NQI to guide their clients to the right place.

5. Recommendations

- *Strengthen the focus on quality*
 - Promoting the use of international standards in the export sectors, including agriculture, manufacturing and tourism, must be a key element of the export-oriented strategy. During GTP II, the Ethiopian trade strategy should give particular attention to the quality of export products.
 - Improvements of product quality and productivity at all levels of the supply chain require structured technical and managerial training. This calls for a better mechanism by which local and foreign experts can assist private operators in factory layout, manufacturing design and product development in line with international standards.
- *Raise awareness in the public sector*
 - There is a need to further invest in the sensitization of staff in the relevant Ministries, institutes and other public agencies for the need to promote conformity assessment, because the level of awareness of the role of international quality standards for export promotion appears to vary significantly from one relevant Government entity to another. The focus of further capacity building in this regard should be on strengthening the public sector's ability to see compliance needs from the perspective of the producers and enhancing the public institutions' service-orientation.
 - The NQI Forum and NQI Technical Committee should be strengthened. NQI institutions operating at the technical levels and servicing producers should seek greater proximity to their clients. This is necessary to improve the knowledge and

⁴⁰ In the context of the WTO-SPS/TBT agreements the proportionality principle is reflected in the provision that measures taken by members should be “no more trade-restrictive than necessary”, and every trade restriction needs to be based on scientific evidence of a risk to the life or health of humans, animals or plants. Moreover, under the SPS Agreement, all measures must be based on the *Codex Alimentarius*, the International Plant Protection Convention (IPPC) or the World Organization for Animal Health (OIE) standards. In case of deviation from these international standards, appropriate risk assessment is required.

understanding among producers of the purpose and the functioning of the NQI and to enable them to address their requests to the right places in the system.

- *Fill the gap of quality-raising services and raise the quality of existing services*
 - The capacity of service providers for testing, certification and inspection for the priority sectors should be evaluated against the priority needs of export companies. It will then be necessary to devise a strategy to make available key missing services and to upgrade existing ones by providing for expertise, enhanced human resources and modern equipment. A priority should be setting up SPS enquiry points and strengthening TBT enquiry points.
 - Improving test procedures with more and better equipment and additional trained experts is essential to ensure that manufacturers in the prioritized export sectors can comply with international standards without having to resort to testing abroad, which generates additional high costs in foreign currency.
 - Enhancing risk analysis and management, in particular at the border, is an element that would lead to smoother functioning of the Ethiopia-Djibouti corridor and, thus, facilitate access of Ethiopian goods to the export markets.
- *Raise private sector awareness*
 - There is an urgent need for further sensitization, capacity building and training on quality and promotion of conformity assessment through outreach and extension work in industry and agriculture by the relevant Ministries and Institutes and other relevant public and private entities. The focus should be on training the trainers, and on innovative solutions, such as using the model of agriculture extension workers to provide services for the prioritized manufacturing sectors, especially for domestic SMEs.
 - NQI institutions should design and implement an outreach strategy that would provide the private sector with clear, reliable and user-friendly information on regulations, conformity assessment services, and quality enhancement services.
- *Strengthen institutional and policy coordination*
 - In order to streamline the NQI it is recommended to map out all regulating entities, implementing and supporting institutions with mandated responsibilities to cover for standardization, metrology and accreditation, conformity assessment and quality promotion (including those that are acting at the sectoral level), to obtain a comprehensive picture on regulation. This would help to identify overlapping responsibilities and to remedy problems, as well as identifying and filling gaps in the NQI.
 - It will also be necessary to design, operationalize and institutionalize a culture of sharing and collaborating across the NQI, including in the promotion, use and maintenance of laboratories, machinery and equipment.
 - Emphasis may be given to strengthening the sectoral Institutes and possibly similar, but more specialized, institutions at the sub-sector level. These should support product development and the improvement of manufacturing process in line with official and private quality standards, including environmental and labour standards.

Chapter VII:

Infrastructure, logistics and investment conditions

1. Introduction

The quality of industrial infrastructure, the transport and logistics system and the overall administrative and regulatory context have a strong impact on the overall environment for business activities and the motivation of private firms to invest in productive capacity. Shortcomings in these areas have impaired the competitiveness of Ethiopian manufacturers, production and export trade. They have also made potential exporters hesitant to turn to external markets and to make greater international marketing efforts for fear of being unable to meet international contracts.

By virtue of their universal relevance to almost all productive sectors, basic public services are of particular importance for the willingness of domestic entrepreneurs and foreign investors to start new industrial ventures in Ethiopia, or to enlarge the production and export capacity of their factories, something that is indispensable for reaching the objectives of GTP II.

Ethiopia has made significant progress in implementing the infrastructure development pillar of GTP I. It is also at an advanced stage in the process of designing a comprehensive Trade Logistics Strategy. A Blueprint Strategy Report (Nathan 2013, 2014a, 2014 b) lists a number of critical factors that have to be taken into account to ensure that the Trade Logistics Strategy contributes effectively to the vision of Ethiopia becoming a middle-income country. These include:

- A reliable communication system, which is essential to most of the advances in transport and logistics envisioned;
- The acquisition of internationally compatible monitoring systems to enable frequent updating of systems and specific services as well as connectivity worldwide without the need to develop special interfaces;
- Electronic exchange of data and electronic money transfers;
- An extended and safe road network to ensure that Ethiopia has good connections within the country (linking rural areas to urban areas) and to each of the neighbouring states;
- The development of strategically placed storage, distribution and collection centres;
- End-to-end railway connections with efficient terminals at the Port of Djibouti and the inland depots developed as public-private partnerships in which services are provided by the private sector; and
- The provision of effective air cargo services for regional cities so that they can become additional logistic hubs, strengthening regional economic spaces.

These infrastructure and logistic issues are overlapping with those related to the overall bureaucratic environment, on the one hand, and those related to trade facilitation, on the other. In this chapter, the infrastructure for public utilities in electricity, water, telecommunications and cargo transport will be discussed first. Section 3 will then assess the situation in the transport, transit and logistic system. Finally, the overall administrative aspects of doing

business will be addressed in section 4. A detailed analysis of the customs-related aspects of trade facilitation will be provided in chapter VIII.

2. Infrastructure

Public investment in infrastructure is necessary not only to enhance the efficiency of existing production and marketing, but also to crowd-in private investment in additional productive resources by both domestic and foreign entrepreneurs. During the GTP I phase, Ethiopia has made significant progress in infrastructure. Overall, its infrastructure indicators compare favourably with those of other low-income countries. Public infrastructure investment has also contributed significantly to the growth of Ethiopia's construction sector and overall GDP growth.

Still, limited coverage, high cost, low quality or unreliability of electricity supply, water and telecommunications constitute a serious constraint on export growth. If local firms do not have access to reliable services in these areas, their production may be disrupted or they are forced to rely on costly alternatives, i.e. generators. Evidence from enterprise surveys suggests that constraints in electric power and water provision infrastructures, together with shortcomings in the transport infrastructure, still are responsible for an estimated 50 percent of the productivity handicap faced by Ethiopian firms.

2.1 Electric power

Inadequate supply of the manufacturing industries with electricity has impacted negatively on the flow of production in the prioritized sectors and has been one of the reasons for low capacity utilization. Increasing the production of electricity and improving its distribution, together with the rapidly expanding needs not only of a growing urban population but also of the manufacturing industries, is the greatest infrastructure challenge for Ethiopia (Foster and Morella 2010). In order to meet the targets of GTP II, Ethiopia's current power generating capacity will need to be doubled.

Ethiopia's power system is one of the least developed in sub-Saharan Africa. But the country is endowed with a vast hydropower potential and in a position produce electricity from this source at lower costs than neighbouring countries. This means that, in addition to meeting the domestic power demand, there is also a potential for exporting considerable amounts of electricity.⁴¹

Ambitious plans exist to expand electrification over the coming years, including the construction a large dam on the Blue Nile with a design capacity of about 5.8 gigawatts, more than four times Ethiopia's total capacity installed today. Yet, it will take considerable time, going beyond the GTP II phase, to develop this hydropower capacity.

Power utilities in Ethiopia are under the control of the state-owned Ethiopian Electric Power Corporation (EEPCO). It has managed to keep electricity distribution losses quite low compared to other low-income countries. As it provides domestic industries with electricity at subsidized prices⁴², power provision represents an important charge for the public budget. With increased productivity in the manufacturing industries there would be scope to gradually raise power tariffs and cost recovery, so that public funds could go into further infrastructure investments rather than subsidizing current consumption.

⁴¹ Foster and Morella (2010) have estimated Ethiopia's export potential for hydroelectric power at 26 terawatt-hours per year, which would generate revenue in the order of almost 2 percent of its current GDP. Mobilizing this potential would, however, require heavy investment not only in power-generating capacity but also in transmission capacity.

⁴² The tariffs applied by EEPCO cover less than 50 percent of the costs (Foster and Morella 2010).

2.2 Water and sanitation

The supply of water and environmentally sound waste water management are of crucial importance for the efficiency and sustainability of industrial activities, in particular in the textiles and leather sectors. In recent years, access to water and sanitation has improved at an impressive speed. Yet, there is still a deficit in water supply compared to the growing agricultural and industrial needs in connection with the agriculture-led industrialization strategy. This deficit is largely explained by very low reliance on boreholes (Foster and Morella 2010).

Strong improvements in water utilities are necessary to upgrade irrigation systems and raise agricultural productivity. At present, only around 3 percent of the Ethiopia's cultivated area can be irrigated. Achieving higher agricultural productivity is a central challenge, not only from the point of view of increasing food production for the fast growing population, but also in order to raise the quantity and quality of agricultural inputs to the prioritized export sectors (see also chapter V for its importance for supply-chain management, and chapters XI to XIV for the needs of the prioritized export sectors). Ethiopia has adopted an explicit rural water policy, but it lacks a rural water agency to spearhead the implementation of rural water projects. A map of rural water points to monitor progress is also missing (Foster and Morella 2010).

Distribution losses in Ethiopia's water utilities system are relatively high (40 percent, compared an average of 33 percent in other African low-income countries). Like for power utilities, there is an important subsidy element in Ethiopia's water tariffs,⁴³ which are substantially lower than those in other African countries with scarce water resources (Foster and Morella 2010). While this kind of subsidization has a positive impact on the profitability and competitiveness of textiles and leather producing firms, it may impact negatively on their motivation to use water more efficiently, and there is a trade-off between this form of subsidization and alternative development-enhancing allocations of public financial resources. Industrial productivity gains resulting from different measures, aimed at increasing efficiency of manufacturing firms, may also give room for bringing water tariffs closer to the supply costs.

Ethiopia is faced with an exceptionally high variability of rainfalls and affected by frequent droughts and floods, which have a serious impact on agricultural productivity. For this reason, Ethiopia will need to invest substantially in improving its water storage capacity. Since, on the one hand, hydroelectric power generation and water supply are closely linked and, on the other hand, the Government plans to accelerate the creation of additional hydro capacity, there is an opportunity to develop multipurpose storage systems. These could serve the needs of the power sector, while at the same time facilitate and stabilize agricultural irrigation (Foster and Morella 2010).

2.3 Information and telecommunications infrastructure

The availability of information, communication and telecommunications technology (ICT) is of growing importance not only for the internal efficiency of manufacturing firms and communication with their actual and potential clients, but also for the flow of information on numerous trade aspects between the relevant public agencies and the private actors, as well as for communication among these public agencies (see also chapters VII and VIII). Currently, coverage of ICT services in Ethiopia is the lowest in Africa. Improving the ICT infrastructure involves not only accelerated investments in the physical telecommunications infrastructure, but also an adaptation of Ethiopia's institutional and regulatory framework.

⁴³ As in the case of electric power, these tariffs recover less than 50 percent of the utility costs.

While investment in modern ICT equipment is a major challenge at the firm level, especially in the export-oriented manufacturing sectors, the enhanced provision of public infrastructure required for the use of these technologies is an important task for the Government during the GTP II period. Greater efficiency in Customs and transit procedures depends on improved ICT services. For example, the Customs Transit Protocol between Ethiopia and Djibouti aims to achieve full automation and has an agreed timetable for introducing it, but the poor telecommunications network represents a real bottleneck. Furthermore, due to the insufficient coverage of the mobile telecom network, trucks in the transit corridors are untraceable on their ways to and from the ports. The planned introduction of the proposed intermodal system, with high-quality optical fibre cable on the entire length of the railway, should contribute to solving these connectivity problems.

2.4 Transport infrastructure

The availability and quality of transport facilities and logistic services are key determinants of the capacity of Ethiopian firms to export goods and services in a speedy and cost-competitive manner. Delays caused by poor logistics in transport corridors drive up the cost of shipping and make the trade flows unreliable and unpredictable. The expansion of tourism also highly depends on the development of transport infrastructure.

The Ethiopian government, and its various implementing agencies, have come a long way in terms of reforming and improving logistics operating environments and major projects to improve the road and railway network are underway. Yet, the evidence suggests that Ethiopia still fares poorly *vis-à-vis* other countries in infrastructure and the ease of international shipments. These are important areas that merit closer attention during the GTP II period.

In terms of road density and penetration, Ethiopia is still below the average of sub-Saharan Africa. However, it is set to reach this average in a few years. Ethiopia's road network tripled from less than 33,000 km in 2000/01 to almost 100,000 km in 2013/14, and road density per 1000 sq.km increased from 29.9 km in 2000/01 to 90.5 km in 2013/14, which is a great achievement by any measure. Moreover, the proportion of areas more than 5 km away from all-weather roads was brought down from 64.1 percent in 2011/12 to 40.5 percent in 2013/14.

Ethiopia continues to invest heavily in improving its transportation infrastructure. In addition to a further substantial extension and upgrading of the road network, both urban and rural, the infrastructure programme includes the construction of about 2,400 km of new, electrified, standard gauge railway lines, some of it double track, including in particular a new railway connection between Addis Ababa and the container port in Djibouti. Major investments are also underway for the enlargement and modernization of the cargo aircraft fleet of Ethiopian Airlines and for improvements in the infrastructure needed for the full implementation of the multi-modal transport system (see also chapter VIII).

Apart from further upgrading the existing long-distance road connections, a major challenge remains the transport of agricultural inputs from rural areas to factories for processing. In connection with efforts to strengthen the domestic supply chains in the agro-industry, textiles and leather industries (see chapter V), and to develop tourism country-wide, there is an urgent need to improve the accessibility of rural areas, while at the same time ensuring that the existing road network receives adequate maintenance.

2.5 Land availability and industrial zones

Similar to the availability of public infrastructure and services, the possibility of exporting firms to acquire and use land at reasonable costs for their production sites affect their competitiveness and their willingness to invest. Under Ethiopia's land lease regime, land remains federal state property while administration of land leases is in the responsibility of the

regional authorities. This often complicates the setting-up of new and the enlargement of existing factories. While the regime has its merits, especially for preventing real estate speculation, the way in which it currently operates involves cumbersome bureaucratic procedures that tend to discourage investors.

The creation of industrial parks and private industrial zones would go some way in addressing constraints related to the access to land and facilities. The Government has embarked on the development of industrial parks that do not only provide land for manufacturing activities, with reduced rates for land lease for firms from the prioritized sectors, but also custom-made facilities and essential services.⁴⁴ Four of these parks were planned to be opened by 2015, but to date only one of them is partially functioning (Bole Lemi in Addis Ababa). It consists of 20 factory sheds that are leased to 12 firms to produce garments and leather goods (World Bank 2015a). In addition, a number of the private industrial zones have been sanctioned by the Government, of which the Eastern Industrial Zone has started operations.

According to the World Bank (2015a), the creation of industrial parks and zones has been held back for a number of reasons, including an effective and functioning policy, regulatory and institutional framework; weak strategic planning and demand driven approach; poor on-and-off site infrastructure planning; lack of specific on-and-off-site costing, performance agreements, and economic and financial analysis; lack of systematic investment promotion to attract anchor investors; and deficiencies in designing and implementing a linkages program, a communications and outreach strategy, and establishing and tracking performance indicators.

In any case, it remains to be seen whether producers from the light manufacturing sectors find them attractive enough to relocate. Depending on the initial experiences, the concept of industrial parks may need to be refined over time. The prioritized export sectors can only benefit from further development of industrial zones, as these allow for the creation of synergies and agglomeration effects, thereby attracting investments in productive capacity. Industrial parks have a strong potential to enhance technology innovation and transfer; to improve services for maintenance of existing machinery; to raise productivity; and to improve the traceability of products along the value chain. Industrial zones designed for manufacturers in specific sectors can also be instrumental for facilitating the establishment of marketing networks among enterprises whose scale is too small to meet demand by large overseas buyers on their own. The advantages they offer, may also help to promote the transition of small informal enterprises into the formal sector.

Accelerated and more systematic development of industrial parks and zones would help reduce the constraints related to the lack or insufficient quality of infrastructure facilities. Public investments in modern infrastructure in power and water supply often do not reach scattered industry units and are more efficient and, thus, more justified when they are concentrated on agglomerations of enterprises with similar needs. They can, for instance, improve energy supply by making use of locally available renewable energy resources, such as bio-waste or small hydropower stations. Industrial zones also facilitate compliance with environmental standards in the management of waste, waste water, emissions and hazardous chemicals, as well as systematic monitoring of compliance.

The policy challenge that remains to be dealt with is how to further strengthen and implement a comprehensive strategy for industrial parks and zones. This strategy must ensure that not only they meet the needs of businesses located in these zones, but are also dynamically linked to the rest of the economy. The creation of new industrial zones should be a central parameter in infrastructure planning and investment.

⁴⁴ Bole Lemi and Kilinto in Addis Ababa, Hawassa, Dire Sawa and Kombolcha.

2.6 Infrastructure costs

Additional heavy infrastructure investment, especially in power generating capacity and water supply, will imply a heavy financial burden. A 2010 World Bank study (Foster and Morella 2010) estimated that if all infrastructure gaps were to be closed by 2020, this would require public investment expenditure of more than \$5 billion per year between 2010 and 2020. There may be some possibilities to rationalize current infrastructure operations and spending and to make it more efficient.⁴⁵ As better infrastructure will contribute to faster export and higher GDP growth, it will also contribute to generate higher public revenues in the future. However, even with these considerations, the level of investment spending required clearly exceeds Ethiopia's budgetary possibilities. Accordingly, the study estimated an annual financing gap of \$3 billion per year. To the extent that this additional infrastructure finance cannot be found from external development partners, infrastructure upgrading will have to be phased over a longer period of time, and it will be necessary to carefully identify priorities and infrastructure gaps that represent the most binding constraints for companies in the exporting sectors.

3. The transport and transit system

3.1 Transit corridors

Since all goods that travel by sea to and from Ethiopia need to transit through another country, the trade corridors from Ethiopia to sea ports are of vital strategic importance to Ethiopia. Efficiency in the management of cargo movements along these corridors is a key determinant of the costs involved in export and import activities.

Ethiopia relies on the seaports of Djibouti for more than 90 percent of its foreign trade. Notwithstanding efforts to open up alternative routes, Djibouti is likely to remain the main transit route in the foreseeable future. Overall, the transit services provided by Djibouti to Ethiopian cargo seem to be efficient and not costly. Djibouti is aware that in the long term Ethiopia could develop alternative routes and trade through ports in neighbouring countries and is therefore interested in providing to its larger neighbours the most efficient transit services possible. A new container terminal, a further extension of which is planned for the coming years, will significantly increase Djibouti's port accessibility and capacity, which then will also considerably benefit transit trade from and to Ethiopia.

The main road connection from the Port of Djibouti to Addis Ababa is in fairly good condition on the Ethiopian side but less so on the Djiboutian side of the border. It is relatively long (910 km) because it follows the contours of the landscape. A shorter route that follows the railway line is partly unpaved; the full paving of the road is scheduled to begin shortly.

For northern Ethiopia, the closest port is Port Sudan. The latter only handles less than 5 percent of Ethiopia's external trade, mainly sesame seed and other products that are processed and warehoused in northern cities. A major disadvantage of this corridor is the distance (1,200 km to the nearest suitable hub in Ethiopia). Truck tariffs are also higher in Sudan, which means that the disproportionate share of the corridor on Sudanese territory raises the transport costs. For a number of reasons⁴⁶ cargo is generally trans-shipped at Gedaref in Sudan rather than going straight through to Port Sudan.

⁴⁵ Foster and Morella (2010) provide a detailed account of possible savings.

⁴⁶ The main reasons are different allowances on gross vehicle mass and differences in the length of trucks allowed in Ethiopia (18m) and Sudan (22m). The latter follows the COMESA recommendation for vehicle dimensions, including a length dimension of 22m. Ethiopia has a valid reason for not following the recommendation because it has a number of mountainous regions and, in traversing this terrain, roads include sharp bends, meaning that a truck of 22m in length would not be able to manoeuvre around these bends.

Other less important transit corridors include the Addis Ababa – Nairobi – Mombasa Corridor through Kenya and the Berbera Corridor through Somalia. Mombasa is the closest port for southern Ethiopia. Although it has been extended in recent years, it is currently operating above design capacity in many of its terminals. The poor quality of the road in Kenya is currently the greatest deterrent to the expansion of trade and transit between Ethiopia and the East African Community. Berbera in Somalia is nearly the same distance from Addis Ababa as Djibouti, but the Port has no ship-to-shore cranes. However, this disadvantage is partly compensated by the fact that tariffs are 40 to 60 percent lower than in Djibouti, making it attractive for certain types of cargo, especially food aid delivered to the eastern lowlands.

The Maritime Affairs Authority is responsible for monitoring the condition and performance of Ethiopia's major transport corridors, including through bilateral agreements with neighbouring countries. In the case of the Djibouti Corridor, there is a Joint Commission designed to address corridor problems. In the case of Kenya, a Corridor Management Committee has been created to foster relations between Ethiopia and Kenya for resolving corridor management issues and enhancing the development impact of the corridor under construction. Although Ethiopia and Djibouti have invested heavily in transport and transit infrastructure, the planning and implementation appears to be sub-optimally coordinated, so that it is not operating at maximum efficiency.

3.2 Transport systems

3.2.1 Road transport

The road transport sector comprises owners of individual trucks; road transport companies; and associations of individual truck owners. With the exception of freight transport rates, which are market-determined, the Ethiopian road transport sector is regulated by the Transport Authority. It issues vehicle and driver registrations and certifications, regulates passenger transport prices, registers and licenses domestic and cross-border transport service providers, and registers associations established with the specific purpose of providing freight and passenger transport services.

The cost of inland transportation and the availability of reliable trucks from and to Djibouti is a reported problem. Approximately 6,470 trucks are licensed for the Djibouti Corridor. The main licensing criterion for companies and associations is the age of the fleet. At least 33 percent of the fleet must not be older than five years and 10 percent must be less than ten years old. This means 57 percent of the truck fleet can be more than 10 years old. This explains why a large part of the truck fleet is in poor condition. Trucks transporting goods for export are very often old and break down on their way to Djibouti, incurring considerable delays and missing vessels departing from Djibouti. At present, it takes two days to cover the 892 kilometers to the port. Trucks are also untraceable on their way due to the poor mobile telecom network. Moreover, the truck fleet is not sufficiently diversified to meet the particular requirements for safe transportation of specific goods.

Given the high costs of transport, trucks are frequently overloaded to reduce the unit cost of transport. But vehicle overloading significantly accelerates the rate of deterioration of road pavements. The cost associated with vehicle overloading could be avoided by enhanced cooperation with neighbouring countries in establishing and enforcing harmonized regulations, effective control measures and overload fines.⁴⁷

⁴⁷ Truck overloading, the considerable damage it causes to the road network and the resulting additional costs for road rehabilitation are problems that concern many African countries. After COMESA member countries have now reached agreement on harmonized regulation on vehicle load limits, COMESA is currently working, with support by Ethiopia, on measures to facilitate national processes to implement the regional decisions on vehicle overload control.

There is growing awareness amongst national authorities that cargo tracking is a useful tool for facilitating trade. Improved tracking reduces the risk of contraband and deviated cargo, and the need for convoys.⁴⁸ With a view to establishing a regional transport management scheme, COMESA has put in place a system that provides a single platform for information exchange and various transit trade instruments, including transit bonds, cargo tracking, monitoring the movement of goods, overload control and insurance, among others. However, Ethiopia is using a national tracking system, with a technology similar to that of the COMESA system but designed to work only in Ethiopia and not across the border and so not along the Ethiopia-Djibouti Corridor, and it is not yet clear how well this system is working.

3.2.2 Rail transport

The new standard gauge railway, currently under construction and scheduled for completion before the end of 2016, will fundamentally change the profile of the Ethiopian transport sector. There will be a dramatic shift of freight from road to rail. The Ethiopian Railway Corporation is predicting that about 85 percent of the Ethiopia-Djibouti Corridor freight will be carried by rail in the future.

It is planned that the railway line will be operated from terminal to terminal, with Inland Container Depots (ICDs) being developed at key economic hubs and node points⁴⁹ and with direct rail services to selected major customers who can contract long-term scheduled rail services with dedicated block trains.⁵⁰ The ICDs will be served by a road-based freight distribution and consolidation service, and logistics service providers and distribution warehouses will tend relocate at or near the ICDs in order to reduce costs. Again, planning of the railway and related infrastructure was not done in a coordinated “end-to-end” fashion, so that the direct connection of the new railway line with the container port in Djibouti and with Modjo Dry Port will most likely be delayed, meaning that for some time freight would have to be reloaded twice.

3.2.3 Air transport

The Ethiopian Civil Aviation Authority administers the air transport sector. It has the responsibility for the registration of aircraft, certification of airworthiness, licensing and certification of personnel (air traffic control, security and crew) and airports, provision of air traffic control, and aeronautical information services. The responsibility for construction, maintenance, and administration of aerodromes lies with the Ethiopian Airports Enterprise.

Ethiopian Airlines operates six cargo airplanes and two regular flights each night to Belgium for the export of perishable goods, mainly cut flowers, to Europe. Moreover, Ethiopian Airlines offers direct cargo service to Asia, the Middle East, and other African destinations, as well as charter services.

Air traffic is also a key element in the development of tourism. In view of its geographical location, and the international connections of Ethiopian airlines, air travel is the most obvious mode for tourists entering into Ethiopia. But given the size of the country and the remaining gaps in other longer-distance modes of traffic, air connection is also the most convenient mode of tourist travel within the country. In terms of domestic flight network Ethiopia is the leading country in Africa, with about 20 airports of different grades both national and international.

⁴⁸ In the past, Djibouti at times required convoys, and it may require them again in future, in line with Article 11 of the WTO Trade Facilitation Agreement (see chapter VIII). This article stipulates: “Each Member may require the use of customs convoys or customs escorts for traffic in transit only in circumstances presenting high risks or when compliance with customs laws and regulations cannot be ensured through the use of guarantees”.

⁴⁹ Major node points will be Modjo and Sebeta (Addis Ababa), Mekele and Awash.

⁵⁰ This is likely to concern primarily the transport of fuel, mining products, bulk grain, fertilizer or cement.

3.3 Trade logistics

3.3.1 Ethiopia's logistics performance in international comparison

The performance of the logistics system is central to economic growth and trade competitiveness. The success of China and, in recent years Vietnam, in international trade is anchored in a strong transport and logistics infrastructure. So far, poor logistics in Ethiopia have been a critical constraint that has adversely impacted trade. The impact it may have on the international competitiveness of Ethiopian exporters can be inferred from international comparisons as they are regularly undertaken by the World Bank.

(a) Trading Across Borders Indicator

In the context of its annual Doing Business Report, the World Bank is including the Trading Across Borders Indicator as a key element for its ranking of countries. The indicator measures the financial cost and time spent as well as the number of documents required for firms to complete a cross-border transaction by sea transport. In the 2015 issue of that Report Ethiopia is ranked 168th among 189 countries, i.e. among the countries with lowest performance (World Bank 2015b). Ethiopia has even lost eight ranks since 2012.

Ethiopia underperforms, relative to comparator and competitor countries, in the time it takes to import and export as well in the cost of exporting and importing. According World Bank statistics, exporting a standard container of goods by sea transport from Ethiopia takes 44 days (excluding the time for sea transport),⁵¹ as compared to 30.5 days for the average of Sub-Saharan Africa (SSA), 21 in China and Vietnam, or 17 days in India. The costs of exporting a container from Ethiopia amount to \$2,380 (excluding tariffs and the cost of sea transport), against \$2,270 for the SSA average, \$1,332 for India, \$823 for China and \$610 for Vietnam (World Bank 2015b).

Importing a standard container is even more onerous: it costs \$2,960 and it also takes 44 days. Although the cost is equivalent to the SSA average, the importing and exporting time is higher. More worrisome, the costs are much higher than in other developing countries, whose firms are competing with Ethiopian exports in a number of export markets.

(b) Logistics Performance Index

The World Bank's Logistics Performance Index (LPI) reflects, on a scale from 1 (worst) to 5 (best), the private sector's perceptions of a country's logistics performance.⁵² The Index measures the efficiency in customs clearance, the quality of trade- and transport-related infrastructure, the ease of arranging competitively priced shipments, the quality of logistics services, the ability to track and trace consignments, and the frequency with which shipments reach the consignee within the scheduled time.

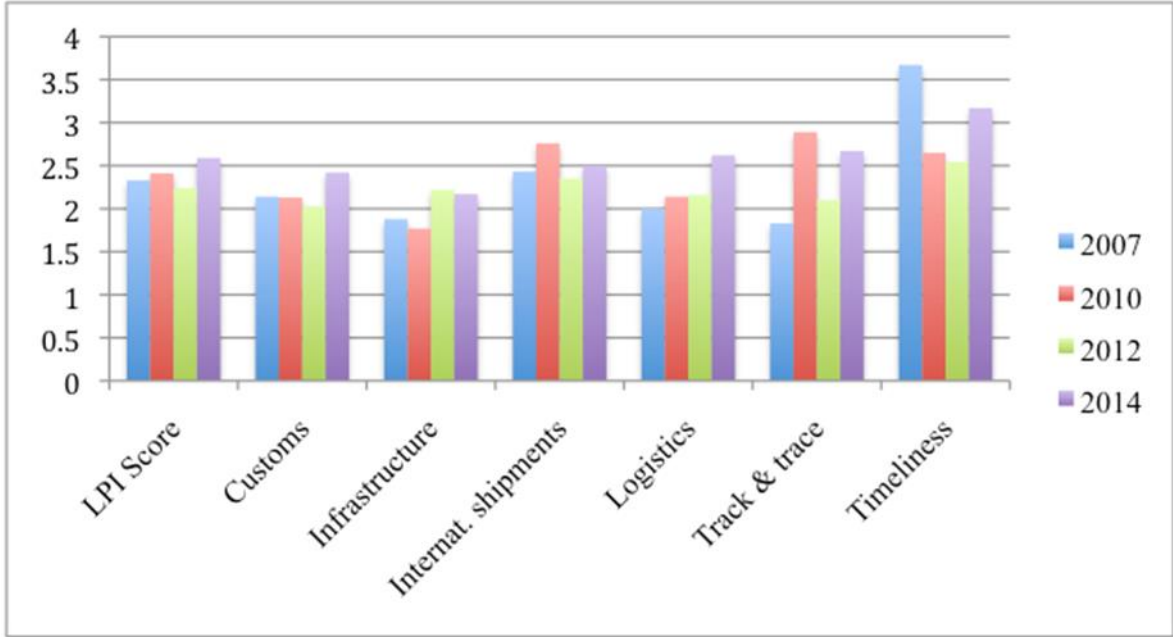
In the 2014, LPI Ethiopia is ranked 104th among 160 countries on overall performance, lower than South Africa (34), Vietnam (48), China (28), or the SSA average. Its overall logistics performance has slightly improved between 2007 and 2014. The specific indicators for

⁵¹ The 44 days and the total costs can be broken down as follows: 27 days for document preparation (\$520), 7 days for Customs clearance and inspection (\$290), 3 days for ports and terminal handlings (\$270), and 7 days for inland transportation and handling (\$1,300).

⁵² The LPI is an interactive benchmarking tool designed to help countries identify the challenges they face in their trade logistics systems and possibilities to improve their performance. It is based on a worldwide survey of operators on the ground (global freight forwarders and express carriers), providing feedback on the logistics "friendliness" of the countries in which they operate and those with which they trade (see also World Bank 2015b).

Customs and logistics indicators boasted a steady improvement over the same period.⁵³ By contrast, infrastructure, tracking and tracing, international shipment and, in particular, timeliness show a deterioration compared to previous LPI Reports (figure 7.1).⁵⁴ Although timeliness improved during the GTP I period, its score in 2014 was lower than in 2007. This trend may result from the growing congestion at the container terminal, bulk terminal and Modjo Dry Port (see section 3.3.2). As a result, the tracking and Customs clearance capacities also declined (Nathan 2013).

Figure 7.1: Ethiopia’s scores in the Logistics Performance Index, 2007-2014



Source: World Bank (2015b)

In the 2014, LPI Ethiopia is ranked 104th among 160 countries on overall performance, lower than South Africa (34), Vietnam (48), China (28), or the SSA average. Its overall logistics performance has slightly improved between 2007 and 2014. The specific indicators for Customs and logistics boasted a steady improvement over the same period.⁵⁵ By contrast, infrastructure, tracking and tracing, international shipment and, in particular, timeliness show a deterioration compared to previous LPI Reports (figure 7.1).⁵⁶ Although timeliness improved during the GTP I period, its score in 2014 was lower than in 2007. This trend may

⁵³ The Logistics indicator assesses the competence and quality of logistics services (e.g., transport operators, customs brokers). The Customs indicator assesses the efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies, including Customs.

⁵⁴ The Infrastructure indicator assesses the quality of trade and transport related infrastructure (e.g., ports, railroads, roads, information technology). Tracking and tracing indicators assess the ability to track and trace consignments. The International Shipments indicator assesses the Ease of arranging competitively priced shipments. The Timeliness indicator measures the time of shipments in reaching destination within the scheduled or expected delivery time.

⁵⁵ The Logistics indicator assesses the competence and quality of logistics services (e.g., transport operators, customs brokers). The Customs indicator assesses the efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies, including Customs.

⁵⁶ The Infrastructure indicator assesses the quality of trade and transport related infrastructure (e.g., ports, railroads, roads, information technology). Tracking and tracing indicators assess the ability to track and trace consignments. The International Shipments indicator assesses the Ease of arranging competitively priced shipments. The Timeliness indicator measures the time of shipments in reaching destination within the scheduled or expected delivery time.

result from the growing congestion at the container terminal, bulk terminal and Modjo Dry Port (see section 3.3.2). As a result, the tracking and Customs clearance capacities also declined (Nathan 2013).

On the positive side, Ethiopia has performed better than the average in SSA on the overall LPI score and in the Customs, international shipment, logistics competence, and tracking and changes indicators. It even was one of the top performers among all low-income countries.

3.3.2 Ethiopia's logistics system and ongoing reforms

Both inbound and outbound trade logistics impact on the cost competitiveness, product extension and quality and market penetration of Ethiopia's exports as well as on the willingness of large foreign companies to locate part of their production in Ethiopia. For certain production processes which are recently booming in Ethiopia, such as electronics, textile and apparel or other assembly-type operations (engines and motor vehicles) with a high import content and small profit margins per unit, delays and high shipping costs can put investment in this areas out of picture (Kassahun 2014).

In a number of policy and planning documents the Ethiopian Government has acknowledged that improving its overall logistics operating system to facilitate the movement of goods across the country is key to economic development and has embarked on a programme to improve logistics performance, in parallel to investing heavily in transport infrastructure.

Ethiopia's National Logistics Strategy addresses up to 100 logistic challenges, including inefficient infrastructure and payment systems as well as freight forwarding and Customs services. The Strategy will be implemented over a period of five years under the guidance of a high level Ethiopian National Logistics Council. The execution of the strategy, which attributes a pivotal role to the private sector, may lead to urgently needed improvements in Ethiopia's logistic performance. In the context of this Strategy, the Government has merged three state-owned enterprises (Ethiopian Shipping Lines, Ethiopian Maritime and Transit Services and Ethiopian Dry Port Service Enterprise) into the Ethiopian Shipping and Logistics Enterprise (ESLSE) and introduced the multimodal transport system.

ESLSE has reported significant improvements in its logistics performance in recent year as a result of improved multimodal cargo operations and in enlargement of the Modjo dry port. The total volume of Shipments via Djibouti have almost doubled since 2012/13, while the average dwelling time at the port of Djibouti has been reduced from 20 to 8.7 days, which implies a considerable reduction in storage costs for Ethiopian firms.

The Ethiopian Shipping Line and Dry Ports provide their services at break-even-point, but ESLSE's procedures for importing inputs seem to lack clarity and sometimes do not adequately reflect the priority status given to the strategic sectors in Ethiopia's development strategy. Moreover, the monopoly of ESLSE as the Ethiopian freight forwarder has given rise to concerns among manufacturing firms in the priority sectors. They relate to the need to apply for waivers for all transport by vessels other than those of the ESLSE. Such applications for authorization are rarely treated fast and efficiently, so that the import of inputs is often delayed.⁵⁷

The dry ports on the main road connection with Djibouti, at Semera, in Afar Province, and Modjo, closer to Addis Ababa and at the connection point for the Djibouti and Mombasa-Nairobi-Addis Corridors, play a key role in Ethiopia's national logistics system. The Modjo terminal has been operating in recent years a dry port for import containers unloaded in

⁵⁷ This has led to a call from the Ethiopian Association of Basic Metals and Engineering Industries for a public-private dialogue forum directly responsible to the Office of the Prime Minister.

Djibouti and forwarded to Modjo by ESLSE's multimodal unit. About half of Ethiopia's inbound container traffic is handled at this terminal.

The reduction in dwelling times in Djibouti and the higher transport volume may have led to longer average storage times at the dry ports, especially Modjo, where storage facilities are cheaper than in Djibouti. Currently, the Modjo dry port is operating close to, if not beyond, its design capacity, resulting in long waiting times for the delivery of imported inputs for domestic processing. Major improvements in the logistics system are expected from a further significant extension of the main dry port at Modjo and the creation of a number of additional ICDs and dry ports.

Imports into Ethiopia may be handled under either the unimodal or the multimodal system. Under the unimodal system, Ethiopian Customs require additional documents, which are not required if imports are made under a multimodal transport contract (see also chapter VIII). The logic of requiring less documents for multimodal transport is that one single operator (such as ESLSE) is responsible and liable for the entire transport chain. The system of multimodal transport (mostly, but not necessarily, in containers) is designed to deliver imported goods directly from foreign suppliers to a container depot in one of the Ethiopian dry ports in different parts of the country (especially Modjo, but also Mekele, Semera and Gelan). Companies, designated as Authorized Economic Operators that dispose of a bonded warehouse, may also receive these containers directly at their premises (see also chapter VIII). Obviously, the more this latter option is used, the less will be the congestion at the container depots at the dry ports.

Handling merchandise trade with the multimodal system can significantly reduce the time, and so the cost, of transit and transport. Apart from allowing all required customs formalities to be handled within the country, it lowers foreign exchange costs of demurrage at the port of Djibouti and results in shorter lead times for manufacturers relying on imported inputs. However, it appears that, at present, a multimodal contract can only be issued by ESLSE, which operates a cargo reservation regime that obliges importers to make use of its services. So far, the implementation of this system has been far from smooth and it is not uncommon for incoming containers to be held up in a terminal for several weeks.

The National Logistics Strategy is an appropriate framework for addressing the main challenges in the field of trade logistics, which are to implement the multi-modal transport scheme more effectively, to enhance the services of ESLSE and to increase competition in logistics services. The successful and prompt implementation of all elements of the Strategy is central to alleviating logistics constraints on the way to doubling Ethiopia's exports during the GTP II phase.

4. Enabling conditions for business activities and public-private dialogue

4.1 Regulation of business activities

The general business environment influences the efficient and effective functioning of the economy and trading activities. Despite significant progress in improving the overall business and regulatory environment, many challenges remain in facilitating the business operations in Ethiopia. As in the case of infrastructure, transport and logistics, mastering these challenges is of particular importance for enabling the existing and potential new economic operators in the prioritized sectors to meet the GTP II targets.

According to *the Doing Business 2015 Report* by the World Bank (2015b), Ethiopia is ranked 132 out of 189 countries, performing less well than comparators, such as Vietnam at 126, South Africa at 61 and Bangladesh at 115. While Ethiopia's rankings on specific issues, such as dealing with construction permits, enforcing contracts and insolvency procedures are

better, low rankings on issues such as starting a business and getting credit must give rise to serious concern.

On “*Ease of Trading Across Borders*” (a subset of Doing Business), Ethiopia’s performance is even worse, as it is ranked 168 out of 189 countries, far behind several comparator countries and the averages for SSA or landlocked developing countries.⁵⁸ Similarly, according to the *Global Enabling Trade Report* prepared by the World Economic Forum in 2014, Ethiopia’s performance ranking among 138 countries was 118. Ethiopia’s performance ranking on infrastructure was 116 and on its operating environment 115.

The Ethiopian Government is fully aware that private sector-led development is a necessary condition for sustainable economic growth. However, bureaucratic procedures and processes still inhibit the start and growth of private sector enterprises, slow down business activities and increase transaction costs, all of which result in reduced domestic and global competitiveness.

According to a study by USAID (2012)⁵⁹ on Business Enabling Environment, very detailed product or activity-specific licensing law came into effect in Ethiopia in July 2010. There are over 980 licensing categories which oblige businesses to apply for multiple licenses to run the various aspects of their business. The new system requires that an applicant undertakes a number of administrative procedures before applying for a license, and the same applicant needs multiple licenses for closely related business activities. This system has created additional, at times time-consuming and unnecessary, layers of bureaucracy. Although it is fairly easy for larger, well-established businesses to obtain or renew their licenses, for smaller businesses some of these requirements are hard to meet and might push businesses out into the informal sector, rather than bringing enterprises into the formal sector. Although the Government has legitimate concerns to monitor businesses, including weeding out fraudulent activities and widening the tax base, the fragmentation of licensing puts pressure on smaller businesses and potential new market entrants. A medium way would be to create a broadly defined trade category for activities that require limited supervision.

4.2 Dialogue between the public and the private sector

In the process of economic upgrading and industrialization some lessons may be drawn from the experiences of other countries in the past. However, even then private firms and the Government both act on largely unknown territory in their efforts to build an internationally competitive industrial sector and are therefore bound to make mistakes in their management and policy choices. The institutionalization of a dialogue on all aspects related to business regulation, the provision of incentives for strategically important economic activities and the implementation of measures related to infrastructure and logistics is therefore crucial. The success of floriculture exports from Ethiopia demonstrated that good coordination and partnership between the Government and the private sector, and the ability to identify key areas of intervention are essential for an effective sector development strategy (Gebreyesus 2014).

The Ethiopian Chamber of Commerce and Sectoral Associations has played a key role in the institutionalization of a permanent platform for policy dialogue between the business community and the government, at the national and regional levels. With financial and

⁵⁸ Comparator countries rankings were: Mauritius (17), Vietnam (75), Kenya (153), COMESA average (136), SSA average (142) and landlocked economies average (140).

⁵⁹ The study was prepared under the Agricultural Growth Program – Agribusiness and Market Development, a flagship project under USAID’s Feed the Future strategy for Ethiopia. It is USAID’s largest contribution to Ethiopia’s Agricultural Growth Program that aims at improving the productivity and competitiveness of agriculture-based value chains.

technical backing from the International Financial Corporation, the Chamber of Commerce and the government prepared and signed a memorandum of understanding establishing the Ethiopia Public-Private Dialogue Forum (PPD) in 2010. The forum's objective is to foster trust and cooperation between the private sector and the government in order to address regulatory or implementation constraints effecting the business enabling environment.

One of the first issues the PPD addressed were bottlenecks in trade logistics that were identified by manufacturers associations as one of their main constraints. During this process, the PPD organized a forum which generated a list of very concrete recommendations for reforms that would ease trade logistics. As a result of the collaborative process several relevant line ministries have been responsive and at least part of the suggested reforms have been addressed. An issue of contention with some stakeholders, however, is that these consultations are not encompassing enough and that in some cases the stakeholders lack technical capacity and information to engage effectively with the government on the issues under consultation. Generally, most of the institutions stated that there are no consultative mechanisms to provide an opportunity for stakeholders to comment before any new laws or regulations are introduced or before changes are made (Kassahun 2014).

5. Recommendations

Given the enormous needs for public investment in all areas of infrastructure, the right priorities and the best way of sequencing the implementation of projects have to be found. It is therefore necessary to follow a systematic and coherent approach, to identify priority areas according the most binding constraints perceived by producers in the prioritized sectors, and to regularly review progress in overcoming these constraints as well as the need for adjustments of these priorities. These lie in the following areas but, to the extent that they involve large public expenditures they require further specification in order to evaluate costs and financing possibilities.

- Increase and stabilization of energy supply for operators in the export sectors continues to be a priority in order to reduce the frequency of interruptions in production and in the possibility to use automated systems in the management of production and marketing as well as in the industry- and trade-related entities in the public administration.
- Regarding investment in the extension of water utilities, priority should be given to the needs of selected export sectors. Perhaps even more important from the point of view of bringing Ethiopia's comparative advantages in terms of natural endowments to bear on the performance of these sectors, is a rapid improvement in water supply for agriculture: together with a wide extension of agricultural irrigation systems these are crucial for strengthening domestic supply chains in agro-food, textiles and leather production.
- Development of power generating capacity should be closely coordinated with the development of water utilities. The possibility of setting-up multipurpose storage systems, serving the needs of both power generation and water supply for agricultural irrigation and industrial use, should be considered with priority.
- Solving the problem of frequent bottlenecks in telecommunication is essential for increasing the efficiency of private firms as well as the public administration especially in Customs administration and transit procedures.
- With regard to transport infrastructure, direct connection of the new Addis-Ababa-Djibouti railway line with the container terminals at the port of Djibouti and at the Modjo Dry Port must be established with urgency. While strengthening the long-

distance road network, rapid development of rural and regional road systems must not be neglected. These are essential for enhancing domestic supply chains, increasing the quantity and upgrading the quality of agricultural inputs to the prioritized export industries, and supporting the development of countrywide tourism.

- Ethiopia and Djibouti should establish a joint railway regulatory authority; reassess where there may be infrastructure gaps (such as marshalling yards, access to the port container stacks and links to dry-ports) and build the infrastructure to close these gaps; and examine the possibility of allowing restricted access to the track for private sector service providers on the basis of a block train system.
- A Joint Ethiopia-Djibouti Corridor Management Authority should be set up with the immediate task of implementing the recommendations of the Ethiopian Maritime Affairs Authority in connection with its proposed logistics strategy and to set up a performance monitoring and evaluation system.
- Ethiopia is not implementing most of the COMESA transport facilitation instruments although it would be of benefit to Ethiopia to do so. It is recommended that a study be carried out to understand why these instruments are not being used and how they can be implemented along the major corridors used by Ethiopia.
- The Government needs to develop a clear strategy for industrial zones to ensure not only that they meet the needs of businesses located in such zones, but also that vertical and horizontal linkages, between operators in the zones and domestic firms outside these zones, are created or strengthened. It is recommended to further extend the existing industrial zones and establish and promote additional ones. It should be ensured, however, that rent or lease costs are bearable also for smaller and newly founded enterprises. The performance of the newly created industrial parks must be monitored and, where needed, their facilities adapted to the perceived needs of the manufacturers.
- Logistic services for bulk industrial raw material imports provided by ESLSE must be made more reliable and efficient. ESLSE should be more flexible in authorizing transport with vessels other than their own and accelerate the procedure for waiver application, especially when such transport fills gaps in its own capacity or is significantly faster.
- The full implementation of the multimodal system should be accelerated, the reasons for its unsatisfactory functioning be identified and remedied with priority. Existing regulations on using the multimodal transport system for all types of loadings should be better enforced. Ethiopia should also re-inforce the hard infrastructure to support multimodal systems combining trucking, railways, airways, and shipping to improve connectivity and increase competition.
- The Government would need to undertake further and continuous measures to enhance the business and regulatory environment, including reducing red-tape and bureaucracy; enhancing transparency in policy implementation; and improving consistency in enforcing regulations. Regarding the allocation of land, bureaucratic procedures in the land lease process need to be trimmed off.
- The institutionalization of a permanent platform for dialogue between government and representatives of firms, private and public, large and SMEs, should be strengthened further. It should be extended to all aspects related to business regulation, the provision of incentives for strategically important economic activities, and the implementation of industrialization-related measures. It should also include dialogue

fora at the regional and sectoral levels, where sector specific public institutes and private-sector associations have an important role to play. The sectoral Institutes can provide an effective forum for such dialogue, but they will have to link up with institutions that pursue the dialogue at the level of the entire manufacturing sector with representatives of the relevant Ministries. Private-sector associations, on the other hand, tend to be more representative than managers of individual firms in their perception of constraints and needs of the producers.

Chapter VIII: Trade Facilitation

1. Introduction

Ethiopian firms tend to face much higher costs for engaging in exports. They necessitate more time to reach the destination markets than their competitors in other developing countries, and are also subject to additional documentation requirements when exporting and importing. On the other hand, the international trade landscape, dominated by global supply chains and international logistic networks, demands fast and reliable cross-border routes, increasing even more Ethiopia's challenges.

Optimizing trade facilitation is therefore of paramount importance for enhancing the international competitiveness of manufacturing firms operating in Ethiopia. The standardization, harmonization and simplification of trade procedures and documents, including activities and practices involved in collecting and processing data required for the international movement of goods, will have a direct impact on its ability to reach the ambitious targets for export growth and industrialization since it allows exporting firms to have better access to inputs for value-added production and greater participation in global supply chains. Apart from supporting efforts to increase value-added exports and integration into global value chains, trade facilitation will also help to:

- increase and enhance revenue collection;
- secure long-term savings by Customs and other border agencies;
- encourage investment in the financial and insurance sector through transit and customs guarantee solutions;
- increase the participation of small- and medium-sized firms in international trade through IT solutions such as single window, electronic payment among others; and
- professionalize the public sector.

This chapter will first review the trade facilitation reforms that are already under way in Ethiopia and the challenges that remain. It will then compare current trade facilitation practices, in particular those related to Customs procedures, with the international standards set by the WTO Agreement on Trade Facilitation. The last section will assess Ethiopia's remaining needs for compliance with these standards and make recommendations on how to fill the gaps.

2. Ongoing reforms and remaining challenges

The Government of Ethiopia has already introduced a number of trade facilitation reforms, mostly contained in the Customs Proclamation approved by the Ethiopian parliament in June 2014. These reforms are aimed, mainly, at moving from a gate-keeper approach to a trade facilitation approach.⁶⁰

As part of its Public Sector Reform Programme tariff rates have been rationalized, documentary requirements reduced, procedures simplified and computerisation enhanced.

⁶⁰ Several elements of Ethiopia's reforms in trade facilitation are supported by the Investment Climate Facility for Africa, a partnership between governments, private companies and development partners, and the International Finance Corporation (IFC) and several bilateral development partners.

This has led to a significant reduction in clearance times, an increase in revenue collection and the elimination of systemic corruption.

Currently, the Ethiopian Revenue and Customs Authority (ERCA) is working on trade facilitation measures, and one of the tools that is going to be implemented is an electronic Single Window (ESW). The Single Window involves long-term high-level political commitment and change among stakeholders faced with challenges related to the application of information and telecommunications technology in customs procedures. Furthermore, ERCA, with support from the European Development Fund, is in the process of upgrading its computerized customs management system.

Despite these improvements and ongoing reforms, Ethiopian firms still face considerable operational constraints as a result of very time-consuming and convoluted trade and transit procedures and formalities in the areas of application for import licences, foreign exchange permits and letters of credit; vessel arrival, cargo discharge and temporary storage; release of original documents from the bank and transit clearance process in Ethiopia; the clearance process in Djibouti; and border clearance.

The processing of documentation that is necessary to benefit from privileges like the voucher systems and subsequent reconciliation is often very slow. The voucher system only allows three import transactions per year and is validated only once a year. As bureaucratic procedures are slow, companies have often settled tax payments for the ease of getting their shipments rather than dealing with the provisions of duty free status. Similarly, payments under the duty draw back scheme may take up to six months and such long delays are a drain on the working capital of the companies concerned.

The low ranking of Ethiopia in the World Bank's Trading Across Border Indicator may be explained, to a large extent, by the more burdensome Customs clearance process and additional required imports and exports documentation. Ethiopia has the longest Customs clearance and inspection time (seven days) among its neighbours. For exporting a standard container of goods by sea transport from Ethiopia, eight documents are required. Importing the same standard container of goods is even more onerous insofar as it requires 11 documents. According to the World Bank indicator, Ethiopia's Customs clearance procedure is less efficient compared to the average of low-income countries and SSA, among which it ranks only 9th out of 13.⁶¹

The OECD has developed recently a set of trade facilitation indicators aimed at helping developing countries to identify areas for action and to assess the potential impact of reforms (OECD 2014). The set of indicators comprises a wide range of border procedures, including advance rulings, appeal procedures, internal and external institutional cooperation, fees and charges, formalities, governance, transparency, and private sector participation. Measuring trade facilitation by these indicators provides a basis for governments to prioritise trade facilitation measures and mobilise targeted technical assistance and capacity-building efforts.

An OECD report that assesses Ethiopia's performance against these indicators (OECD 2015) suggests that Ethiopia has performed very well in certain areas but is lagging behind in others. Ethiopia's performance was above the average of the SSA and low-income countries regarding the involvement of the trade community, internal border agency cooperation as well as governance and impartiality. By contrast, it scored less well as far as harmonisation and simplification of documents, and automation and streamlining of procedures are concerned. These latter areas are those where Ethiopia could reap the largest benefits in terms of trade

⁶¹ The Customs indicator assesses the efficiency of the clearance process (i.e., speed, simplicity and predictability of formalities) by border control agencies, including Customs.

volumes and trade costs. Continued efforts in the areas of information availability and fees and charges would bring further benefits.

The implementation of Ethiopia's National Logistics Strategy (see also chapter VII) is expected, *inter alia*, to improve Customs clearance and administration structures. One possibility for Ethiopia to further advance in trade facilitation is through alignment with COMESA's trade facilitation programme that aims at consolidating the internal market and to reduce transaction costs. Its Regional Customs Bond Guarantee Scheme provides one regional bond for transit goods to replace multiple national bonds for each country of transit, reducing the total cost of freight by between 15 and 20 percent, and its Virtual Trade Facilitation System (CVTFS) is a software application that integrates all trade facilitation instruments at one online platform, providing real time information on the location of goods and means of transport and integrating all customs and trade related documentation under a single sign-on.⁶²

Trade facilitation, in the context of the COMESA's regional trade agreement, has several advantages, such as:

- Elimination and simplification of procedures among neighbouring countries, as well as the establishment of regional information points, would avoid duplications and reduce costs and time of business operations;
- Some measures (such as single window or testing procedures) involve significant fixed costs, their implementation would be more effective from a regional approach.
- Some trade facilitation measures need to be implemented in coordination with neighbouring countries and in cooperation between border agencies, freedom of transit and customs cooperation.

3. Ethiopia's practices compared to international trade facilitation standards

3.1 The relevance of international trade facilitation standards for Ethiopia

The recently approved Customs Proclamation explicitly refers to international standards and requirements and it incorporates modern and international principles of customs procedures and administration. It is, to a large extent, in line with the Revised Kyoto Convention. This Convention, coupled with a number of other international conventions on customs practices⁶³ and the Standards to Secure and Facilitate Global Trade framework (SAFE)⁶⁴, aim at helping Governments to strike a balance between the customs functions of control and revenue collection, on the one hand, and trade facilitation, on the other. Their recommendations help to ensure that customs are able to carry out their responsibilities more efficiently and effectively, and are able to facilitate the international movement of goods while ensuring full compliance with national laws.

⁶² In 2012, COMESA Secretariat launched a pilot project for fast-tracking the implementation of the CVTFS in the Addis-Ababa-Djibouti Corridor. Once the work has been completed, the system will enable to enhance cross-border trade and to control the processes that facilitate the movement of goods across borders in the region so as to implement efficient and less costly regulatory procedures (WTO 2012).

⁶³ The Revised Kyoto Convention contains a set of uniform principles for simple, effective and predictable customs procedures that also achieve effective customs control. The Istanbul Convention governs the temporary admission of goods. The Arusha Declaration provides basic principles to promote integrity and combat corruption within customs administrations. The Nairobi and Johannesburg Conventions enable customs administrations to afford each other mutual assistance, on a reciprocal basis, with a view to preventing, investigating, and repressing customs offences.

⁶⁴ The SAFE framework contains supply chain security and facilitation standards for goods being traded internationally.

Probably most important as a reference point for trade facilitation practices is the WTO Agreement on Trade Facilitation (TFA), concluded in December 2013 (WTO 2013), which is emerging as the new global standard for trade facilitation measures. The Agreement sets out a series of good practices in the area of trade facilitation and international transit goods. According to the OECD, the implementation of all trade facilitation measures included in the TFA would reduce business costs by 14 percent in low-income countries such as Ethiopia, with the largest benefits resulting from harmonization and simplification of documentation, streamlining border procedures, and automating Customs procedures⁶⁵.

In the following sections, the current logistics and customs practices will be assessed against the WTO-TFA standards. WTO-TFA refers to six groups of measures:⁶⁶ (1) Transparency on the applicable legislation, tariffs, Customs procedures and judicial system; (2) Governance and consultations to establish a framework where all stakeholders participate in the design and development of trade facilitation policy and regulations; (3) Procedures for appeal under which any person is entitled to request an impartial and independent review of decisions made by the Customs authority; (4) Disciplines on fees, charges and penalties in connection with services provided by government agencies, including Customs; (5) Measures that are applied or enforced exclusively by Customs; and (6) Coordination and cooperation among stakeholders at the national and international levels.

3.2 Transparency

In Ethiopia, Proclamations and regulations must be published in the *Negarit Gazeta* to enter into force.⁶⁷ Nonetheless, trade regulation (for example, import and export fees and charges) enacted through Ministerial directives, lacks transparency. Although in recent years stakeholders have benefitted from better access to information on directives through online access, the structure of these sources makes it often difficult to find directives without specific reference numbers. Ethiopian agencies publish information on customs procedures and legislation on websites, for example on preferential treatment, as well as manuals and handbooks on rules of origin and imports, export and transit procedures. However, documents cannot always be downloaded, the interface of these websites is not user-friendly and website information is often outdated and rarely provided in English. Furthermore, internet connectivity and power supply are not reliable.

ERCA offers enquiry points called customer service centres, which deal with requests for information or direct these enquiries to the competent agency. It also runs a free call centre to answer queries from the public. The main constraint identified in this case is the lack of trained staff able to answer all queries and the establishment of a central enquiry point or enquiry points in all border agencies.

3.3 Governance and consultations

- Comments before the entry into force and consultations:

Prior to the enactment or amendment of proclamations or regulations, the House of People's Representatives and its Standing Committees should conduct public hearings on drafts and gather comments from stakeholders on all draft proposals for legislation. Likewise, the rule-making procedure of the Council of Ministers requires a prior public consultation on the draft before its approval. Only the parliamentary scrutiny of laws foresees a consultation stage on

⁶⁵ Reforms in harmonizing and simplifying documentation, streamlining border procedures, and automating Customs procedures will have the greatest impact in the reduction of costs with 3 percent, 2.8 percent and 2.4 percent, respectively.

⁶⁶ For a detailed listing and description of these measures, see Annex to this chapter.

⁶⁷ Customs Proclamation No. 859/2014 and Council of Ministers Regulation No. 122/1993.

processes or procedures across all agencies. At individual clearance points, there is provision for regular meetings between border agencies and customs brokers or other representatives of the business community. However, there is no general obligation to provide opportunities for comments or carry out consultation among different stakeholders. For instance, the adoption of directives is not regulated in a uniform and binding manner. Private sector stakeholders cannot comment on draft directives.

- National Committee on Trade Facilitation:

There is no specific committee dealing with trade facilitation issues. Responsibilities in the area of trade facilitation are shared between the Export Promotion Council, chaired by the Prime Minister; the Export Coordination Committee under the Ministry of Transport; the Customs and Logistic Committee, chaired by ERCA; the multimodal Implementation Follow-up Committee; the Electronic Single Window Steering Committee; and the National Logistic Council, recently established in connection with the National Logistics Strategy.

Coordination and partnerships between the public and private sectors are still at an early stage. The establishment of such partnerships requires the leadership of an appropriate organizational entity to guide them towards the effective implementation of jointly-agreed trade facilitation measures.

- Formalities and documentation requirements:

Exporters and importers need to submit numerous documents for Customs clearance.⁶⁸ Although Customs import and export declarations can be submitted electronically, ERCA continues requiring submission of hard copies along with supporting documents. One reason for this is likely to be the absence of a legal framework in Ethiopia to recognize documents exchanged electronically, in relation to e-commerce, e-signatures, and e-payments (Nathan 2014). As a result, traders are confronted to unnecessary procedures and the redundant requirement of documents.

The 2010 regime has increased requirements for business licenses and requires individual licenses for each category or product listed under the new Ethiopian Standard Industrial Classification (ESIC), which contains more than 980 items. This reform has imposed additional costs since businesses must now get multiple licenses to process a single shipment (Nathan 2013).

ERCA will work to enact new legislation that recognizes electronic processing of transactions and payments to achieve the full range of automation benefits and eliminates paper documents to the extent possible. Likewise, ERCA will conduct a review of documents and Customs procedures to ensure alignment with international standards, conventions and other instruments (Nathan 2014).

3.4 Procedures for appeal and review

The new Customs Proclamation provides for three levels of administrative appeal and the possibility of a judicial review. At the first level, recourse can be taken to a Complaint Review section of the Customs administration. Branch offices of the Customs administration are mandated to review decisions on the origin, valuation, description, and tariff classification of goods, as well as decisions following post-clearance audit; whereas the complaint review

⁶⁸ Export documents are: bank permit, bill of landing, commercial invoice, Customs export declaration, export permit, health and fumigation certificate, and packing list. Import documents are: bank permit, bill of landing, certificate of origin, commercial invoice, customs import declaration, foreign exchange authorisation, import permit, insurance documentation, packing list, payment receipt, pre-shipment inspection clean report of findings (World Bank 2015).

section considers further appeals of those decisions, in particular the review administrative penalties.

At the second level, persons aggrieved by the decision of the complaint review section or the office of the director general can file an appeal to the Tax Appeal Commission. At the third level there is a possibility to request judicial review by the Federal High Court of decisions made the Tax Appeal Commission.

With the three levels of recourse for review and appeal of customs decisions, and the requirement to render decisions in writing stating the reasons, Ethiopia can be said to be in full compliance with the mandatory provisions of the WTO-TFA on these matters. At any rate, ERCA still needs to implement the appeals procedure provided for within the new customs proclamation effectively and, as a part of the implementation, it should develop a new directive on appeals and an information strategy to ensure the business community is fully aware of the appeals system. The appeals procedures within other border agencies should be reviewed in consultation with stakeholders.

3.5 Disciplines on fees, charges and penalties

Regulation No. 190/2010 stipulates that fees and charges shall not exceed the costs incurred to provide a given service. In addition, all government agencies shall publish all the fees and charges that they apply and any approved changes thereto.⁶⁹ The ad valorem nature of the fees applied in Ethiopia cause these fees to vary hugely depending on the value of the consignment and do not reflect ERCA's real cost of performing the service. Therefore, these fees appear to be inconsistent with the TFA, which requires the fee to cover only the cost of the service.

Regarding penalties for a breach of Customs laws, regulations or procedural requirements, the Customs Proclamation stipulates that such penalties can be imposed only on persons or entities directly responsible for breaches (carriers, or warehouse permit holders) or involved in the transit of goods. The amounts are defined in ranges depending on mitigating or extenuating factors (Article 157.1), where the mitigation factor is the offender's disclosure and consent to pay the penalty. The offender is notified through a standard form sent by the Complaints Review Section of ERCA (Article 6 of the ERCA directives). Moreover, the remuneration of Customs officers is not linked to the assessment or collection of a penalty.

Although these new provisions on penalties disciplines are aligned with the TFA, the lack of consistency and transparency in their application has given rise to concerns amongst the business community. The Customs Proclamation's principles need to be further developed by other directives setting for guidelines and procedures on penalties.

3.6 Customs procedures

- Risk management, Authorized Economic Operators and post-clearance audit:

ERCA relies on a risk analysis, which is, however, implemented in a rudimentary fashion. More than half of the shipments examined are not uniformly entered into the risk management system. The Risk Management Office is therefore piloting a new Trader Risk Data Profile System, designed to share information to help develop, update and refine risk profiles. The System seeks to develop a list of those companies that seem to avoid compliance with Customs regulations and to identify the cause of the risk, for example tariff and valuation discrepancies or lack of knowledge or understanding of the trade laws. Based on these

⁶⁹ The detailed regulation of how public bodies are to impose fees and charges is provided in the Ministry of Finance Directives on Fees and Charges No. 1/2011. On the import side, there is a fee for x-ray scanning of goods in transit and an inspection fee (currently 0.07 % of the dutiable value of the goods, regulated by Inspection Procedures Directives No. 14/2009). On the export side there is a fee refused entry of goods and allowed to be re-exported (5 % of the duties and taxes payable on the goods).

outcomes, the Tariff and Valuation Office, the Legal Office and other offices will hold workshops or provide technical assistance and advice to enhance the understanding of import regulations and promote compliance with these regulations.

In addition, ERCA is currently making efforts to improve its risk management system in order to lower the number of consignments that must undergo physical inspection. With this purpose, ERCA has reviewed the import cargo procedures and implemented international recommendations on risk management. This review aims at grouping companies into those that are voluntarily compliant (“green channel”), those that try to be compliant but are sometimes unable to so (“yellow channel”), and those for which there are indications that they try to avoid compliance or deliberately do not comply (“red channel”). This segmentation allows Customs to concentrate controls on non-compliant companies and has led to a considerable reduction in the share of cargo that undergoes physical inspection. Nevertheless, Modjo Dry Port still needs to discriminate between cargos that must move fast through the system and cargos that will need to be stored, then cleared, sold and removed. The lack of an effective risk management system produces congestions in Modjo terminal.

Currently, ERCA is developing an Authorized Economic Operators (AEO) scheme for “green channel” companies that would benefit from a special bypass lane at the border, expediting vehicles through a fast track and cutting time at border to 15 minutes for most vehicles (Nathan 2013). The system encourages compliance of traders and helps to decongest border posts. With the introduction of the new Trader Risk Data Profile System, ERCA can better identify and monitor compliant companies and encourage them to apply for AEO status.⁷⁰

However, at present, even companies with AEO status often cannot dispose of imported intermediate goods on time due to unnecessary delays in customs administration. While containers destined for these firms are delivered directly from ports to their factory premises, opening these containers mostly requires the presence of Customs inspection officers. Moreover, all air-shipped items for AEOs are inspected and processed at the airport premises.

Companies that try to comply but they have with mixed results, should be accorded yellow channel documentary inspection. Currently a “yellow channel” designation seems to lead almost automatically to “red channel” physical inspection. This should occur only when a problem is identified (Nathan 2013). ERCA is also implementing a Post Clearance Audit program as a component of the new risk management and AEO systems, with technical support from IFC. The program targets “red channel” companies for desk and field audits from the list of those that seem to deliberately do not comply.

- Customs automation and single window:

ERCA is using a computerized customs management system (ASYCUDA++),⁷¹ but electronic filing is not mandatory in Ethiopia, and relevant data cannot be readily transferred between agencies. As a result, traders are still required to physically visit various agencies (ERCA, the Ministry of Trade, standards certification agencies, banks and shipping enterprises) involved in licensing and goods clearance. They also have to submit the same

⁷⁰ Currently, only 13 companies are designated as AEOs under Proclamation No 622/2008 of 2008 Articles 14(2) and 112(2).

⁷¹ The Automated System for Customs Data (ASYCUDA) is a computerised customs management system that handles manifests and customs declarations, accounting procedures, transit and suspense procedures. It provides for Electronic Data Interchange between traders and Customs. The ASYCUDA software is developed by UNCTAD, taking into account the international codes and standards developed by the International Organisation for Standardisation, the World Customs Organization and the United Nations. The most up-to-date version is ASYCUDA World, but Ethiopia is using an earlier version, ASYCUDA++.

documents at several stages of the trading process. An interface between border agencies would greatly reduce processing time, eliminate the need to furnish documentation at each step, and enable archiving and data retrieval.

ERCA plays a leading role in an ongoing project to introduce an Electronic Single Window (ESW), which will network regulatory authorities i.e. Customs, Ministry of Agriculture, Ministry of Transport, Ministry of Trade, etc. Moreover, ERCA, as the lead of the steering committee composed of relevant stakeholders, is conducting a business process re-engineering study. In addition, ERCA started the Customs Management System project in 2012, with EU financial support, to fully change the existing system to a new and better system that could support the implementation of the new customs proclamation (see also section 4.2.2).

To accomplish all these improvements, Ethiopia needs to upgrade the quality of its telecommunication network. At the border with Djibouti, it is highly irregular and presents a problem in transferring data from one country to the other. Furthermore, Ethiopia needs to develop an appropriate legal framework for accepting electronic documents in lieu of manual ones.

- Pre-arrival processing:

Article 28 of the new Customs Proclamation allows for the pre-arrival lodgement of documents in electronic format and a pre-arrival clearance. After examining the declaration and supporting documents, ERCA may issue a release of goods upon arrival.

However, even if information is received in advance, clearance procedures start only when goods arrive. To fully implement this measure, ERCA needs to operationalize the regulation through directives for developing Article 28 of the Customs Proclamation and to coordinate with other border agencies. The Single Window may be the ideal framework for coordinating all border agencies and implementing this measure.

- Electronic payment to agencies involved in border clearance:

Payments for all agencies are currently made either in cash or to a bank, and the duty payment receipt is required at the time of presentation of the declaration. This process requires the presence of a representative of the importer at the bank and, depending on the range of charges associated with the transaction, at the cashier of one or more agencies. This procedure consumes considerable time, adding to the cost of clearance for importers and exporters.

The wording of the Customs Proclamation opens a window to introduce electronic payment, provided that the regulatory framework for financial services is in place. The National Payment System Proclamation recognizes the possibility of electronic transfer of funds by implementing the principle of the evidentiary value of electronic transfers, signatures, and documents, including checks, in legal proceedings. Nonetheless, the effective implementation of this measure will require a specific legal framework for the development of electronic financial transactions, which is in preparation.

- Release of goods prior to the final determination of Customs duties, taxes, fees, and charges:

The Customs Proclamation provides for the possibility of release of goods upon receiving a guarantee from the importer to secure payment of the taxes and duties within a certain period of time. However, ERCA applies this measure only for selected goods, and its Directives lay down in detail the procedures for such releases as long as a guarantee is provided. Normally, the release of goods still depends on the payment of duties and taxes, according to Article

27(1) of the Customs Proclamation, which stipulates that, in general, goods may not be released before the payment of duties and taxes.

On the other hand, Article 29 provides that ERCA may release goods prior to the completion of Customs formalities, upon agreement that the declarant will subsequently accomplish all the custom formalities. This provision would appear to adequately provide for a more generalized release of goods against guarantees. In addition, the simplified procedures for AEOs, in principle, also allow for the separation of release of goods from the final determination of duties, taxes, fees, and charges.

- Expedited shipments

The new National Logistics Strategy aims at reducing Modjo Dry Port release time to three days for priority cargo that requires fast service and for those goods that are left at Modjo in storage before paying duties and removing the cargo. For fast clearance, goods that are in the dry port will have to be picked up within two days of clearance or the rate will become punitively high. By contrast, for regular clearance, the container will be taken to the bonded warehouse. The implementation of this fast track clearance will decongest Modjo dry port operations so that it can deliver faster service for those shippers who want immediate release.

- Average release times:

Even though Customs offices work 16 hours daily on seven days a week, the overall dwell time at Modjo Dry Port still is 41 days. Once goods arrive at the gate, Customs officers review the documents, check the seal and return the documents to the driver. This takes about 10 minutes, followed by 25 minutes to offload the container in the yard. But, for freight that is designated for inspection, it can take 5 days to locate and move the container to the inspection area. The physical inspection usually takes 1-2 days. Other agencies responsible for prohibited or contaminated products are also involved in the final clearance. Better coordination of these controls could significantly reduce dwell time at the dry port (Nathan 2013).

Approximately 10 percent of containers are at Modjo for 8 days or less, while around 25 percent are in the yard for more than 2 months. About 28 percent of containers are stripped after Customs clearance, and shipped to the importers as loose cargo (Nathan 2013). The clearance process is considerably easier, more transparent and shorter, when the multimodal transportation scheme is used (table 8.1).

3.7 Coordination between different stakeholders

Administrative responsibility for different elements of trade facilitation are split between several Ministries and departments, including the Ministries of Trade, Industry and Finance, the Road Transport Authority, ELSE and others. Coordination among these different entities remains weak, at both the technical and inter-Ministerial levels. This has a negative impact on the capacity to formulate, coordinate and implement reforms.

The lack of a single agency leading trade facilitation reforms is a major obstacle for the implementation trade facilitation reforms. Another obstacle is the lack of coordination among committees and bodies responsible for different trade facilitation issues. Currently Ethiopia has several committees, but there is no effective coordination mechanism in place. In the context of the Electronic Single Window (ESW) project, the various agencies and ministries, which are members of the Steering Committee of the ESW, signed a Memorandum of Understanding as an expression of true commitment by all stakeholders to effective coordination and implementation of the ESW.

Table 8.1:

Customs clearance process for multimodal and unimodal transport

<i>Multimodal clearance</i>	<i>Unimodal clearance</i>
<ul style="list-style-type: none"> ▪ The ship’s manifest is sent to Addis Ababa, where key data is recorded and sent to the ESLSE office in Djibouti and the Association of Djiboutian clearing agents. ▪ On arrival, the Djiboutian clearing agent obtains a customs transit document from Djibouti Customs, a delivery order from the ship’s agent and a gate pass from the port authority, and issues a waybill for the shipment. ▪ The information from the Customs transit document is transferred to ERCA in Addis Ababa. The truck is sealed and the seal number entered into the Djiboutian and Ethiopian transit documents. ▪ At the Galafi border post, the ERCA officer prints the T-1 transit document and gives 3 copies to the driver to present at each checkpoint on the way to Modjo Dry Port. Seals are checked, the T-1 is stamped and the module updated to show that the truck has passed each checkpoint. The Transit Management Office at ERCA in Addis Ababa electronically monitors the movement of shipments through the Corridor. ▪ The truck weight is checked at Awash and recorded. Trucks that are overweight are forced to wait until another truck can take the excess weight. ▪ At Modjo Dry port, final customs clearance takes place and goods are released. 	<ul style="list-style-type: none"> ▪ ERCA’s Transit Coordination Office at the Port of Djibouti has computerized transit documents, but no connectivity to ERCA in Addis-Ababa or with Djibouti Customs or the Port. Paper documents are carried among the offices and manifest data must be entered manually. ▪ Once declarations and duty payments are made, the dispatch order must be e-mailed or faxed to Djibouti where the Transit Office enters the information into the log book. ▪ All the necessary documents are then compared for accuracy. On approval, the transit document is generated and attached to the documents, which are sealed for presentation at the inspection desk at the border post. The customs officer at the border verifies the seal and the documents before generating a sealed road transport manifest that permits importation to Ethiopia. At the Mille checkpoint, the declaration is re-entered since this is the first point in the transit movement with connectivity to the ERCA head office in Addis Ababa. ▪ Approximately 22% of unimodal transits are in the port for 1-8 days, while 70% of transits are in the port for 9 – 90 days. Reducing this delay is a major challenge to address. ▪ ESLSE acts as the clearing agent for bulk, break bulk and containerized traffic arriving on ships of the Ethiopian Shipping Line. In this case, the Dispatch Order is sent by e-mail or fax to ESLSE in Djibouti, while the other documents are all couriered. ESLSE in Djibouti completes the port and transit operations with the Port and Djibouti Customs and then submits documentation to the ERCA Transit Coordination Office in Djibouti. ESLSE provides the driver with a road transport manifest and the goods are released to the border post where the documents are verified. At the Mille checkpoint, the declaration is re-entered into the computerized customs management system. ▪ The truck weight is checked at Awash and recorded. Trucks that are overweight are forced to wait until another truck can take the excess weight.

4. Ethiopia's gap in trade facilitation and how to close it

4.1 Ethiopia's remaining needs for compliance with WTO-TFA standards

The preceding sub-section has shown that, in some areas, Ethiopia's practices are already in line with the WTO-TFA standards, whereas in others there is considerable gap between current arrangements practices. Table 8.2 lists 35 specific measures contained in the agreement⁷² and identifies measures in which Ethiopia is already compliant (category A), measures that Ethiopia is in a position to become compliant with its own means after a period of transition (category B), and measures for which Ethiopia will require external technical assistance and capacity building as well as a period of transition (category C).⁷³ However, it should be noted that trade facilitation and logistics agenda extends beyond what is covered by the WTO-TFA to encompass, for example, logistics-related regulatory measures (for example, non-tariff measures) and transport and distribution-related services that can give rise to excessive costs for traders. These issues are addressed in chapters VII and VIII of this study. Reform targets and indicators should therefore not be limited to the areas covered in the WTO Agreement.

Table 8.2:

Categorization of Trade Facilitation Measures for Ethiopia (2015)				
WTO-TFA Article	Measures	Currently implemented	Technical assistance	Category
1.1	Publication	No	No	B
1.2	Information available through Internet	No	Yes	C
1.3	Enquiry point	No	Yes	C
2.1	Opportunity to comment and information before entry into force	No	Yes	C
2.2	Consultations	No	No	B
3.1	Advance rulings	No	Yes	B
4.1	Right to appeal or review	No	No	B
5.1	Notifications for enhanced controls or inspections	No	Yes	C
5.2	Detention	No	No	B
5.3	Test procedures	No	Yes	C
6.1 6.2	Disciplines on fees and charges imposed on or in connection with importation or exportation	No	No	B
6.3	Penalty disciplines	No	No	B
7.1	Pre-arrival processing	No	No	B
7.2	Electronic payment	No	Yes	C
7.3	Separation of release from final determination of customs duties, taxes, fees and charges	Yes	No	A
7.4	Risk management	No	Yes	C
7.5	Post-clearance audit	No	Yes	C

⁷² For a description of these measures see table in the Annex to this chapter.

⁷³ This assessment is based on a previous gap analysis by the World Bank (2014), which has been extended by using additional data collected by the UNCTAD secretariat from March to July 2015, as well as additional desk-research and recent studies on trade facilitation.

7.6	Establishment and publication of average release times	No	Yes	C
7.7	Trade facilitation measures for Authorized Operators	No	Yes	C
7.8	Expedited shipment	No	No	B
7.9	Perishable goods	No	No	B
8.1	Border agency cooperation	No	Yes	C
9.1	Movement of goods intended for import under customs control	Yes	No	A
10.1	Formalities and documentation requirements	No	Yes	C
10.2	Acceptances of copies	No	No	B
10.3	Use of international standards	No	Yes	C
10.4	Single window	No	Yes	C
10.5	Pre-shipment inspection	No	Yes	C
10.6	Use of customs brokers	No	Yes	C
10.7	Common border procedures and uniform documentation requirements	No	No	B
10.8	Rejected goods	Yes	No	A
10.9	Temporary admission of goods and inward and outward processing	No	No	B
11	Freedom of transit	Yes	No	A
12	Customs cooperation	No	No	B
13.2	National committee on trade facilitation	No	No	B

4.2 Closing the gap

For those measures that are considered to be Categories B and C in table 8.2, this section will present recommendations for actions to close the gap. Most of these measures are primarily relevant for import trade. However, the capability of many Ethiopian manufacturing firms and exporters to produce and export goods at international competitive prices depends on imported intermediate goods. It follows that these measures are also of key importance for the success of the export-oriented industrialization strategy. Delays in, and costs of, customs and logistics procedures have been one of the reasons for low capacity utilization in Ethiopian manufacturing industries and have put a constraint on the expansion of their production and their possibilities to integrate into global value chains.

4.2.1 Coordination among border agencies and public-private partnership

Although initiatives, such as single windows and one-stop border posts, have resulted in increased cooperation among border agencies, a lack of coordination among border agencies has been part of the obstacles causing delays in implementation of reform programs, during the GTI I period. Generally, each border management agency carries out its responsibilities and minds its own rationale and processes. Even at operational level, border agencies do not sufficiently coordinate their interventions in import and export processing. The current challenge in trade facilitation therefore relates not so much to the design of policies and reforms but primarily to the efficient coordination and effective implementation of these reforms.

Existing fora at the operational and implementation level should be reviewed and, where they are absent, developed and implemented in consultation with the business community. The review should examine the regularity and membership of the fora to ensure that they provide timely information to the relevant sectors and allow for clear outcomes that take account of

the private sector concerns expressed. Where no platforms for effective consultation exist, discussions should take place with all stakeholders to identify the most practical structures and to agree on a realistic implementation timetable.

Raising awareness among the all actors involved in import, export and transit activities is also necessary to ensure the effectiveness of trade facilitation reforms. To address this information gap, ERCA needs to provide organized training sessions, so that these actors are aware of their rights and obligations.

4.2.2 Customs modernization

ERCA is currently running the following projects aiming at modernization custom procedures and practices:

- Introducing scanning machines for cargo transiting through the Ethio-Djibouti corridor: This project, supported by China, aims at facilitating transit and expediting clearance at border posts and offices at destination. While the installation of these machines is yet to be completed, some have already been installed at the Galafi entry post on the Ethio-Djibouti corridor. They will also be used at the new railway connecting the Djibouti port with Addis Ababa.
- The customs valuation system used by ERCA has recently been upgraded to the Ethiopian Customs Valuation System (ECVS) with financial and technical support from India. Currently, the system has been installed; and the project is in its implementation phase.
- The Ministry of Trade has pilot-tested an online trade registration and licensing system and is rolling it out across the regions.

In addition to completing the implementation of these projects, Ethiopia needs to reform its legal framework in order to promote Customs automation. Two main areas where new legislation will be required are the recognition of electronic processing of transactions and payments, and the elimination to the largest possible extent, of the requirement for paper documents.

Trade facilitation through Djibouti would also be enhanced by the harmonization of the computerized customs management systems of the two countries. ERCA is at an advanced stage of replacing its current system with a next generation customs management system. It is important that the solution is compatible with the systems used by Ethiopia's neighbours, in particular ASYCUDA World used in Sudan and Djibouti.⁷⁴

4.2.3 Multimodal transport

At present, imports into Ethiopia are handled under the unimodal or multimodal transportation system (see also chapter VII). Under the unimodal system, Ethiopia Customs requires additional documents, which are not required if imports are made under a multimodal transport contract (see table 8.1 above). This is notably the case for the Bill of Lading, Packing list and a copy of the invoice. Also, under the unimodal mode, the Ethiopia-Djibouti Customs Coordination Bureau has to review the documentation and issue a "printout", which

⁷⁴ A seamless interface with Djibouti Customs is of particular relevance given the current proposals to establish an Ethiopian Inter-Modal Dry Port (IMDP) to handle goods shipped in and out of Djibouti but from, and destined to, Ethiopia. The IMDP is reliant on an inter-customs agreement on a special arrangement allowing the uninterrupted transfer of Ethiopian transit cargo via the rail-intermodal system – a seamless service with a high degree of security. A possible arrangement could be based on block clearance of a special section of the ship's manifest.

is then returned to Djibouti Customs, before the T1 for onward transit can be issued by Djibouti Customs.

Under a multimodal contract, the declaration made in Ethiopia suffices for Ethiopia and Djibouti Customs to issue the T1 document for onward transit. The logic of requiring less documents for multimodal transport is that one single operator (such as ESLSE) is responsible and liable for the entire transport chain. One option that could be considered is developing a proposal for a legal reform in Ethiopia that would make it easier also for other companies to import under a multimodal contract. Such a reform would contribute to Ethiopia's compliance with both Article 8 (Border Agency Cooperation) as well as Article 10 (Formalities connected with Importation, Exportation and Transit) under the Trade Facilitation Agreement.

4.2.4 Ethiopia-Djibouti Customs Coordination and Cooperation

At present, Djibouti Customs and Ethiopia Customs have separate offices at the main border crossing in Galafi, with different opening hours and working days. Such a situation makes cross-border procedures more cumbersome for traders and tends to increase delays at the border. One solution for enhancing the efficiency of customs procedures at the Ethiopia/Djibouti border is to develop a one-stop border post that consolidates border control functions in a single public hall for exiting one country and entering the other with harmonized working hours. This could be done in the context of a COMESA-wide programme towards “one-stop border posts” (OSBP) and also contribute to comply with TFA Article 8 (Border Agency Cooperation). Ethiopia’s new National Logistic Strategy foresees to introduce one stop border posts in Galafi, operated jointly by Ethiopia and Djibouti, as well as at the border with Kenya.

As trucks would have to stop only once at the border this would reduce time and costs involved in border crossings. This form of cooperation would also increase efficiency and reduce cost for the Customs administrations of both countries. It would also facilitate communication, sharing of intelligence and experience, communication and sharing of ideas, information and experiences that can result in more effectively combatting fraud. Implementation of an OSBP involves four elements: a legal framework to provide border officers with the jurisdiction to apply their national laws within the territory of the adjoining state; the design of procedures and traffic flows at the common control zone; appropriate Information and communication technologies, and the design of integrated physical facilities. Ethiopia could significantly benefit from the establishment of an OSBP especially in combination with enhance “behind-the-border” operations.

Similarly, Ethiopian Customs currently authorize the transit of good through an office in Djibouti. In practice, this means that Customs clearing agents have to first submit documents to Djibouti Customs, from there go to the Ethiopian office – which issues a “printout” – and with this printout the clearing agent goes back to Djibouti Customs to be issued the T1 transit document. This complication could be facilitated through a bilateral agreement, which would allow Ethiopian Customs to work more closely with Djibouti Customs, for example potentially inside Djibouti Customs, similar to a one-stop border post. This reform would be in line with Article 8 (Border Agency Cooperation) of the WTO Trade Facilitation Agreement.

Ethiopia and Djibouti have signed a Cooperation and Partnership Framework Agreement establishing a Bilateral Mixed Commission. In addition, a Bilateral Agreement on Transit, signed in 2009, has led to the creation of a Permanent Committee on Transit where both countries coordinate initiatives to facilitate the transit. However, it seems that this Committee has not accomplished much progress on this issue.

It is suggested that the above Committee is provided with more political support and a clear road plan, and to include the recommendations mentioned above in its terms of reference. International technical assistance and funding opportunities for this purpose may also be available and should be strongly considered by Ethiopia. Strengthening the Ethiopia - Djibouti Commission and the Permanent Transit Committee would contribute to ensure compliance with TFA Article 8 (Border Agency Cooperation).

Efficiency gains would also result from the use of standardized forms by the two countries' Customs administrations. This could reduce the number of documents required for cross-border procedures and their complexity. At present the T1 transit forms used by Djibouti and Ethiopia do not have the same format, and it appears that, in day-to-day practice, Ethiopia does not always apply standard forms. Aligning official procedures and actual practices at the border to TFA Article 10.3 (Use of International Standards) may imply modifying Ethiopia's import, export, or transit formalities and procedures, especially its transit declaration.

4.2.5 Transit trade and transport monitoring

Monitoring and publishing data on the efficiency of transit by Customs can be a very valuable tool for users of public services (such as importers, agents) to plan their operations. It can also help identify potential bottlenecks and put pressure on Customs and other agents to further improve their services. Against this background, the WTO-TFA encourages signatory States "to measure and publish their average release time of goods periodically and in a consistent manner" (Article 7.6). Beyond the TFA, several countries and regional organizations have established or are setting up "transport observatories", which may also cover issues related to Customs transit.

At present, neither Ethiopia nor Djibouti Customs are measuring and publishing their release times in a systematic manner. One option for trade facilitation that should be considered to improve transparency in custom release times is to establish a Transport and Transit Observatory along the Djibouti-Ethiopia trade corridor. The establishment of such an Observatory would be in line with TFA Article 1 (Publication and availability of information), Article 7.6 (Establishment and Publication of average release times) and Article 8 (Border Agency Cooperation).

Further implementation of the on-going programme towards e-tracking of cargo transports, especially on the main transit corridor to and from Djibouti would reduce the need for checkpoints and physical inspections. It would alleviate the administrative and control burden of the Custom administration and contribute to ensure compliance with TFA Article 11 (Freedom of Transit).

4.2.6 Authorized Economic Operators

The expansion of the AEO scheme (see also section 3.6) would also reduce the administrative burden on Customs authorities and at the same time make an important contribution to increasing the efficiency of domestic export firms that have to rely on imported inputs. In this context, it is recommended to increase the number of Ethiopian AEOs to the largest possible extent, to support Djibouti in setting up an AEO system in compliance with Article 7.7 of the TFA, and develop a bilateral programme for both countries. This would require a detailed assessment of the implication of the scheme for risk management, post clearance audits, separation of release and clearance, and the provision of guarantees. It may also need to involve collaboration with Djibouti Customs. This analysis would constitute a step forward to ensure compliance with TFA Article 7.7 (Authorized Operators), Article 7.9 (Perishable Goods), Article 8 (Border Agency Cooperation), Article 9 (Movement of goods intended for import under Customs control).

4.2.7 Policy coordination for effective trade facilitation

State interests at the border include protection of national security, enforcement of import and export restrictions and prohibitions, collection of revenue, recording cross-border statistics, and enforcement of International Health Regulations. The responsibility for protecting these interests is vested in several state agencies. They include Police, Security, Customs, Immigration, those responsible for Sanitary and Phyto-sanitary regulations, and the bureau for standards. Since each of these agencies is under the responsibility of a different Ministry or Department, the responsibilities for different aspects of trade facilitation policy are also divided between the Ministries of Trade, Industry and Finance, the Road Transport Authority, the Ethiopian Shipping & Logistics Services Enterprise or the Ethiopian Civil Aviation Authority.

The lack of a single Government entity taking the lead on trade facilitation and logistics has made the coordinated implementation of a holistic trade facilitation reform very difficult. A possible solution would be to establish a National Trade Facilitation and Logistics Council consisting of all the relevant Governmental and non-governmental departments and agencies, and chaired at the highest level of government, preferably by the Prime Minister. Such a Council could meet twice a year to define the trade facilitation and logistics performance objectives and to set targets and indicators of performance measurement, and monitor progress every six months. A National Trade Facilitation Committee would have the advantage of not only overseeing increasing compliance international trade facilitation standards, but also helping to resolve most of the issues arising out of the lack of coordination among border agencies. Institutionally, the Ethiopian National Trade Facilitation Committee could be merged with an entity that oversees the ESW.

Since trade facilitation is closely linked to the overall transport and logistics system, the reform agenda should not be limited to the areas covered in the WTO-TFA and discussed in this chapter. It must also encompass logistics-related regulatory measures, including non-tariff measures, and services in the area of transport and distribution, which have been addressed in chapters VII and VIII, as well as in the chapters dealing with sectoral issues in Part III of this study.

ANNEX to chapter VIII

WTO Trade Facilitation Agreement Articles

<i>WTO-TFA Article</i>	<i>Title</i>	<i>Sub-Article</i>	<i>Title</i>	<i>Comments</i>
1	Publication and Availability of Information	1.1	Publication	Issues covered by this article are publication; information available through the internet; enquiry points; and notification. Member States are required to publish 'promptly' a wide range of specific information related to the requirements and procedures for clearing goods for import or export on the Internet.
		1.2	Information available through Internet	
		1.3	Enquiry Points	
		1.4	Notification	
2	Opportunity to Comment, Information before Entry into Force and Consultation	2.1	Opportunity to comment and information before entry into force	Introduces obligations on Member States to consult traders and other interested parties prior to introducing new or amended laws or regulations related to the movement, release and clearance of goods. It also provides for regular consultations between border agencies, traders and other stakeholders within its territory.
		2.2	Consultations	
3	Advanced Rulings	3.1	Advance Rulings	Advance rulings are binding decisions by customs, at the request of the trader concerned, on specific aspects of goods, in particular the classification and origin of the goods in preparation for importation or exportation. Advance rulings facilitate the declaration, and consequently speed up the release and clearance process, as the classification of the goods has already been determined in the advance ruling, and is binding on all customs offices for the specified period of its validity – which may be three months or a year.
4	Appeal or Review Procedures	4.1	Right to Appeal or Review	Expands provisions on appeal or review procedures - administrative or judicial – beyond those already contained in GATT Article X. Member States are encouraged to extend these provisions to decisions by other relevant border agencies and not just Customs.
5	Other measures to enhance Impartiality,	5.1	Notifications for Enhanced Controls or Inspections	Contains obligations on Member States relating to border controls and inspections

<i>WTO-TFA Article</i>	<i>Title</i>	<i>Sub-Article</i>	<i>Title</i>	<i>Comments</i>
	Non-Discrimination and Transparency	5.2	Detention	of foods, beverages or feedstuffs. Where a Member State issues notifications or guidance for enhancing the level of control or inspection of such goods, the article obliges the Member State concerned to base such controls or inspections on risk, to apply such measures uniformly at relevant points of entry, to withdraw the procedures promptly when the circumstances no longer justify them, and to publish promptly an announcement of the termination of the measures. It also requires the importer or his authorised agent to be informed of any cases where the goods have been detained, and, if a first test proves negative, it obliges the Member State to carry out a second sample test if requested to do so.
		5.3	Test Procedures	
6	Disciplines on Fees and Charges imposed or in connection with importation and exportation	6.1	General Disciplines on Fees and Charges imposed on, or in connection with, importation and exportation	The aim of this article is to limit the size of fees and charges to the approximate cost of the services rendered, in keeping with existing GATT obligations. A publication requirement has been included, together with a clause requiring Member States to review their fees and charges periodically and not to demand payment of revised charges before the information on them has been published.
		6.2	Specific Disciplines on Fees and Charges imposed on, or in connection with, importation and exportation	
		6.3	Penalty Disciplines	
7	Release and Clearance of Goods	7.1	Pre-arrival Processing	Sets out the procedures which Member States are obliged to establish or maintain for the release and clearance of goods for import, export or transit. Includes: pre-arrival processing, electronic payment; separation of release from final determination of customs duties, taxes, fees and charges; risk management; post-clearance audit; establishment and publication of average release times; trade facilitation; expedited shipments; and perishable goods.
		7.2	Electronic Payment	
		7.3	Separation of Release from Final Determination of Customs Duties, Taxes, Fees and Charges	
		7.4	Risk Management	
		7.5	Post-Clearance Audit	
		7.6	Establishment and Publication of Average Release Times	
		7.7	Trade Facilitation Measures for Authorized Operators	

<i>WTO-TFA Article</i>	<i>Title</i>	<i>Sub-Article</i>	<i>Title</i>	<i>Comments</i>
		7.8	Expedited Shipments	
		7.9	Perishable goods	
8	Border Agency Cooperation	8.1	Border Agency Cooperation	Obliges Member States to ensure that its authorities and agencies responsible for border controls and procedures for import, export and transit of goods cooperate with one another and coordinate their activities in order to facilitate trade, including alignment of working days and hours; alignment of procedures and formalities; development and sharing of common facilities; Joint controls; and establishment of one stop border post control.
9	Movement of Goods intended for import under Customs Control	9.1	Movement of Goods intended for import under Customs Control	Requires Member States, to the extent practicable, to allow goods intended for import to be moved within its territory and under customs control from the point of entry to another customs office from where the goods can be released or cleared.
10	Formalities Connected with importation, exportation and Transit	10.1	Formalities and Documentation Requirements	Aims at minimizing the incidence and complexity of import, export and transit formalities aimed at decreasing and simplifying documentation requirements. It covers: formalities and documentation requirements; acceptance of copies; use of international standards; single window; pre-shipment inspection; use of customs brokers; common border procedures and uniform documentary requirements; rejected goods; and temporary admission for goods including inward/outward processing.
		10.2	Acceptance of Copies	
		10.3	Use of International Standards	
		10.4	Single Window	
		10.5	Pre-Shipment Inspection	
		10.6	Use of Customs Brokers	
		10.7	Common Border Procedures and Uniform Documentation Requirements	
		10.8	Rejected Goods	
		10.9	Temporary Admission of Goods and Inward and Outward Processing	
11	Freedom of Transit	11.1 - 11.3	Transit Charges, Regulations, and Formalities	Expands on GATT Article V that each Member State is to treat products in transit no less favourably than if they were being transported to their destination without going through the territory of that Member State. Member States are also required to remove any regulations or
		11.4	Strengthened Non-Discrimination	
		11.5 - 11.10	Transit Procedures and Controls	

<i>WTO-TFA Article</i>	<i>Title</i>	<i>Sub-Article</i>	<i>Title</i>	<i>Comments</i>
		11.11 - 11.15	Transit Guarantees	formalities on traffic in transit that are either no longer needed or whose obligations can be addressed in a less trade-restrictive way.
		11.16 - 11.17	Transit Cooperation and Coordination	
12	Customs Cooperation	12	Customs cooperation	Sets out the terms and requirements for improving customs cooperation and establishing a framework for cooperation that obliges Member States to share information with other countries to ensure orderly coordination of customs control, while respecting the confidentiality of information held, including measures promoting compliance and cooperation; exchange of information; verification; provision of written requests; protection and confidentiality; provision of information; postponement or refusal of a request; reciprocity; administrative burden; limitations; un-authorized use or disclosure; and bilateral or regional agreements.
13	Institutional Arrangements	13.1	Committee on Trade Facilitation	Provides for a WTO Committee on Trade Facilitation (replacing the Negotiating Group on Trade Facilitation) to address implementation and application of the Agreement. Member States have agreed that there should be an initial review of the operation of the agreement four years after it has entered into force. Also requires Member States to establish a national committee on trade facilitation, or designate an existing mechanism to facilitate both domestic implementation and coordination of provisions of the Agreement.
		13.2	National Committee on Trade Facilitation	

Chapter IX:

Promotion of investment and strengthening finance

1. Introduction

As for many other developing countries, industrial catching-up in Ethiopia faces serious financial constraints. According to the World Bank (2016), one third of Ethiopian firms in the manufacturing sectors have identified access to finance as a major constraint. In agriculture and commerce in the rural areas, this proportion is likely to be even higher. This constraint is being felt both in short-term financing of current activities and in long-term financing of investment for extension and technological upgrading of productive capacity-building.

In Ethiopia, only 16 percent of manufacturing firms can dispose of a bank loan or a line of credit, compared to 23 percent in SSA and 34 percent in the rest of the world (World Bank 2016). Another financing constraint arises from the virtual absence of supplier credit, which is of particular importance for the financing of current operations. The international average for working capital financed by supplier credit is in the order of 10 percent, and the SSA average in the order of 8 percent, but in Ethiopia this source of working capital for manufacturing firms accounts for less than one percent. In addition to these constraints in domestic currency financing, access to foreign exchange for the import of intermediate and capital goods is a frequently reported problem.

Capital accumulation, through investment in productive capacity, is a precondition for sustained export growth in the prioritized sectors, and GTP II therefore aims at raising the rate of private investment in GDP from around 17 percent in 2013/14 to more than 20 percent in the coming years. Whether this will be realized or not, depends on two factors: First, the willingness of private entrepreneurs to invest in additional productive capacity, and second the possibilities to finance such capital spending. In order to stimulate the willingness to invest, the Government has put in place quite generous tax incentives. But the expectations that potential investors have with regard to future demand for their products and the easiness of operating their business also have a strong influence on their willingness to extend and upgrade productive capacities.

When it comes to the financing of investment expenditure by the private sector, equity capital is the main source at the stage of setting up a new business, while retained profits is preferred at the stage of expanding and upgrading production capacity. According to the World Bank (2016) these forms of internal financing account for about 85 percent of investment financing in Ethiopia, which is substantially higher than the international average (72 percent) and the SSA average (77 percent). Conversely, complementary external financing from the banking system is much lower in Ethiopia than in other countries. This suggests that the banking system in Ethiopia should assume a stronger role, than in the past, in providing long-term credit for the financing of private investment.

The banking sector in Ethiopia consists of the national Development Bank of Ethiopia (DBE), 18 commercial banks, 31 microfinance institutions and five capital goods finance companies.⁷⁵ Among the commercial banks, the largest is the state-owned Commercial Bank of Ethiopia. It accounts for about 70 percent of total assets of all commercial banks (IMF 2015), but most of its lending (80 percent) is for financing public investments. According to a recent study by the World Bank (2015), the share of credit to the private sector has

⁷⁵ As of June 2014; see World Bank 2015b.

consistently been declining from 66.5 percent in 2007/08 to 40.1 percent in 2013/14. Similarly, the ratio of private sector credit to GDP declined from 15.4 percent in 2003/04 to 10.9 percent in 2013/14, and has been below the SSA average since 2008.

Since technological upgrading and enlargement of productive capacities implies increasing imports of machinery and equipment that cannot be produced in Ethiopia, investment financing also has a large foreign exchange component. FDI can contribute to solving the problem accessing foreign capital, although expectations in this regard have been fulfilled only partly, as the amount of FDI inflows was lower than expected – and lower than Ethiopia’s potential to attract such investment.

Higher investment in productive capacity in the manufacturing and services sectors will therefore require further efforts to attract the most appropriate types of FDI, but also a stronger role of the DBE and the commercial banks in the intermediation between international capital markets and foreign lenders, on the one hand, and domestic investors and importers of capital goods, on the other.

Section 2 of this chapter will first review the current policies and remaining challenges in the area of domestic investment and finance for private firms. Sub-section 2.1 will address various constraints that have emerged in recent years for domestic companies in the financing of current operations. The following sub-section will discuss the need and options for strengthening the nexus between profits from export activities and further investment in productive capacities, which bears on both the propensity of entrepreneurs to invest and the possibilities of self-financing of their investment projects. The crucial role of the domestic financial system in supporting the desired expansion of the prioritized sectors, and possibilities to render it more effective in playing this role, are the subject of sub-section 2.3. Section 3 then turns to the question of how the contribution of FDI to meeting the financing needs of the Ethiopian industrialization strategy could be optimized, before a number of recommendations on strengthen finance will be presented in the last section.

2. Challenges and constraints in domestic investment and finance

2.1 Financing current operations: Working capital constraints and payments facilities

2.1.1 Financing working capital

A major constraint to the current operations of Ethiopian manufacturing firms in all sectors is their shortage of liquid working capital, i.e. the difference between their liquid current assets and their current liabilities. This is particularly important for small and medium-sized enterprises (SMEs) operating outside global value chains, as it impacts negatively on their efficiency and competitiveness. Insufficient working capital and inadequate payments facilities, especially in connection with imports of inputs, are among the main reasons for sub-optimal capacity utilization. SMEs often have to rely entirely on the cash flow they can generate internally or on expensive micro-finance schemes, which reduces their ability to assume larger export orders and to expand their activities. The shortage of liquid working capital has two main reasons: the lack of flexibility in inventory management and the difficulties to obtain short-term credit facilities from the banking system and suppliers.

As a result of complicated procedures for the import of inputs and the unreliable delivery times of such imports, many companies feel obliged to hold larger inventories than what would be necessary for their current production, in order to minimize complications resulting from reordering, and to provide for contingencies of input unavailability. Shortcomings in the national logistic system and the obligation to pay import duties upfront are binding working capital that would otherwise be available to meet current liabilities. In addition, payment for exports is typically received only several months after delivery. The scarcity of working

capital is exacerbated by long delays in the refund of import duties and the reimbursement of VAT. Simplification and acceleration of administrative and logistic procedures (see chapters VII and VIII) would thus mitigate the working capital constraint of manufacturing firms.

The problem of working capital shortage could be alleviated also through easier access to, and cheaper arrangements for, short-term credit lines. An approved credit line, even if not used, creates a fallback position in situations of cash-flow difficulties and would allow companies to operate more comfortably. In the Ethiopian manufacturing sectors the proportion of working capital financed by banks is less than 6 percent, compared to an international average of more than 10 percent. And whereas, on average, 30 percent of firms in other countries use bank credit to finance working capital (around 23 percent in SSA), this share is as low as 14 percent in Ethiopia.

In particular, firms outside Addis Ababa generally find it difficult to access financial services and credit because the network of bank branches throughout the country is quite thin. Bank branches have increased four-fold since 2010, but more than a third of these branches is located in Addis Ababa. The rural areas still lack good access to financial services. (IMF 2015a,b).

An additional constraint arises from the conditions to obtain overdraft authorizations, which are the typical form of financing working capital in Ethiopia. These require firms to hold an equivalent amount of cash balances in their working capital, the value of inventories and the amount of claims on clients not being taken into account. Moreover, it appears that, according to current regulations, it is not possible to use commercial bank credit and development bank financing in parallel. But, in principle, finance for working capital should come from commercial banks while the DBE provides a large share of longer-term investment finance. The challenge here is to strike a better balance between financial control, which is necessary to prevent and penalize misuse and to ensure financial soundness, and satisfying the financial needs of producers in the prioritized sectors to improve their operational efficiency.

2.1.2 Facility of making payments in foreign currency

Another constraint domestic firms face is linked to the difficulties in making payments for imports in foreign currencies. While indispensable in an economy that is short of hard currency, foreign exchange rationing has been a hindrance for many manufacturing firms in the prioritized sectors to produce efficiently and at internationally competitive terms.

Depending on the specific productive activity, imports of inputs to current production require access to foreign exchange and mechanisms that allow for short-term financing and facilitate payments for such imports until the output generated by using these inputs can be exported and can earn foreign currency. Although the DBE has introduced an export credit guarantee scheme to facilitate access of exporting firms to working capital, many domestic companies appear to be frequently constrained in the timely procurement of essential inputs from foreign suppliers as the granting of foreign currency permits takes considerable time. Furthermore, domestic firms, including those that are producing primarily for export but have to import some of their inputs, are not allowed to make international electronic payments, even of small amounts, by using an international corporate credit card. Instead, they have to go through a paper-based process, which is not only time consuming but also not acceptable by their foreign counterparts.

While Ethiopian subsidiaries and affiliates of large foreign enterprises can rely on the internal financing mechanisms and borrowing capacities of their parent companies, these working capital and payment constraints are likely to become more severe in the coming years for domestically owned firms, as they aim to engage more and more in export activities. It will therefore be important, during the GTP II phase, to evaluate, in consultation with domestic

exporting firms, how the allocation of scarce foreign exchange can be better brought in line with the needs of firms in the prioritized sectors.

2.2 Strengthening the propensity to invest and internal financing

2.2.1 Current policy

The Ethiopian Government tries to stimulate the willingness of domestic entrepreneurs to set up new firms and to extend existing ones through a number of incentives. Principal investment incentives are temporary income tax exemptions, which apply to both domestic and foreign companies engaged directly or indirectly in export activities. The length of the tax holiday granted depends on the area of investment, the share of exports in a company's total production and the geographical location where the investment is undertaken (table 9.1). There is also the possibility of carrying forward losses incurred beyond the period of tax exemption.⁷⁶

Table 9.1:

Corporate income tax exemption scheme in Ethiopia			
<i>Conditions for exemption from corporate income taxation</i>		<i>Years of tax exemption</i>	<i>Years of tax exemption for firms in underdeveloped regions</i>
New manufacturing or agro-industry activities			
A	At least 50% of total production for export	5	6
B	At least 75% of total production are inputs to export production in other firms	5	6
C	Additional special qualities of individual ventures fulfilling condition A or B	up to 7	up to 8
D	Production for export, but less than 50% of total production	2	3
E	Additional special qualities of individual ventures fulfilling condition D	up to 5	up to 6
F	Entire production for the domestic market	2	3
Extension or upgrading of activities fulfilling conditions A-F:			
G	Extension or upgrading increases production value by at least 25%	2	3
<i>Source:</i> Council of Ministers Regulation No.84/2003; Ethiopian Government Portal, at http://www.ethiopia.gov.et/investmentincentives			

In addition to the temporary exemption from corporate income tax, companies in the export sector also enjoy one hundred percent exemption from customs duties and other taxes on imports of machinery and equipment, construction materials, as well as spare parts worth up to 15 percent of the value of the imported investment capital goods, provided that the goods are not produced locally in comparable quantity, quality and price. Exemptions from import

⁷⁶ Companies that incur losses during the tax holiday period can carry forward such losses for half of the income tax exemption period following the expiry of the exemption period.

duties or other taxes are also granted for the import of raw materials and intermediate goods for the production of export goods.

All these privileges for firms engaged in export activities are meant to make production for export more profitable than production for the domestic market and to raise the international cost competitiveness of Ethiopian manufacturing. Clearly, these tax and duty privileges imply costs in terms of forgone public revenue, thus, representing a public investment into industrial development. In order to identify the effectiveness of the income tax privileges and to strike an appropriate balance between the fiscal costs and the economic gains of this policy, it may be useful to regularly evaluate how much additional export revenue can actually be attributed to the full profit tax exemption of exporting firms. This is warranted by the need to finance high public expenditures for investment infrastructure that is benefitting the export industries.

The policy to grant tax privileges not only to those firms that are directly exporting but also to those whose production consists of intermediate goods for further processing by the exporting firms (condition B table 9.1) is an important element of Ethiopia's investment promotion policy. However, it may be necessary to go a step further and provide incentives also for investment further up the domestic value chain, before raw material inputs reach the manufacturing sectors, including for the commercialisation of agricultural production and livestock breeding. These stages are particularly weak elements in the domestic value chain at present (see chapter V). The provision of investment support at these stages deserves greater attention than hitherto, in order to strengthen Ethiopia's capacity to export and to attract foreign investors.

2.2.2 Fostering an export-profit-investment nexus

Capital accumulation, or investment financing, of domestic firms in the prioritized sectors primarily relies on corporate savings, i.e. internal financings from retained profits. For a dynamic industrialization and growth process, it is essential that corporate profits are re-invested to the largest extent possible in the extension and upgrading of productive capacities, i.e. that an export-profit-investment nexus is established. The current practice of investment promotion involves only a weak link between the provision of tax privileges for corporate profits and the use that companies make of these profits.

From this perspective, it may be worth considering to focus tax privileges on retained and re-invested profits, rather than fully exempting profits from export activities across the board. The key importance of creating an export-profit-investment nexus is illustrated by the experience of the industrially successful East Asian economies (UNCTAD 2003). In these cases, strong enterprise profits simultaneously increased the incentive of firms to invest and their capacity to finance new investment, which in turn further boosted profits by enhancing both the rates of capacity utilization and productivity growth.

Another measure that would both stimulate the willingness to invest and facilitate internal financing of such investment would be special depreciation allowances. The practice of accelerated (or digressive) depreciation, to replace the current straight-line (or linear) depreciation, would reduce reported profits at the beginning of an investment cycle and, provided that there is some taxation of corporate profits, increase a company's cash flow. The latter results from the implicit tax credit that comes with the accelerated depreciation allowance scheme and would be the higher and the longer the more frequently new investments are carried out.

2.3. Financing domestic investment in productive capacity

2.3.1 Constraints to long-term financing from commercial banks

Financing needs frequently exceed the self-financing capacity of firms that aim at expanding rapidly, particularly when technological upgrading and new product development require a fast turnover of machinery and equipment. As a complement to self-financing from retained profits, long-term bank credit is therefore an important complementary source of financing capital accumulation, while equity finance plays a role primarily at the stage when new firms are set up. Like most sub-Saharan countries, Ethiopia has a very thin capital market and few non-bank financial institutions. Bank lending constitutes almost the only external source of investment finance for firms. But, the banking system in Ethiopia plays a much smaller role in long-term investment financing than elsewhere. According to an assessment by the World Bank (2016), only about 8 percent of private investment in manufacturing activities is financed by bank credit. This is not only lower than the international average, but also lower than other SSA countries. Only 16 percent of manufacturing firms use banks to finance investments, compared to 24 percent internationally. This suggests that the banking system in Ethiopia could be more effective in supporting long-term capital investment, something that is also witnessed by the grievances of many managers of companies in the prioritized sectors. The reasons for relatively small involvement of the banking system in the extension and upgrading are threefold:

(a) Limited lending capacity of commercial banks

First, commercial banks have an insufficient capacity for long-term lending. This is due to the limited provision of liquidity by the central bank, from which the banking system can create credit. It follows that bank lending is based primarily on the amount of savings and time deposits (see also sub-section 2.3.4). In addition, long-term commercial bank lending to private firms is constrained by the obligation of banks to acquire government bills at an amount equivalent to 27 percent of the new loan disbursements. The financial resources raised by the Government this way are then transferred to the DBE with the intention to enable the latter to provide project financing in priority areas at preferential interest rates. In principle, this appears to be an appropriate instrument of coordination between trade and industrial policy on the one hand, and financial policy, on the other, because it directs credit to long-term finance for structural transformation. However, it appears that owing to a long lead time for project appraisal and approval at the DBE and prudential limits on single borrowers, a significant proportion of the financial resources channelled to the DBE does not reach potential investors (IMF 2014).

The banking system's capacity to extend long-term investment finance is further constrained by the obligation of banks to hold 40 percent of their loans in short-term credits (IMF 2014). In addition, credit ceilings are imposed on banks to prevent them from overexposure to credit risk and to ensure the stability of the banking system. However, the application of credit ceilings does not seem to differentiate between different classes of borrowers and purposes of loans and therefore may hamper the extension of credit also to creditworthy firms in the prioritized sectors. Moreover, a large part of bank financing is absorbed by the financing of large infrastructure projects, which could potentially lead to a "financial crowding-out".

(b) Commercial banks' perception of lending risk

Second, even within their lending capacity, banks are reluctant to extend long-term investment loans because risk assessment is often difficult in the Ethiopian manufacturing sector. This can be traced to information asymmetries between firm managers and the banks with respect to the value of a firm's existing assets and the quality of its investment opportunities.

Access to bank credit has therefore depended largely on the size of the firm, with smaller and new enterprises encountering severe financing constraints. Investment projects by new firms

or of an innovative nature typically cannot be financed from past profits. In these cases, risk assessment is rendered more difficult because there is no track record of the entrepreneurial skills of the manager and the profitability of the investment project that is to be financed still needs to be discovered.

The less advantaged firms are forced to rely on family and friends and informal financial intermediation, including various types of microfinance institutions. To some extent, these sources of finance fill an important gap left by the formal financial system, but their financing is of limited utility for real productive investment. This is because it comes in relatively small amounts, with very short maturities and at high costs, and can therefore be used only to cover temporary working capital needs or to finance the purchase of simple equipment for the provision of services (Kota, 2007).

(c) Conditions for obtaining long-term bank credit

The third main reason impairing bank financing of productive investment is related to the conditions for obtaining long-term credit. Commercial banks in Ethiopia provide loans typically with a maximum maturity of 7 years, at interest rates of 14% or more, and request “mortar and brick” collaterals. Depending on the type of project that is to be financed this maturity may be too short, and the restrictive collateral requirements, partly related to the difficulties in risk assessment on the part of the commercial banks, often keep potential investors from starting or expanding their activities, because they are unable to provide such collateral. This is an obstacle for smaller firms, potential new entrants and women entrepreneurs, even though they may have a considerable potential for product and process innovation. The only collateral they may be able to provide tends to be in the form of intangible assets, which are partly embedded in human capital and, generally, very specific to the particular firms in which they reside (Hall, 2002).

Furthermore, the application procedures for bank loans appear to be unnecessary lengthy and bureaucratic. Despite the stringent collateral requirements by the banks, which leave them with very little creditor’s risk, it often takes considerable time to complete the formalities for borrowing. According to managers from the leather industry it can take more than a year to obtain a loan approval and disbursement.

To sum up, the challenge for the Government, including the central bank, is to combine sectoral support policies with a more pro-active approach to designing a financial system that facilitates access of firms in the prioritized sectors to short-term and long-term finance at reasonable terms.

2.3.2 Focussing the allocation of credit on the prioritized sectors

Within the overall volume of credit that the banking system is able to provide, it is essential that credit is allocated efficiently, which, in the concrete context of GTP II, means allocating credit to the most promising investment projects in the prioritized sectors.

Since it is neither possible nor desirable that anybody who seeks credit is granted it, some discrimination between good and bad projects, and reliable and non-reliable borrowers, is necessary in any financial system. But, it has to be well balanced: If it is inappropriate or absent (credit is extended too easily), it becomes a recipe for a financial crisis. If discrimination goes too far and credit provision is too narrowly concentrated on only a few borrowers, it restricts production and investment activity and slows down industrial growth (Aglietta and Orlean, 1982).

For the efficient allocation of credit, it is therefore essential that discrimination is oriented at the objectives of the overall development strategy and not exclusively at the risk-return criteria of commercial banks. It is important to bear in mind that, from the perspective of

financing development, it is not only the microeconomic profitability of an investment project that matters, but also the external benefits the project generates for the economy as a whole. This consideration is generally accepted for infrastructure projects and their public financing from budget receipts or from development banks.

The contribution of the commercial banking system to financing development could be enhanced by a variety of measures. First, restrictions on lending for consumption or for other non-productive purposes could induce banks to extend more long-term loans for investment purposes. Second, to the extent that insufficient provision of long-term investment credit is due to uncertainties of banks regarding the credit risk, government guarantees for loans to finance promising investment projects of firms may be helpful. By reducing the credit default risk, such guarantees would also lower the risk premiums on such long-term investment loans. The resulting lower interest cost for investors would reduce the probability of defaults, and thus the likelihood of governments having to cover such losses under the guarantee scheme. It is true that the provision of credit guarantees for selected projects will entail fiscal costs when a project turns out to be a failure. These costs should be weighed against the increase in investment that is made possible by such guarantees, and the dynamic income effects, including higher future tax revenues, these additional investments may generate.⁷⁷

Third, the allocation of credit in favour of investment in the prioritized sectors can also be influenced by the provision of interest subsidies or the refinancing of selected types of commercial loans by the central bank (see sub-section 2.3.4). Fourth, a way to bring commercial lending criteria and development finance considerations to bear on credit allocation could be through joint financing of certain investment projects by private and public banks. While the commercial bank would contribute its expertise through the assessment of the viability of a project from a private sector perspective, the public financial institutions would make a judgement from the point of view of the project's overall developmental merits, and their co-financing would reduce the risk for commercial banks. This kind of arrangement might also serve to leverage public financing with private financing, thereby responding to the problem of underfunding that is typical for national development banks in developing countries. This kind of syndicated lending allows the public banks to lend for more projects, including of small and medium-sized enterprises, thereby diversifying its project-related risk. It would also reduce the risk of patronage on the part of both the private and public financial institutions involved. It has several precedents, for example in the current large-scale activities of Brazilian national development bank (BNDES)⁷⁸ and in some successful late-industrializing countries in East Asia (Amsden 2001), but also in several developed countries in the post-war period.

2.3.3 The role of the development bank and other public banks

(a) Filling the long-term financing gap

Against the background of insufficient commercial bank lending for investment, on the one hand, and the need for a comprehensive trade and industrialization strategy to consider the microeconomic viability of individual projects, as well as their possible strategic role in the

⁷⁷ An interesting private sector approach of collateral provision to solve the problem of ambiguous credit risk and resulting high borrowing costs, is the Enat Bank's collateral fund for women, which pools deposits by third parties made for the purpose of allowing the bank to extend loans to women entrepreneurs who cannot provide the required collateral themselves (see <http://cawee-ethiopia.org/?p=3231>). The programme is still at its infancy but has a considerable potential, especially when supported by larger international donor institutions.

⁷⁸ The Brazilian national development bank, Banco do Desenvolvimento de Todos os Brasileiros (BNDES) is an example of a financially sound institution that focuses on investment projects in infrastructure and industry. Half of its loans are made in association with private commercial banks, and more than 25 percent of its operations are in support of small enterprises.

process of structural transformation, public banks and the DBE, must assume a key role in long-term investment financing. The DBE currently offers the best access to investment finance, providing loans at an interest rate of 8.5%. However, the equity capital requirement for each project of 30% is quite high.

A particular problem for the financing of investment in machinery and equipment results from the fact that practically all these capital goods have to be imported and paid for in hard currency. The sums of the latter exceed the current export earnings of individual firms and of the Ethiopian economy as a whole. The International Finance Corporation (IFC) is an official source of such financing. Using an IFC facility requires, however, co-financing by a local bank and the IFC interest rate is very much the same as that practiced by domestic commercial banks in the spirit of avoiding competition with local banks and financing institutions. Obviously, the debt service has to be paid in US dollars, which introduces the additional exchange-rate risk, especially in view of the long history of devaluation of the Ethiopia Birr.

Firms that are part of Global Value Chains may also obtain foreign currency credit from the lead firms in such value chains or links with foreign banks that these lead firms may provide. This possibility is open only to a very small number of Ethiopian firms and depends on central bank regulation governing private capital inflows. In order for foreign exchange loans to be allocated to strategically important investment projects, the banking system must play an intermediary role between providers of finance in foreign currency and domestic borrowers. Such a task primarily falls on the DBE. In this process of intermediation, it is crucial that foreign exchange borrowing is strictly linked to the financing of the foreign exchange component of an investment project, on the one hand, and the capacity to meet the resulting debt service obligations with foreign exchange income earned from the extra exports, on the other.

In intermediating between domestic firms and international lenders, the DBE is in a central position between, on the one hand, domestic public banks, possibly sectoral development banks, and, on the other hand, foreign providers of external finance, such as the World Bank Group, the African Development Bank and the development finance institutions of developed countries, which have a credit standing that allows them to borrow from international capital markets. Sectoral public banks may be helpful in the preparation of projects for possible financing by the multilateral of foreign providers of development finance.

(b) Considering the strategic importance of specific investment projects

It is inevitable in economic life that some innovative investment projects that are bank-financed will turn out to be a commercial failure because it is only by undertaking such projects that their profitability can be discovered. Differently from private commercial banks, development banks have a development objective: their loan analysis takes account not only of the financial return of a specific project but also its larger economic and social development impact. They can provide finance for investment projects that would typically be judged too risky by a private bank, either because full recovery of the cost of investment is a long-term process, such as from infrastructure investment, or because investment is carried out by small and/or innovative enterprises that aim to produce new products or apply new production processes.

Public banks, and the development banks in particular, should not be expected to have the same degree of profitability as private commercial banks. Indeed, disproportionate pressure for profitability would cause managers of public banks to deviate from their developmental mandate (Levy Yeyati, Micco and Panizza, 2007). The DBE's statement on its vision ("100%

Success for All Financed Projects by 2020”)⁷⁹ may not only be unachievable but even in contradiction with its function to contribute to the accelerated development of the prioritized sectors. While in providing credit, a commercial bank aims at minimizing the risks of making mistakes in credit allocation, a development bank may be better advised to aim at minimizing the costs of mistakes when they occur.

Another aspect of the development objective of development banks and other public banks is related to the coordination of several complementary investment projects. An individual investment project can fail to be profitable unless there is simultaneous investment in upstream and downstream activities, particularly if such activities require geographic proximity. Physical infrastructure is a prime example. But a similar argument applies to the availability of appropriate production inputs (i.e. appropriately skilled labour as well as physical inputs that match a country’s level of technology) or to the presence of a buyer of a firm’s production.

In this sense, a major problem for entrepreneurs, who act as independent agents, is how to coordinate productive investment by many firms in a way that enables them to mutually benefit from upstream, horizontal and downstream linkages. Where such mutual benefits occur, the economy-wide impact of an investment project exceeds by far its private, microeconomic profitability. Hence, the DBE or other public banks, acting in a way that is well coordinated with the trade and industrialization strategy, have an advantage in financing investments whose profitability depends strongly on complementary investment. This was the role played by development banks in Japan, the Republic of Korea and Taiwan Province of China (see, for example, Khan, 2004).

With a view to closer coordination of the trade strategy with the financial sector, smaller public banks that specialize in lending to individual sectors could also have an important role. Typical examples include publicly-sponsored incubators that are mandated to finance innovative activities (including in the area of research and development) and that dispose of sector-specific knowledge that enables them to assess the risks and potential returns in terms of increasing the sectors efficiency and competitiveness. Following the Chinese model, for example, sectoral public banks, re-financed by the national development bank or the central bank (see section 2.3.4), can assume an important role due to their closer proximity to the various actors in the sectoral value chains. If properly staffed, they are likely to have a better picture of sector-specific financing bottlenecks and are therefore well placed to identify the real financing needs of exporting companies, on the one hand, and the financing priorities arising from the need to strengthen the entire sectoral supply chain, on the other.

Financial policy may also contribute to strengthening cross-sectoral linkages. For example, although banks are facilitating lending to farmers for the purchases of fertilizers and seeds, there is no similar facility for the purchase of agricultural machineries. Such a facility could not only give a boost to mechanization and productivity growth in agriculture, but it could also be devised in such way that it would raise the demand for domestically produced agricultural machinery and thereby help advance the domestic metals and engineering sector.

2.3.4 The central bank as an agent of development

In its regulation of the financial sector and lending practices, the National Bank of Ethiopia (NBE) is pursuing a very prudent strategy, setting collateral requirements for bank loans relatively high and putting caps on borrowing by firms. It also imposes a high reserve requirement on banks (40 percent) and obliges them to hold a large share of their assets in government bonds. The NBE has been successful in lowering inflation and ensuring stability

⁷⁹ See the website of the DBE at <http://www.dbe.com.et/home/index.php/about/mission-vision-values>.

in the domestic financial system. Apart from its regulation that channels financial resources from the commercial banks to the DBE it has not seen its role as pro-actively contributing to the manufacturing-led export-oriented development strategy. Yet, from the point of view policy innovation in support of that strategy some options may be considered for a stronger integration of the NBE.

(a) Central bank liquidity provision and credit creation

Insufficient productive investment in poorer countries is often attributed to their low level of domestic savings. It follows that, prior savings, particularly household savings, are needed for the financing of investment. This is based on the assumption that the banking system can only provide credit to the extent that it intermediates between depositors and borrowers (UNCTAD 2010: ch.V); otherwise recourse to foreign savings (capital inflows) would be necessary to step up investment. The latter may only be necessary if investment requires the imports of capital goods over and above what can be financed from foreign currency export earnings, while the provision of investment credit by the domestic banking system does not necessarily require savings or time deposits prior to the granting of bank credit.

This is because the central bank can enable the commercial banks to expand their volume of credit themselves (“*ex-nihilo*”) by providing the required liquidity to the banking system.⁸⁰ In this regard, coordination of central bank policy with sectoral support policy meets with the challenge that the NBE has only few effective instruments for managing liquidity in the banking system. Efforts by the NBE to establish an active secondary market for government securities would be a step forward (IMF 2014).

By contrast, concerns that credit creation, based on liquidity provision, by the central bank is always inflationary and therefore counterproductive may not be justified. First, it is clear that the quantity of such liquidity provision has to be controlled and that it has to be ensured that the additional bank credit is provided only for the domestic currency element in productive investments in the priority sectors (and not for consumption credit, for example). Second, monetary expansion does not automatically translate into higher inflation when inflationary pressures resulting from wage increases and food prices can be avoided. Third, if there still is an inflationary effect, the disadvantage of a moderate price increase has to be weighed against the advantage of raising the rate of investment in the priority sectors on their way to meet the GTP targets (see also chapter III).

(b) Specific central bank facilities and direct lending

Supporting economic growth can be understood not only as a supplementary responsibility of the central bank, but as their developmental role that could be included in their mandate. This means that the central bank would support the provision of investment credit for strategically important activities more directly than by the management of overall liquidity in the banking system. This could take the form of linking liquidity provision to specific forms of credit extended by the commercial banks, or even direct financing of non-financial firms. There are numerous examples when central banks have assumed such a developmental role and directly financed structural transformation and productive capacity building (UNCTAD 2013: ch. III; Epstein 2005, 2007).

For example, the central bank may enlarge the commercial banks’ capacity for long-term lending for activities that contribute to productive capacity building in the prioritized sector

⁸⁰ In terms of macroeconomic theory the tendency toward macroeconomic equilibrium will be achieved in this case not by adjusting investment to a given level of savings, but the other way around: higher investment will generate higher savings through an increase in profits, which will (also) allow the repayment of the initial investment credit (UNCTAD 2006: Annex to ch.I).

by differentiating reserve requirements according to the type of loans provided by the commercial banks or by providing selective refinancing of bank loans at preferential rates. Exemption of such loans from broadly applied credit ceilings on commercial bank lending would be another possible measure. Such practices played a central role in the industrialization of many countries⁸¹. It is true that such measures taken in recent years by central banks in developed countries were a response to the exceptional circumstances of the financial crisis or persistent recession when traditional monetary policies to stimulate economic activity were ineffective. But there are strong arguments in favour of using this kind of central bank policy systematically under the structural circumstances prevailing in a poor country like Ethiopia. In coordination with an export-oriented industrialization strategy, it could help to compensate for shortcomings in the functioning of the financial system.

The same consideration may lead to a step further by engaging the central bank in direct lending for selected projects which, by their nature are unlikely to be financed by commercial banks but have important implications for the development of an entire sector (Epstein, 2007).⁸² Such lending is provided by the DBE, but here it is circumscribed by the financial resources of the Bank.

3. Foreign direct investment in the industrialization strategy

3.1 The role of FDI and FDI promotion in the overall industrialization strategy

FDI inflows are an important element in the expansion of the prioritized export sectors. They are they a source of external financing, and they also provide access to international marketing networks, as well product design and technology that are not available domestically. Attracting such investment into priority export sectors requires prospective investors to be convinced that Ethiopia is a profitable and secure place in which to invest.

In addition to the investment incentives that are provided to all investors in the export-oriented sectors, foreign investors in Ethiopia are guaranteed the possibility to repatriate their capital and profits. As Ethiopia is a member of the Multilateral Investment Guarantee Agency, affiliated to the World Bank, foreign investors are also insured against non-commercial risks.

Ethiopia's pro-active FDI promotion policy has succeeded in attracting significant FDI into the country, in particular in the textile, clothing and leather sectors. According to UNCTAD's *World Investment Report*, Ethiopia received \$953 million of FDI in 2013, a notable increase over the levels achieved in previous years, and for 2014 FDI inflows are estimated at \$1.2 billion, another 26 percent growth. Even so, this represented just 1.7 percent of FDI flows to Africa, seventeen other African countries receiving more FDI than Ethiopia. The total stock of inward FDI in Ethiopia in 2014 is estimated at \$7.2 billion, just 0.9 percent of the total for Africa, suggesting a potential for a further substantial increase. Given the current level of domestic investment and the remaining challenges in international marketing, attracting significantly higher export-seeking FDI is a big challenge for Ethiopia on the way to achieving the goal of doubling its exports during the GTP II period.

⁸¹ Such direct and indirect financing practices in support of industrial development were used by the central bank of France until the mid-1980s and similar measures were also practiced in other European countries in the post-war era of economic reconstruction, including Belgium, Germany, Italy, the Netherlands and the United Kingdom (Hodgman 1973; O'Connell 2012).

⁸² For instance, before the First World War and in the inter-war period, the Bank of England supported different industrial sectors, including textiles, metallurgy, shipbuilding, aluminium, rayon and wood-pulp industries. The Bank became heavily involved in some companies taking equity stakes and participating directly in their management. In 1929, the Securities Management Trust was instituted as a holding company for managing the stakes acquired by the bank in various firms. Similarly, the Bank of Italy got involved in the financing and indirect management of different industrial firms (O'Connell 2012).

This highlights the need for a strategic and targeted approach to attracting FDI and for greater synergy in the formulation and implementation of investment and trade policies. With such a strategy in place, there is no reason why Ethiopia should not be able to attract between US\$2 to US\$3 billion worth of FDI per year; and, with an appropriate policy framework designed to optimize the balance between inflows and developmental benefits, this could contribute substantially to the country's development objectives. There appears to be considerable scope for investment not only from large internationally operating corporations, but also from the Ethiopian diaspora. The latter may be particularly suited to relatively small-scale, but important, investments in strategic activities such as business support services, where some members of the diaspora also have valuable knowledge and experience to offer.⁸³

3.2 Refining FDI policies

Effective co-ordination and alignment of Ethiopia's trade, industrial and investment policies, in particular with regard to institutional arrangements for disseminating information on FDI possibilities, and for procedures to authorize and implement such investment, are critical in promoting FDI as an integral element in Ethiopia's manufacturing-driven export-led growth strategy. For this purpose, the one-stop-services of the Ethiopian Investment Commission (EIC) need to be further developed, including a proactive and sustained engagement with investors during the entire duration of the investment process. The EIC investment information and data management requires upgrading to make it more investor-friendly and to better inform policy.

But a policy approach that aims at integrating FDI in the overall strategy of agriculture-based manufacturing-led industrialization must go beyond simple marketing of Ethiopia as production location based on the advantage of abundant labour and low unit labour costs. First, it needs to consider that FDI is a vehicle to get access to Global Value Chains, which offer different options for integration (see chapter X). Depending on the option chosen, FDI promotion would need to be target to different types of FDI.

Second, what matters for the contribution of FDI to the success of the overall industrialization strategy is not just its quantity but also its quality in terms of generating dynamic benefits for their respective sectors and the economy as a whole. The daunting challenge is therefore to reconcile the profit interests of foreign investors with Ethiopian development objectives. The latter include technology transfer and knowledge spill-overs. Even more important, it is crucial to ensure that foreign-owned companies create direct linkages with the domestic economy and contribute to strengthening the domestic value chain, i.e. that they allow an upgrading in global value chains by substituting imported primary goods and intermediate goods with inputs that are currently and potentially available domestically.

The policy orientation of the EIC may need to be adjusted to this objective. While FDI in the prioritized export sectors, especially in the clothing and footwear industries, has significantly contributed to raising production and exports, little is known so far about its impact on the development of the local industry in terms of linkages with domestic firms, spillovers of technology and management know-how, or training of the domestic workforce. In order to ensure that FDI generates such dynamic benefits for the Ethiopian economy, the Government would be well advised to develop standards and metrics for measuring and monitoring the performance of FDI.

⁸³ The hope that investment from the Ethiopian diaspora is based on the considerable size of this community, which comprises more than 3 million emigrants. The Government may indeed consider to mobilise more proactively Ethiopian Diaspora development finance as well as utilise their business and knowledge networks to facilitate Ethiopian exports to the United States and Europe. With an estimates of annual income ranging between \$10 billion and \$39 billion and of annual savings between \$1.9 billion to \$7.6 billion they may have a potential to invest significantly more than the current \$1.2 billion per year (Makonnen 2014)

The Government should also be alert to the risk of entering into excessive wage and tax competition for FDI with many other countries that compete as production locations (Keen and Simone 2004). In many countries, tax incentives have often led to disappointing results in terms of attracting a type of FDI that has a sustained positive impact on structural change and development. The focus on the provision of tax advantages for foreign investors is often driven by media and other corporate assessments that identify taxes as an important variable. This consideration is especially valid for Ethiopia whose agriculture-based industrialization strategy can count on significant other comparative advantages: the country's considerable domestic raw material base for the agro-food industry and the manufacturing of textiles, clothing and leather goods sectors. If the domestic supply chains in these sectors are strengthened (see chapter V), and further progress is achieved in transport and trade facilitation (see chapters VII and VIII), these comparative advantage could be a more powerful attraction for foreign investors than tax privileges or extremely low wages.

4. Recommendations

- Working capital should come from commercial banks, but arrangements for short-term credit facilities need to be adjusted in such a way that the operations of export firms will be significantly less constrained in the futures by a critical shortage of liquid working capital. In this context, banks should be induced to enlarge their branch network throughout the country to ensure greater local presence.
- The officially set rate for long-term bank lending should be at a level that makes more investment projects by SMEs viable, while maintaining the financial soundness of the commercial banks. If necessary, downward adjustments in the lending rate could be accompanied by lowering the official interest rate on savings accounts which is not the main incentive to save anyway.
- Commercial banks should be induced to extend the maturities for investment lending and to better adapt collateral requirements to the ability of small- and medium-sized firms to provide such collateral.
- In order to direct commercial bank lending to financing strategically important investment projects, restrictions on lending for non-productive purposes should be re-enforced and the Government should consider sharing the overall credit risk of banks by extending credit guarantees for certain types of loans.
- The DBE and other public banks should further facilitate access of domestically-owned firms to long-term finance. In their lending activities, they should not select borrowers on the same criteria as commercial banks but be prepared to assume risks that are inevitable in a process of structural transformation, but which commercial banks are unable to assume.
- The establishment and/or the strengthening of sectorally-specialized public banks, focussing on long-term financing for the prioritized industries, should be considered.
- Possibilities should be explored for the NBE to assume a stronger developmental role by providing more liquidity to the banking system, in a targeted and selective manner, for example by offering specific re-financing facilities for commercial long-term investment loans, or by engaging in direct lending to investors in the prioritized sectors.
- Investment incentive schemes should be reviewed with the objective of establishing a closer link between profits from exports, on the one hand, and investment in the upgrading and extensions of productive capacity, on the other. In this context, the

effectiveness of temporary corporate profit tax exemptions for exporting firms across the board should be evaluated and consideration should be given to make such tax privileges dependent on the re-investment of profits.

- The EIC should be enabled to further develop its one-stop-services and to make them more investor-friendly. The EIC or an affiliated institution should improve data collection and evaluation on FDI and on the performance of individual FDI projects in terms of their linkages with domestic firms and knowledge and technological spillovers. These evaluations should be used as basis to adjust FDI incentive schemes and the criteria underlying FDI authorization and tax privileges.

Chapter X:

International Marketing and Global Value Chains

1. Introduction

Legal market access, as discussed in chapter IV, is a necessary condition for the scope of international marketing, but it is not sufficient for export success. Marketing strategies are required to raise exporters' knowledge of market conditions and current and upcoming demand trends in foreign markets. They are also necessary for good visibility of the relative strengths the Ethiopian export sectors and their products.

Ethiopian manufacturers typically have little or no experience with formal marketing channels. To meet the marketing challenge, one option would be to attract those foreign investors that bring the knowledge and experience needed to operate in international markets. Ethiopia has begun to attract such investors into the textile and leather sectors. In this case, Ethiopia is marketed as a production location, where the distribution and marketing of the final product is left to the large foreign companies that are bringing FDI to Ethiopia or are subcontracting some elements of their internal value chain to Ethiopian firms. This form of Ethiopia's integration into international trade largely relies on its participation in global value chains. In order to achieve the ambitious export targets of GTP II, a comprehensive trade strategy is needed to combine the marketing of Ethiopia as a production location, based on its comparative advantages, with additional measures aimed at promoting and marketing domestically-produced goods.

This chapter will first review those elements of an international marketing strategy that are indispensable and the options for measures to internationally promote both, Ethiopia as a production location and Ethiopian products. Section 3 will then discuss possibilities for directing Ethiopia's marketing efforts to specific forms of integration into global and regional trade, before a number of recommendations as they derive from the challenges identified in the preceding sections will be presented in section 4.

2. Requirements and options for international marketing

2.1 Minimum requirements for international marketing success

2.1.1 Awareness of market access opportunities

In order to achieve the targeted increase in exports of products from the prioritized sectors, better use must be made of the opportunities under AGOA, EBA and preferences offered by other countries for LDCs. Most Ethiopian manufacturers of textiles, clothing and leather products do not take full advantage of these international trade preferences in their favour. For example, in spite of the support offered by the AGOA support infrastructure, the United Nations Commission for Africa (UNECA) and USAID, Ethiopian exports from the prioritized sectors to the United States are still quite small compared to those of some other AGOA-eligible countries.

Greater efforts to inform domestic producers, especially SMEs, of legal market access possibilities and possible destination countries are therefore indicated. In response to the less than satisfactory export performance under AGOA, the Ministry of Trade has developed a document entitled "Ethiopia's National AGOA Response Strategy Draft" for the period 2014-2018, covering the agro-processing and horticulture sector, the textiles and clothing sector and the leather and leather goods sector (MoT, October 2013).

The strategy outlines an institutional support mechanism that facilitates the effective implementation of the strategy, including:

- the National Export Steering Commission, chaired by the Prime Minister, to oversee the implementation of the strategy;
- the National AGOA Steering Committee, chaired by the Minister of Trade, to guide the implementation of the strategy;
- the National AGOA Centre, composed of key stakeholders, as the implementing agency; and
- technical working groups in specific sectors with a view to developing detailed action plans based on the draft Strategy.

The international trade privileges for products of Ethiopian origin can also be used more extensively and aggressively as an argument to attract additional FDI and to convince globally-operating distribution chains to source their products from Ethiopia.

2.1.2 Conformity with international standards and dependability of supply

Successful export orientation also requires exporters' awareness of the need to meet official and internationally agreed regulations regarding sanitary and phytosanitary requirements and to overcome technical barriers to trade, and their capability to conform to such standards (see chapter VI). Depending on their specific products and their business strategy, they also have to meet privately-defined quality standards. While meeting such private standards is a precondition for entering into certain market segments, it also offers opportunities for product diversification (see also sub-section 2.3).

Compliance with international legal and private product standards is essential for all Ethiopian manufacturing industries, but it is a particular challenge for Ethiopia's agro-food industry, because in this sector international standards are very numerous and very high. With few exceptions agro-industry firms are not certified under any of the international quality standards programmes. The stage of Ethiopia's integration into international trade with manufactures, the type of manufactures it can export from the prioritized sectors, and the structure of the international markets for these products are such that efforts to increase these exports must start, as a *sine-qua-non*, with strong improvements at the early stages of the development of a domestic value chain (see chapters V and VI). Otherwise, even the best marketing efforts at the external front are likely to lead to frustrating results.

By the same token, if Ethiopia manages to raise its capacity to produce a larger amount of the good quality raw materials and intermediate goods that go into the manufacturing processes, at internationally competitive costs, this will raise the awareness of international lead firms and large distribution networks of the advantages of sourcing from Ethiopia itself.

2.2 Enhancing market knowledge of Ethiopian manufacturers

Existing domestic manufacturing companies and potential new entrants are often not well informed of the demand and supply trends in the global market and in selected countries, nor of the roles of international lead sourcing firms, production networks and distribution channels or how to access them. They need additional support to develop their knowledge of international markets and to forge links with key players in the global value chains and international production networks.

The challenge here is for national and sectoral support institutions, both public and private, to step up their competences and capacities to provide such support at a greater scale. Such support could consist of market studies and of possible links with international production and distribution networks. Such measures should be part of a strategy that goes beyond

information about legal market access opportunities and international product standards; they must enable Ethiopian exporters to use these opportunities, including at the regional level. For this purpose, the Government should empower the sectoral Institutes to further enhance their marketing support services.

2.3 Branding, geographical indications and specific labelling

The creation of specific Ethiopian brands may be one element of national and sectoral marketing strategies. It should be envisaged for products that are of superior quality or have otherwise a potential for distinctive international recognition. Identifying unique product characteristics and branding or labelling such products should preferably be related to international frameworks for such specifications, such as the Agreement on Trade-Related Property Rights (TRIPS) of the WTO or sealing from private organizations.

2.3.1 Geographical indications

TRIPS provides an international legal framework for geographical indications.⁸⁴ Such indications on specific goods are meant primarily to protect the interest of producers in specific regions, and the products that have particular qualities due to their specific origin. If recognized internationally, such indications protect against undue imitation, misappropriations and counterfeit, and to safeguarding traditional knowledge. They also allow for, and the same time require, traceability of products along the supply and value chains.

From the perspective of product marketing, such indications may help to strengthen the reputation of certain products, their producers, and possibly the entire sector, with possible effects on the competitiveness of other Ethiopian goods. They may cover products ranging from agricultural and other natural goods, over traditional goods, such as handicrafts, to industrially manufactured products. For example, among agricultural products, coffee and honey could be candidates for such protection of geographical origin. Another example is constituted by highland sheepskin leather and goatskin suede, which are of exceptionally high quality, and final leather goods using these materials.

Before geographical indications can be protected internationally, they have to be embedded in national legislation.⁸⁵ Such legislation is currently absent in Ethiopia. The Ethiopian Intellectual Property Office drafted a proclamation and related regulations on geographical indications in 2012, but these have not been enacted into operating laws. Once the required legislation is place, there is a need for building an expert knowledge on geographical indications, their application and administration.

International experience shows that this type of product identification and protection has to be combined with other business strategies (e.g. aggressive international marketing and entering into international business partnerships), so that the unique characteristics of the respective products are duly valorised and communicated.

2.3.2 Distinctive sealing from private institutions

There is also the option of having an internationally-recognized labelling of goods produced on the basis of raw materials emerging from organic agriculture or from socially and environmentally responsible production and marketing. This could be helpful to enter certain

⁸⁴ In the definition of the WTO-TRIPS Agreement (Art. 22.1), geographical indications “identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin.”

⁸⁵ Article 22.2 of the WTO-TRIPS Agreement specifies that “members shall provide the legal means for interested parties to prevent use of indications which mislead the public as to the geographical origin of the good, and any use which constitutes an act of unfair competition within the meaning of Article 10bis of the Paris Convention (1967).”

niches of the international markets for food, textiles, clothing, finished leather and leather goods. Given the global trends, consumer goods markets, such as labelling, are likely to rapidly gain importance in the coming years.

For example, much of Ethiopia's coffee production is by definition organic. This could be a starting point for introducing organic certifications for coffee, but also for other Ethiopian products that qualify for it. Such efforts could be extended by helping agricultural producers and manufacturers in the prioritized sectors to introduce health- and environment-friendly and socially sound practices or to bring these practices in line with international standards and tastes, as in the case of honey. This could give Ethiopian agriculture and the agriculture-based industries an additional instrument to compete in higher price segments of the international consumer goods markets. Moreover, it might allow products of smaller agricultural units and processing firms to compete internationally, thereby turning the otherwise problematic aspects of the existing structure of agricultural production and agriculture-based manufacturing into the positive,

Obviously, product distinction through geographical indication or labelling by international private associations will be possible and effective only for limited number of Ethiopian products. This form of product differentiation may also serve as a basis for building reputation and developing brands. It is crucial to ensure that any product certified or branded in this context meets the quality exigencies of international consumers; otherwise distinguishing such goods would be counterproductive.

So far, awareness of the private and public sector on these issues is very limited, and initiatives by public and private institutions towards the identification of eligible products, leave alone their registration and certification, are at a very early stage.

2.4 Raising the visibility of Ethiopian exports and exporting firms

Except for the foreign-owned companies that are part of, or closely affiliated with, large international manufacturers or distributors, the individual manufacturers operating in Ethiopia are unlikely to be able to successfully undertake international market efforts individually, especially at the global level. Since, on the other hand, there is no Ethiopian Export Promotion Agency to support such efforts, sectoral institutions and associations must play a central role in the design and implementation of collective marketing strategies.

Given the structure of the global markets for the main Ethiopian manufactures exports, the scope for domestically-owned companies to successfully "go-out-and-sell" is relatively limited. Rather, potential international buyers will "come in and buy". Most buyers on these markets not only have considerably larger market power, but they also tend to have a much clearer picture of global sourcing possibilities than most Ethiopian firms have of their possibilities to sell their products abroad. Still, the picture that potential international buyers have of the advantages of sourcing from Ethiopia can be influenced by enhancing the visibility of the Ethiopian export sectors.

Improving visibility of current activities and support measures in higher value-added segments of the value chain may start by using traditional links with buyers of lower value-added products exported in the past. This is one of the avenues that could be pursued especially in the coffee and leather sectors. Perhaps more important is the intensified use of modern communication technology. So far, the existing Ethiopian sectoral institutes and private sector associations have a very limited presence in the Internet. Their websites are frequently poor, not up to date and often use bureaucratic rather than commercial language. In order to have an impact on the visibility of Ethiopia's strengths in the prioritized export sectors, these presentations and access to information have to become much more client-friendly and focus on the questions that potential international buyers may have. In order to

achieve improvements in this area, it may be necessary to use the services of experienced and specialized service providers from abroad.

Enhanced representation of Ethiopia's export industries in international textiles and leather trade fairs could also have a large pay-off. It would allow to forge direct and personal links not only with managers of large foreign distribution and retail companies as well as with representatives of the lead companies in global value chains, but also with smaller buyers from niche markets. The Government already supports participation of Ethiopian producers in such trade fairs by sharing the cost of such participation. This support should certainly be continued and intensified, but it is also necessary to ensure that it is line with a clear sectoral marketing strategy, and that the Ethiopian participants are equipped with sufficient competencies and commercial communication material.

3. Marketing orientation

Efforts to increase manufacturing output and employment, and to strengthen measures to improve international competitiveness, tend to be geared primarily to raising exports to the global market. This is certainly justified in view of the size of the markets of developed countries and of the fast growing emerging economies. However, given the scale at which the Ethiopian manufacturing industry is currently operating, marketing efforts should not neglect opportunities in the regional markets, and for that matter, in the domestic market itself.

The markets of neighbouring countries and the wider African and Middle Eastern region, may deserve heightened attention in the orientation of Ethiopia's overall export marketing strategy for all prioritized sectors as a whole, including also the metals and engineering sector. But competition with foreign suppliers also takes place in the domestic market, and there appears to be considerable scope, especially in the clothing sector, to increase the share of Ethiopian companies in the domestic market, which would help to reduce the worrisome trade deficit in in these goods.

3.1 World market orientation and participation in global value chains

Attempts of integrating Ethiopia's light manufacturing industries into global trade at the global level have to take account of Global Value Chains (GVCs), which are dominated by large transnational corporations (TNCs), mostly based in developed countries. This is particularly important for clothing and leather products, which makes it extremely difficult for domestically-owned firms to market their products directly to retailers in the largest foreign markets, except perhaps for certain niche products. Efforts to increase the visibility of these firms should be primarily geared to market Ethiopian firms, rather than their products, as possible elements in a GVC. This has to be reflected in these companies' own business strategies, which would aim at entering into longer-term production contracts with large retail companies operating globally or in the largest national or regional markets. Product marketing should then not be a concern for the Ethiopian firms, since this task is assumed by their foreign counterparts.

3.1.1 The role of Global Value Chains for integration into international trade

In general, GVCs provide considerable opportunities for developing countries to integrate into the global economy at relatively low cost and technology thresholds, but they imply giving up a certain degree of managerial autonomy within firms and also of policy autonomy of the Government.

GVCs are largely based on advances in information and communications technology and lower transportation costs. These enable TNCs to fragment and unbundle the production of goods and services across countries and regions with a view to taking advantage of differences across countries in production costs, skills, availability of raw materials or market

access opportunities. The *modus operandi* of the GVCs provides opportunities for developing countries to engage in the production of certain tasks in the value chains in accordance with their comparative advantages.

GVCs in markets for textiles, clothing, leather, footwear and other leather products are amongst the largest in terms of value-added trade. GVCs in these sectors are buyer-driven (as opposed to seller-driven GVCs that characterise other sectors, for example the automobile industry), where lead firms are large retailers, marketers and branded manufacturers (Gereffi 1994). Suppliers in developing countries typically produce directly or indirectly, i.e. through sub-contracting, for lead firms of the GVCs. These lead firms control new techniques and brand names, and mostly concentrate activities at the upstream stage in the global value chain, such as product design and finance, as well as at the downstream stages, such as logistics and marketing. These activities are all more knowledge and skill intensive than those in the middle of the value chain, i.e. the various physical stages of production, which are entrusted to GVC participants in developing countries.

In order to strongly integrate into international trade, most Ethiopian firms will be obliged to get access to these lead firms and to use their distribution and marketing channels in destination markets. The distribution of gains from participating in GVCs between lead firms and developing country suppliers depends on their relative bargaining power, which in turn depends on factors, such as the uniqueness and capability of suppliers, and the codifiability and complexity of the production process. The degree of power asymmetry between lead firms and suppliers would favour the lead firms the lower the capability of suppliers and the higher the ability of lead firms to codify production processes.

Thus, although the overall benefits of producing and trading within GVCs are positive, it could also entail winners and losers, and the potential distributional impact is controversial. Furthermore, access to GVCs is not automatic. A necessary condition for integrating into GVCs is the ability to produce competitively in terms of price, cost, and quality as well as meeting stringent delivery specifications. Joining GVCs also requires intense competition for FDI. It should also be realised that integrating into GVCs increases the vulnerability of the Ethiopian manufacturing sector to global economic shocks.

3.1.2 Options for development paths within Global Value Chains

A pertinent issue in the context of strategic participation in GVCs is exploring the options for GVC development paths. Ethiopia faces a set of distinct paths for participating in GVCs (UNCTAD, 2013). These are:

(a) Engaging in GVCs

This option is relevant for Ethiopian manufacturers in the textiles, clothing, leather and leather goods industries, since they are at an early stage of global value-added trade. Under this option, integration into GVCs allows increasing the domestic value added components of exports, but also requires an increasing import content of these exports, as many inputs for domestic processing are imported. This pattern of trade typically coincides with the inflow of processing FDI and the establishment of processing contracts with TNCs.

(b) Preparing for GVCs

Ethiopian exporters also have the option of seeing their exports remain predominantly within sectors and industries with domestic productive capacities, which require a relatively limited need for import content. In this case, FDI inflows would help produce intermediate goods and services for export products, substituting imports. This pattern of trade and FDI preserves domestic value-added in trade, but integration into GVCs is less

rapid. The textiles, clothing and leather sectors in Ethiopia appear to provide a match for this development path for trade integration.

(c) Upgrading within GVCs

Some developing countries with an already significant level of integration in GVCs have succeeded in increasing exports with a higher domestic value-added content over time. Whether and to what extent this path can be followed, and which exporters in Ethiopia could take it, largely depends on the development of competences, i.e. technical and managerial skills and the capability to innovate.

(d) Competing in GVCs

Competing successfully at a significantly higher value-added level through highly developed domestic capacity for export, and FDI that integrates domestic operations in international production networks, is another potential development path. China and the newly industrialised economies in East Asia are examples of countries that have successfully pursued this path. For Ethiopia, this is a realistic longer-term option.

(e) Leapfrogging into GVCs

Only a few countries have experienced rapid development of domestic productive capacity for export, competing successfully at high value-added levels. In these cases, FDI has often acted as a catalyst for trade integration and domestic productive capacity-building.

At Ethiopia's stage of integration into international trade of manufactures, both the "engaging" and "preparing" development paths appear to be consistent with its current comparative advantage and the development of its productive capacities. In the short to the medium-term, an optimal "mix" of the two paths would maximise the opportunities for increasing engagement with GVCs and building the capacity of the domestic economy for value-added trade.

3.2 Regional market orientation

Export possibilities for smaller domestically-owned firms also exist outside the largest markets, in neighbouring and other developing countries, where the demand for clothing often rises faster than in the developed countries. Exports to African countries have already grown, given the pace of population and income growth of African and Middle Eastern countries. The latter represent an important potential market for products of all the prioritized sectors, especially for finished goods. Quality exigencies tend to be less stringent, consumer preferences to be more similar to those in the domestic market, standardization requirements to be less stringent and transport costs lower than in global trade. It follows that, as in the domestic market, the scope to successfully "go out and sell" appears to be greater in the regional market than in the global market. Importantly, a somewhat shielded, regional market appears to be an ideal training ground for young industries, before going global.

Membership in the COMESA Free Trade Agreement would facilitate the access of Ethiopian manufacturers to 26 countries of the East African Community, Southern Africa Development Community and the Common Market for Eastern and Southern Africa.

4. Recommendations

The following actions would be conducive to meeting the challenges for raising the international competitiveness of Ethiopian producers and to strengthening the marketing of Ethiopian products or of Ethiopia as a production or sourcing location by foreign companies:

- Public institutions and private sectoral associations should make greater concerted efforts to enhance knowledge among producers of demand trends in the global and regional markets. The Government should help these institutions to raise their respective competences as well as human resources and financial means.
- The AGOA Response Strategy should be implemented and closely monitored. The Ethiopian Export Promotion Agency (or a similar agency) could be resurrected to spearhead Ethiopia's drive for export expansion to the US and other destinations as well. In this regard one-stop-consultation services at the sectoral level, not only about the legal framework for market access, but also about trends and dynamics in the global supply and demand structures, should be introduced.
- Internet visibility of Ethiopian export companies and sectoral associations must be substantially improved, and participation of representatives of Ethiopian producers in international trade fairs should be intensified, with strengthened financial support and strategic guidance from the Government and sectoral Institutes.
- The Government and sectoral institutions should focus their support to firms that are participating in GVCs to upgrade within these value chains. But support by these institutions to firms that have a potential to succeed in niche markets outside GVCs or need to strengthen their competitiveness vis-à-vis importers in the national market should not be neglected.
- With regard to branding, geographical indications and other types of labelling of Ethiopian products, a systematic approach should be taken to identify all potentially relevant stakeholders at the national and sectoral levels, to raise the awareness of possible benefits from such initiatives, and to evaluate the originality and unique quality identity of potentially eligible products.
- Greater attention should be given to the specific opportunities for producers in all prioritized sectors in the regional markets of Africa and the Middle East. Further integration in the existing preferential trade areas of EAC and COMESA, including its Free Trade Agreement, would help to enlarge the export market to neighboring countries, favoring middle and small enterprises.

PART IV:

Strategically important and prioritized sectors

Part III takes a closer look at the recent performance and specific challenges in several of the sectors that are given priority in Ethiopia's agricultural development-led export-oriented industrialization strategy. The first chapters provide an assessment of those manufacturing sectors where the greatest potential exists for international trade integration and rapid export growth, namely agro-food processing, textiles and clothing, and leather and leather goods. These sectors share a number of constraints and challenges for further export expansion. They are also sectors where Ethiopia can build on country-specific comparative advantages, which so far have been exploited only to a very limited extent.

The last chapter looks into three other important sectors, two of which - the chemical industry and the metals and engineering sector - are of interest for this study primarily because they can produce essential inputs for the prioritized export sectors. Their development is a key element in strengthening the domestic supply chain. The focus of this chapter is on the potential of these sectors to replace inputs that still have to be imported in large amounts. However, developing the capacity to supply more of these inputs to domestic manufacturing firms – and also to the agricultural and construction sectors – may also open new options for these sectors, especially for the metals and engineering industry, to gradually become more export-oriented.

Finally, the tourism sector, where remarkable progress has already been achieved in recent years, will be examined as it has strong potential to become an even more important foreign-exchange earner for the Ethiopian economy in the future.

Chapter XI:

The Agro-food Industry

1. Introduction

In Ethiopia's agricultural-development-led industrialisation strategy, agriculture is considered the key for rapid and sustainable growth. The Industrial Development Strategy (IDS), introduced in 2002, gives highest priority to the linkage between agriculture and industry, i.e. the agro-industry sector.

More than a decade later, however, agro-industry is still in an underdeveloped state. Although agro-industries account for the largest share of manufactured goods in Ethiopia, with food and beverages constituting about 52 percent, they still contribute for less than 5 percent to GDP (UNIDO 2012). Enhancing processing and marketing of agricultural production, i.e. agro-industry and agribusiness, would provide the needed capital and services to farmers, raise demand for agricultural products and connect farmers with markets, thus generating income and employment and improving productivity and quality of agriculture too.

This chapter will investigate how the agro-food industry can enhance its contribution to raising Ethiopia's exports.⁸⁶ It starts by providing an overview of the agro-industry's current structure and level of development, including export volumes and composition (section 2), as well as a review of the recent performance of Ethiopia's agro-food industry (section (3)). These sections confirm that until now Ethiopia's agro-exports are undiversified and almost entirely limited to primary, unprocessed and thus low value added products.

Section 4 elaborates on the policy context for agro-industry development and reviews sector specific aspects of the framework for compliance with product quality standards, which are of particular importance for international trade in the food sector. Section 5 investigates the export potential of Ethiopia's agro-industry. Favourable natural and human endowments, and a policy and institutional environment which supports agriculture-led industrialization and private sector involvement, put Ethiopia in a good position to enhance agro-industry development and exports. Yet, benchmarking Ethiopia against other economies worldwide shows that, while its export performance for raw products is encouraging, the country is clearly not exploiting its full potential for producing and exporting more sophisticated, higher value, agro-products.

There are many challenges and constraints along the value chains that remain to be addressed to realise Ethiopia's agro-industry export potential (section 6). Agricultural producers operate on a small scale, have limited access to technology and inputs, generate low yields and experience high pre- and post-harvest losses. Most of them operate below designed capacity due to inconsistent quantity or quality supply of raw materials or poor state of machinery, and the resulting output compromises both local and international quality standards. Moreover, marketing systems are mainly informal and unable to provide adequate services to agro-processors. Based on this assessment, the last section recommends ways to address the current constraints.

Attempts to provide a detailed picture of the current status of food agro-industry in Ethiopia are constrained by a lack of recent, reliable and consistent data. The surveys conducted by the

⁸⁶ It will exclude sectors where the raw materials come from land or animals but are not used for manufacturing food products, i.e. wood, petroleum, rubber, non-metallic and metallic minerals, textiles and leather.

Central Statistics Agency (CSA) vary in coverage and frequency.⁸⁷ The most recent available statistics from the annual “Report on Large and Medium Scale Manufacturing and Electricity Industries Survey” provide detailed data on agro-industry and its subsectors until 2012/13.⁸⁸ If not otherwise stated, this chapter relies on data from large and medium-scale companies as those enterprises are most likely to export. As the food agro-industry sector consists predominately of small-scale operators, it follows that, where possible, the data is complemented by other sources, such as the CSA “Report on Small Scale Manufacturing Industries” from 2010, conducted on a sample basis and providing data for 2007/08.

2. The structure of the Ethiopian agro-industry

In 2007/08 (the most recent year for which data on both medium/large-scale and small-scale food manufacturers is available) more than 26,000 enterprises were registered. Less than 2 percent of these were medium- to large-scale, while the great majority of the sector consists of small-scale businesses with less than 10 workers. These figures do not include the informal micro- and cottage-scale sector, for which information is very limited. Most of these small businesses operate without power-driven machinery and cater for the domestic low-income market.

Among the medium- and large-scale manufacturing industries, food and beverages is the largest single sector in terms of registered units and employment. In 2010/11, 32 percent of all units were active in this subsector. Food and beverages remains also by far the largest contributor to medium- and large-scale manufacturing value-added (CSA 2012, 2014).

As of 2010/11, there were 687 medium- and large-scale enterprises in manufacturing of food products and beverages, of which 30 were public and 657 private, in forms of individual ownership, partnership, Share Company, private limited, or co-operatives. Based on enterprise numbers in 2010/11, the Government was little or not involved in the production of prepared animal feeds, soft drinks and mineral waters, dairy products and other food products manufacturing. Four enterprises operate in each of the following sectors: sugar, macaroni and spaghetti, spirits, and malt liquor.

Both the number of enterprises and persons employed by the medium- and large-scale (public and private) food and beverages industry increased between 2006/07 to 2012/13 (table 11.1). The number of units grew by 80 percent and employment by 47 percent; consequently employment per unit decreased from 94 in 2006/07 to 76 in 2012/13. In 2010/11, of the 67,471 persons engaged⁸⁹ in food and beverages, slightly less than one third (21,503) were employed by public enterprises and nearly all of this was in larger scale enterprises of 50 or more persons. Only three public enterprises employed less than 50 persons. Private enterprises, on the other hand, tended to be smaller: of the 657 private enterprises, 415 employed less than 50 persons.

⁸⁷ The CSA surveys distinguish manufacturing enterprises by size of employment and level of mechanisation: (i) (public and private) medium- and large-scale manufacturing establishments, engaging ten or more persons and using power-driven machines – the only survey conducted annually and by census; (ii) small-scale manufacturing establishments engaging less than ten workers and using power-driven machines; (iii) cottage/handicraft manufacturing establishments performing their activities by hand, i.e. using non-power driven machinery (CSA 2010).

⁸⁸ The most recent complete report is from 2012 (providing data for latest 2010/11), the 2014 report is only available in parts.

⁸⁹ The category “employees” includes all persons on the payroll, whether seasonal or temporary workers. The number of seasonal and temporary workers has been adjusted to give the equivalent of full-time workers. “Persons engaged” refers to paid employees, unpaid working proprietors, active partners and unpaid family workers. Note that in medium- and large-scale food and beverage manufacturing the difference in numbers is rather small: 67,072 employees vs. 67,471 persons engaged in 2010/11 (CSA 2012).

Key subsectors among medium- and large-scale enterprises in food and beverages are soft drinks and mineral water, grain milling, sugar and confectionary, and bakery, which together accounted for nearly 70 percent of total employment in the sector (table 11.1). Particularly strong growth in the number of enterprises was registered in animal feeds, dairy, and soft drinks and mineral water; in terms of employment generation, animal feeds, wine, soft drinks and mineral water, and grain milling were the strongest growing subsectors between 2006/07 and 2012/13.

In the small-scale manufacturing sector, grain mill services are by far the largest subsector. As of 2007/08, it accounted for over half of all small-scale manufacturing establishments and persons engaged. Its share in the gross value of production and value added was slightly lower, but still dominant with around 40 percent of all small-scale manufacturing. Compared to that, the contribution of the only other food agro-processing subsector, i.e. “manufacture of food products except grain mill services”, was negligible (table 11.2).

There is a clear gap in operational scale between medium- and large-scale food manufacturing enterprises on the one hand and small-scale enterprises on the other. In 2007/08, nearly 25,000 small-scale units together produced a value added of ETB 537 million, while at the same time 485 medium- and large-scale units achieved more than four times as much, i.e. ETB 2.3 billion.

In the small-scale sector there was a large difference between “permanent employees” (39,962 persons in food manufacturing and grain mills in 2007/08) and “persons engaged” (74,771), which includes, besides employees, also unpaid family workers and paid/unpaid apprentices. This is reflected across the entire small-scale manufacturing sector, and illustrates the lower level of income generation in the small-scale sector. Although there are no reliable figures for employment in the informal sector, it is estimated that it employs more people in food processing than the formal sector, especially in rural areas.

Regionally, medium- and large-scale food and beverages manufacturing is concentrated in Addis Ababa, Oromiya and Amhara, where altogether 76 percent of medium- and large-scale businesses are located (40, 26 and 10 percent, respectively) (CSA 2012).⁹⁰ Overall, it was found that the food industry is located mostly close to major urban centres, due to infrastructure, skilled labour availability and access to markets. Proximity to raw material production is considered less important, except for sugar and malt manufacturers, which have bulk intake and deal with demanding delivery schedules (UNIDO 2012).

In terms of existing fixed assets and new capital expenditure in large- and medium food agro-industries, public enterprises have benefitted from higher investments, on average, than private enterprises.⁹¹ Although there are more than 20 times as many private enterprises than public ones, their share in fixed assets amounts to only 68 percent, while their share in new capital expenditure is 71 percent. This shows that the private sector has a slightly higher propensity for new investment, relative to existing asset base, but only marginally so. Self-financing from retained profits plays a key role for the upgrading and enlargement of productive capacity. Of the food and beverage manufacturers that reported for the medium- and large-scale survey (CSA 2012), 85 percent financed their investment in fixed assets (including building and other construction works, machinery and equipment, vehicles etc.) by own funds, only the remaining 15 percent by bank loans.

⁹⁰ Small-scale grain mills in rural and urban areas display a similar regional concentration on Oromiya, Amhara and SNNPR (CSA 2010).

⁹¹ Fixed assets per public enterprise are valued at ETB 48.3 million and per private enterprise at 4.7 million. New capital expenditure was ETB 15.6 million versus ETB 1.7 million, respectively (based on data from CSA 2012).

Table 11.1:

**Medium- and large-scale food and beverages manufacturing units and employees,
2006/07 and 2010/11**

	Number of establishments		Number of employees	
	2006/07	2012/13	2006/07	2012/13
All food products and beverages	381	687	35,686	52,441
Meat, fruit and vegetables	9	21	2,086	2,827
Vegetable and animal oils and fats	26	43	991	844
Dairy products	3	13	760	543
Grain milling	86	254	3,697	10,307
Animal feeds	1	7	61	808
Bakery	180	178	6,008	6,015
Sugar & confectionary	16	28	9,226	7,436
Macaroni and spaghetti	9	17	1,427	1,548
Other food products	13	44	1,394	2,315
Spirits	14	16	1,104	958
Wine	2	3	510	2,657
Malt & liquor	9	8	4,091	3,636
Soft drinks & mineral water	13	55	4,331	12,547

Source: CSA 2012, 2014

Table 11.2:

Small-scale agro-industry: Selected structural indicators (2007/08)

	Establishments		Persons engaged		Gross Value of Production		Value-added	
	Number	Per cent	Number	Per cent	ETB '000	Per cent	ETB '000	Per cent
Manufacture of food products	1,541	3.6	4,748	3.4	308,346	11.1	57,255	5.0
Grain mill services	23,047	53.2	70,023	50.4	1,113,873	39.9	479,700	42.0

Source: CSA 2010

3. Recent performance of the agro-industry

3.1 Production

Despite impressive growth in several subsectors, the share of the agro-processing industry in Ethiopia's GDP has remained low and behind target. The gross value of output (GVP) of the medium- and large-scale enterprises increased by more than 6 times between 2006/07 and 2012/13 (table 11.3). The subsectors with the highest output were grain milling (21 percent of food and beverages total GVP), malt and liquor (19 percent), soft drinks and mineral water (17 percent), and wine (13 percent). During the same time the contribution of the sugar and confectionary subsector fell from 33 to 10 percent.

Value-added has also increased significantly since the mid-2000s. From 2006/07 to 2012/13, it grew at an average annual growth rate of 29 percent for the whole food and beverages sector. Some subsectors have shown particularly strong growth during this period, notably wine (94 percent), grain milling (83 percent), malt and liquor (36 percent) and dairy products (35 percent), although their development has been very volatile from year to year. Two subsectors (meat, fruit and vegetables, and animal feeds) has had a negative value added in 2012/13. The importance of the sugar and confectionary industry declined too. Whereas its value added still amounted to ETB 3 billion in 2010/11 – accounting for a share of 38 percent of food and beverage manufacturing value added, it decreased sharply to ETB 224 million in the following year. By 2012/13 its value added had grown again, but was still behind malt and liquor, and wine. Together those three subsectors accounted for 73 percent of value added in food and beverage manufacturing.

In terms of value added per person – an indicator of productivity improvement – growth has been impressive (table 11.3), but has lagged behind total value-added growth. Malt and liquor, and wine have the highest value-added per person, by far, followed by dairy products and sugar and confectionary. In addition, strong growth was recorded in grain milling, while value-added per person was negative in animal feeds, and meat, fruit and vegetables in 2012/13.⁹²

3.2 Exports

Exports from the large- and medium-scale agro-industry continued to reflect the low level of agro-industry development in Ethiopia. There is little diversification into processed and value added commodities (UNIDO 2015). In 2013, the share of agro-industry products in total trade accounted for 66 percent, but almost all exports were primary agricultural (or raw) products with little value addition, if any. Trade was highly dominated by raw vegetables, coffee, oils and fats, and meat. The main export markets were Sudan (raw vegetables and meat), China (raw oils and fat), and Germany, Saudi Arabia and the United States (raw coffee) (UNIDO 2015).

In comparison to the value of raw agro-industry exports (US\$ 2,662 million), processed exports are very small (US\$ 34 million). Furthermore, the share of processed agro-industry exports in total agriculture-related exports fell from 1.8 percent in 2003 to 1.3 percent in 2013 (UNIDO 2015). Although this may be explained in part by favourable international price developments for unprocessed primary commodities until 2011, it also indicates that structural transformation has advanced only slowly. Export earnings from low value-added raw products have grown faster than those from products with high value addition.

⁹² Total factor productivity for the entire medium- and large-scale manufacturing sector has reportedly followed the pattern of labour productivity (Gebreeyesus, 2013).

Table 11.3:
Production and value-added in medium- and large-scale agro-industry enterprises,
 by product group, 2006/07-2012/13

<i>Product group</i>	<i>Gross value of production (ETB million)</i>		<i>Value-added per employee (ETB thousand)</i>		
	<i>2006/07</i>	<i>2012/13</i>	<i>2006/7</i>	<i>2012/13</i>	<i>Average annual growth 2006/7- 2012/13 (percent)</i>
Manufacture of food and beverages	5,975.9	38,061.4	50	140	19
Meat, fruit and vegetables	159.8	1,625.3	25	-14	*
Oils and fats	120.3	745.2	27	96	24
Dairy products	99.7	534.2	39	166	27
Grain milling	519.0	8,168.4	5	74	57
Animal feeds	7.7	753.5	30	-320	*
Bakery	442.4	1,690.9	23	47	13
Sugar and confectionary	1,972.5	3,856.1	82	161	12
Macaroni & pasta	232.9	936.0	30	126	27
Other food products	165.4	883.4	48	105	14
Spirits	150.1	471.3	32	17	-10
Wine	87.9	4,778.3	70	689	46
Malt and liquor	1,373.2	7,327.5	107	522	30
Soft drinks and mineral water	644.9	6,291.4	33	52	8

Source: CSA 2012, 2014

Among the latter, the most important product groups were processed vegetables, cereals and fruits (table 11.4). Exports of these goods have been highly concentrated on a few trading partners: 71 percent of processed vegetables exports went to the United Kingdom, in the case of processed cereals the two most important markets United Arab Emirates and United States together accounted for 67.4 percent, and 74.7 percent of all processed fruit exports went to regional markets, mostly United Arab Emirates, Kenya and Egypt (UNIDO 2015).

Albeit starting from a low level, export of most processed agro-industry products was very dynamic during 2003-2013 (19.4% annual average growth in value terms). This holds true, in particular, for processed vegetables (80.4% export value growth), but processed fruits, sugar, fish, alcoholic beverages, meat, dairy products and cereals also grew faster than the average of all Ethiopian processed agro-industry exports.

The rapid expansion of processed vegetables exports indicates that Ethiopia's efforts to develop an entire value chain are successful. Exports of fresh, chilled, frozen vegetables and vegetables preparations and preserved, has become the most important value chain for the country within the agro-industry sector. By contrast, the performance of the processed coffee sector has been surprisingly poor. Coffee is one of the emblematic products of Ethiopia, but the country has only specialized on the production and export of unroasted coffee rather than

taking advantage of the dynamic world demand for processed coffee (roasted, essences and preparations). The value of processed coffee exports shrunk dramatically since 2003, from \$2.4 million (representing more than 40 percent of the total value of processed agricultural food in 2003) to a negligible \$0.1 million in 2013.

Ethiopia's trade balance of the agro-industry sector in 2013 was in surplus thanks to the positive performance of raw exports. It swung from a \$77 million deficit in 2003 to a \$1,758 million surplus in 2013 (figure 11.1). By contrast, in processed agro-industry products import dependency remains strong. The main imported products in the latter year were: processed oils & fats and processed cereals. This indicates that there is domestic market potential for such value-added products (UNIDO 2015).

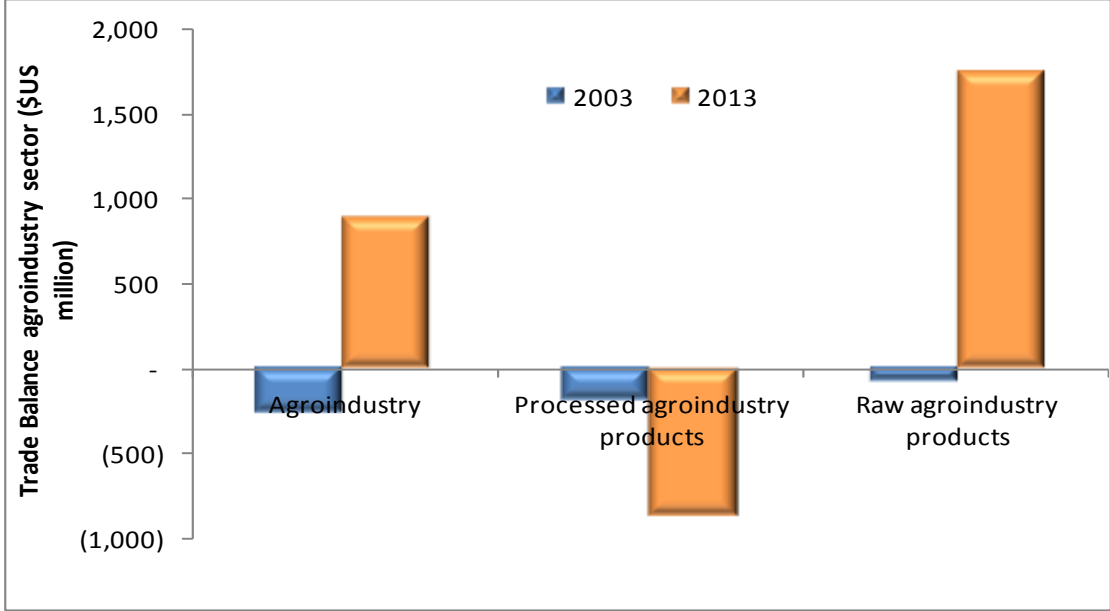
<i>Table 11.4:</i>				
Exports of processed agro-industry exports from Ethiopia,				
by product group, 2003-2013				
<i>Product group</i>	Exports <i>(\$ thousand)</i>		Share in processed agro-industry exports <i>(percent)</i>	
	<i>2003</i>	<i>2013</i>	<i>2003</i>	<i>2013</i>
Vegetables	25.2	9,207.7	0.4	26.9
Cereals	1,075.3	6,976.7	18.6	20.4
Fruits	91.2	6,536.6	1.6	19.1
Alcoholic beverages	114.2	4,524.4	2.0	13.2
Oils & fats	1,319.3	2,586.5	22.8	7.6
Spices	526.4	2,313.0	9.1	6.8
Dairy products	139.2	922.9	2.4	2.7
Fish	7.5	409.6	0.1	1.2
Tobacco	–	265.6	–	0.8
Miscellaneous edible products	81.0	214.6	1.4	0.6
Coffee	2,408.7	133.1	41.6	0.4
Meat	1.7	46.5	0.0	0.1
Sugar	0.5	26.5	0.0	0.1
Cocoa	–	3.7	–	0.0
All processed agro-industry products	5,790.1	34,167.3	<i>100</i>	<i>100</i>
<i>Memo items:</i>				
All raw agricultural exports	312,007.8	2,661,907.7		
Share of processed products in total agro-industry exports <i>(percent)</i>			<i>1.8</i>	<i>1.3</i>
<i>Source:</i> UN-COMTRADE				

A comparison of Ethiopia’s performance based on the Export Competitiveness Index, using data from 2003 to 2013, is encouraging for the raw agro-industry sector, as the country improved its ranking by from position 115 to position 77. On the other hand, countries like Cote d’Ivoire, Chile and Argentina, which have similar similar agro-product exports as Ethiopia, lost market share, as a result of these countries’ efforts to shift to more processed agro-products by strengthening their domestic value chain (UNIDO 2015).

Regarding export competitiveness of processed agro-industry products, UNIDO (2015) finds that although Ethiopia improved seventeen places in the ranking by 2013, it is only at position 135. Its processed agro-industry exports only reached \$0.40 per capita, and its market share increased to 0.006 percent only. It is thus evident that Ethiopia is not exploiting its potential considering the strong comparative advantage in agro-industry products.⁹³

Figure 11.1:

Trade balance of the Ethiopian agro-industry sector by processing level, 2003-2013



Source: UN-COMTRADE (UNIDO 2015)

3.3 Capacity utilization and investment

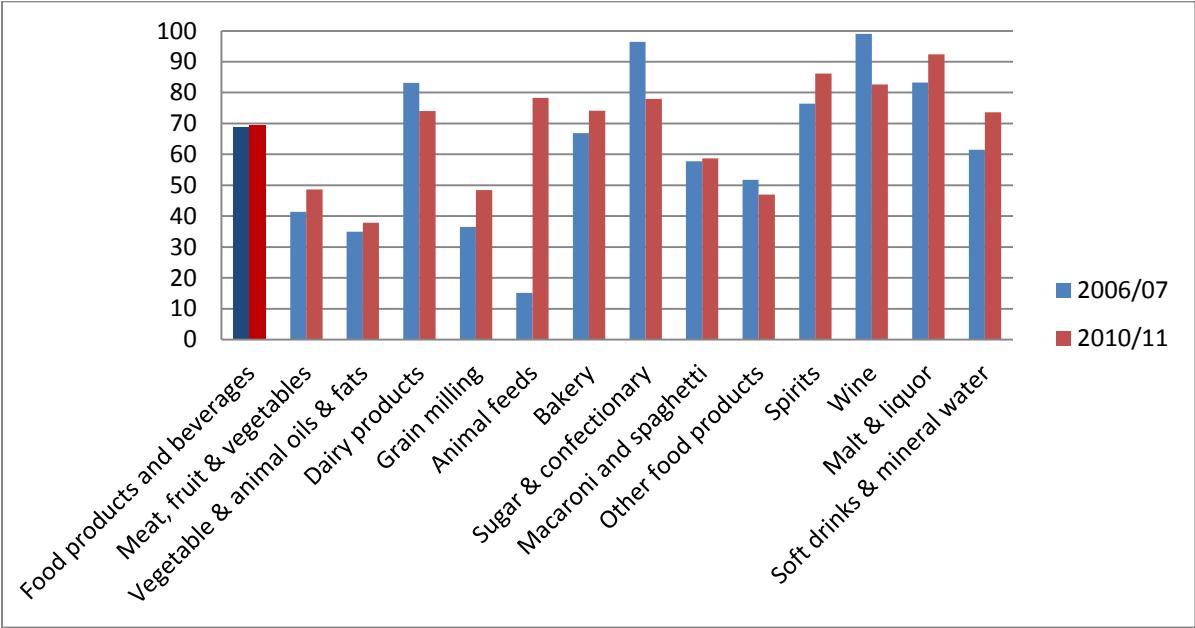
The relatively disappointing export performance of the agro-processing industry has been accompanied by a low degree of capacity utilization. While the latest data on capacity utilization is for 2010/11, more recent information from managers of the agro-industry suggests that the situation has not fundamentally changed in more recent years. According to CSA data from 2010/11, of the 687 food and beverages processing companies 482 operated under capacity. Overall, capacity utilisation in the food and beverages industry remained essentially unchanged from 2006/07 to 2010/11, at just below 70 percent. It varies greatly across sectors (figure 11.2). The better performing subsectors were those with efficient raw material supply, such as malt and liquor and winery industries - thanks to high and regular raw material imports; sugar and sugar confectionary – thanks to integrated local raw material

⁹³ Indonesia and Egypt are revealed as interesting role models, because they are two of the major exporters of raw and processed vegetables, meaning that they have concentrated their efforts to develop the whole value chain.

supply; and dairy with a well-organized system for collecting raw materials. The subsectors with least capacity utilization included vegetable and animal oils and fats (37.9 percent). While capacity utilization greatly increased in animal feeds, it declined in the dairy, wine and sugar subsectors. In addition, it varied by enterprise ownership: overall capacity utilization in food and beverages is 81 percent in public, but only 65 percent in private enterprises.

Figure 11.2:

Capacity utilization in medium- and large-scale food and beverages industries, 2006/07 and 2010/11



Source: CSA 2012

4. Policies and Institutions

Obviously agricultural policies and policies in support of processing agricultural produce in the agro-industry are closely interconnected. Key institutions for formulating government development policies and programmes for agro-industry include the Ministry of Agriculture and Rural Development, the Ministry of Finance and Economic Development and the Ministry of Trade and Industry. Support services are dispersed across different institutions and coordination has proven to be difficult.

The agriculture-based industrialization strategy focuses on agricultural commercialisation and product diversification; a shift to higher-value crops and livestock; promotion of niche high-value export crops; support for the development of large-scale commercial agriculture; effective integration of farmers with domestic and international markets. The suggested measures are adapted to the particularities of the different geographical regions, but are generally geared to creating strong linkages between agriculture and agro-industry, e.g.:

- Introduction of appropriate extension packages that will enhance farmers' choice of technologies.
- Expansion of micro-financing institutions to facilitate credit and financial services to borrowers.

- Establishment of an institute for diploma-level training for extension agents and more technical and vocational education and training in agriculture.
- Improving the supply of agricultural inputs (fertilizer, seed, etc.) and trading outputs.
- Strengthening and diversifying autonomous cooperatives, and improving their organization and marketing services, so as to enable them to act as a bridge between small-scale farmers and the commercial sector.
- Better use of water resources, water harvesting and small-scale irrigation.
- More effective agricultural research that matches and is responsive to the market.

Ethiopia's Industrial Development Strategy gives highest priority to the linkage between agriculture and the agro-industry sector. Within agro-industry, the sectors initially chosen for priority development included food processing (e.g. sugar and sugar related industries); textile and garment; meat, hides and skins. The underlying rationale was that those sectors provide strong linkages with agriculture, are labour-intensive and have a comparative advantage in export markets. Over time, new priority sectors, such as the flower industry, have been added.

GTP I envisaged a minimum annual agriculture growth rate of 8.1 percent, tripling the number of farmers receiving relevant extension services, and more than doubling the production of key crops from 18.08 million to 39.5 million metric tonnes (ATA 2015). It aimed at enhancing the productivity and production of smallholder farmers and pastoralists, strengthening marketing systems, improving participation and engagement of the private sector, expanding the amount of land under irrigation, and reducing the number of chronically food insecure households. GTP I placed particular emphasis in micro- and small-scale enterprises that are labour intensive, use agricultural products as inputs and are export oriented and import substituting. While micro and small-scale industrial development is regarded as the key strategic direction of industrial development and a broad-based springboard for the development of competitive domestic industries, medium and large enterprises (especially in the the sugar and food and beverages industries) are promoted to create a competitive national economy by ensuring rapid and sustainable technology transfer, raising exports and creating a conducive environment for micro and small enterprise development (MoFED 2013).

The Micro and Small Enterprises Development Strategy is based on a number of principles, including: Legalization of the informal sector; facilitation of access to finance, appropriate technologies, market information and advice (e.g. technical, business, financial, etc.); provision of physical infrastructure and incentive schemes; encouragement of partnerships; strengthening of capabilities for entrepreneurship, skills and business management.

The government has been investing in technical, vocational education and training to support the development of micro and small enterprises in general and that of selected industries (e.g. sugar, meat and dairy processing) in particular. To enhance agricultural production and technology, efforts have been made, like the introduction of a Participatory Agricultural Demonstration Training and Extension System.

Several institutional reforms of relevance for the agro-industrial sector have been launched since the early 2000s.⁹⁴ It included the creation of new institutions and upgrading existing ones, such as the Agricultural Transformation Agency (ATA) that was established in 2010 to

⁹⁴ Christy et al. (2009) distinguish between three levels of needs that a government may consider in its efforts to create an enabling environment for agro-industrial activities: essential enablers (land tenure and property rights, infrastructure, and trade policies); important enablers (standards, regulations and services related to production, research and development, financial services for agro-industry); and useful enablers (ease of doing business, business development services, horizontal and vertical business linkages).

promote agricultural transformation by supporting existing structures of government, private sector and other non-governmental partners. In view of the need for the agro-industry and other sectors to meet stricter quality requirements and international product standards, the National Quality Infrastructure (NQI) has been reformed (see chapter VI).

Several agencies are specifically mandated to set food standards and to regulate food production. The Ethiopian Food, Medicine and Health Care Administration and Control Authority is empowered to set national food standards and regulate food production, storage distribution and trade and to oversee regulated quality control laboratories. The Ethiopian Standards Agency (ESA) is empowered to develop and monitor Ethiopian standards for cereal, pulses sesame, coffee and chickpeas. The Ethiopian Conformity Assessment Enterprise (ECAE) provides certificates of conformity for products such as cereal grains, oilseeds and honey that conform to relevant national or international standards. However, food standards appear not to be a high priority area and across the agencies, coordination could be better and enforcement stronger.

In addition to policy measures aimed at improving licensing, registration, customs and taxation procedures, fiscal incentives were introduced to increase private domestic and foreign investment. The creation of industrial parks is another important instrument to encourage and facilitate investment in additional productive capacity in the prioritized sectors, including agro-food processing. In addition, a privatization program has aimed at enhancing private sector engagement in these sectors.⁹⁵ Aiming at creating a less bureaucratic regulatory system and eliminating corruption, the government is enforcing transparency and accountability (MoFED 2013).

5. Export potential of Ethiopia's agro-industry

The global market conditions for developing countries that aim at increasing their foreign-exchange earnings through exports of processed food are broadly favourable. With an annual average of 9.7 percent, world export growth of processed agricultural food exceeded that of total world trade during 2003-2013. Global trade in coffee, tea and mate, oils and fats, spices, miscellaneous edible products, cereals, meat and dairy products registered growth rates of more than 10 percent annually.

Ethiopia's natural endowments represent an unexploited potential for the development of agriculture and the agro-processing industry: adequate rainfall; abundant arable land, of which 80 percent remain uncultivated to-date; a suitable climate and various agro-ecological zones that enable Ethiopia not only to produce different crops all year round, but also to be competitive in both variety of crop production and yields (e.g. sesame seeds) within the Eastern Africa region.

Increasing globalisation, growing FDI and continued improvements in national physical and institutional infrastructure have created new opportunities to increase production and trade of higher value-added agro-industry products. Though being landlocked, Ethiopia has an advantageous geographical position for expanding existing markets and exploiting new potential ones.

Integrating with regional neighbours helps facilitate participation in global value chains, especially for countries that are landlocked and have limited resources and domestic markets (Huria and Brenton 2015). As stated, regional countries have become increasingly important export destinations for Ethiopia in recent years.

⁹⁵ For instance, sugar, malt and liquor, and soft drinks and mineral water enterprises have been offered for privatization in the past (UNIDO 2012).

An analysis of value chains and world market shares explores which Ethiopian agro-products are more competitive than others. One approach to assess which agro-industry sectors are most promising to benefit from focused interventions to enhance agricultural commercialization, agro-industrial development and exports is the analysis of value chains, as conducted for the Agro-Industry Master Plan (2009, 2010) (see UNIDO 2012). Such an analysis is particularly useful in agro-industry development because it focuses on the linkages between agricultural production, agro-processing and marketing as the raw material moves from producers through the entire value chain until it reaches the final consumer. It covers all actors along the chain, i.e. producers, processors, traders, exporters, retailers and consumers, as well as providers of support services such as input suppliers and transporters. Ultimately, the analysis aims at improving the performance of the value chain by reducing losses, and raising quality and quantity of the product.

Based on in-depth value chain analyses, 12 agricultural products were selected and prioritized, according to the following criteria:

- The importance of the commodity to the economy: the population involved in production, marketing, processing and related services; the importance to national food security; and the contribution to foreign exchange;
- Competitive advantage in farm production and agro-processing relative to other, especially neighbouring, countries;
- Attractiveness of the industry to investors;
- Access to the requisite technology, infrastructure, services, and facilities; and,
- Potential for short-term impact: the sectors and commodities likely to show significant improvement along the value chain without requiring major investment in infrastructure.

The first group of priority commodities includes cereals (wheat, maize, teff and barley), oil seeds (sesame, Niger seed, linseed and rape seed), coffee, and sugar. They are commodities of significant economic importance due to the number of people involved in their production and their contribution to food security and to foreign exchange earnings. Also, they have the potential to have an impact in the short term with relatively little investment.

The second group of priority commodities, i.e. dairy, meat, tea, fruits and vegetables, are equally important economically, but would require significant investment in infrastructure and a concerted effort to enhance their global competitiveness.

The third group of priority commodities, i.e. honey, pulses, spices, and grapes/wine, are found to have a competitive advantage in comparison to other countries and they have the potential for a short term impact, but they have relatively low national economic importance and are more relevant for niche or specialized market development.

Another method, which is useful for establishing specifically the export potential of agro-industry products in Ethiopia, is to analyze whether the country has gained or lost world market in those goods where global demand is highly dynamic or static in terms of growth (table 11.5). It provides key insights regarding Ethiopia's potential, its ability to compete and satisfy international demand, and the degree to which Ethiopia is benefiting from the opportunities and signals that the world market offers (UNIDO 2015).

This analysis reveals that raw coffee and raw oils and fats were the most important champion products, because world demand grew above the average growth rate of all agro-industry products and Ethiopia gained world market share during 2003 to 2013. These product groups are usually "quick winners" since they are already competitive. It follows that they are

strategic for the country to show quick achievements in the short run (UNIDO 2015), although they may not contribute to industrial development.

<i>Table 11.5:</i> System of classification of Ethiopia's agro-industry export subsectors			
		<i>Global demand</i>	
		Growing faster than average	Growing slower than average
<i>Change in Ethiopia's global market share</i>	Gain	Champion	Overachiever
	Loss	Underachiever	Declining
<i>Source:</i> UNIDO 2015			

The underachievers were raw cereals, raw sugar, processed oils & fats, miscellaneous edible products and processed coffee. World demand in these product groups was highly dynamic, but Ethiopia lost market share during 2003 to 2013. This category of products is probably the one that requires most attention through policy intervention and private sector actions to improve its export performance and compete internationally. The best scenario for Ethiopia would be to pursue a productive transformation and turn these products into champions to respond positively to world market signals. Among them, processed oils and fats, and processed coffee, can be considered as the ones with the highest potential due to the strong export performance in the raw stage (UNIDO 2015).

The great majority of Ethiopian agro-products, most importantly raw vegetables and raw meat, are found to be overachievers as the country gained position in the international market even though world demand was static (table 11.6). Exports of fresh, chilled, frozen vegetables and vegetables preparations and preserved, constituted the most important and dynamic value chain within Ethiopia's agro-industry sector (UNIDO 2015).

<i>Table 11.6:</i> Classification of Ethiopian agro-industry exports by product category, 2003-2013			
<i>Product category</i>	Exports 2013 (\$ million)	Number of products	Share in agro-industry exports 2013 (percent)
Champions	1,380.6	6	51.2
Underachievers	11.4	6	0.4
Overachievers	1303.3	12	48.3
Declining	0.8	1	0.1
Total	2696.1	25	100.0
<i>Source:</i> UN-COMTRADE			

Box 11.1:

Opportunities for Ethiopia's coffee industry

Ethiopia is the 5th largest coffee producer in the world and by far the most important one in Africa. Ethiopian coffee comes from diverse genetic Arabica varieties, which makes it unique in flavor and aroma. Being high quality, it gives Ethiopia an advantage compared to international competitors such as Brazil and Vietnam that harvest mainly Robusta. Only Colombia – also a big producer of Arabica – constitutes a strong competitor, whose coffee quality is recognized in international markets.

Ethiopia has gained world market share in raw coffee exports despite numerous constraints in its value chain, including the small scale of coffee plantations, poor cultivation practices, high post-harvest losses and low productivity. Poor linkages between coffee producers and processors, lack of skills and experience in processing coffee, and inadequate processing techniques are among the reasons for limited value addition. These are all aspects that need to be addressed, if Ethiopia is to improve its world market position in the coffee sector.

Identifying unique product characteristics would be beneficial for creating a niche market. Much of Ethiopia's coffee production is by definition organic. It follows that public and private efforts should concentrate on extending organic certifications to farmers who qualify and helping others to introduce environmentally friendly practices. This would give smallholders a unique opportunity to compete internationally.

Source: UNIDO 2015

6. Challenges and constraints in agro-food processing and export

6.1. Low capacity utilization and its causes

Ethiopian agriculture and its agro-processing industry are far from fully utilising their potential. The provision of raw material for agro-processing can be significantly increased, as 80 percent of the country's arable land remains uncultivated. Although agro-food processing has been growing with the support of government policies, growth rates and exports fell short of GTP I targets. Poor output quality constitutes a major constraint for Ethiopia's agro-industry exports.

Existing production capacity would have allowed a better production and export performance. Insufficient market demand has been the cause for capacity underutilization only in 18 percent of the *medium-sized and large* companies. By contrast, for 52 percent of the companies operating under capacity, the main reason was a shortage of raw material supply. For 4 percent of the companies, low capacity utilization was due to the lack of access to financing; for 3 percent the single main reason was the lack of timely foreign exchange availability and for another 3 percent a shortage of supply of spare parts.⁹⁶ In most cases, however, these factors were combined.

The main constraints faced by the *small-scale* food processing sector are, in this order, lack of sufficient capital, obstacles from government rules and regulations, absence of adequate skills and lack of smooth supply of raw materials. Not being fully operational or not working at full capacity is the result of poor infrastructure (mostly shortage of water), lack of markets, shortage of supply of spare parts and inadequate raw material supply (CSA 2010). The sugar industry subsector, for example, has achieved considerable progress in increasing sugar plantation area and productivity, creating new employment, extending irrigation

⁹⁶ The picture is similar for the 326 enterprises that are not fully operational: Here, the main reasons are a shortage of raw material supply (29%), shortage of electricity and water supply (7%), and insufficient market demand (4%).

infrastructure, and constructing factories and housing. But the sugar industry's output has only achieved 36 percent of its GTP I target. Delays in new and expansion projects, as well as a low level of production in existing factories, were held responsible for this sub-optimal achievement (MoFED 2013).

There are still major challenges that remain to be addressed to realise Ethiopia's full agro-industry potential. Operating at sub-optimal levels has meant that profit margins of agro-firms were insufficient to allow for higher self-financed investments. As a consequence, many agro-processing operations continued to be inefficient and produce poor and inconsistent quality.

6.2 Raw material supply and vertical integration

Close vertical links between agriculture and agro-industry are essential to ensure that raw material inputs are available at the time and in quantity and quality required for the production line. However, the Ethiopian agro-industry suffers from very weak linkages to agriculture. This results in an insufficient, inconsistent and poor quality raw material supply for the industry.

Small-scale subsistence farmers with average land holdings of only 0.2 ha per capita account for an estimated 97 percent of agricultural production (GTP Progress Report 2013). They depend on rain-fed production, dispose of only very basic production techniques, have poor storage facilities and lack adequate information as to product requirements of processors. Only few farmers are organized into market-oriented farmer associations and cooperatives, thus limiting the possibility to pool resources in order to meet challenges such as access to storage, transportation, grading and packaging. As a result, agro-industry suffers from higher costs for bulking, transportation and other handling services, which is reflected in costly raw material prices for industry.⁹⁷ The lack of vertical integration between these small-scale farmers and industrial processors is at the heart of many problems constraining growth and efficiency in Ethiopia's agro-industry. Domestic marketing systems are largely informal. They consist of small and medium scale private traders, who are unable to benefit from economies of scale, lack access to capital and packaging technology, and have only limited agri-business and technical skills in marketing and trading. As a result, product shelf life is shortened and distribution of products limited to the immediate vicinity. Schemes that aim at linking the production and processing parts of the value chain, such as the Ethiopia Commodity Exchange, are still in the early stages.

Among the reasons for which the agro-processing sector cannot always count on a growing and reliable supply of agricultural raw material inputs are insufficient contract enforcement procedures. The cooperatives (producer groups), supplying raw products to the agro-processing industry, are governed largely by informal rules. Not only are producers often unaware of the time-sensitiveness of raw material provision for the agro-industry, but they also frequently breach initial agreements and sell to other buyers for trivial changes in product prices. This makes the flow of inputs for processing very unreliable. A major challenge is therefore to make farmers more aware of the critical importance of reliable supplies, long-term business arrangements with the agro-processing industry and, more generally, of the crucial role of forward linkages for the economy as whole.

The fact that smallholder agriculture is spread out widely over the country complicates the efficient sourcing of the agro-processing industry. Strengthening the role of cooperatives that cater the products of their members in bulk to the industry is a major element in increasing the efficiency of the supply with agricultural raw material.

⁹⁷ For example, wheat costs US\$ 300-350 per tonne in Ethiopia compared to US\$ 200-250 in China and Vietnam (UNIDO 2014).

The Government has recognized this challenge and is supporting the creation of cooperatives and the organization of producer groups. Yet, due to lack of management and organizational know-how the dependability of these institutions is still limited. In order to improve the consistency and reliability of input supply to the agro-processing industry, such organizational shortcomings should receive priority attention. Yet, smallholder producers individually and the producer groups (cooperatives) appear to have a limited business orientation. Small farmers and associations do not view themselves as businesses aiming at profit maximization and determining production primarily in response market demand.

The poor agricultural value chain is the key constraint for agro-industrial growth. This holds true especially for SMEs, and results in a significant under-utilization of the existing capacity, which in turn leads to high overhead and operating costs and is often reflected in higher product prices.

6.3 Technical equipment, finance and skills

The efficiency of the food processing industry suffers from aged and/or outdated technologies and a dependence on imported equipment and spare parts. Apart from a few modern factories, agro-processing equipment and facilities tend to be inappropriate, some more than 50 years old. Support and facilities to modernize the equipment are limited.

A major reason for the inadequacy of machinery and equipment is the difficult access to and relatively high cost of credit (see also chapter IX). The fact that agro-processors, and especially small-scale enterprises, suffer from a lack of finance from traditional financial institutions, is a major constraint that needs to be addressed to promote new agro-industry enterprises and the development and upgrading of existing ones. This is also important for enhancing export capacity. The lack of access to finance is the reason why small-scale enterprises are less likely to export than large enterprises and foreign-owned ones, which can more easily meet the large fixed costs involved in setting up an international distribution system (Clarke 2005).

Furthermore, the agro-processing sector lacks the human resources to upgrade production. Although production know-how in agriculture has been disseminated through the State's extension system, business, managerial and technical skills are still rather limited in Ethiopia's agro-processing sector. Larger companies have effective systems for staff recruitment, training and development, while the informal cottage and micro-scale enterprises, which provide the major share of the employment in agro-processing, are usually simple family businesses with one or two employees.

6.4 Quality assurance

In the agro-processing industry quality assurance is central. Yet, emanating from traditional production practice, harvesting and post-harvest handling of agricultural products in Ethiopia often suffers from inadequate sanitation and hygiene. Cleaning, sorting and grading is frequently poor. Impurities and foreign matter as high as 15 percent by weight have been observed. A weak post-harvest infrastructure, coupled with long handling chains between farmers in rural areas and processors who are often based in urban areas for reasons of better access to infrastructure, markets and labour, further contribute to quality deterioration and contamination. Unsurprisingly, post-harvest losses are very high. They are estimated to be as high as 40 percent of production for highly perishable products and 20 percent for cereals and pulses. Adulteration, i.e. intentional addition of foreign substance into food products, is frequent observed among traders collecting products from smallholder farmers and supplying to processing industries. Adulteration problems also exist among the smallholder producers themselves.

Moreover, since activities in the agricultural extension system are focused on crop extension, livestock farmers are deprived of sufficient and effective extension services, including training in livestock management, business skills and technical assistance that would help to raise the level of animal husbandry and, thus the quality of meat, dairy products and raw leather.

A major challenge for Ethiopia's agro-industry is how to meet international quality standards, such as those promoted by the FAO Commission on Phytosanitary Measures and the World Organization on Animal Health and the WTO Agreements on Sanitary and Phytosanitary (SPS) measures and Technical Barriers to Trade (TBT). For export oriented agro-food processing companies, these product quality standards are very high. With few exceptions agro-industry firms are not certified under any of the international quality standards programmes.

Although serious attempts have been made at the institutional level to address this quality problem (see also chapter VI), most agricultural producers are still unaware of the existence of sanitary standards, let alone the need to comply with them. Institutional, human resource and technical capacities of the regulating, implementing and supporting institutions are poor, and there is neither SPS notification authority nor an SPS enquiry point. The SPS/TBT Agreements are relevant not only because they set standards for product quality and measurement, food safety, and animal and plant health, but also for labelling and packaging, shipping and financial documentation. Implementing these rigorous quality controls and food safety measures require finance, skilled personnel and suitable infrastructure such as laboratories, all of which are not yet sufficiently available to domestic food processing enterprises.

Government entities set up to offer support services are the Food, Beverage and Pharmaceutical Industries Development Institute under the Ministry of Industry, the Ethiopian Food, Medicine and Health Care Administration and Control Authority under the Ministry of Health and the Ministry of Agriculture. However, the capacities of these institutions to service the private sector on compliance issues are quite limited.

Moreover, since activities in the agricultural extension system are focused on crop extension, livestock farmers are deprived of sufficient and effective extension services, including training in livestock management, business skills and technical assistance that would help to raise the level of animal husbandry and, thus the quality of meat, dairy products and raw leather.

6.5 Infrastructure and logistics

Expansion of the Ethiopian agro-processing industry has been constrained by inadequate infrastructure, especially access to water and industry-level electricity and road networks. Improving access to three-phase electricity is crucial for growth of manufacturing activities and enhanced water supply is fundamental especially for the food processing industry. Another challenge is to raise the efficiency of logistics services. Their inadequacy causes additional high costs and delays and severely weakens the competitiveness of current and potential agro-industry exporters (for a detailed analysis of these constraints, see chapter VII).

6.6 Institutional coordination of sectoral support

Despite extensive policies and strategies to enhance the sector, agro-industrial support and investment still seem rather ad hoc. A major challenge is therefore to improve joint planning, coordination, and collaboration among different public institutions. There are Industry Development Institutes for various sectors as well as an Agro-Industrial Development Department within the Ministry of Trade and Industry that attempt to help, but their

institutional effectiveness is limited. Existing institutions face capacity constraints to implement policies and strategies making the delivery of quality public services insufficient. Institutional mechanisms to promote foreign trade are restricted. Underlying many of these constraints is the lack of trained staff who can address strategy and structural issues, implement strategies, monitor performance and take remedial actions.

Also, coordination and cooperation in planning and decision-making between public and private players appears inadequate. Reportedly erratic regulations with regards to prices, licensing, business registration, land administration, customs administration and private banks, have contributed to discourage investment, upgrading and international marketing efforts of agro-industrial firms.⁹⁸

7. Recommendations

Ethiopia will have to make additional concerted efforts to promote growth and structural transformation of agriculture and agro-industry through diversification into higher value-added and more sophisticated products, to adopt new technologies and to link with regional and global value chains. The preceding analysis leads to a number of recommendations, especially those related to infrastructure, logistics and customs services, which are equally relevant for the other prioritized sectors (see chapters VII and VIII). In addition, the following recommendations may help to meet the specific challenges for the agro-processing industry:

- ***Improve policy consistency and coordination between stakeholders***

As illustrated by the success of Ethiopia's floriculture exports, good coordination and partnership between the Government and the private sector, and a good identification of key areas of intervention are essential for an effective sector development strategy (Gebreeyesus and Iizuka, 2012). For consistent and coherent policy support, the following need to be in place:

- a sound institutional framework that coordinates support across all government and non-government institutions and development partners
- a dedicated agro-industry support organization that acts as a focal point for the development of the whole value chain of agro-industry
- up-to-date and reliable agricultural, food processing and trade statistics to inform policy formulation, evaluation and monitoring.

The Agro-Industrial Development Department must become more action-oriented, with a clear mandate to involve the private sector. One of its major functions should be the analysis and monitoring of Ethiopia's agro-industry sector to provide market information to the government and industry stakeholders. Furthermore, a Manufacturing Efficiency and Response Unit to collect information on day-to-day problems of the sector and provides adequate interventions, especially to address issues of food safety and traceability should be created (UNIDO 2012).

Fora for public-private dialogue and exchange at the national and sectoral should be strengthened with improved participation of sectoral and civil society associations.

- ***Promote the creation of Integrated Agro-Industrial Parks***

The agro-industry would benefit from further development of industrial zones (see also chapter VII). In order to achieve synergy and agglomeration effects, it is recommended to further extend the existing schemes for such zones with the creation Integrated Agro-

⁹⁸ See Gebreeyesus (2013) and Altenburg (2010) for more detail.

Industrial Parks, dedicated to agro-processing and located in strategic production hubs (see UNIDO 2012, 2014). Potential subsectors to be prioritized for the development of such parks include meat and canning, spice extraction and edible oil production industries, as well as agriculture and agro-processing machinery manufactures, including packaging industries (UNIDO 2013).

The development of special food parks could be instrumental for facilitating the establishment of marketing networks among enterprises whose scale is too small to meet demand by large overseas buyers on their own. Furthermore, food parks may create a favourable environment for the transition of informal micro-food processing enterprises into formal small- and medium-scale units.

Efforts must be made therefore to involve the small-scale sector for an inclusive and sustainable industrial development, e.g. by offering special tax, financial and training incentives, and by enhancing its links to agricultural production.

- ***Enhance vertical integration between agriculture and industry***

Establishing Rural Transformation Centres (RTCs) in combination with industrial parks is one possible avenue to help address the industry's raw material supply and quality constraint. UNIDOs' Programme for Country Partnership for Ethiopia suggests establishing at least 20 RTCs should be established for each industrial park. At RTCs farmers can sell their output and receive key production inputs (e.g. fertilizers and seeds), thus contributing to a less fragmented and more organized, demand-driven and quality-oriented agricultural supply. As a further service to agro-industry, the centres could establish primary processing, cold and dry storage facilities, and improved agro-logistics systems (UNIDO 2014).

Another way to improve vertical integration within the value chain is through the introduction and extension of contract farming to ensure the desired specification and quantity of raw materials. In contract farming, agricultural producers enter into legally binding agreements with processors as to production methods and technology; output quantity, quality and prices; and technical and financial support. Re-organising the linkages in this way can produce outcomes that would benefit not only processors by having a guaranteed delivery of crops or livestock products, but also agricultural producers by providing them with much needed inputs and services (e.g. seeds, fertilizer, equipment, finance and technical advice), and access to stable and secure markets. In combination with this, improving horizontal linkages between farmers (e.g. via market-oriented farmer associations or cooperatives), would be beneficial for creating economies of scale and facilitating postharvest handling, thus promoting a more efficient raw material supply chain for the processing industry.

- ***Introduce and enforce quality standards***

Heightened attention will need to be paid to the quality of products to ensure access and competitiveness in destination markets. It will be important to develop and ensure product conformity with technical and market requirements. This implies that there should be a well-established food safety and quality control and standardization system, which can identify product quality issues along the value chain and implement standards, regulations and certification schemes.⁹⁹ In the public sector there is a need for capacity building and training on all issues related to implementation and compliance with quality standards, both at the national level, in the Ministries responsible for agriculture and health, and the various agencies that are part of the National Quality Infrastructure; and at the sectoral level, for example in the Food, the Beverage and Pharmaceutical Industries Development Institute and

⁹⁹ See Kellermann (2006) for details on establishing a national quality infrastructure in Ethiopia, necessary to implement standardization, metrology, testing, certification and accreditation.

the Food, Medicine and Health Care Administration and Control Authority. To address this lack of coordination and leadership, it should be considered placing coordination of the introduction of relevant international food standards and compliance under the Prime Minister's office.

The public institutions should strengthen their outreach activities to raise awareness among private actors in the agro-processing industries of the increasing need for compliance with international quality standards. The Ministry of Trade should establish and operationalize the SPS notification authority, and the Ministry of Agriculture SPS should create enquiry points and further develop the database on rejections of Ethiopian products in export markets due to SPS-issues. This database should be open to the public, especially the exporting companies.

As non-tariff barriers to trade are becoming increasingly significant, it is important that hazard analysis and risk management are introduced in the food processing industry. All of this requires considerable investments in institutional infrastructure, standardisation and testing equipment as well as human resource training.

Chapter XII:

The Textiles and Clothing Industry

1. Introduction

Although the textiles and clothing sector accounts for less than half a percent of Ethiopia's GDP, it is given top priority in Ethiopia's industrialization strategy, for three reasons: first, the global market for textiles and clothing offers considerable export opportunities; second, it is a very labour-intensive industry with a large potential for low-skilled employment; third, it offers the possibility to develop an entire value chain from agricultural production to the manufacturing of final goods. Cotton is the main input to the production of textile yarns and fabrics which, in turn, are the main input for the manufacturing of clothing.

The Ethiopian textiles industry and, in particular, the clothing industry have an international comparative advantage due to a large supply of low-skilled labour and low labour cost. The cost of labour in Ethiopia's textiles and clothing industry is between two to ten times lower than in China and one to two times lower than in Viet Nam. As textiles and apparel manufacturing is linked in a long value chain that extends from cotton farming to garment manufacturing and fashion design, the domestic availability of cotton is also considered a competitive advantage.

Yet, these comparative advantages do not automatically translate into competitive advantage. Competitiveness depends on the efficiency in resource allocation, factor productivity, quality of products and the ability to reliably deliver the required volume on time and to specification. In all these areas Ethiopia's textiles and clothing manufacturers lag behind producers in many other developing countries. Thus, the potential of the textiles and clothing industries as engines of growth and employment creation is yet to be realised.

2. Structure of the textiles and clothing sector

The textiles and garments sector comprises three broad categories of firms: standalone spinning firms, producing cotton yarn for domestic and export markets; textile mills engaged in weaving and knitting, and integrated textile mills engaged in spinning, weaving/knitting, dyeing, finishing and garment making; and standalone garment manufacturers. The product range of the sector includes a variety of yarns, fabrics, blankets, bed-sheets, carpets, bags and hosiery, and wearing apparel.

At the upstream end of the value chain, cotton production is a key element in supply chain for textiles and garments production. Cotton farming in Ethiopia has a long tradition and is favoured by a suitable climate and a vast land (3 million hectares) that are suitable for cotton cultivation. Currently, however, a mere 4 percent of the cultivable land is used. Cotton is produced by a large number of smallholder farmers, which account for 27 percent of the cultivated land for cotton. A relatively small number of large commercial farms are cultivating 42 percent of this land, while the five state farms account for 31 percent. State farm are generally better equipped with technology and farm management skills than smallholders.

In 2012, the annual production of raw cotton was 120,000 tons, while that of lint cotton (i.e. raw cotton prepared for yarn production by ginning) was only 43,500 tons. Quality standards and efficient processes are greatly lacking in domestic ginning activities, explaining not only

the low extraction ratio of only 38 percent, but also the relative low average quality of the lint cotton extracted.

In 2013/14, the 130 large and medium-sized firms active in the manufacturing of textiles and clothing in Ethiopia accounted for 5.3 percent of all manufacturing firms in the country. Two of these companies are partly in public ownership, in joint venture with foreign investors, and two state-owned integrated mills are scheduled for privatization.¹⁰⁰

The textiles and clothing sector includes 18 cotton ginning mills; 3 spinning mills producing textile yarn for the domestic market and export; 12 textile factories producing knitted and woven fabrics and 22 vertically integrated firms, in addition to the 60 manufacturers of clothing.¹⁰¹ The latter are mostly engaged in cut-make activities as they lack the capacity for product design and development, and marketing. Garment manufacture relies on imported fabrics as much of the local supply is inadequate in terms of quantity and quality.

The textile industry is larger and more vertically integrated than the clothing sub-sector, which is more labour intensive. 78 percent of textile manufacturers had more than 50 employees, as against 42 percent of clothing firms. Overall, 25,300 persons were employed in the textiles and clothing sector (about 16,000 in textiles and 9300 in the clothing sector) in 2013/14, accounting for 13 percent of all manufacturing employment (Large and Medium Manufacturing Businesses Survey, August 2014). Young women with relatively low skills represent a high percentage (68%) of the clothing industry, though less for textiles (45%) industries (ILO 2014).

The gross value of capital assets and investment flows in the textiles and clothing sub-sectors were 700 million Birr and 120 million Birr respectively in 2013/14. The annual production capacity of the apparel sub-sector is 22 million pieces of woven apparel and 57 million pieces of knitted apparel (TIDI 2013), but this capacity is largely underutilized. Looking forward, the increasing trend of export-oriented FDI in the textiles and clothing sector can make a major contribution to achieving the ambitious export targets in the coming years.

In 2014, only 3 percent of the sales of textiles firms and 4 percent of the sales of clothing producers were generated by export. The largest share of these exports went to Europe. In 2013 Germany was the most important export destination, accounting for 47.5 percent of all Ethiopian textile and clothing exports, followed by Turkey (18.8 percent) and China (10 percent).¹⁰² Overall, foreign-owned companies contribute more than 75 percent to Ethiopia's textile and apparel exports. More recently, there clothing exports to the United States have also risen fast, in connection with FDI and the preferences offered under AGOA, although Ethiopian textiles and clothing producers still appear to make little use of these advantages.

3. Recent performance of the textiles and clothing industry

Labour productivity is still low by international standards, but considerable advances were made in this regard between 2007 and 2011, the last years for which data is available. Value-added per employees increased at an annual average of 18.1 percent in the textiles sector and by 92 percent in the clothing sector (CSA 2014).

¹⁰⁰ Kombolcha and Bahirdar.

¹⁰¹ The number is expected to reach 80 in 2015.

¹⁰² The share of Turkey has risen considerably in recent years following large Turkish investments in the industry. One Turkish firm alone (*Ayka Addis*) accounts for more than 56 percent of Ethiopia's textiles and apparel exports.

Although the production of yarn has risen by more than one third between 2010/11 and 2013/14, it has been largely insufficient to reach the GTP I target.¹⁰³ Similarly, output growth in the textile fabrics and garment industry has also lagged far behind their targets.

The same is also true for the industries' export performance. The GTP I included a target export value of \$1,000 million for exports of textile and clothing by 2015. However, after four years of plan implementation, exports of textile and clothing amounted to only \$104 million (table 12.1). This will make the export target for 2015 unreachable.

Table 12.1:
Ethiopian exports and imports of textiles and clothing, by sub-sector, 2010 – 2014
(million dollars)

	2010		2011		2012		2013		2014	
	Export	Import	Export	Import	Export	Import	Export	Import	Export	Import
Textile yarns and similar products	6.7	120.4	20.1	107.4	19.1	113.7	37.8	183.3	40.2	188.1
Textile fabrics based on cotton	10.1	9.0	13.0	14.5	5.3	15.0	7.3	28.1	14.0	26.7
Apparel and clothing accessories	12.2	131.0	34.6	143.6	39.1	234.0	42.6	301.0	49.5	439.9
Total	29.0	260.4	67.6	265.5	63.5	362.7	87.7	512.4	103.7	654.7

Source: UNCTAD secretariat calculations based on United Nations COMTRADE database
Note: The data used refer to SITC numbers 651, 657 and 658 for yarn, 652, 654, 655 and 659 for fabrics (i.e. excluding synthetic fabrics) and 85 for apparel.

According to international trade statistics¹⁰⁴, the export value of yarn grew at an annual average rate of more than 56 percent between 2010 and 2014, and that of exports of apparel at an annual average rate of 42 percent. By contrast, exports of textile fabrics expanded only at an average rate of 8.5 percent over the same time span, and with large fluctuations from year to year, which are likely to be due to a large FDI project in the production of textiles fabrics by one Turkish company that subsequently switched to apparel making.

During the GTP I period, the Ethiopian textiles and clothing sector has remained highly dependent on imports of intermediate goods, which made the trade deficit for both yarns and fabrics increase (tables 12.1 and 12.2). In addition to this, the deficit in finished clothes rose dramatically, showing that, despite considerable increases in recent years, domestic production at all levels needed for the value chain is still largely insufficient to meet the fast growing domestic demand.

¹⁰³ In 2013/14 actual yarn production amounted to 37,000 tons, against the GTP target of 127,700 tons for that year (TIDI 2013).

¹⁰⁴ Since up-to-date statistical information was not available from domestic sources, international data are presented here. There are some differences with domestic for earlier years due to different methodology of data collection and computation, but the trends are identical in both sources.

Additional domestic and foreign investment for 169 new textiles and apparel factories was hoped to create 40,000 new jobs during the GTP I period, but both domestic investment and FDI have been modest and remained far behind the objectives.¹⁰⁵

<i>Table 12.2:</i> Trade balance in textiles and clothing, by subsector, 2010, 2012 and 2014 (million dollars)			
	2010	2012	2014
Textile yarns and similar products	-113.7	-94.6	-147.9
Textile fabrics based on cotton	1.1	-9.7	-12.7
Apparel and clothing accessories	-118.8	-194.9	-390.4
Total	-231.4	-299.2	-551.0
<i>Source:</i> UNCTAD secretariat calculations based on United Nations COMTRADE database			
<i>Note:</i> see table 12.1.			

Product and market diversification are important trade outcomes and are closely related to economic growth and structural transformation. 244 textiles and clothing product lines were exported in 2012, and the number of export markets increased from 60 to 73 between 2009 and 2013. However, export growth was achieved almost entirely with existing products in established markets; only 3 percent of the export growth can be attributed to new product line.¹⁰⁶ In the international trade performance index, the Ethiopian textiles and clothing sector was ranked below that of other developing countries, whose exporters are competing in the global markets, such as China, Vietnam or South Africa.¹⁰⁷

4. Policies and institutions

The Ethiopian Government, in cooperation with external development partners, supports the transformation of the textiles and clothing sector into a major export industry in various ways. It supports capacity building in export-oriented textiles and clothing companies through the provision of benchmark studies and partial financing of foreign experts, sector-specific management training programmes and marketing efforts, such as participation in major

¹⁰⁵ Export-oriented FDI success stories in recent years include large Turkish investment and the sourcing of garments by established European retailers. *Ayka Addis*, the Ethiopian subsidiary of the Turkish textile giant *Ayka Textile*, has invested US\$ 140 million in a factory, inaugurated in 2010, that has a capacity for textiles exports of \$100 million per annum and can employ up to 10,000 persons (All Africa, 2 August 2013, "Ethiopia: 50 Turkish Textile Factories to Relocate in Ethiopia"). The globally operating retailer *H&M* established its office in Addis Ababa in 2012, and has been buying clothing from a number of Ethiopian manufacturers since then (Wall Street Journal, 15 August 2013, "H&M Looks to Source Clothing from Ethiopia"). *Tesco Plc.* and the British arm of *Wal-Mart Stores Inc.* are also buying clothing from Ethiopian manufacturing plants. *Primark*, a large apparel retailer operating from Ireland and the United Kingdom has also been sourcing from Ethiopia for the last two years since 2013.

¹⁰⁶ The Herfindahl-Hirschmann Market Concentration Index increased from 0.14 in 2009 to 0.18 in 2012 for the Ethiopian textiles and clothing industry, indicating less market diversification.

¹⁰⁷ The Trade Performance Index provide a systematic overview of sectoral export performance and comparative and competitive advantages, based on past trade performance. It calculates the level of competitiveness and diversification of a particular export sector using comparisons with other countries. In particular, it brings out gains and losses in world market shares and sheds light on the factors causing these changes. Moreover, it monitors the evolution of export diversification for products and markets (ITC 2007).

international trade fairs. Currently, *Kaizen* management training¹⁰⁸ is given to all exporting local factories to improve efficiency. Government also finances marketing expenses, such as sharing the cost of the participation of Ethiopian firms in international trade fairs. In addition to the efforts of the Ethiopian Investment Agency to attract FDI, the Government has also engaged in joint ventures with foreign investors.

As in the other prioritized sectors, the export-oriented firms in the textiles and clothing industry benefit from a range of incentives to expand investment and promote export production (see chapter IX). The Development Bank of Ethiopia provides long-term investment credit at favourable interest rates for up to 70 percent of investments in production capacity. Emphasis is on support for investment in the up-stream segments of the value chain, i.e. the clothing sub-sector. With more investment in this sector, it is expected that, through increased demand for textile fabrics and yarn, motivation for investment in the textile sector will also be strengthened.

The attempt by the Government in 2010/11 to promote vertical integration of cotton production with the textiles industry, by banning the export of lint cotton, has not achieved the desired results in terms of higher supply of this crucial input. The Government is aware of the need for a reliable flow of domestic and imported raw materials and intermediate goods for manufacturers, on the one hand, and of the considerable input procurement problems of these firms, on the other (see sub-section 5.1). In response to these bottlenecks, it has initiated the establishment of an industrial input supply enterprise to address input shortages, such as for cotton.

The Government continues to pursue its ambitious objectives during the five-year phase of GTP II, building in large part on its National AGOA Response Strategy. Under this Strategy, employment is targeted to increase in the textiles and clothing industry to 330,000 by 2018, which means that the number of jobs would have to increase at an annual average rate of 90 percent between 2014 and 2018. This will require a dramatic acceleration of job creation over the annual job growth rate of 10 percent between 2007/08 and 2013/14.

Similarly ambitious are the production objectives. The production of raw cotton production is targeted to rise from currently around 120,000 tons to 1.3 million tons in the short run and to 4.5 million in the long-term. According to the Ethiopian Cotton Production and Marketing Strategic Plan, lint cotton production (43,500 tons in 2012) was planned to expand to 241,000 tons in 2015. While the time frame for reaching these objectives is coming to an end, the long-term plan to greatly expand the cultivated land area and to produce 4.5 million tons of cotton (MoARD 2011) will be pursued further. For this purpose the Government identified 117 “*woredas*” (basic administrative units in Ethiopia) with suitable land and climate for increased cotton production with a view to increase the share of locally produced textile fabrics in clothing manufacturing to 60 percent of total fabric use.

In the textiles subsector, the number of large and medium scale factories is planned to rise to 39 by 2018, and the number of persons employed in textile factories to 70,000. Moreover, the efficiency of small-scale ginning, spinning and weaving companies is expected to rise considerably (90 percent capacity utilization). For the clothing sub-sector employment is targeted to rise to 260,000 by 2018. This should be achieved by increasing the number of garment factories to 600, of which 52 large-scale factories, 128 medium-sized local garment companies, 420 small-scale garment companies. Together, these establishments are planned to reach a value of garment export to the United States alone of \$682 million.

¹⁰⁸ *Kaizen* is a management practice of Japanese origin aiming at continuous improvement that has received worldwide recognition as an important pillar of long-term competitive strategies (www.kaizen.com).

In order to accelerate the development of the sector, the Textile Industry Development Institute (TIDI) was established under the Ministry of Trade and Industry in 2010 with the mission to lead, coordinate and control the development of the sector, and to provide one-stop support services to the industry. The Institute is a key element in efforts to strengthen the support infrastructure for the textiles and clothing industry. Other public institutions, such as the Institute of Textile and Fashion Technology and the Textile Garment Research Centre of Bahir Dar University can also play an important role in upgrading technical, managerial and marketing skills in the textiles and clothing industries.

The Ethiopian Textile and Garment Manufacturers' Association (ETGAMA), founded by the private sector in 2003, provides its members with global market information, training and advisory services. It also helps them to establish relationships with foreign clients and in compliance with national and international production and product standards. Together with the international distribution chain *H&M*, TIDI and ETGAMA have started a programme to create larger garment exporting entities by clustering small- and medium-sized clothing factories and cooperation of these clusters with fabric manufacturers. This programme is also supported by the Government and may be a new way of engaging the many small apparel factories which otherwise would find it hard to pursue export activities individually, given the limitations in their production to capacity, difficulty to access finance and lack of international marketing experience.

5. Challenges and constraints

Ethiopia's comparative advantage in the manufacturing of textiles and clothing has been largely eroded due to low productivity and technical inefficiencies at all levels of the value chain. Moreover, Ethiopian exporters have considerable difficulties in meeting the product quality required to successfully compete with producers in other countries. They also have insufficient capacity to meet large order volumes, to deliver consistently on time and to diversify their products.

One major reason for these constraints is the lack of integration in the domestic supply chain, which causes problems of adequate supply of raw material inputs and intermediate goods, in terms of quantity, quality and prices. Other reasons within the sector include: insufficient availability of skilled manpower, managerial competences and adequate technology, as well as lack of experience in international marketing and merchandising. As for other sectors, a number of structural factors hamper the motivation and ability of current and potential textiles and clothing manufacturers to expand their activities or venture into new ones. This includes difficult or costly access to finance, shortcomings in infrastructure and logistic services, and overly complicated administrative procedures, particularly in connection with customs clearance of exports and imports of inputs.

5.1 Availability and quality of raw materials and intermediate goods

The shortage, unreliability and cost of critical inputs at competitive prices at all stages of the value chain have been identified as the most binding constraint on the expansion of textile and clothing production and exports. According to the Manufacturing Business Survey of the Central Statistics Agency in 2014, shortage of raw materials is the single most important cause for underutilization of production capacity in textiles and clothing firms.

The challenge for the government in this context will be to increase efforts to promote better vertical integration of the domestic supply chain. This will require close coordination of actions by the different Ministries involved, especially the Ministry of Agriculture and Rural Development, the Ministry of Industry and the Ministry of Trade, as well as cooperation with industry support agencies at the different levels of production.

5.1.1 Inputs for the production of textiles

Regarding the textiles industry, it is vitally important to raise the supply of cotton to the textile yarn sub-sector and, at the subsequent stage of the value chain, to remedy the critical shortage and reduce the cost of textile yarn for the production of textile fabrics and to improve the quality of these inputs.

The quality of lint cotton is low due outdated ginning techniques. While increasing investment in new technologies in some ginneries has recently led to some productivity improvements, the sub-sector continues to suffer from the absence of a functioning quality standard and grading system for cotton and lack of mechanisms for pricing and forecasting demand and supply. In order to bring the large potential for domestic cotton production to bear on the development of the textiles industry, the challenge is therefore not only to expand cotton plantation, as envisaged, but also to raise the quality of cultivation, harvesting and distribution.

Production of raw cotton of good quality is constrained by poor productivity, as commercial cotton farming only accounts for a small share of cotton production and traditional farming practices in small-size family farms compromise the quantity and quality of cotton growing and harvesting. Increasing the volume of raw cotton output is not only matter of expanding cotton cultivation, but also of raising the average yield per hectare of the cultivated area.

A first challenge in this context is to mobilize financial resources to enlarge production units and to improve irrigation, since the productivity of large-scale irrigated cotton farming is about twice that of small-scale rain-fed farming. A second challenge is to strengthen pest control, given that many cotton plantations are seriously attacked by pests, and the type of seed and availability of pesticides largely determine the yield per hectare. While the large commercial farms use chemicals to protect their plantations, the smallholder farms do not have sufficient financial means to do so. Also, the quality of the harvested cotton quality is affected by inappropriate cotton picking, transportation and storage mechanisms.

Against this background, strengthening extension services to small-scale cotton growers to promote the use of better seeds and related technology and inputs, combined with additional measures to expand commercial cotton farming would be instrumental in raising out and improving the quality of raw cotton. Although a few large cotton producers already exist, there has been no comprehensive strategy so far to support the transition from smallholder to commercial cotton farming.

Surprisingly, another constraint at the stage of the production chain appears to be a shortage of rural labour during picking season. This may be explained by the fact that most of the cotton is grown in sparsely populated areas and that the cotton harvesting season coincides with that of other crops.

At the stage of ginning (i.e. the cleaning and preparation of raw cotton for use in textile yarn production), lack of modern technology and management results in a low extraction rate, which compromise quality. The challenge at the stage of cotton production is to introduce higher technology ginning machinery at a broad scale.

Since 2012/13, the production of lint cotton has been falling and it seized to meet the increasing demand of the domestic textile yarn producers. As the volume of domestic production in 2013/14 was less than half its level in 2010/2011, textile mills were forced to import lint cotton, mainly from India.¹⁰⁹ The declining trend in lint cotton production in the presence of rising demand despite is likely to stem from considerable inefficiencies in the domestic marketing system. The domestic marketing of cotton does not follow international

¹⁰⁹ The production of lint cotton fell from around 79,500 tons in 2010/11 to 36,000 tons in 2013/14.

market prices. As no established standards are applied in trading, the process of price formation is not functioning efficiently and there is no adequate price differentiation among products of different quality. The absence of established standards in the market has led to a situation where middlemen are in a very strong position. While the purchase prices to be paid by textile manufacturers have been rising as a result of supply shortages, prices paid to the farmers tend to be too low. The latter therefore do not receive the right market incentives for increasing their production and improving quality, but also tend to shift from cotton to other crops such as sesame and sugarcane where they receive better prices.

Spinning firms, on the other hand, are not allowed to import cotton as long as there is supply in the domestic market and, in the absence of a price classification based on quality grading, they are often obliged to purchase cotton regardless of quality, which leads to overpricing of lower and medium range cotton and creates difficulties for spinners to compete in the international market.

To a certain extent, an improvement of this situation in the coming years may result from the creation of an industrial input supply enterprise by the government, together with the provision of support to farmers to enable them to meet quality standards and enforce strict control of compliance with these standards.

Within the textiles industries, manufacturing of fabrics (knitting and weaving) is based on inputs of yarn. However, standalone spinners produce most of their yarn for direct export and there is a shortage of yarn of adequate quality for the production of fabrics (see section 3). One reason for this is likely to be the design of financial incentives for the textiles industry. The provision of long-term investments loans at relatively favourable terms to textile companies, including spinners, is linked to these firms' export performance. This implies that supplying yarn to the domestic textiles industry is discouraged, although there is a shortage of domestic yarn input for these industries.

The unsatisfactory performance of the yarn producing subsector indicates a need for a strong investment push, especially in the standalone spinning mills, and to redirect incentives for producers in a way that favours their integration into the domestic value chain.

In addition, the producers of textile fabrics are also faced with inadequate supply of other inputs from domestic sources, such as dyes and chemicals, as well as trimming, accessories and packaging material. They depend on imports of such inputs, which involve lengthy processes of obtaining permits and making payments in foreign currency, as well as additional costs and longer lead times due to international transportation, and delivery from Djibouti.

5.1.2 Inputs for the production of clothing

Increasing the volume and quality of inputs of domestic origin is also a challenge at the subsequent stage of the value chain, i.e. the production of garments from textile fabrics. Ethiopia's producers of textiles and clothing must import a large share of their textile inputs, mainly from China, India, Pakistan and Turkey, because potential domestic suppliers fail to produce sufficient quantities of intermediate goods of the type and quality required (see sections 3 and 5.2).

Import dependence of clothing manufacturers is a matter of concern as fabric accounts for 85 percent of the total production cost in garment manufacturing. According to ETGAMA, the supply of fabric from local textile mills only meets 10 percent of the inputs of fabrics. It follows that many factories limit their activities to cut-and make operations. This means that, in practice, they are only selling labour to foreign companies which are importing all their intermediate goods to Ethiopia and pursue activities the subsequent stage of the value chain, including trimming, again abroad.

5.2 Productivity, technical efficiency and finance

Many other developing countries share with Ethiopia the advantage of low labour costs compared to industrialized countries where most of the textiles and clothing are consumed. Since the textile sector is typically the first candidate for export-oriented industrialization in developing countries with a large supply of unskilled and low-skilled labour, there is fierce competition on the textiles and clothing markets among producers from different developing countries. This competition is felt not only on foreign markets but also on the domestic market. In this environment, the ability of Ethiopia's textile and clothing producers to compete successfully largely depends on the efficiency of their production and the type and quality of their products.

In addition to the constraints resulting from malfunctioning of the domestic supply chain, Ethiopia's textile and clothing manufacturers still suffer from a considerable degree of inefficiency in the production process and the quality of their products only partially meets the requirements of demand (Abegaz 2013). Technical inefficiency and poor management are reflected in low rates of capacity utilization: 52 percent in the textiles and 66 percent in the clothing sector.

A major challenge for the entire textiles and clothing industry in the coming years will be to increase productivity. Another determinant of competitiveness at the firm level is the ability to deliver the volumes and quality demanded by the given delivery dates. In all these areas, Ethiopian producers are at a disadvantage against those in other countries. The relatively small size of individual exporting makes it impossible to respond to large volume orders, and timely delivery is often hampered by irregular input supply, cumbersome customs procedures and inadequate logistic services.

The challenge in the Ethiopian clothing industry for the longer term is to increasingly engage in higher-skilled downstream (product design, development and innovation) and upstream (marketing and merchandising) activities, and eventually reduce dependence on foreign-managed global value chains (see also section 5.4.2 and chapter X). This will not be possible without substantial additional investment in skill formation, productive capacity and the appropriation of up-to date technology.

5.2.1 Skills and competences

Currently, there is a general shortage of adequately trained manpower and qualified personnel in the textiles and clothing industry, including at the various levels of management. Most firms, including current or potential exporters, suffer from a sub-optimal allocation of resources and inputs, often due to inappropriate factory layouts and material flow management. This problem is exacerbated by high labour turnover and absenteeism, especially in the clothing sector, where the requirement for incoming skills is relatively low but learning on-the-job and experience matter for productivity.

Even though the Government has been putting considerable efforts to expand vocational schools and universities, their capacity of produce the required quality of manpower in the textiles and clothing industry is still insufficient. This is partly explained by the lack of practical knowledge and experience among the graduates of these institutes (ETGAMA 2012). Many of the larger firms in the industry are in a position to train their staff, but this implies additional costs which smaller firms are mostly unable to bear. Better coordination of academic and vocational training curriculums with the specific practical skills required in the textiles and clothing industries, and the introduction of sector-wide programmes for regular technical training and skill development are therefore major challenges.

5.2.2 Machinery, equipment and production techniques

So far, there is an inadequate utilization of up-to-date technology in most of the domestically-owned textiles and clothing firms, and poor research on, and upgrading of, production processes. The challenge of significantly improving technical equipment and production techniques exists at all levels of the value chain, from cotton farming to finishing garment products. Ethiopian exporting firms exhibit significant challenges with regard to the optimal use of existing machines, and are not in position of using computer-assisted manufacturing and design technologies to the same extent as their international competitors. They also face a shortage of adequately skilled maintenance professionals for the existing machinery and equipment, and it is often difficult to obtain spare parts.

Additional FDI is likely to increase overall efficiency of the sector and to lead to further growth of textiles and clothing exports. But the challenge is not only to attract additional FDI to the sector but also to ensure that dynamic benefits, such as technology transfer and knowledge spill-overs take place. It is also crucial to ensure that foreign-owned companies create direct linkages with the domestic economy and contribute to strengthening the domestic value chain, i.e. the substitution of primary goods (cotton) and intermediate goods (yarn and cotton-based textile fabrics) by goods that are currently and potentially available domestically. The policy and strategy of the Ethiopian Investment Agency may need to be adjusted to this objective.

5.2.3 Financial services

Cotton growers, textile mills and clothing manufacturers see their motivation and capabilities to raise their productivity and to expand their production constrained by difficulties in securing working capital and high costs of credit. Insufficient working capital is a major limitation for starting and sustaining export activities, especially for small- and medium-sized enterprises operating outside established global production networks. Moreover, very restrictive collateral requirements for credits often keep potential investors from starting or expanding their activities. Sectoral support policies must therefore be combined with a more pro-active approach to designing an overall financial system that facilitates access of firms in the prioritized sectors to short-term and long-term finance at reasonable terms, with regard to interest rate, maturity and collateral requirements (see also chapter IX). Similarly, as the textiles and clothing sectors are still highly dependent on imported inputs, faster growth in these sectors may require reviewing the principles and mechanisms for the allocation of foreign exchange in favour of payments for inputs to these sectors.

5.3 Challenges related to infrastructure, logistics services and customs practices

Efficient transportation is key to the ability of textiles and clothing producers to compete internationally, as the market for these goods and the participation in global textiles and clothing value chains require fast reactivity to international orders, as well as speedy delivery to foreign clients. The management of the domestic supply chain from cotton to finished textiles is made more difficult by poor transport and logistics at the local level, and when engaging in imports export activities, domestic textiles and clothing manufacturers have to make higher expenses for transport, logistics and customs clearance for exports and imported intermediate goods than many of their competitors in other developing countries.

Although the Government is fully aware that export-oriented industrialization requires a well-functioning transport and logistics infrastructure and has embarked on very ambitious programs of investment in these areas, the expansion of production and export of textiles and clothing in line with GTP I targets has continued to be hampered by serious shortcomings in these areas. Poor transport and logistics facilities create problems for the regular inflow of imported inputs and undermine the export of textiles and clothing, both in terms of cost

effectiveness and its adverse impact on exporters' capacity to deliver reliably on-time, which are key requirements of international clients.

Next to the problem of sourcing inputs, shortages and interruptions in electricity and water supply are the second most important reason why the production capacity of textiles and clothing manufacturers remains underutilized. The initiative to expand industrial zones and the development of five new industrial parks would go some way in addressing constraints related to lack of industrial land and facilities (see also chapter VII).

Although the tariff on imported fabrics has recently been significantly reduced, it still amounts to 20 percent. Exporters of garment are exempted from duties on imports of inputs for export production through bonded warehouse and voucher schemes. However, the implementation of these schemes, by the relevant administrative units, often appears to counterproductive (see also chapter VIII).

5.4 Marketing and compliance challenges

Most Ethiopian manufacturers of textiles and clothing do not take full advantage of international trade preference for Ethiopian exports. In spite of the support offered by the AGOA support infrastructure, UNECA and USAID, Ethiopian textiles and clothing exports to the United States are still quite small compared to those of some other AGOA eligible countries (ETGAMA 2013). A major challenge is to raise the awareness, especially of smaller and medium-sized firms of the opportunities provided by AGOA and other preference schemes. As about 70 percent of the total exports of Ethiopian textile and clothing exports go to Europe, there are also already established trade links which can be expanded further under the umbrella of the EBA initiative. Taking better advantage of preferential market access requires that the public and the private sector collaborate more closely.

Ethiopian textile and apparel producers, especially those operating independently, face problems in having access to updated and reliable information on markets, price and quality requirements and upcoming trends. In the clothing market, this kind of information is indispensable to make timely marketing and production decisions. Market development is particularly difficult to achieve by small and young apparel enterprises. Hitherto unsystematic attempts to provide these firms with technical assistance did not yield the desired results.

A key challenge for the private actors in the textiles and clothing sector is to learn how to design and apply appropriate marketing strategies; the challenge for public and private support institutions is to help domestic firms raise their knowledge of dynamic market conditions and consumer demand in destination markets. Concerted initiatives are also necessary to develop their capacity to link up with global production and distribution networks, which are crucial for market penetration.

Given the existing structures of the global textiles and clothing markets, there is only limited scope for domestically-owned firms to internationally market their products on their own. The international trade privileges for products of Ethiopian origin can be used more extensively and aggressively as an argument in policy initiatives to attract additional FDI and to convince large, globally operating distribution chains to source more products from Ethiopia.

The global apparel market is dominated by large companies selling international branded products and by international distribution chains located in the developed countries (see chapter X). They have strong market power and suppliers from developing countries, especially, small and medium-sized firms whose activities are mostly limited to cut, make and trim activities and have little or no scope to negotiate prices. In addition to dictate prices, the large buyers also require strict delivery schedules and quality, which in the Ethiopia's context are difficult to meet.

Typically, suppliers in developing countries produce directly or indirectly for these lead firms. The challenge for Ethiopian firms is to get access to these lead firms, which are based mainly in developed countries, in order to be able to use their distribution channels in destination markets. Lead firms control many factors that play a central role in competition, such as product design, new techniques or brand names (Gereffi et al 2005). They mostly concentrate activities on the upstream/backward, or downstream/forward linkages in the chain, such as design, logistics, finance, and marketing, which are more knowledge and skill intensive (Fernandez-Stark et al 2011).

Given that Ethiopia is at an early stage of global value-added trade, there is little choice in the short term, but to integrate in these global value chains. In the first instance, this will require, continuation of importing intermediate goods, but at the same time all possible efforts have to be made to increase the domestically value-added components of export. This form of integration can be significantly supported by increasing the inflow of processing FDI and the conclusion of processing contracts with large foreign retail companies (UNCTAD, 2013). It policy efforts are concentrated on investment in skills and productive capacity, including FDI, and on the efficient production of intermediate goods based on domestically available raw cotton, imported intermediate goods can be increasingly substituted by domestic ones. Therefore, the marketing strategy for Ethiopian textiles and clothing cannot be separated from the investment strategy and strengthening the domestic supply chain.

An increasingly important challenge for exporters of textiles and clothing is their capability to meet official and internationally agreed regulations regarding sanitary and phytosanitary requirements and technical barriers to trade (see chapter VI). Depending on their specific products and their business strategy, they also have to meet privately-defined quality standards. The first and foremost challenge in this context is to raise the sensitivity for all private and public actors in the domestic supply chain for the need to seek information about such standards and to build compliance capacity. A particular concern, regarding the textiles industry, is the absence of the implementation of the international standards in cotton. This has, according to ETGAMA, an impact on cotton quality and price. It follows that a parallel task for the public sector is to strengthen the sectoral elements in the national quality infrastructure for product testing and certification.

TIDI leads the development of standards for the textiles sector and follows up on their implementation by providing technical assistance to companies to comply with them. TIDI services include pre-auditing and provision of plans for corrective action, as well as certification. In order to effectively fulfil its functions with regard to international standards compliance in the textiles and clothing industry, TIDI would need accreditation by an international accredited body. It would also need portable equipment for measuring dissolved oxygen, total nitrogen, total phosphorus, total suspended solid, biochemical and chemical oxygen demand in the field; and training in safeguarding the environment and application of new technologies. ETGAMA also has an important role to play; while ETGAMA is not a certifying institution, it helps its members to link with Government and donor entities providing certification.

6. Recommendations

In addition to the recommendations in the earlier chapters regarding infrastructure, logistics, customs procedures and financing support that are relevant for all sectors prioritized in Ethiopia's industrialization strategy, the following specific recommendations for the textiles and clothing sector emerge from the preceding analysis.

With regard to the overall policy orientation for this sector, the Government should focus its efforts on strengthening the domestic supply chain and increasing the supply of domestic inputs at each stage of value-addition. It should also review the form of supporting investment in productive capacity, by shifting the focus from directly promoting exports to promoting overall production capacity at all levels of the value chain, so as to increasingly substitute imported raw materials and intermediate goods by domestically-produced cotton and textile fabrics. This would not only improve the sectors trade balance but also open greater possibilities for new firms to use the domestic market as a springboard for developing their competitiveness and capacity to export. As the textile and garment industry is still at an infant stage, a higher degree of protection against import competition on the domestic market appears to be justified, provided that in parallel efforts are stepped up to increase investment in domestic production capacity at all stages of the value chain.

After its establishment in 2010, TIDI now has to finalize its groundwork as soon as possible in order to be able to better coordinate the efforts of the relevant entities in the Government, the public administration and private stakeholders. The Government needs to empower the Institute to further enhance its coordination, training and marketing services to textiles and clothing manufacturers. The capacity of TIDI needs to be significantly upgraded with a view to providing tailor-made and comprehensive support across the entire value chain, and to extend its services especially in the areas of supply chain coordination and product quality assurance.

TIDI and other sectoral institutions must assume a key role in building awareness of international product and production standards and compliance capacity. Cotton farmers and local textile firms also require technical and financial support for standards compliance.

- ***Strengthen the domestic supply chain***

Efforts to exploit Ethiopia's comparative advantage in textiles and clothing production must start at the stage of cotton production. An expansion of comprehensive agricultural extension services is required to improve farming and harvesting practices, to raise productivity and to control pests. This should be combined with a coherent, long-term strategy to accelerate the commercialization of cotton farming.

At the stage of domestic cotton marketing, it is essential to develop the local markets for raw and lint cotton, to enable producers to receive the right market signals regarding the, type and quality of raw materials required for domestic production of cotton-based yarns and textile fabrics. The introduction, in close cooperation with the private sector, of an official quality standard and classification system is central to market development.

In the absence of an efficient domestic market for intermediate products and given the critical input shortages that are currently holding back exporting firms, the Government should set up an input supply public enterprises to help address and remove to the largest possible extent remaining constraints on imports of intermediate goods to bridge the gap between the demand for and domestic supply of intermediate inputs. As a short term solution to facilitate the clothing sector's access to textile fabrics, it would be useful to identify fabric sources from other AGOA privileged countries, in order to observe rules of origin in international trade agreements.

- **Increase productivity and production**

Clustering or merging smaller manufacturers would generate scale economies in production, with clear productivity benefits. This would also enable firms to better fulfil large volume orders. Similarly, vertical integration should be encouraged, if and where feasible, and receive public financial support, if necessary.

Efforts should be reinforced to increase the number of large and medium-sized textile and garment factories. Attracting additional FDI into integrated textiles and clothing manufacturing activities may be helpful in this regard, but equally important is additional support of Ethiopian entrepreneurs, especially by facilitating the financing of new investment, mergers of smaller firms into bigger ones and promoting subcontracting arrangements between established firms and new entrants.

In order to ensure that FDI generates dynamic benefits for the Ethiopian textiles and apparel industry, the Government would be well advised to develop standards and metrics for measuring and monitoring the integration of FDI with the domestic economy, especially through backward linkages from clothing to fabric and yarn production, with a view to raise the contribution of large foreign-controlled firms to substitute domestically available intermediate goods for imports.

Ethiopia would need to develop the capacity for national research and development, and innovation in the areas of product design and manufacturing. For this purpose, industry-university collaboration needs to be extended and deepened by developing centres of excellence in relevant industrial vocations. The Institute of Textile and Fashion Technology and the Textile Garment Research Centre of Bahir Dar University, the Addis Ababa and Adama Science and Technology Universities and the Institute of Technology of Mekelle University can play an important role in this context.

A critical element of the Government policy, to promote light manufacturing in general and garment firms in particular, is the promotion of industrial zones specific to textile and garment manufacturers, where sector-specific infrastructure, logistic, financial and quality management facilities are provided.

In the context of strengthened private-public cooperation, the Government could provide additional financial support to national private sectoral associations to enable them to upgrade their support to firms in the apparel industry in sharing knowledge and experience in efficient production and marketing.

- **Upgrading sector-specific skills**

Improvements of product quality and productivity at all levels of the supply chain require structured technical and managerial training. This calls for a better mechanism by which foreign/local experts can assist factory operators in layout design, manufacturing design, productivity improvement and product development.

On-the-job skills training and sustained and comprehensive industry and vocational training collaboration is critical in the effort to raise productivity. It is vitally important to align the curriculum and instruction of TVET institutions with the workforce and skill requirements of the textiles and clothing manufacturers through greater cooperation between public education and training institutions and private firms.

Sector-specific institutes and associations need to strengthen their support to firms in training of their workforce and developing their technical, managerial and marketing skills through systematic training programmes that, inter alia, promote learning from relevant successful experiences in other developing countries. Setting up a centre that continuously provides training to management, technical staff and other workers should be considered.

- **Strengthen international marketing and global value chain integration**

Measures to expand trade should include studies of a selected number of target markets, concerted promotion of exports to these markets, and linking with international trading networks in order to facilitate the expansion of exports to the United States and Europe. It is

also indispensable to strengthen efforts aimed at increasing the awareness among producers of the advantages offered by preferential market access, and to better disseminate information about ways of using these advantages and on rules of origin.

Ethiopian textiles and apparel producers should engage more in regional trade, supported by accelerated entry to the COMESA FTA (see chapter IV). Greater attention should be given to the specific opportunities in African and Middle Eastern regional markets, which offer a cost advantage in view of country's geographical location and because these markets are likely to accept average quality products with better profit margin.

The Government and sectoral support institutions should help current and potential exporters of textiles and, in particular, clothing to develop market awareness and knowledge of consumer demand in export destinations as well as to forge links with key players in the global value chains and international production networks in the textiles and clothing sector.

A critical element in meeting the trade promotion and infrastructure challenge in the textiles and clothing sectors is the need to develop and upgrade the standardisation, quality assurance and accreditation architecture in Ethiopia. This needs to be undertaken in accordance with international standards and best practice. Collaborative partnership and co-ordination with relevant national and international donor institutions' programmes is central to making this happen.

Chapter XIII:

The Leather and Leather Goods industry

1. Introduction

Among the five sectors identified in the GTP as having the potential to boost the growth of the economy (agro processing, textile and garments, leather and leather products, chemicals and metal industries), the leather sector has been the only one so far with a positive trade balance. The value of global trade in leather, footwear and leather products in 2015 is estimated at around \$160 billion, with a strong tendency to grow further. Firms in developed countries dominate the higher value-added segments of the global value chains (designing, branding marketing and retailing), while several developing countries (e.g. India, Indonesia and Vietnam) with abundant labour have successfully engaged in the low value-added functions, in line with their labour cost advantage. Ethiopia is in a similar situation, but has the additional asset of a large potential of raw hides and skins from domestic livestock breeding.

The Ethiopian leather sector comprises activities at various levels of value addition. Tanning industries, while moving over time to a more advanced level of finished leather manufactures, provide inputs to domestic footwear and leather goods producers. These subsectors are very labour intensive and have the potential to become a major provider of employment. Such a potential remains to be fully realised yet. While the policy objective was to increase the number of workers in the leather manufacturing sector to 48,000 by 2015/16, in 2013/14 the sector actually employed around 18,750 persons (10 percent of employment in the entire manufacturing industry), with a job growth rate of 26 percent between 2007/08 and 2013/14.

The cost of semi-skilled labour that represents the largest part of employment in the leather industry is lower than in countries whose producers are competing with those of Ethiopia, such as China and Vietnam. There is evidence that in the Ethiopian leather goods industry unit labour costs, i.e. the level of wages adjusted for labour productivity, are significantly lower than in other developing countries (World Bank 2015a).¹¹⁰

Given the sector-specific comparative advantages, the leather sector has a potential to gain markets shares in the global market for leather and leather products and to become a world class supplier of high quality finished leather and leather products, including shoes, garments, gloves and accessories. Foreign investors have been increasingly discovering this potential. However, the extent to which these comparative advantages translate into a competitive advantage on international markets depends on various factors, especially the overall technical efficiency of the sector, labour productivity, and the quantity and quality of the locally supplied raw materials.

Ethiopia's long tradition in the production of leather and leather goods and its long-standing commercial trading relationships with foreign clients is another asset in its efforts to further integrate into international markets. On the other hand, this tradition has also shaped the socio-economic structures that determine today's value chain and modes of production. These traditional structures appear to be incompatible with the ambition to develop the Ethiopian leather industry in a way that would raise its international competitiveness and make it a major source of income and employment creation. Therefore, further development of the

¹¹⁰ Rodrik (2014) reports that the level unit labour costs in the production of the single product category leather loafers are 85% lower than in China, 59% lower than in Tanzania and 48% lower than in Vietnam.

leather and leather goods industries depends not only on raising the efficiency of the production process inside the sector and an upgrading and enlargement of productive capacities, but also on the efficiency of the entire domestic value chain and the success of international marketing efforts.

GTP II aims at pushing for an accelerated shift in the production and export structure towards products with a higher value-added content. Such a shift is desirable not only with a view to achieving the ambitious employment objectives for the leather manufacturing sector, but also because the global export markets for footwear and leather goods has been growing faster than the market for finished leather, leave alone the market for raw hide and skins.

The next section of this chapter will first depict the structure of the Ethiopian leather and leather goods industries (section 2) and review its recent performance of (section 3). This will lead to a discussion of the main sector-specific constraints, challenges and opportunities for these industries in section 4, before some recommendations will be formulated in the last section.

2. Structure of the Ethiopian leather and leather goods industry

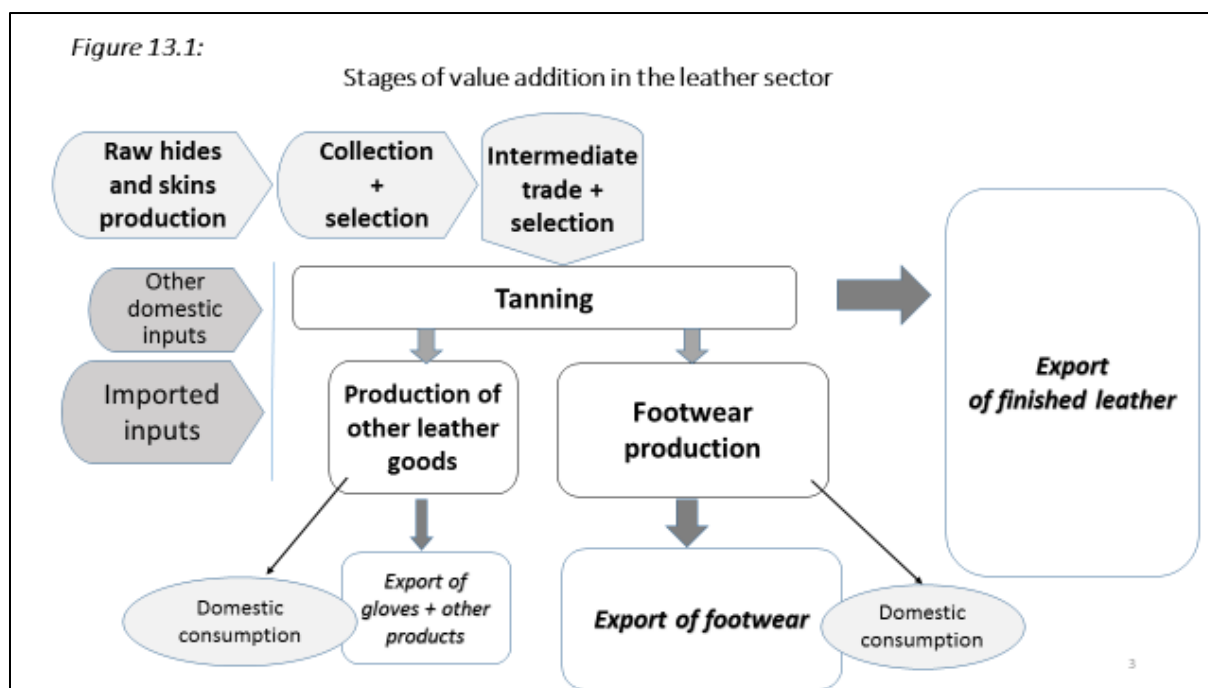
The leather industry is segmented into three sub-sectors: the production of finished leather from raw hides and skins (tanneries), the production of leather footwear and the production of other leather goods such as garments, bags, gloves, belts and accessories (figure 13.1). The two latter sectors are processing domestically produced and imported finished leather. They also have to import most other inputs, including chemicals but also simpler packaging materials like wrapping papers and shoe boxes. In addition to the three leather manufacturing sub-sectors, the recovery and collection of skins and hides, at the upper end of the value chain, is a critical element for the overall development of the leather sector and for exploiting Ethiopia's comparative advantage. At present, the domestic value chain is not well integrated and most participants in the leather supply chain operate independently instead of interdependently (USAID 2013).

In 2013/14, the industrial Ethiopian leather and leather goods sector comprised 29 tanneries, 16 medium- and large-scale footwear manufacturers and 15 leather products firms (LIDI 2015). In addition, about 400 small and micro enterprises and a huge number of small workshops are operating in the leather and leather goods sector, and there are also many informal activities, especially in the collection and distribution of raw hides and skins.

Foreign-owned companies have been driving recent output and export growth in the finished leather, footwear and gloves sub-sectors, while most Ethiopian firms still have a low level of export-orientation. Overall, the share of sales revenue from exports in total firm revenue is around 27 percent (CSA 2014). This relatively low share reflects both the relatively large domestic market of a country with a rapidly growing population of more than 90 million in 2015) and the underperformance of Ethiopia's manufacturing exports compared to other countries of comparable size.

Many exporting firms are relatively small: in 2012, 50 percent of the exporters had sales of less than \$100,000, while 31 percent of exporters had sales exceeding \$1 million. The latter accounted for 94 percent of all exports of leather and leather goods (World Bank 2014).

Finished leather represents the largest share of Ethiopia's output and export of leather products. In 2014 it accounted for around 75 percent of total leather-related exports (table 13.1). Tanneries produce leather for the local market and export, mainly to China, India and Italy.



The *leather footwear* sector accounts for about 20 percent of production and export of the Ethiopian leather and leather goods industry, with 20 industrial manufacturers that are already involved or have the potential to engage in export activities. In recent years this sub-sector has registered the strongest inflow of FDI.

Industrial production of *leather goods other than footwear* represents only a small share of the formal leather sector, and there is almost no FDI in this sub-sector, except in the production of gloves. The latter stands out as the fastest growing activity in the sub-sector since 2011. By contrast, the production of garments, bags and accessories has stagnated and performed far below targets. Such goods are produced almost entirely for the domestic market, but production is not sufficient to satisfy domestic demand, which is now being met by imported goods and substitute products (USAID 2013:66).

3. Recent export performance

Total export earnings of the leather manufacturing sector increased rapidly between 2008/09 and 2013/14, from \$75.5 million to \$133.0 million (table 13.1). During 2010-2014, Ethiopia's leather-related manufactures recorded an annual average growth rate of more than 61 percent (table 13.2). While this rate is considerably higher than that of world export growth in these goods, indicating a gain in market share in world exports, it is still far behind the ambitious government objective of reaching an export value of over \$416 million in 2013/14 and over \$495 million by 2014/2015 (table 13.2). Given the export performance so far, it is unlikely that this latter target will be met.

The ranking of Ethiopia's leather and leather products industry in the dynamic trade performance index in 2013 was better than that of other major developing country leather exporters like China and Viet Nam.¹¹¹ Although the gain in market share underlying this

¹¹¹ The trade performance index calculates the level of competitiveness and diversification of a particular export sector using comparisons with other countries. In particular, it brings out gains and losses in world market shares and sheds light on the factors causing these changes. Moreover, it monitors the evolution of export diversification for products and markets. The TPI is limited by its purely quantitative approach, although it does

measure has been at a low level, it confirms that further advances in technical efficiency and international marketing have the potential to considerably raise the export revenue from the fast growing market for these products.

3.1 Finished leather

While finished leather output has been growing rapidly in recent years, tanneries have operated far below their capacity (see also section 4 below). The value of exports of crust leather fell from more than \$90 Mio. in 2011 to less than \$200,000 in 2014, after the introduction of a 150% tax on export of semi-finished crust leather in December 2011. In parallel, finished leather exports rose from \$25.3 Mio to \$97.7 Mio during the same period, the main destinations being China, Italy and India.

Finished leather exports have been growing mainly thanks to the 10 foreign-owned tanneries. Only a few local tanneries have the technological capacities required for export production. However, Ethiopian leather prices have increased in recent years, and as clients in target markets are price-sensitive, this has caused a loss of potential market share to competitors from China, Pakistan and India, for instance (Laarksonen 2015). The upward trend in prices may result from the fact that the domestic supply of hides and skins regularly falls short of demand (see also sub-section 5.2), which leads to fierce price competition among tanners who, desperate for supply, often bid up the price of the raw materials, with attendant effects on the cost of finished leather production and the profitability and international competitiveness of tanneries (USAID 2013).

<i>Table 13.1:</i>							
Export value of leather and leather products, 2007-2014							
<i>(thousand \$)</i>							
	<i>2007/ 2008</i>	<i>2008/ 2009</i>	<i>2009/ 2010</i>	<i>2010/ 2011</i>	<i>2011/ 2012</i>	<i>2012/ 2013</i>	<i>2013/ 2014</i>
Pickled leather	32,088	19,131	-	-	-	-	-
Wet blue leather	29,288	14,867	-	-	-	-	-
Crust leather	17,719	23,128	37,755	70,140	48,697	-	-
Finished leather	12,259	11,152	12,878	25,335	51,456	101,020	97,692
Footwear	9872	7,195	5,737	8,642	10,162	19,193	30,543
Gloves	-	-	-	-	1,561	3,077	4,315
Other leather goods	29	-	138	213	182	150	396
Total	101,255	75,472	56,507	104,341	112,060	123,442	132,947
<i>Source:</i> LIDI 2014							

provide a systematic overview of sectoral export performance and comparative and competitive advantages (ITC 2007).

3.2 Leather Footwear

The ambitious export growth targets under GTP I and II for the leather footwear industry reflect the intention to make this sector the leading sub-sector in the leather industry to pull the entire value chain. The GTP II target is to raise the share of footwear in total leather exports from 22.9 percent in 2013/14 to more than 60 percent in 2019/20. However, although footwear exports have been growing very fast since 2010, they have remained far behind the target (table 13.2). Exports of the leather sector are still dominated by finished leather which has a much smaller domestic value-added content. The share of Ethiopian footwear exports in total Ethiopian exports of the leather industry is also much smaller than the share of footwear in global leather-related exports (79 percent).

The impressive export growth of the footwear sub-sector has been accompanied by an increase in the number of export markets for footwear, from 41 in 2009 to 50 in 2013, and a change in the geographical structure of these exports (table 13.3). While Europe had been the main destination until 2011, the United States, China and neighbouring Kenya came to be the main importers of Ethiopian footwear in 2014, according to data from the Ethiopian Revenue and Customs Authority (ERCA). At the same time, the growing exports were concentrated on fewer producers¹¹², indicating that the average firm size of exporting firms has increased.

The big leap to the United States from a low basis has been favoured by AGOA and came about with the establishment of the big Chinese firm *Huajian*, which produces exclusively for large retailers in the United States. The firm plans to invest \$2 billion until 2018 (Brautigam et al. 2013).¹¹³ Other globally operating companies have also set up their own production facilities in Ethiopia, or are in the process to do so; and there is currently an increased interest of major retailers and brand manufactures in the USA to source from Ethiopian firms.

Table 13.2:
Export performance of the Ethiopian Leather Sector, 2010/11 to 2013/14, compared to GTP I and II targets

<i>Product Type</i>	Export value (\$ million)			Average growth p.a. 2010/11- 2013/14 (percent)	2013/14 GTP I target achievement (percent)	2019/20 GTP II target (\$ million)	Average growth p.a. required to achieve GTP II target (percent)
	2010/11 actual	2013/14 actual	2013/14 Target				
Finished leather	25.3	97.7	130.4	56.9	74.9	214.1	14.0
Leather footwear	8.6	30.5	260.7	52.5	11.7	485.9	58.6
Leather goods and garments	0.2	4.7	25.6	186.4	14.4	100.0	66.5
<i>of which:</i> Leather gloves	0.1	4.3	–	–	–	75.5	61.2
Total	34.1	133.0	416.8	61.6	31.9	800.0	34.9

Note: The annual growth rate to achieve GTP targets for 2019/2020 (last right-hand column) is the average rate required for the years 2013/14 to 2019/20.
Source: LIDI 2014

¹¹² The Herfindahl-Hirschmann Market Concentration Index increased from 0.28 in 2009 to 0.73 in 2012.

¹¹³ *New Wing* from Hong Kong has begun shoe production in Ethiopia for the United States. *George Shoe Corporation* of Taiwan, Province of China, opened a factory in 2014 and already plans to expand its shoe production capacity fivefold.

3.3 Other leather goods and garments

The annual average increase in Ethiopian exports of leather goods other than footwear in 2010-2014 was particularly fast (186.4 percent), albeit from a small basis. This increase was mainly an account for exports of gloves by three companies, two of which are foreign owned.¹¹⁴ Major global brands in the market for leather goods, have established bases in Ethiopia with a view to sourcing leather and leather products. Although glove-making is a relatively small segment in the leather industry, it has a strong potential for further growth thanks to the local availability of the top quality of Ethiopian highland sheepskin and goatskin suede.

Table 13.3:

Exports of footwear, by region of destination, 2010-2014
(thousand \$)

	2010	2011	2012	2013	2014
North America	407.2	659.3	8,643.9	20,451.4	18,606.5
Europe	4,720.5	6,060.0	4,074.4	1,156.7	1,536.7
Asia	299.4	275.8	547.8	776.2	3,823.9
Middle East	99.8	138.2	230.5	342.3	208.5
Africa	2,118.6	1,310.8	557.7	4960.3	6795.4
Total	7,645.5	8,444.0	14,054.3	27,686.8	30,971.0

Source: Ethiopian Revenue and Customs Authority Database

4. Policies and institutions

Notwithstanding the delays in reaching the objectives specified under GTP I, the Ministry of Industry now targets an increase in exports of leather and leather products to \$800 million by and an increase of jobs to 94,000 by 2019/20. In order to achieve these objectives the Government is set to strengthen the policies for the Ethiopian leather and leather products industry that it has pursued over the past 5 years. These policies have been aiming, in the short run, at shifting leather production from the wet-blue stage to crust, and then to finished leather. The introduction of a 150% tax on export of semi-finished crust leather in December 2011 was successful in raising domestic value addition in the leather sector by increasing the volume of hides and skins that are processed to finished leather domestically. The longer-term objective, as included in the GTP, is to gradually increase the supply of domestically produced finished leather for the production of goods with a higher value-added content, especially shoes.

Together with textiles and clothing, the leather sector, especially shoe production, has already benefitted more from the Government's proactive FDI promotion policy than other sectors and attracted significant export-oriented FDI. Ethiopia's potential in providing high quality raw materials domestically gives rise to the expectation that internationally operating companies will not easily relocate their production to other countries merely in response to

¹¹⁴ Major global brands in the market for leather goods, such as *Pittards* of the United Kingdom, *Otto Kessler* of Germany and *Hiroki* of Japan have also established bases in Ethiopia with a view to sourcing finished leather and leather goods from Ethiopia.

changes in the international patterns of labour costs, as often experienced elsewhere. If foreign investors' expectations of local quality leather supply are met, there is a great chance that they will further increase their investments. A well-functioning domestic value chain is therefore crucial (see section 5.2 below). On the other hand, little is known so far about the impact of FDI on the development of the local industry in terms of linkages with domestic firms, spillovers of technology and management know-how, or training for the domestic workforce.

While the Government has put in place trade and investment regimes in support of an export-oriented development of the leather industry, the implementation of facilitation measures and incentives and the institutional arrangements for the trade-investment interface appear to have been suboptimal in terms of transparency and effectiveness. Although the National Export Steering Committee oversees the overall export performance, there is no dedicated export promotion agency at the operational or delivery level, since the Ethiopian Export Agency seems to be no longer operative.

Publicly-owned service and input providers and financial institutions are also an integral part of the industrial support strategy benefitting the leather industry (see chapters V to X). A key instrument is the development of industrial zones that can provide custom-made facilities and services for the leather and leather goods industry in different parts of the country; the most ambitious of such projects is the creation of "Modjo Leather City" (Laaksonen 2015:33). The Government has also initiated the setting up of an industrial input supply enterprise to address shortages of intermediate goods, including leather.

With a view to increase the efficiency of existing factories and the creation of new factories, the Ministry of Trade in 2013 drafted a new National AGOA Response Strategy for the leather and leather industry and other sectors until 2018, to be overseen by the National Export Steering Commission. The implementation of the Strategy is to be ensured by an AGOA Steering Committee, the AGOA Centre and Technical Working Groups composed of stakeholders.

Various public support institutions assist producers by promoting exports and encouraging investments, both foreign and local. At the sectoral level, the main organization responsible for planning, coordinating and supporting producers is the Leather Industries Development Institute (LIDI), operating under the Ministry of Industry (MoI).¹¹⁵ The establishment of LIDI in 2010 was an important step in institution-building, which has the potential to help the sector, especially domestic producers in operational efficiency and product quality. As the Institute matures and gathers experience of how to best support the activities in the leather sector in the coming years, it will play a key role in supply chain co-ordination, identification of appropriate industrial practices, and provision of consultancy services, including on quality control, and delivering product-testing services.

LIDI is also to provide vocational and managerial training, marketing support and feasibility studies for new industrial projects.

In addition, there are two private sector associations, the Ethiopian Leather Industries Association (ELIA) and the Ethiopian Raw Hides and Skins Suppliers Association (ERHSSA). ELIA organizes an important regional marketing event, the All African Leather

¹¹⁵ The sector also enjoys support from development partners, most noticeably the United Nations Industrial Development Organization (UNIDO), the United Nations Development Program (UNDP), the United Nations Economic Commission for Africa (UNECA), the United States Aid for International Development (USAID), the UK Department for International Development (DFID), the Italian Cooperation Agency, and the Governments of France and India, which are among many others involved in various specific interventions including technical, technological, marketing and research support.

Fair, which is held every year in February in Addis Ababa. While primarily set up to promote the interest of suppliers of hides and skins, and less well organized and influential than ELIA, ERHSSA potentially plays an important role in the leather value chain from raw hides and skins suppliers to the tanneries.

5. Constraints, challenges and opportunities for the leather industry

The basic challenge for the Ethiopian leather industry is twofold: first, to increase the quantity and quality of its output and move up further the value chain in production; second to translate greater production and productivity into export growth. Currently, the Ethiopian leather industry meets with numerous constraints in addressing the above challenges. Some of these lie within the leather sector itself, and are related to productivity, capacity utilization, leather supply chain management as well as the adaptation of production to international standards and market requirements. Other constraints lie outside the leather sector and are related to the provision of inputs from other industries, infrastructure facilities, financial and logistic services and customs procedures.

As in textiles and clothing, the relatively small size of firms that have no capacity to export large volumes has been a major restricting factor for export expansion in leather product. Equally important are a number of operational constraints at the firm level causing delays in delivery and inefficiencies in the production process. Some of these constraints result from regulatory and administrative procedures, others are related to the implementation of rules, regulations and incentive schemes and, at times, inconsistencies between the objectives of different stakeholders and counterpart institutions.

In addition to affecting negatively the competitiveness of Ethiopian manufacturers, these constraints reduce the willingness of potential domestic and foreign investors to start industrial ventures or to enlarge the production capacity of existing factories. They also make potential exporters hesitant to turn more consequently to external markets and to make greater international marketing efforts for fear of being unable to meet international contracts.

5.1 Productivity, technical efficiency and competitiveness

Evidence from a number of studies (see, for example, Abegaz 2013; USAID 2013) suggests that a major constraint for most export firms in the leather sectors is a significant degree of technical inefficiency. The average rate of capacity utilization in the commercial manufacturing of leather and leather goods is only 49 percent, and waste and rejection rates are high.

Available data indicates that capacity utilization rates in tanneries are, on average, in the order of 79 percent for hides and 45 percent for skins (LIDI 2014). In the processing of hides they are lower (65 percent) in domestically owned factories than in foreign-owned factories (84 percent), whereas in the processing of skins they are higher in domestically owned firms (49 percent) than in tanneries with foreign ownership (40 percent).

According to a World Bank Study (2012) the average rate of product rejection at delivery amongst Ethiopian footwear makers is 5 percent, as compared to 1 percent in similar firms in China and even less in Vietnam. Similarly, the cutting waste rate among Ethiopian firms has been 5 and 30 percent, compared to less than 3 percent in Vietnam, or 10 percent in China. Furthermore, many Ethiopian exporting firms have been reporting problems with the optimal use of their machinery and equipment.

LIDI has taken initiatives to help firms to improve their productivity, but technical refinement of tanning and footwear manufacturing remains a central challenge for the industry. Meeting this challenge requires both an improvement of skills and an upgrading of production facilities.

5.1.1 Skills and competences

In recent years, a marked improvement has been observed in the middle and top levels of management thanks to technical, managerial and marketing interventions by development partners and also as a result of support from buyers engaging with factories in anticipation of sourcing. Collaboration of domestic producers with foreign-owned companies operating in Ethiopia has also been helpful, as it has allowed domestic firms to improve their problem-solving skills.

In spite of these efforts, lack of labour skills and technical know-how at all levels of responsibility for production and management remain the principal causes of technical inefficiencies. Workers and semi-skilled operators often lack industrial experience. Despite considerable improvements in recent years, their productivity is still low by international standards. Moreover, footwear companies also suffer from high labour absenteeism and turnover rates, which are raising production costs and reduce the benefits derived from learning by doing. Inside firms, sharing and updating of information is often incomplete or delayed, due partly to insufficient implementation of information technology, partly to a lack of communication culture on the part of the management. Inadequate coordination of personnel is often a reason for delays in the production and delivery process.

This is particularly harmful for firms that are engaged, or would like to engage, in production for foreign consumer goods markets. Success in these markets requires considerable flexibility and high operations' speed. The footwear industry is a dynamic fashion industry where market participants must quickly respond to changing needs, tastes and preferences of their clients while keeping a short lead time in order to be successful. A small number of firms that formerly exported semi-finished leather can build on long-standing ties with clients in Europe, especially Italy and the United Kingdom, some of which have now become competitors in the market for finished leather. Most Ethiopian producers have entered the international finished leather and footwear markets only recently, or are about to do so, and their middle level-managers have very limited experience and know-how in developing, producing and marketing goods for export markets. Top-level managers also lack exposure to worldwide competition, where they have to deal and successfully negotiate with seasoned sourcing executives of, mostly large, foreign companies.

These challenges have been recognized by LIDI and ELIA. These institutions have supported Ethiopian exporters by sending their staff to international training courses and trade fairs. Notwithstanding this progress, these institutions themselves are still far from disposing of enough well-experienced or adequately skilled collaborators to provide such support at a sufficiently broad scale.

Another competition-related challenge for the leather industry results from increasing sensitivity of consumers of leather products especially in developed countries for the environmental impact of the production process and an ethically responsible production of the leather raw material. Dealing with this challenge requires greater awareness of consumer preferences and evolving international product standards, but also a high degree of technical competence on the part of breeders, traders and tanners, which so far is not widespread (see also sub-section 5.2.1).

5.1.2 Machinery and equipment

A large part of the leather and leather goods industry is operating with outdated machinery and equipment that often does not meet the requirements for internationally competitive production. This is mainly a problem in the domestically owned factories where investment in modern technology, for example leather foil printing, is required for increasing the production

of exportable leather goods. In addition, local workers are not always trained well enough in handling the machinery and equipment they dispose of.

One challenge is therefore the selection and import of machinery and equipment with technological specifications that match both the capabilities of the available labour force and the exigencies of production for foreign markets.

Maintenance of imported machinery, especially in the footwear sector, is often difficult due to a lack of local expertise, resulting in lost production time. Most of the local footwear factories in Ethiopia can only afford to import used machinery, which tends to raise maintenance costs. Furthermore, managers complain about the problem of obtaining spare parts that have to be imported. Importing those goods is complicated and costly, or even impossible, due to problems in accessing foreign currency, customs duties and cumbersome customs procedures as well as inadequate logistic services. This, in turn, gives rise to seeking the solution in modifications of the installed machinery or the use of inappropriate spare parts that impair productivity and product quality.

5.2 Availability and quality of raw materials and intermediate goods

5.2.1 Inputs for the production of finished leather

The most binding of all constraints for the leather industry, and indeed one of the reasons for the low capacity utilization in leather manufacturing and the slower than expected growth rate of exports, is the shortage and insufficient quality of inputs due to supply bottlenecks at various stages of the value chain. Local suppliers are providing, directly or indirectly, tanneries with about 80 percent of their requirement of raw hides and skins (Abebe and Schaefer 2013). So far, however, Ethiopia has exploited its comparative advantage of a huge cattle population only to a very limited extent. Despite the fact that the country has an exceptionally large livestock, tanneries continue to have difficulties in sourcing raw hides and skins from domestic sources.

Cattle rawhide production at the producer level exceeds tanning capacity, yet only about one third of this production reach modern industrial tanneries. In the case of sheep skin the percentage is in the order of 90 percent, which amount only to less than half of the capacity for the production of finished leather from sheepskin. As for goat skins, tanneries receive 86 percent of all the raw material, which comes close to covering their entire finishing capacity (USAID 2013). Acute shortages, erratic supply volume and poor average quality of hides and skins are major reasons for tanneries' low capacity utilization (UNIDO 2012). Another reason for supply shortage is low yields at pre- and post-slaughtering stages.

At the pre-mortem stage, the quantity of raw hides and skins is limited by a low flock reproduction rate of only 37 percent (compared, for example, to 180% in New Zealand¹¹⁶), with an additional loss resulting from a high livestock mortality, which at 14.4 percent is also higher than in other countries, as subsistence farmers tend to use animals for draught power until they die (USAID 2013).

Furthermore, the supply of hides and skins is closely connected with local meat consumption, which makes slaughtering very seasonal, commonly following Christian and Muslim holidays and fasting seasons. In addition, illegal cross-border trading of live animals and raw hides and skins to neighboring countries contributes to insufficient local raw material supply for the leather industry (Laarksonen 2015). It appears that cash-short tanneries and traders failing to settle credits with raw hides and skins suppliers on time (see also sub-section 5.4 below),

¹¹⁶ See <http://www.bbc.com/news/business-24610075>, October 2013.

coupled with the ban on exports of unprocessed hides and skins, leave dealers to search for boarder trades that are more lucrative.

The often poor quality of raw hides and skins, as well as the high mortality rate, mainly derive from poor animal husbandry practices. Most Ethiopian livestock owners farm at subsistence level with very low income and are unable to follow the best husbandry practices in terms of feeding, watering and breeding. Poor shelter and shearing also significantly deteriorate quality. The problem is compounded by the inadequacy of disease control, adequate veterinary services and medication, so that the quality of raw hides and skins is frequently affected by skin diseases and skin marks, and by the epidemic spread of ectoparasites (*ekek*). It has been estimated that nearly 80 percent of all sheepskin from the highland areas of Ethiopia is affected by *ekek*, frequently leading to the rejection of the sheepskin by tanneries (USAID 2013:14).

Poor nutrition and treatment not only reduces quantity and quality but also the average size of hides and skins. A larger hide offers a better “cut value” and hence flexibility to produce a wider range of products, including, for example, upholstery leather for the automotive and household furniture industries.

The amelioration of livestock breeding is therefore a major challenge. It will require improvements in the quality and quantity animal feed, the introduction of better controls to identify animal diseases and measures to cure them, as well as greater quality orientation in the recovery of hides and skins.

At the post-mortem stage, a low off-take ratio contributes to the supply problem. Ethiopia’s off-take ratio for hides is only 7 percent, compared with the African average of 13 percent and a global average of 20 percent, and only a third of these hides are actually collected for supply to tanneries in the “modern” sector. For sheepskins, the off-take ratio is 33 percent, which is closer to the African average of 35 percent, but less than half the ratio of 71 percent in China.

Another crucial constraint is the lack of modern abattoirs and insufficient use of the existing ones. In 2013, only two of Ethiopia’s nine abattoirs had internationally recognized certifications, and for three abattoirs these were in process. But only 20 percent of raw hides and skins transacted in the formal market are collected from urban abattoirs and slaughter houses (Abebe and Schaefer 2013). The other 80 percent come from rural areas, where often outdated techniques are used to obtain, store and transport hides and skins.

The hides and skins supply chain is relatively long. It can go from household farmers to micro collectors, from them to large collectors that sell to small traders and/or agents, which in turn sell to large traders/or agents before the raw material reaches the tanneries. In some rural areas, the most convenient way for small producers to market their raw hides and skins is selling to traditional local tanneries that benefit from strong local demand for their products but have low exigencies with regard to the type and quality grade of hides or skins. As a result, these products never reach the formal value chain for purchase by modern tanneries (USAID 2013).

The Ethiopian authorities are aware of this and, in 2013, they introduced a legislation aimed at streamlining the domestic supply chain (Proclamation 457/2005). However, this legislation remains to be fully implemented. Meanwhile, a new legislation has been passed (Proclamation 819/2014 and regulation 341/2015), aiming at the establishment of marketing centres for live animals, including slaughtering. This may also impact positively on the commercialization of the leather value chain, although the new legislation is primarily directed at meat production. The challenge is to set up a strategic actions plan for the rigorous implementation of this legislation, including also the introduction of incentives for the production and collection of raw materials with better quality.

At present, the value chain lacks a well-developed standard for the collection and quality classification of hides and skins and sufficient price incentives that would provide a premium for superior quality (Laaksonen 2015). Implementing and enforcing the livestock Sanitary and Phytosanitary requirements of international buyers would significantly enhance the quality of Ethiopian livestock and as a consequence, the quality of the hides, skins, and leather that companies can process into higher value items. Developing the meat export sector, instead of exporting live animals, would also ensure greater availability of hides and skins for the leather and leather products industry

Furthermore, the procurement of essential chemicals for tanning processes is a frequent problem for Ethiopian firms, since most of these chemicals have to be imported. While the cost of the material itself is the same for producers all over the world, Ethiopian firms appear to be at a disadvantage vis-à-vis their competitors on international markets with regard to the speed and cost at which such imports are being processed (see also section 5.2.2.).

5.2.2 Inputs for footwear and leather goods manufacturers

Inadequate supply of inputs to the finished leather sub-sector has repercussions on the production further down the value chain, i.e. of footwear and other leather goods. Another major challenge faced by footwear companies, next to the availability of quality finished leather, is the weakness of ancillary industries in the supply chain and the resulting shortage of other required inputs, especially chemicals as well as soles and accessories like ornaments or toe puffs, labels and package material. In addition, there is a lack of technical support industries that provide quality products, such as shoemaking lasts or cutting knives, or services, such as design and product development.

According to managers of footwear companies, almost all non-leather inputs are imported due to the unavailability in the local market. This also forces footwear factories to use the services of trading houses to consolidate various inputs into one container as individual payments in foreign currency to various suppliers would require several foreign currency permits and multiple costs for letters of credit. This has often also resulted in extra inspection cost, frequent receipts of “wrong” specifications and increased lead time due to transportation and customs clearing.

In order to be prepared for the contingencies that may result from weaknesses in the domestic supply chain and import dependence, footwear exporting companies tend to hoard finished leather in larger amounts than would be operationally necessary. Similarly, they tend to import large quantities of inputs, particularly chemicals. The Government has addressed shortages of chemicals by giving exceptional permission to manufacturers to open bonded warehouses in Ethiopia, but irregularities in supply, both in variety and quality, still mean high inventory costs for the tanneries.

A major coordination challenge results from the fact that hides and skins are a buy-product of meat production. A higher off-take and flock reproduction rate would imply a higher supply of meat, for which consumers have to be found. Since at the present level of per capita income in Ethiopia domestic meat consumption is unlikely to grow in the coming years at the same speed as the demand for raw hides and skins and for finished leather, exports of meat would need to be considerably increased. However, such exports are subject to severe sanitary standards which are difficult to meet at the current state of slaughtering practices in Ethiopia.

5.3 Constraints and challenges related to trade logistics, customs practices and finance

5.3.1. Transport, logistics and trade facilitation

Price is the main determinant of procurement decisions of leading firms in the international markets for finished leather and leather goods. But the costs of procurement depend not only

on relative production and wage costs in different producing countries; they are also influenced by the costs and efficiency of transport, trade logistics and border management. In this regard, companies in the leather and, particularly, in the leather goods industries are suffering from suboptimal cross-border transport and logistics services, and cumbersome customs clearance processes (see chapters VII and VIII).

On the import side, remaining restrictions often complicate the task of Ethiopian producers of leather and leather goods to strengthen their international competitiveness, as they raise the cost of critical inputs, especially leather and accessories that are essential for exporting firms. In addition, such imports are frequently delayed and rendered more costly, even for firms designated as Authorized Economic Operators (AEOs). On the exports side, efficient customs procedures are of particular importance as the international value chain is characterized by the interest of retailers to keep their inventories as low as possible, so that the ability to produce “just-in-time” and to respond swiftly to changing fashion trends is crucial (WTO 2014). Yet, unnecessary delays often occur already at the stage of preparing an export business. For example, it is habitual to provide potential clients with product samples, and the quality and quick delivery are decisive for the successful conclusion of a business. But sending abroad leather samples and footwear samples in excess of three kilograms and over three pairs respectively, result in the goods been withheld at customs until corresponding payment or letter from LIDI is presented. It also seems that the customs treatment of samples is often arbitrary. Improvements in these areas are therefore a major challenge on the way to upgrading the international status of the Ethiopian leather industry.

Easy and speedy transportation is not only important for cross-border trade, but also a key element in the functioning of the domestic value chain from raw material production by individual households, small farmers and local slaughter houses to larger traders or tanneries. However, efficient transport is not always warranted. While the ongoing projects to improve transport infrastructure at the national level will significantly facilitate the import and export activities of the leather and leather goods industry, it remains to be ensured that infrastructure planning and investment is well linked to the production centers of the industry and coordinated with the creation of new industrial zones. Also, the better integration of abattoirs into the supply chain and greater efficiency of the raw material collection process may also require targeted improvements in regional infrastructure. This also needs to take into account that transport of cattle to the abattoirs requires special transport facilities.

5.3.2 Power and water utilities

Although heavy public infrastructure investment has led to major improvements in electric power generation and distribution (see chapter VII), the most common infrastructure-related problem in the Ethiopian leather industry still appears to be the unreliability of electric power supply. As a consequence, some footwear factories reportedly use heavy duty generators to avoid production interruptions and to ensure that they can fulfill export commitments. Since this kind of electricity is considerably more expensive than the one obtained from large-scale public power suppliers, it reduces their profitability and represents a disincentive for further investment to enlarge production capacity.

Although considerable progress has been achieved in access to water, which is of particular importance for the leather industry, a lot more needs to be done. Most tanneries use groundwater, which is more costly than municipal fresh water supply. Enhanced control and appropriate waste water treatment represent an additional challenge, as environmental concerns will continue to gain importance in the coming years as population growth and the broader process of industrialization will be associated with accelerated urbanization.

5.3.3 Financial services

According to managers from the Ethiopian leather and leather goods industry, access to working and investment capital, high costs of financial services by banks (such as letters of credit), long delays in the authorization of letters of credit and cumbersome procedures to obtain foreign currency permits are also major constraints to the efficiency and further development of the leather industry. While foreign companies investing and operating in Ethiopia can relatively easily find financing from their home countries, access to investment finance is especially limited for small- and medium sized domestic producers of leather and leather goods (see also chapter IX).

An even stronger constraint for firms in the leather industry appears to be the scarcity and cost of working capital. They are obliged to hold relatively large inventories as they cannot rely on the delivery of inputs in due time to carry out export orders and also not to have to face the burdensome import-related bureaucracy. Also, export payments are typically received only several months after delivery. The scarcity of working capital is exacerbated by long delays in the reimbursement of VAT (which also causes additional interest costs to the extent that bridging finance is available) and the requirement to hold cash balances of the same amount as working capital credit. These constraints are likely to become more severe the more firms engage in export activities.

Working capital constraints in the footwear and leather goods sub-sectors tend to have repercussions on firms further down the value chain. It has been reported that as a result of working capital shortages, tanneries leave sizable unpaid invoices for up to 6 months. This, in turn reduced the possibilities of the larger traders to extend credit to small traders to collect hides on their behalf (USAID 2013: 73).

In order to be able to carry out large volume orders from major export destinations in the presence of domestic supply shortages, producers must import not only chemicals and accessories, but in some cases even leather. Factory managers have indicated that they often cannot procure the required inputs from foreign suppliers on time due to the fact that foreign currency permits take excessively long to be approved.

5.4 Marketing Challenges

5.4.1 Market access, tariffs and non-tariff barriers

Ethiopian producers of leather and leather goods are still far from taking full advantage of the opportunities offered by AGOA, EBA and trade preferences offered by other potential importing countries to LDCs. The recent increase in footwear exports to the United States is mainly on account of foreign companies that have undertaken export-oriented FDI in Ethiopia. Making domestically-owned firms in the leather and leather goods sector benefit from such preferences still remains a major challenge.

Awareness also needs to be raised among domestic producers of the need to meet international quality standards and conform to market requirements and regulations in cross-border trade. The challenge is not only to meet legal technical barriers to trade, but also to meet private quality standards of potential importers with regard to ecologically and socially sound forms of production. Small and medium-sized domestic enterprises in the Ethiopian leather industry lack sensitivity for the need to comply such regulations and standards, as well as the expertise and capacity to do so. Larger and foreign-owned firms in Ethiopia are doing better in this regard because of their broader exposure to international markets, the experience of their managers and their financial means.

5.4.2 Marketing orientation and techniques

Knowledge of Ethiopian leather products is minimal at end market destinations. Although producers of finished leather products in countries, such as Italy and China, know about the

superior quality of Ethiopian sheep leather, consumers do not. This is partly due to the relative small share of Ethiopian leather products in the global market, partly due to the absence of targeted marketing efforts. The managers of domestic firms, in particular, the producers of shoes and other final consumer goods consider international marketing as one of the most distinctive challenges for the Ethiopian leather industry.

At present, export deals are mostly initiated by foreign buyers seeking suitable supplies, rather than a result of pro-active marketing efforts on the part of Ethiopian producers seeking buyers. Such efforts will be crucial in an attempt to reach the ambitious targets of GTP II. Many local footwear firms find production for the local market more lucrative, because it requires less marketing effort and costs. The activities of LIDI have not yet been able to promote an export culture.

Few Ethiopian producers have managed to integrate into international value chains. Domestic firms are also relatively small compared to competitors in international markets for leather and leather goods, making it difficult for them to seek and capture export possibilities individually. The challenge is, thus, to find means of support for Ethiopian producers as a group to obtain the information required to being able to identify and assess specific market opportunities.

A government-supported design of an international marketing strategy for the Ethiopian leather industry as a whole will have to be selective, not only with regard to the goods promoted, but also with regard to the export markets targeted. In this context, the challenge is to grasp the considerable possibilities for exports to emerging economies, especially in Asia, whose consumer goods markets are growing faster than the markets of developed countries. In addition, the regional leather goods market in Africa appears to offer considerable opportunities for expansion. In comparison with global trade, regional trade is smaller in scale and has the advantage that local producers may find it easier to meet the tastes and exigencies of consumers in neighbouring countries. Exploring regional markets may offer opportunities to expand prior to moving to international markets. Furthermore, Ethiopian producers appear to have an edge over competitors from other countries in the region as the footwear industry has started earlier in Ethiopia.

6. Recommendations

In addition to the proposals made in Part Two of this DTIS, which are of relevance for all prioritized sectors, the analysis of most binding constraints for the Ethiopian leather and leather goods industries leads to the following sector-specific recommendations. While in several cases, policies already go into the right direction, some measures have to be adjusted and their implementation needs to be strengthened. The recommendations are grouped in two categories, first recommendations related to increasing the efficiency in the use of existing productive capacity and, second, recommendations related to a further expansion of productive capacity and exports.

6.1. Raising the efficiency in using existing productive capacity

There is considerable scope to raise output and exports of the leather manufacturing sector even without major additional investment in new productive capacity. The most urgent task for the producers of leather and leather goods, existing public and private institutions and the government is to address the underutilization of existing productive capacities, low productivity and technical inefficiencies at all stages of the value chain.

- *Strengthening the domestic supply chain*

There is an urgent need for a coherent strategy to raise the quantity and improve the quality of raw hides and skins available to the leather industry. In the short run, importing raw hides and skins, especially from neighboring countries where no or only few tanneries exist, may be a cost effective solution. It follows that simplifying and facilitating imports procedures become essential. In this context, setting up public input supply enterprises that could play an intermediary role with foreign suppliers of various inputs, which are in short supply domestically, is a promising option. In the medium term, efforts should be concentrated on exploiting Ethiopia's sector-specific comparative advantage, to the largest extent possible, by strengthening and rationalizing the domestic value chain. For this purpose, it is necessary to design a strategic actions plan to commercialize livestock breeding and the recovery and collection of raw hides and skins. In this regard, a strategic actions plan could include the following:

- The supply of domestic raw hides and skins can be increased by raising the off-take flock and reproduction rates, reducing death rates, discouraging the export of live animals and punishing illegal border trade. Since increasing the domestic supply raw hides and skins this way would imply a higher supply of meat, it is crucial to closely coordinate such policies with measures that help to increase the demand for meat, especially exports.
- Efforts to increase the domestic supply of quality raw hides and skins must start with significant improvements in animal husbandry. For this purpose an outreach and extension programme should be designed, in partnership with stakeholder associations, which raises the sensitivity among suppliers for the importance of efficient recovery and quality.
- Introducing systematic control of cattle and sheep diseases is essential, as is the provision of appropriate medication. Suppliers of raw hides and skins also need technical and logistic support for improving the quality and quantity of animal feed and the overall conditions for efficient livestock breeding.
- Recovery can be considerably improved by rigorous implementation of regulations regarding the pre-slaughter and post-slaughter management of hides and skins by promoting the use of modern abattoirs and slaughterhouses.
- Proclamations 457/2005 and 819/2014 should be enforced rigorously and expeditiously in order to eliminate stages in the supply chain that do not add value. This may require the creation of additional public agencies to oversee the country-wide implementation of this legislation.
- The introduction of official quality standards and conformity assessment by the relevant public agencies and private institutions would help promote better quality. Such efforts will take time to bear fruit, because it requires a major change in attitude on the part of small farmers and large household breeders.
- Commercialization of raw hide and skin production requires a pricing mechanism that provides a premium for superior quality. The practical application of a quality standard would be instrumental in this regard. This could be complemented by training of small and intermediate traders and operators at marketing centres for better skin and hide preservation.
- The creation of larger units for livestock breeding should be encouraged. It would help to introduce a commercial spirit in cattle farming, facilitate efforts to improve husbandry and control animal diseases, increase the efficiency of raw hide and skin

recovery and collection. Promoting the creation and expansion of rural cooperatives may be useful in this regard.

- ***Improving technical efficiency of domestic producers***

With a view to raise the average efficiency of domestic firms, i.e. both labour and capital productivity, additional action on a broad front is necessary to advance the skills and competences of entrepreneurs, managers and workers to enable them to master modern technologies, especially in tanneries. This should include the following:

- LIDI and private sector associations, such as ELIA and ERHSSA, should enhance and upgrade their direct deployment of expertise, with a focus on quality control, supply-chain coordination and benchmarking of industrial practices that are best-suited for the Ethiopian leather and leather goods industry. As resources are limited, it may be necessary to concentrate such support on selected firms that have the greatest potential to succeed in international competition.
- The Government should provide additional support to the existing sectoral institutions and associations to expand their capacity to deliver the training and advisory services to producers.
- Public financial support to firms that temporarily employ foreign experts to advance managerial and technical know-how at the operational level may have a considerable impact on the efficiency of these firms and, beyond that, may generate multiplier effects for the entire domestic leather industry.

- ***Improving logistic and financial services, customs procedures and infrastructure***

- The imports of essential inputs should be facilitated through softened conditions and fast-track import procedures.
- Better access to working capital from firms at all stages of the value chain needs to be facilitated. Given that the domestic supply chain in the leather sector is especially long and complex, starting at the level of subsistence farming and small-scale raw material trading in all parts of the country, greater local presence of banks and public financial support institutions throughout the country is of special importance for the leather sector.

6.2 Expansion of productive capacity

The targeted increase in exports of leather and leather goods with a high content of value-added require better use of the legal framework for trade, in particular with regards to the opportunities offered by AGOA, EBA and emerging-markets preferences for LDCs. Strengthening marketing efforts that take into account the sector-specific conditions and exigencies of the markets of targeted export destinations should also be pursued. The following actions would be conducive to meeting both these challenges:

- In order implement and monitor the AGOA Response Strategy more consequently, one-stop-consultation services, about market access, leather product standards and quality requirements for specific client groups, should be introduced.
- Further integration into the preferential trade areas of EAC and COMESA would help to further increase exports of leather goods to neighboring countries.
- Public institutions and private sectoral institutions should make greater concerted efforts to enhance knowledge of producers of leather goods of the demand and supply trends in selected export destination countries and of the roles of lead sourcing firms, production networks and distribution channels in the global leather value chains and

help domestically owned firms link up with these. Government support for participation of Ethiopian producers in international leather fairs could have a large pay-off, as it would allow for the creation of linkages with major international production networks and retailers.

- Better information of small-end medium-sized enterprises about quality control procedures and international marketing opportunities through public institutions and private associations could enhance the contribution of such enterprises to export and to increase their propensity to upgrade and enlarge their production capacities.
- Strategies that aim at identifying niche markets, product specialization and specific client groups in the markets for shoes and other finished leather goods would help to use available resources for international marketing in the most efficient manner. Private sector associations, especially those that already exist such as ERHSSA and ECCSA and ELIA, could play a greater role in such strategies and in strengthening the capacity for national research and development for innovation in product design and manufacturing processes.
- In order to enable domestic leather and leather goods manufacturers compete successfully at the international level greater efforts must be undertaken to sensitize them for the need to meet international technical and quality standards (see also chapter VI). In addition to the relevant Ministries and the institutions forming the National Quality Infrastructure, LIDI must assume a stronger role in this context.
- It is essential to develop and upgrade systems and institutions for product standardization with regard to quality, certification and accreditation that are consistent with international standards for the leather industry. Specifically, there is a need to improve test procedures, to enhance risk analysis and management, to strengthen the TBT enquiry point, and to make compliance services available on the spot at industrial zones where leather and leather goods manufacturers are located.
- Since individual domestically-owned firms have little, if any, capacity to undertake international marketing efforts, there is a need for the strengthening government and institutional support for the promotion of Ethiopian leather products in selected foreign markets. The design of the export marketing strategy may be partly outsourced to experienced international marketing service providers. The creation of a specific Ethiopian brand for product lines of superior quality and affiliation of individual producers with international ethical labelling organizations, could be elements of such a strategy (see also chapter X).
- The creation of larger units in footwear production that can operate at a larger scale would help to raise productivity and enable them to accept more sizeable orders. In this context, the promotion of subcontracting between larger and smaller firms and among smaller producers could also be helpful.
- Increased FDI can help increase productive capacities in the leather industries, accelerate the transfer of technology and managerial know-how, offer opportunities for on-the-job training of local employees, and facilitate access to foreign markets. Efforts to attract FDI should focus on increasing productive capacity in the higher value-added segments of the industry, but should not be at the expense of support for the entry of new domestic firms and for domestic investment to upgrade and enlarge productive capacity.

Chapter XIV:

Other prioritized sectors: Metal Industries, Chemicals and Tourism

1. Introduction

This chapter looks at the evolution of three other prioritized sectors, namely the metal and chemical industries, and tourism. The development of the chemical and of the metal and engineering industry is oriented at reducing import dependency, while improvements in the tourism sector are expected to make Ethiopia one of the leading touristic destinations in Africa, and can strengthen the role of the sector as an important supply of foreign exchange.

The development of the metals and chemical industries can advance together with the country's industrialization process and, in particular with the input demand originating from the prioritized export sectors, as well as the with the expansion of the domestic (public and private) construction projects. A larger target supply of chemical products is also seen as essential for raising productivity and production in the agricultural sector.

The development of tourism in particular could lead to the creation of new jobs, especially for women and the youth. While the tourism industry can be an important element in the overall process of structural transformation, its development should be well-balanced with that of the manufacturing sector, in order to avoid over-reliance on foreign exchange income from tourists.

2. The Ethiopian Metals and Engineering Sector

2.1 Structural characteristics of the metals and engineering sector

Ethiopia's metals and engineering industry still is at an infant stage, but has expanded considerably in recent years. From 2011 to 2014/15, its share in the country's total manufacturing value of production rose from 12.6 percent to 16.3 percent.¹¹⁷ It comprises activities in the manufacturing of basic iron and steel; the fabrication of structural metal products, tanks, reservoirs and steam generators; the manufacture of other metal products, including cutlery and hand tools; and of the manufacture of transport equipment, i.e. parts and accessories for motor vehicles and their engines and other transport equipment, such as motorbikes, bicycles and manually- or animal-driven transport equipment.

The share of basic iron and steel production in the total output of the metals and engineering sector has been in the order of 40 percent since 2008, with a rising trend in recent years. The fabrication of metal products accounted for the largest share of output in this sector in 2011 (46.6 percent), but subsequently saw its output fall in absolute terms and its share drop to just 17 percent. By contrast, following a recent rapid expansion, the transport equipment sub-sector now accounts for the largest share of Ethiopia's metals and engineering industry (tables 14.1 and 14.2). Since 2008, the production of machinery and equipment, both general

¹¹⁷ The International Standard for Industrial Classification distinguishes five sub-sectors of the metals and engineering industry: basic metals; fabricated metal products; machinery and equipment; motor vehicles, trailers & semi-trailers; and electrical and electronics products. The latter sub-sector is not considered as part of the sector for the purpose of the analysis in this section, unless it is specifically referred to. One reason is the limited availability of data for these activities (which are at small scale), another is that most of electric and electronic products fall far from having metal as one of the main inputs and their manufacturing requires different knowledge, skills, technologies and inputs than the broader metals and engineering industry.

purpose (engines, pumps, furnaces, burners, etc.) and special purpose (mainly for the processing of food, beverages and tobacco) has grown fast from a low basis, but it still represents the smallest share of the sector's output. Overall, the past four years have seen a remarkable shift from activities with lower technology content to the production of goods with medium- to high technology content (table 14.1).

The contribution of the metals and engineering industry to total formal employment in manufacturing (7.1 percent in 2014/15) has been much smaller than its share in manufacturing output, evidencing the higher capital intensity and labour productivity compared to other manufacturing activities (CSA 2015). However, in recent years, the total number of workers increased, while the number of firms operating in the sector fell. Most firms in the basic iron and steel industry (and about one third of all firms in the entire metals and engineering sector) employ at least 50 people, while most firms in the fabricated metal subsector are smaller on average, employing less than 20 persons and having a relatively low level of value-added.

The distribution of employment within the metals and engineering sector in 2014/15 mirrored considerable differences in productivity among the sub-sectors (table 14.1): basic iron and steel provided 41 percent of the jobs in the sector (equivalent to its share in output), fabricated metal products 34 percent; and transport equipment 25 percent (CSA 2014, 2015).

<i>Table 14.1:</i>			
Distribution of output and employment in the metals and engineering industry, shares by sub-sector and technology content, 2011 and 2014/15			
<i>(Percent)</i>			
	<i>Output</i>		<i>Employment</i>
	<i>2011</i>	<i>2014/15</i>	<i>2014/15</i>
Basic iron and steel (ISIC 271)	38.6	41.3	41.0
Fabricated metal products (ISIC 28)	46.6	17.1	34.0
Machinery and equipment (ISIC 29)	3.1	n.a.	n.a.
Transport equipment (ISIC 34)	11.7	41.6	25.0
Low- to medium-technology activities	85.2	58.0	n.a.
Medium- to high-technology activities	14.8	42.0	n.a.

Source: CSA 2012, 2014, 2015
Note: For technology intensity definition, see OECD, at <http://www.oecd.org/sti/ind/48350231.pdf>.

The large majority of producers in the metals and engineering sector are private firms. The number of private medium and large firms in the metal and engineering industry in 2015 can be estimated at 250-300.¹¹⁸ In addition, there are more than 3000 small-scale establishments and workshops, and employing more than 4000 people (CSA 2013). These are active mainly in the fabrication of structural metal products, cutlery and hand tools. While most of these small firms are individually owned, there is also a large number of cooperatives in the fabricated metal products group.

¹¹⁸ Estimates based on data from the Ethiopian Central Statistics Authority Report (CSA, 2012), the Ethiopian Association of Basic Metals and Engineering Industries and MIDI.

The largest domestic manufacturer in the metals and engineering industry, however, is the state-owned Metal and Engineering Corporation (METEC) which employs more than 1,000 engineers and about 13,000 staff.¹¹⁹ The corporation was formed in 2010 as an alliance of nine engineering companies operating in various sectors, including aviation, armaments, plastics, and tractor and vehicle spare-parts manufacturers. Today METEC operates about 75 factories in Ethiopia, producing various engineering products, such as agricultural and construction machinery, vehicles (in assembly) and parts of vehicles, as well as electrical parts, such as transformers, power factor correctors and television sets.

METEC plays a central overseeing role for large infrastructure projects and investments in the sectors prioritized in Ethiopia's industrialization strategy. It executes important electric power projects (in cooperation with Alstom of France and the US Spire Corp.), including the electro-mechanical parts for Africa's biggest hydropower plant that is under construction in connection with the Grand Ethiopian Renaissance Dam on the Blue Nile River. Other important ongoing projects entrusted to METEC include the construction of a large coal phosphate fertilizer factory and production sites for the sugar industry. Another role of METEC, which impacts on the development of the entire metals and engineering sector, is to supply inputs to the smaller private manufacturers of metal and engineering products. For a long time, there were no significant linkages between the private firms and the state-owned enterprises in the sector, but recently METEC has started to cooperate with smaller private companies on a sub-contracting basis.

FDI in the metals and engineering sector mainly comes from China, India, Turkey and, to a lesser extent from EU countries. Over the past five years, the fast growing Ethiopian market has attracted over \$350 million in Chinese FDI in automotive and non-automotive transport, aiming at securing a first-mover advantage for future competition in the region. Indian and Turkish investments have been more in the manufacture of basic iron and steel products. An important factor in the decision to invest has been the low cost of labour and other production factors (land, electricity).

A key institution for the development of the sector is the Metals Industry Development Institute (MIDI). The tasks of the Institute are to enhance investment in productive capacity by preparing project feasibility studies, promoting feasible projects and providing consultancy services on project implementation. It also offers training for managers to raise productivity and assists firms in product design. With a view to enhance product development and human resource development, the Institute cooperates with universities, on the one hand, and supports metals and engineering firms in strengthening their own research and development capacities, on the other.

In order to help domestic firms strengthen the international competitiveness of firms, MIDI works on the development of industrial standards, conducts quality tests and supports capacity building in firms to enable compliance with these standards. Other important functions include the creation of linkages between the different sub-sectors and the provision of assistance to firms in input procurement to make them benefit from the advantage of bulk purchases. MIDI is also designed to serve as an instrument in policy formulation and implementation by providing a forum for discussion and cooperation between government agencies and representatives of private firms.

While MIDI operates under the Ministry of Industry, the Ethiopian Association of Base Metal and Engineering Industries is a private sector institution that has the dual function of

¹¹⁹ Bloomberg Business, "Ethiopian Military-Run Company Seeks More Foreign Partners", February 18, 2013. At: <http://www.bloomberg.com/news/articles/2013-02-18/ethiopian-military-run-corporation-seeks-more-foreign-partners>

representing the interests of member companies vis-à-vis the Government and strengthening links among producers, for example by facilitating subcontracting and technology transfer among them. It also arranges industry-specific training for managers and offers a common-purchase facility. Together with MIDI, it can play an important role in coordinating public policies under GTP II with the needs and aspirations of the private producers as well as in helping them to enhance their efficiency.

2.2 Recent performance of the metals and engineering sector

Output of the metals and engineering sector has been growing rapidly since the beginning of the Millennium. Between 2008 and 2011 the annual rate of output growth averaged 29 percent, and since then around 24 percent (table 14.2).

The performance of the sub-sectors differed considerably. Basic iron and steel production continued to grow solidly, whereas the gross value of fabricated metals production declined in recent years after having gone through a period of steady growth between 2003 and 2011. The fastest growing sector since 2011 has been the assembly of motor vehicles and the production of trailers and semi-trailers, where the value of output made a big leap, rising by more than 70 percent annually. Manufacturing of machinery and equipment had shown the highest output growth rate of all sub-sectors between 2008 and 2011, albeit from a very low level. Regrettably, the manufacturing surveys by the Ethiopian Central Statistics Agency for more recent years do not include data on this sub-sector.

Table 14.2:

Gross value of production of the metals and engineering sector,
by sub-sector, 2008, 2011, 2014/15
(million Birr)

	2008	2011	2014/15	Average annual growth (percent)	
				2008- 2011	2011- 2014/15
Basic iron and steel	1081.3	2563.7	6472.9	33.3	26.1
Fabricated metal products	1203.5	3100.0	2680.1	37.8	-3.6
Machinery and equipment	18.3	208.2	-	124.9	-
Motor vehicles, trailers and semi-trailers	789.9	776.1	6519.0	-0,6	70.2
Total	3093.0	6647.5	15672.8	29.1	23.9

Source: UNCTAD, CSA 2014,2015

Although the output of the metal and engineering industries is primarily for the domestic market, exports of metals and engineering products by privately owned firms have also increased rapidly in the last 10 years, albeit at a low level. After a drop in the years preceding GTP I, the value of exports of metals and engineering products from Ethiopia more than doubled since 2011, and in 2014 amounted to about \$135 Mio. or 2.8 percent of all Ethiopian merchandise exports (according to data from international sources assembled in table 14.3).

Exports of machinery and equipment, including electrical products, registered the fastest growth during the GTP I period. Recently, the export of mobile phones (not considered in the table) to other African countries has started. Exports of transport equipment grew faster than manufactures exports overall. They consist primarily of trailers and cargo bodies and are mainly destined for South Sudan and Djibouti.

Table 14.3:
Exports of metals and engineering products, by sub-sector, 2007-2014
(million dollars)

	2007		2011		2014		Average change p.a. 2011-2014
	Value	Percent of total exports	Value	Percent of total exports	Value	Percent of total exports	
Base metals and articles of base metals	38.7	3.0	30.4	1.2	38.3	0.8	7.9
Machinery and equipment, and electrical products	21.6	1.7	12.2	0.5	49.8	1.0	59.6
Transport equipment	14.2	1.1	16.4	0.6	47.6	1.0	42.8
Total	74.5	5.8	59.0	2.3	135.7	2.8	32.0

Source: UNCTAD secretariat calculations based on United Nations Commodity Trade Statistics (COMTRADE) Database

Despite the expansion of the metals and engineering sector, an estimated 90 percent of the domestic demand for base metals as well as metal and engineering products still has to be covered by imports, which in 2014 made up about half of Ethiopia's total merchandise import value (table 14.4). The above-average growth of imports of machinery and equipment reflects heavy public investments in transport, power and telecommunication infrastructure as well as private investments in the prioritized export sectors.

On the import side, China accounted for 38.4 percent of imports of metals and engineering products to Ethiopia in 2014. It was the principal source of imports for all product groups, except road vehicles. Japan was the second largest supplier of imports (24.0 percent) and the largest provider of road vehicles.

Table 14.4:
Imports of metals and engineering products, by sub-sector, 2007-2014
(million dollars)

	2007		2011		2014		Average annual rate of change 2011-2014
	Value	Percent of total imports	Value	Percent of total imports	Value	Percent of total imports	
Base metals and articles of base metals	687	11.8	828	9.3	1934	10.3	32.7
Machinery and equipment, and electrical products	1488	25.6	1821	20.5	5357	28.6	43.3

of which:

Specialized machinery	567	9.8	646	7.3	2023	10.8	46.3
Other industrial machinery and parts	226	3.9	336	3.8	922	4.9	40.0
Electrical, office and data processing equipment	348	6.0	446	5.0	1251	6.7	41.0
Telecommunication equipment	261	4.5	193	2.2	426	2.3	30.2
Power generating machinery and equipment	86	1.5	200	2.3	736	3.9	54.4
Transport equipment	668	11.5	951	10.7	2001	10.7	28.1
<i>of which:</i>							
Road vehicles	624	10.7	847	9.5	1586	8.5	23.3
Other transport equipment	45	0.8	104	1.2	415	2.2	58.6
Total	2643	48.9	3600	40.5	9292	49.6	37.2
<i>Source:</i> UNCTAD secretariat calculations based on United Nations Commodity Trade Statistics (COMTRADE) Database							

2.3 The main sector-specific challenges and constraints

Overall, many operators in the sector feel that the respective roles of MIDI and METEC in the development of the metals and engineering sector are not well defined and that coordination and cooperation among these two important public entities has been less effective than it could be. Improvements in these areas could strengthen the supportive role of both entities for the private manufacturers in the sector.

2.3.1 Raising capacity utilization

Despite significant improvements in recent years in the motor vehicles and trailers sub-sector, average capacity utilization in the metals and engineering industry is still below 60 percent. Thus, raising the rate of capacity utilization alone has a potential for increasing the quantity of output of the metals industry by 20 percent or more, especially in the base metals and fabricated metal products sub-sectors (table 14.5). According to industry managers the reasons for capacity underutilization are due to the overall environment in which the industries operate, but large differences exist in the various subsectors. In the base metals industry, the main constraint appears to be the unreliable supply of energy and insufficient access to working capital, whereas the sub-sectors further down the value chain and engineering activities are particularly affected by unreliable supply of inputs, as well inadequate fiscal and customs arrangements and banking practices that put firms at a disadvantage vis-à-vis foreign competitors. Furthermore, firms in these sectors partly suffer from insufficient know-how and a shortage of skilled labour.

Table 14.5:

**Capacity utilization in the metals and engineering sector^a
by sub-sector, 2011 and 2014/15
(percent)**

	2011	2014/15
Basic iron and steel	53.5	37.9
Fabricated metal products	59.9	51.0
Machinery and equipment	53.9	n.a.
Motor vehicles, trailers and semi-trailers	45.9	82.2
Average all sub-sectors	53.5	54.3
<i>Source:</i> CSA 2012, 2014,2015		
<i>Note:</i> (a) Actual production in percent of yearly output capacity.		

2.3.2 Improving input supply

Raw materials for the metals and engineering industries are essentially iron and steel and intermediate products, as a non-ferrous metal industry does not exist at the moment. Despite considerable iron ore deposits in Ethiopia, there are practically no mining activities. It follows that almost all the raw material is imported, locally available raw material being limited to scrap metal, which is recycled by domestic steel mills to produce bars and billets. The problems with the supply of raw materials refer as much to quality and technical specifications, as to timely availability and price. Iron and steel shipments from Ukraine, traditionally one of Ethiopia's major suppliers, have lately been disrupted at source due to the critical political situation there.

Reducing import dependence of the metals and engineering industry will take considerable time. Thus, enhancing the efficiency of the logistic arrangements for imported inputs and the import duty regime remains a key challenge. It strongly influences the productivity of the sector and the willingness of domestic entrepreneurs to invest in productive capacity and to undertake new ventures or further expand existing activities.

(a) Improving transport, logistics and infrastructure

The procedures that are applied by the Ethiopian Sea Freight and Logistics Service Enterprise for imports of inputs do not always seem to be clear to importers and to adequately reflect the priority given to the expansion of the metals and engineering sector (see chapter VII). Production activities are also hampered by unsatisfactory practices of the multi-modal transport system and the timing of the import duty payment for imported inputs.

Frequent power cut-offs and energy losses are one of the biggest problems for the metal and engineering industry and a major reason for low capacity utilization, disruptions in the flow of production and unreliability of delivery.¹²⁰ Similarly, although considerable progress has already been achieved in telecommunication services, shortcomings in this area continue to impact negatively on the efficiency of the metals and engineering sector in all aspects of its operations.

(b) Solving fiscal and customs issues

Interviews with managers from the industry suggest that the current level and structure of import duties and taxation are not always supportive to a smooth production flow and to shifting the supply from imported to domestically-produced metal and engineering products.

¹²⁰ Reportedly, many firms have made payments to the Ethiopian power service, the National Utility House, for the installation of power factor correction systems, but in many factories these systems have not yet been installed.

This is a particular concern in the assembly industry, which forms an important part of the metals and engineering sector. Local manufacturers and assemblers benefit from a 30 percent custom duty preference compared to imported finished machinery and equipment, but this benefit can only be obtained if the local value-added content of the assembled product accounts for at least 30 percent of the final value, a prerequisite that is hardly possible to fulfil given the level of local wages and the specific nature of assembly production.

Another problem of day-to-day practice, related to imports of parts for local assembly, occurs when items of an import order are missing in the delivery or when they do not exactly conform in terms of the quality or specification ordered. In such cases, the import duty is often levied twice – for the missing or impaired item and for its replacement. Furthermore, manufacturers or assemblers have a need for a contingency stock of parts to avoid undue interruptions of their production, but the tariff system does not allow for the import of items for such purposes and firms are obliged to pay a higher tariff on imports that serve to as a reserve stock.

Another issue for manufacturers in the metals sector is the availability of scrap metal, the domestic supply of which is centralized under METEC but does not meet the domestic demand. Imports of scrap metal are subject to a five percent import duty whereas imports of finished products, which could be produced locally from scrap metals, are duty free. This has raised concerns among domestic manufacturers of such products that they are at a competitive disadvantage vis-à-vis imports.¹²¹

2.3.3 Refining financing and investment policies

Regrettably, the most recent official data available for investment in productive capacity in the metals and engineering industry is only dated 2011. At that time, there was a remarkable degree of underinvestment in the metals and engineering sector. While over the entire manufacturing industry new investment equalled 26 percent of fixed assets in 2011, in the metal and metal engineering sector this ratio was only 16 percent. Investment by private firms represented just 13 percent of fixed assets, while the ratio for public firms was a sound 37 percent (CSA, 2012).

The metals and engineering sector is generally more capital intensive than other sectors, which makes firms operating in this sector especially sensitive to financing constraints. Access to credit remains difficult, in particular for SMEs, which often have to rely on expensive micro-finance schemes (see also chapter IX). Working capital requirements are also high. Since firms have to import most of their inputs, they are obliged to keep high inventories and for long periods to avoid stock-outs.

Although, on average, the financing needs of firms in the metal and metal engineering sector are stronger than in other manufacturing activities, their access to finance is by no means preferential, let alone sufficient, and firms are strapped for resources. Credit is scarce, payback periods are tight, supplier credit is not allowed and the requirement of 30 percent own equity in cash to qualify for a loan from the DBE is too heavy for local investors given the magnitude of the investments needed to operate in this sector. Large firms are relatively better off since they are well established and already have fixed assets to use as collateral, whereas for small and medium-sized firms the absence of credit not only hinders daily operations but also limits their possibility of expansion, including upscaling and technological upgrading.

¹²¹ See, for example, P. Belete, “Metal industry says concerns need heard”, in *Capital*. At: http://capitalethiopia.com/index.php?option=com_content&view=article&id=874:metal-industry-says-concerns-need-heard&catid=35:capital&Itemid=27.

Although the metals and engineering sector is considered a priority sector for industrial development, neither the private nor the public banks have so far devised a sector-specific lending scheme that would facilitate the financing of investment in productive capacity. Moreover, according to managers in the metals and engineering industry, official commitments to, and policy directives for, priority treatment of the sector in the allocation of foreign currency have not been followed consistently in practice. Financial institutions seem to give preference in foreign exchange allocation to importing traders rather than the local metals processing and engineering firms themselves, although it is the latter that are crucial for the generation of domestic value-added, the application of imported new technology and the reduction of import dependence.

According to managers in the metal and engineering industry, the current investment policy has a tendency of favouring foreign investors over local entrepreneurs. For example, FDI permits are reportedly given before an in-depth assessment has been made whether there are potential domestic entrepreneurs willing and able to undertake the same type and scale of investment. Moreover, managers feel that the import tariff system does not facilitate investment in new productive capacity by applying lower tariffs or import duty exemptions for imports of capital goods or engineering and industrial building items for new factory constructions.

2.3.4 Strengthening entrepreneurial and workers skills

Lack of adequate skills, both at entrepreneurial and worker level, is a serious constraint to competitiveness and growth in the metals and engineering sector, and it also hinders full capacity utilization of current plants. Technical capabilities on basic elemental technologies such as casting, hot and cold rolling mill, metallurgy and foundry need to be developed in order to create a sound industrial base from where to expand (MoST, 2011).

Advanced technical skills in automation and operation and maintenance of computer numerical control machine tools are needed for the efficient functioning of modern machinery and equipment, particularly in the metal engineering industry. These skills are just not available at the required levels locally, and firms must engage expensive foreign technical expertise and spend large amounts of foreign exchange for maintenance fees and imported spare parts and accessories (MoST, 2011).

Specialised technical skills are also necessary for the successful adoption, imitation, modification or development of new products. Currently, reverse engineering is the most frequent method used for product development in the metal engineering sector in Ethiopia. Other, sometimes complementary, techniques such as mechanical design, CAD, mold design, strength analysis and product testing are rarely applied, resulting in products of low reliability and inferior quality when scaled-up (MoST, 2011).

More general manufacturing skills that are decisive for productivity, such as production management and planning, process engineering, maintenance management and cost reduction, quality control and productivity improvement, heat treatment, energy conservation, cooling and lubrication, are lacking across the board. For instance, quality and productivity improvements should be able to bring the astonishingly high 32 percent metal scrap rate, compared with 5 percent in other countries, closer to standard industry levels, but such managerial skills are missing (Dinh et al, 2012).

2.4 Options for advancing metals and engineering activities

Options for expanding metals and engineering activities in the coming years are determined by the technical capabilities that are available, or can be expected to become increasingly available. Generally, assembly industries could be expanded in relative short time and would

offer considerable opportunities for learning by doing and product upgrading, and thereby widen the capacity for entering potential export markets in neighbouring countries. Otherwise, options for expansion are better in areas where domestic demand is likely to grow strongly in light of GTP II objectives and/or where the industry has made some inroads in several export markets already. These include:

- sponge iron from potential local iron ore extraction for steel production; investment operating costs for such plants are relatively low;
- basic iron and steel and non-ferrous metals products that are essential inputs for other prioritized industries, where firms currently have to tie substantial working capital in foreign currency;
- tanks, reservoirs and other metal containers for upgrading storage facilities in the context of developing large-scale commercial agriculture and expanding manufacturing activities in the other prioritized sectors;
- steam, other vapour generators and super-heated water boilers as they are used for the production of electricity or for heating materials in manufacturing processes;
- fabricated metal products for household use, such as kitchen receptacles, cutlery, baths or sinks, or as inputs to artisanal or industrial production and construction; SMEs tend to perform well in these activities which have relatively low technology content and investment requirements;¹²²
- pumps, taps and valves, the manufacturing of which requires to develop design, casting, machining and assembling skills, and involves substantial model testing under a variety of conditions;
- other general purpose machinery and equipment, such as refrigerating or freezing industrial equipment as well as ovens and furnaces for household and industrial use;
- machinery with specific applications, namely for construction, agriculture and the food processing industry;
- a range of transport equipment, in particular passenger motor vehicles and heavy trucks; these offer an opportunity to develop value chains linking small producers with larger ones as specialised subcontractors, and of indirectly opening access to international markets to them;

2.5 Public policies to raise demand for domestically produced metal products

Raising demand for domestically available, rather than imported, produced metals and engineering products is an important policy task. In this regard, public procurement can play an important role in the provision of support for nascent industries in this sector. However, the existing directives and procedures often fail to encourage the purchase of local products. The mandatory bidding requirement for public procurement often includes specifications at a level that a potential individual local supplier cannot fulfil, because its production capacity is insufficient to fulfil large orders or because of a problem of financing the production as the advance payment is limited to 30 percent of the total value of the order.

2.6 Recommendations for the metals and engineering sector

If the domestic production of relatively unsophisticated metal and engineering products could be expanded, this would free foreign exchange income for the financing of more sophisticated capital goods that cannot be produced domestically because of their higher technology content. With a view to expanding the import-substitution and export capacity of the sector,

¹²² MIDI has prepared industry profiles of some of these industries with a view to attract investments.

the following recommendations (in addition to those that relate to the manufacturing at large) emerge from the data analysis and interviews with stakeholders:

- The dialogue between government and representatives of firms, private and public, large and SMEs, could be strengthened by using MIDI more effectively. This would allow government institutions to better understand the factors that are constraining operations of the metals and engineering sector in day-to-day practice, and to better focus the design of facilitation measures for productive capacity building.
- Fiscal incentives and financing support could be better linked to the performance of companies with regard to product and process development, the degree of technology adaptation, skill improvements of employees, or number and quality of industrial linkages with other domestic firms, in particular SMEs.
- Linkages between industrial activities and research could be strengthened. Here, too, the existing institutional framework provided by MIDI should be used more effectively. Larger firms may also directly support research projects in universities and other institutions and, in turn, translate research findings into practical application.
- There is need for a more comprehensive approach to strengthening technical and managerial know-how for the metals and, in particular, the engineering sector. This should also include additional and better focussed technical and vocational education and training targeted to increasing the availability of sector-specific skills, especially in casting, welding, extruding, hot and cold rolling, and cutting and forming. This needs to be complemented with strengthening IT skills in design, manufacturing and testing. The development of entrepreneurship should also be actively encouraged, especially in the fabricated metals products sub-sector that requires less capital than the other sub-sectors and offers good opportunities for starting new SMEs.
- Emphasis may be given to the strengthening MIDI and possibly similar, but more specialized, institutions at the sub-sector level. These should support the design, product development and manufacturing process improvement, conduct market analyses, and undertake expansion and rehabilitation studies, possibly with the help of international consultancy firms. These institutions would serve individual producers with the provision of specialized know-how and information, help reduce overhead costs and enable firms to focus on the production itself. They could also serve as an instrument for the formation of managers and engineers active in the design and construction of machinery, especially for agriculture and construction, as well as light vehicles, long and flat metal products. Such institutions could also enhance the handling of technical and economic data, and facilitate the transfer of new technology from abroad through their linkages with developed countries.
- The respective roles of MIDI and METEC, especially in its role as a supplier of inputs to the private metals manufacturers, should be defined more clearly, and cooperation and coordination of their activities be improved.
- While competition between firms in the metals and engineering industry is desirable, it should also be recognized that economies of scale and scope play an especially important role for the efficient production in this sector. It may therefore be useful to consider public support for mergers among smaller producers.
- The tariff system should be more differentiated in favour of imported inputs to the metal and engineering sector, in particular assembly industries. The value-addition requirement of 30 percent of local value-added content of the assembled machinery product for benefitting from the reduced tariff for imports of unfinished metals and

engineering items should be reduced, in view of the actual value-adding capacity of the local assembly industry. Also, a greater degree of flexibility in the tariff treatment of such items for contingency stocks seems to be warranted.

- Regarding the financing of investment, it is necessary to take into account that, as a heavy manufacturing industry, the metals industry, especially the production of steel and machine tools, is more capital intensive than other sectors.
- In public investment, projects priority should be given to using the locally produced metal and engineering products. Consideration should be given to amend public procurement exigencies and procedures to strike a better balance between the need for quality and the capacities of local firms, and/or to introduce local content requirements in public procurement tenders.
- Consideration may also be given to grant tax privileges and/or advantageous financing facilities to firms in other sectors linked to the purchase of construction material or machinery and equipment from local metal and engineering firms, especially agricultural machinery.

3. The Ethiopian Chemical Industry

3.1 Production and trade of chemicals

Up to now the Ethiopian chemical industry makes a very small contribution to GDP. Activities consist mainly of blending, mixing, packaging and finishing of semi-processed chemical products. Only very few base chemicals, such as oxygen and nitrogen, nitric acid and calcium carbide are produced in Ethiopia, although there are significant local deposits of minerals that could be used for the production of base chemicals. Intermediate chemicals produced in the country include caustic potash, caustic soda, sulphuric acid, carbon dioxide, acetylene, magnesium oxide and PVC granules. The main domestically manufactured chemical-based products are soaps and detergents, paints and coatings, some personal care and pharmaceutical products as well as some pesticides.

Similar to the situation in other industries, productivity and capacity utilization in the chemical sector are quite low. One major reason is the insufficient quantity and quality of available raw materials, on top of the existing weaknesses in technology adaptation.

So far, there are almost no exports of chemicals or chemical products, with the exception of rubber. Chemical production in Ethiopia has been almost entirely for the domestic market as the Ethiopian chemical industry sector has not been in a position to produce at quality standards that would make it internationally competitive. At the same time, the supply of domestic chemical industry products has been far from meeting the domestic needs of basic and intermediate chemicals.

The majority of the medium-sized and larger companies involved in the production of intermediate chemicals and chemical-based products import practically all their raw material inputs, although some smaller producers of producers of soaps and detergents are using some raw materials of domestic origin. The prioritized export sectors are therefore highly dependent on imports of chemical products for their manufacturing processes, as is the agricultural sector, which has to import almost all its fertilizers. Thus, imports of chemicals and chemical products account for more than 10 percent of the country's total import bill.

3.2. Policies and institutions

The Government of Ethiopia is aware of the need to strengthen the domestic chemical industry, not only from the point of view of raising the sector's own contribution to income and employment generation, but also in view of its role in the value chain in the domestic manufacturing sector. The Chemical Industry Development Directorate under the Ministry of Industry (MoI) has prioritized a number of chemicals considered to be essential inputs to those manufacturing sectors that play a key role in its agriculture-based export-oriented industrialization strategy (table 14.6). Many of these essential chemicals are required for strengthening the agricultural base and some are used for further processing in the chemical industry itself or metals and engineering sector, the fast growing construction sector, as well as in the medical and pharmaceutical sector and in the production of pulp and paper.¹²³

Market dynamics and the willingness of private entrepreneurs to start or expand industrial activities in the chemical sector in Ethiopia have so far been weak. Against this background, the Government seeks to support the development of the industry with the help of a large state-owned chemical enterprise, the Ethiopian Chemical Industry Corporation, set up in 2013.¹²⁴ This enterprise, which is still at an early stage of its activities, is overseen by the MoI, will set up factories to produce fertilizers, rubber tree products, cements and other chemical products for the domestic market and for export. The Corporation will also conduct feasibility studies and design works for the establishment of new factories and the expansion of existing ones.

3.3. Challenges and opportunities for the development of the chemical sector

3.3.1 Integration into the domestic supply chain

For many chemicals and chemical products, raw materials could be available domestically. For example, there is already a local supply of caustic soda (for formic acid) and there are considerable deposits of potash (for potassium chloride and potassium nitrate), brine (for magnesium chloride and hydrochloric acid), nitrate, talc mineral and titanium. Ethanol for an expansion of the production of polyethylene, and calcium carbonate for the production of calcium carbide are also available. However, there are no facilities for extracting these base chemicals and their processing to intermediate products.

It follows that the challenge for the development of the chemical sector is threefold: First, identify possibilities to make greater use of domestically available chemical raw materials to increase the domestic supply of base chemicals. Second, increase the productivity and capacity utilization of existing chemical firms and build additional production capacities for intermediate chemicals that can be derived from domestically available raw materials. Third, strengthen the ability of the chemical industry to provide inputs for other domestic industries, in particular the prioritized export sectors, as well as for agriculture and the construction sector. Meeting these challenges would not only reduce the high dependence of the manufacturing industries and agriculture on imports of such inputs, it would also free foreign exchange for imports of other essential inputs in the fast growing export industries and create domestic industrial linkages with attendant effects on the creation of value-added and employment.

The production of nitric acid for fertilizers has started in Ethiopia, but needs to be expanded in view of the increasing needs in agriculture. Although the basic raw materials for PET and

¹²³ See Embassy of the Federal Democratic Republic of Ethiopia in New Delhi, "Investment Opportunity in the Chemical Sector in Ethiopia", 2014. At:

<http://www.ethiopianembassy.org.in/investment/Opportunity%20in%20Chemical%20Sector%202014.pdf>

¹²⁴ See Chemicals.technology.com, *Ethiopia to establish Chemical Industry Corporation*. At:

<http://www.chemicals-technology.com/news/newsethiopia-establish-chemical-industry-corporation>, posted 4 January 2013

PVC are not available in Ethiopia, an increase of the local production of PET and PVC (from PVC granules) for packaging and other uses appears to be possible and desirable to reduce foreign exchange costs of the export-oriented industries. In addition, once their production has taken off, export opportunities may to arise for these products, especially in neighbouring countries. The latter is also true in the case of formic acid, polyethylene and talc.

Table 14.6:

Chemicals and chemical products used in key economic sectors					
<i>Sectors</i>	<i>Prioritized export sectors</i>		<i>Other important sectors</i>		
	Textiles and leather products	Agro-food processing, incl. agriculture	Metals and engineering	Construction	Medical and pharmaceutical
<i>Chemicals</i>					
Formic acid	X	X		X	X
Hydrochloric acid		X	X		X
Nitric acid		X	X		
Potassium chloride		X			
Potassium nitrate		X	X		X
Magnesium chloride	X	X	X	X	X
Polyethylene		X		X	
Calcium carbide		X	X		
Polyethylene terephthalate (PET)	X	X	X		
Poly Vinyl Chloride (PVC)		X	X	X	
Talc	X			X	X
Titanium dioxide		X		X	

3.3.2 Adaptation of technology and international industry standards

In order for the Ethiopian chemical industry to accelerate its growth and to catch up with suppliers from abroad, it has to raise the pace of technology adaption. The challenge here is to improve and institutionalize technology transfer mechanisms.

So far, most of Ethiopia's chemical production is not ISO certified, most of the chemicals released in the country are not environment-friendly, and most plants do not dispose of emission-mitigating equipment. Adaptation of chemical production to international technical, environmental and quality standards and certification requirements is essential not only for raising the quality of output of the chemical sector itself but also for better quality of products at subsequent stages of the value chain. This would impact positively of those sectors' international competitiveness.

3.3.3 Raising efficiency and output potential

Raising productivity and capacity utilization in the chemical industry is possible to some extent without new investments in productive capacity, but requires improved labour skills and management know-how, as well as an improvement in trade logistics, to avoid delays in the delivery of essential inputs.

Higher productivity and efficiency will also require technology upgrading, which comes with investment into the import of machinery and equipment. For the envisaged expansion of output, over and above what can be achieved by increased capacity utilization and higher

productivity, considerable additional productive capacity will be needed. Hence, significant financial resources, to finance these additional investments, will be indispensable. One challenge for effective policy support to the chemical industry is therefore to find ways to facilitate access of firms in the chemical sector to financing and foreign exchange (see chapter IX). But the efficient use of an enlarged and technologically upgraded productive capital stock also depends on the availability of additional semi-skilled and skilled labour and competent managers. In this regard, another challenge is therefore to identify the gaps in human capital formation and to fill these gaps by adapting the relevant areas of education and training in both the public and the private sector to the specific needs of the chemical sector.

3.4 Recommendations for the chemical sector

Ethiopia should aim at substituting imported chemicals for its manufacturing sectors, construction and agriculture with intermediate chemicals that can be produced at reasonable costs using base chemicals from the domestically available raw material deposits. Once firms start an efficient production of intermediate chemicals, the Government should support their expansion into regional and international markets. In this context, additional efforts should be made with regard to prospection, exploration and exploitation of local deposits of raw materials for the development of base chemicals.

In order to fully integrate the development of the chemical sector into Ethiopia's trade and industrialization strategy, the MoI should further strengthen the focus of its support to the chemical sector on the industry's capacity to produce those chemicals and chemical products that serve as inputs for the export-oriented textiles and leather industries and agro-food processing, as well as for the construction and the metals and engineering sectors.

A strategy aimed at raising output of the chemical industry should target the improvement of productivity, technological capability, reliability and quality of inputs, as well as accelerated upgrading the technical skills of workers, managers and entrepreneurs and the creation of appropriate institutional arrangements. Since the above will require either public or private investment, it is important to take account of the financing needs in the chemical sector when it comes to the allocation of credit by the financial system. The needs of smaller enterprises, that constitute the majority of chemical firms in Ethiopia, deserve special attention in this context.

The promotion of FDI in the chemical sector could be an instrument for the chemical industry to obtain advanced production technology, technical and managerial know-how and better access to imported inputs. It can also improve the competitiveness of chemical production in Ethiopia vis-à-vis foreign suppliers and, possibly at a subsequent stage, access to foreign markets. But the costs and benefits to attract FDI to the chemical sector need to be carefully weighed against those promoting and facilitating domestic investment, which may be by easier to align with the overall domestic trade and industrialization strategy.

While there appears to be scope to reduce import dependence in the chemical sector to a certain extent, imports of many basic and intermediate chemical products will remain necessary in the foreseeable future. The expansion of the chemical sector would therefore benefit from improved access to and lower costs of imported inputs by improving logistics and border administration. In this context, the establishment of a public enterprise that acts as an import intermediary for the entire sector may be considered.

In a world where environmental and health awareness continues to grow, special attention should be given to environmental sustainability during the industrial development process. Strengthening existing and creating new institutions that help chemical firms understand the usefulness of, and compliance with, national or international technical and quality standards would be conducive to the overall goal (see chapter VI). It would also help improve the

competitiveness of domestically produced chemical products with imported ones and of the exports from the other prioritized sectors further down the value chain.

The Chemical Industry Development Directorate and public enterprises, like the Ethiopian Chemical Industry Corporation, might play an important role in implementing most of these recommendations. The possibility of public-private joint ventures and government support for mergers of several of the small- and medium sized enterprises in Ethiopian chemical sector, especially those producing inputs for the prioritized export sectors, should also be considered.

4. The Ethiopian Tourism Sector

4.1 Introduction

As a service sector, tourism can generate a large number of jobs, and in the medium term, the Government aims at making Ethiopia one of the country's leading sectors and one of the top-five tourism destinations in Africa (MoCT). The increase in global tourist travel, especially from a number of emerging market economies with a growing middle class, together with growing interest in tourism in Africa certainly offer opportunities for Ethiopia.

In 2015, the tourism sector accounted for about 34 percent of Ethiopia's exports of goods and services, for 4.2 percent of its GDP and for 3.8 percent of its formal employment. There is, thus, already a relatively solid base for further scaling up tourism in Ethiopia. Ethiopia's tourism expansion efforts meet the favourable trends and dynamics in global tourism, and successful results have been obtained in recent years. Further progress, as planned in GTP II, will have to be achieved in a highly competitive environment, both at the global and regional levels. This will require considerable amounts of private investment as well as substantial public expenditure for operational support and in investment in tourism infrastructure, facilities, new attractions, and site preservation.

4.2 Tourism capacity

In recent years, Ethiopia has considerably increased its overall capacity to host foreign guests. According to data of the Ministry of Culture and Tourism, the number of hotels' rooms grew at an annual average of 8.5 percent between 2008 and 2013, and accommodation rooms of all kinds by 10.3 percent between 2009 and 2012¹²⁵ (table 14.7). However, it is important to recognize that it is not only the number of accommodations that matters, but also the extent to which these respond to the exigencies of travellers and to international quality standards. The capacity to attract tourists to Ethiopia also depends on the availability of accommodation across the country; at present, two thirds of all star-designated hotels are in Addis-Ababa.

After a modest attempt to streamline the granting of licenses to tour operators, the number of licensed tour operators in Ethiopia has risen to over 300, with about 2,500 employees. Again, the quality of the services provided by these licensed operators is, at least, equally important as their number.

As in other sectors, FDI can make an important contribution to Ethiopia's capacity of providing tourist services, in terms of both quantity and quality. So far, FDI has made a smaller contribution to the enlargement of the country's tourism industry than it has in the Ethiopian manufacturing sector. By mid-2015 there were 5,322 licensed hotel and restaurant

¹²⁵ The most recent national data available on important variables, for example on revenue from tourism and tourism establishments, are for the year 2012. For this reason, this chapter partly uses data and estimates for more recent years using international sources.

projects, of which around 5 percent were FDI projects.¹²⁶ Of these licensed projects 823 (or 9.8%) were in the process of implementation or already fully implemented. Among these, the share of FDI is considerably higher (20.5%), suggesting that, for various reasons, foreign investors are more effective in implementing their projects than potential domestic investors.

Table 14.7:

Accommodation capacity (Number of rooms and shares by type of establishment)					
	2008		2010		2013
	Number	Percent of total	Number	Percent of total	Number
All hotels and similar establishments	13683	100	18128	100	20234
<i>of which:</i>					
5 star	794	5.8	794	4.4	n.a.
4 star	1073	7.8	921	5.1	n.a.
3 star	1368	10.0	1,691	9.3	n.a.
2 star	1527	11.2	1,465	8.1	n.a.
1 star	695	5.1	698	3.9	n.a.
Unclassified	8226	60.1	12,559	69.2	n.a.

Source: MoCT, Tourism Statistics Bulletin, 2009-12

In terms of the infrastructure needed for a well-functioning tourism, Ethiopia has made, and continues make, rapid progress. Access to the country is ensured by very good international air connection to the capital. With about 20 regional airports, Ethiopia also has the highest density of domestic flight network in Africa, and this makes air travel also by far the most convenient mode of tourist transport within the country. Ethiopia has also made major advances in expanding its railway and road networks, although the new roads had not been built with a view to enhancing the tourism infrastructure. The density of the latter has tripled in the thirteen years 2000/01 to 2013/14, which represents a great achievement by any measure. Moreover, the proportion of areas more than 5 km away from all-weather roads declined from 64.1 percent in 2011/12 to 40.5 percent in 2013/14. These infrastructure investments will help to enhance tourism, although they were not primarily undertaken for this purpose.

4.3 Recent tourism performance

In recent years, Ethiopia has gained in overall competitiveness as a tourist destination, but is still lagging behind many other African countries. In the 2015 Travel and Tourism Competitiveness Index of the World Economic Forum, which measures a country's readiness to attract tourists against 14 criteria, Ethiopia only ranked 118th among the 141 countries included in Index (table 14.8).¹²⁷ Nevertheless, the expansion of tourism in Ethiopia has been quite impressive in recent years.

¹²⁶ Up to date, four international hotel chains are present in Ethiopia (*Hilton, Sheraton, Radisson and Marriott*), and all these hotels are in Addis Ababa. *Hilton* is planning to build another hotel of 190 rooms for 2018 in Awassa, a major city located 285km south of Addis Ababa.

¹²⁷ It should be noted, though, that the publication of this index is primarily addressed at potential foreign investors and only partly reflects the perceptions of tourists. Moreover, several of the variables entering into the criteria of the index are arbitrary and cannot be measured quantitatively. The index may nevertheless provide

Distinct from the GTP I targets for exports in the prioritized manufacturing sectors, the targets for the tourism sector for 2015 could well be attained. Tourism arrivals were planned to more than double between 2009 and 2015, to reach one million in 2015. The figure for 2014 was in the order of 770,000 (table 14.9), an increase of 65 percent. Assuming a continuation of this trend, total tourism arrivals may have reached 875,000 in 2015. Travel for holiday and purposes accounted for around 35 percent in 2014, with slightly slower growth than the total.

Revenue from tourism has grown even faster than the number of tourist arrivals (table 14.9). For 2014, it is estimated at almost \$2,900 million, more than double the figure for 2010, already surpassing the GTP I target for 2015. Revenue from domestically provided services for foreign travellers, i.e. accommodation, restaurants, domestic passenger transport and other tourist services, are estimated to have risen by more than 60 percent between 2010 and 2012 to \$840 million. More than two thirds of income from tourism in the past few years was generated by international inbound passenger transport, reflecting the key role of Ethiopian Airlines.

<i>Table 14.8:</i> Ethiopia's Ranking in the Travel and Tourism Competitiveness Index, 2009 and 2015			
<i>Indicator</i>	<i>Ranking</i>		<i>Direction of change</i>
	<i>2015 (141 countries)</i>	<i>2009 (133 countries)</i>	
Natural Resources	63	36	↘↘
Price Competitiveness in Travel and Tourism	69	15	↘↘
Environmental Sustainability	76	109	↗↗
Cultural Resources	79	83	↗
Safety and Security	80	117	↗↗
Air Transport Infrastructure	90	97	↗
Affinity for Tourism / International Openness	93	121	↗↗
Health and Hygiene	104	133	↗↗
Policy Regulations / Business Environment	116	100	↘
Prioritization of Travel and Tourism	118	111	↘
Ground Transport Infrastructure	123	117	↘
Human Resources	126	124	↘
Tourism Infrastructure	134	122	↘
ICT Infrastructure	137	132	↘
<i>Overall ranking</i>	<i>118</i>	<i>123</i>	<i>↗</i>
<i>Overall ranking among African countries</i>	<i>19 (out of 36)</i>	<i>22 (out of 31)</i>	<i>↗</i>
<i>Overall ranking among sub-Saharan countries^a</i>	<i>16 (out of 31)</i>	<i>15 (out of 24)</i>	<i>–</i>
<i>Overall ranking among LDCs</i>	<i>11 (out of 26)</i>	<i>12 (out of 19)</i>	<i>–</i>
<i>Note:</i> The number and composition of countries included in the ranking has changed between the two comparator years. For more information about the methodology, see the source. <i>(a)</i> excl. South Africa <i>Source:</i> World Economic Forum, Travel and Tourism Competitiveness Index, 2009, 2015			

Table 14.9:

Tourist arrivals and revenue, 2009 - 2013

	2010	2011	2012	2013	2014	Annual rate of change 2010-2014
All arrivals (thousands)	468	523	597	681	770	13.3
<i>of which: arrivals by air</i>	403	450	513	586	660 ^e	13.1 ^e
<i>by origin of traveler:</i>						
Africa	140	160	169	217	232	13.5
Americas	95	96	121	130	150	12.1
East Asia and the Pacific	39	36	52	52	61	11.8
Europe	137	163	181	201	231	14.0
Middle East	42	47	51	59	68	12.8
South Asia	15	21	22	23	28	16.9
<i>by purpose of travel:</i>						
Holidays / leisure	171	183	191	232	269	12.0
Other personal purposes	183	199	217	261	287	11.9
Business and professional	114	141	188	189	214	17.0
Revenue (\$ million)	1,434	1,998	1,980	2,551	2,884	19.1
<i>by type:</i>						
Travel	522	758	607	750 ^e	840 ^e	12.6 ^e
Passenger transport	912	1,240	1,373	1,801 ^e	2044 ^e	22.4 ^e
<i>Source:</i> UNWTO, e-library, April 2015; Ministry of Culture and Tourism; and UNCTAD secretariat estimates based on these sources.						
<i>(e) Estimates</i>						

4.4 Policies and institutions

Ethiopia's tourism development policy is formulated in a document by the Ministry of Culture and Tourism (MoCT 2009). It includes the following elements:

- Expansion of infrastructure and tourist facilities essential for tourism development
- Overcoming the serious capacity limitations observed in the industry
- Developing the existing and new tourist attractions in variety, scale and quality
- Increasing competitiveness in the international tourism market through promotional work and the creation of strong market ties
- Strengthening the collaborative relationship among actors participating in tourism development

The Ethiopian Tourism Transformation Council (ETTC), reporting directly to the Office of the Prime Minister, and its secretariat, the Ethiopian Tourism Organization (ETO), were established in March 2014 to provide strategic support to the tourism sector through capacity building on destination management and product development. Their tasks also include to identify and close pressing value-chain gaps, based on studies prepared jointly with the private sector and the international tourism community.

Over time, the activities of the ETTC and its supportive bodies may lead to improvements in coordination with the different actors in Ethiopian tourism. Fifteen professional and trade associations engaged in tourism also conduct regular consultative meetings through the coordination of the MoCT.

During the GTP I period, the World Bank has made an important contribution to policies for the tourism sector through its Ethiopian Sustainable Tourism Development Project, which offered for the first time a holistic development approach, including roads construction, site development, visitors’ service enhancement, product development, and marketing, as well as capacity building for actors in the tourism sector (World Bank 2015).

A major success of the Government's efforts to promote the country as tourist destination has been Ethiopia’s election for the World’s Best Tourism Destination Award 2015 by the European Council for Tourism and Trade.¹²⁸ Even though the selection criteria for this award may be debatable, the choice of Ethiopia suggests that the country’s potential for tourism, also in competition with other countries, is increasingly being recognized internationally.

Investment in star-designated hotels (including resort hotels), motels, lodges and restaurants and tour operations is open for foreign investors (regulation 270/2012). However, FDI in the tourism sector does not enjoy the same advantages as in other sectors. There is an import-duty exemption for imports of capital goods and spare parts (with a value of up to 15% of the value of the initially imported capital goods), but this exemption is granted for a maximum of five years, whereas there is no such time limit for investments in manufacturing and agriculture. Moreover, for hospitality establishments, including star-designated hotels and establishments in remote and protected areas, there is no temporary exemption from corporate income tax.

GTP II targets Ethiopia to collect \$6 billion from 2.1 million tourists by 2020, and that tourism will then contribute 5 percent to GDP.¹²⁹ The ETO has also set targets for destination management and marketing. It plans to upgrade 15 destinations to world-class standards and to promote the Ethiopian National Tourism Brand to 250 million potential travellers, using all promotional mixes and outlets. Furthermore, 20,000 people who indirectly or directly provide tourist services should be trained over the next five years.

To spearhead GTP II, the Ethiopian Sustainable Tourism Master Plan (MoCT 2015) sets out 10 Strategic Pillars, priority projects, and activities in a long-term implementation framework covering 2015–2025 (table 14.10). If properly implemented, this Plan will go a long way in meeting reducing current constraints on the development of holiday and leisure tourism in Ethiopia (see section 4.6).

Table 14.10:

Strategic Pillars of the Sustainable Tourism Master Plan (2015-2025)

Strategic pillar no.	Title	Estimated cost <i>(million birr)</i>
1	Policy, Regulatory and Institutional Framework	156
2	Tourism Product Development	1,462
3	Tourism Marketing and Promotion	951

¹²⁸ See European Council for Tourism and Trade, “Ethiopia hosts World Best Tourist Destination Ceremony and visit of ECTT President”

At: <http://ectt.webs.com/apps/blog/categories/show/1206458-world-best-tourist-destination-award> .

¹²⁹ *The Eminence*, 11 August 2015.

4	Investment in Tourism Facilities and services	957
5	Human Resource Development	606
6	Tourism Research and Development	52
7	Tourist Safety and Security	130
8	Tourism Support Infrastructure and Services	155
9	Conservation and Preservation of Natural and Cultural Resources	814
10	Tourism Development Financing	23
	TOTAL	5,306

4.5 The potential for developing tourism in Ethiopia

Attracting international tourism requires a positive image of the country in the world. In this regard, Ethiopia's relative political stability, social peace and rapid economic development over the past decade are certainly assets, as is the international presence and good reputation of Ethiopian Airlines as a well-connected international air carrier.¹³⁰

Competition for international tourists is facilitated by Ethiopia's country-specific advantages, in particular its cultural heritage and its extraordinary landscape. Ethiopia now has 11 UNESCO registered heritages and is rich in immovable cultural heritages. Studies confirm that tourists are particularly attracted to UNESCO registered sites. Ethiopia also disposes of numerous nature attractions and protected areas.¹³¹ In particular, the Great Rift Valley in the Afar Region, with its unique ethnic culture, has as a great development potential for tourism. In the environs of Addis Ababa, there are ample sites of touristic interests that can be promoted and included in domestic and regional tour itineraries.

Other advantages upon which Ethiopia can build in scaling up tourism are its relative proximity to Europe and to countries with fast growing outward tourism, such as China and India. Ethiopia's tourism sector also ranks well in terms of international price competitiveness. Moreover, as the seat of the African Union and the UN Economic Commission for Africa, Addis Ababa is an important destination for diplomatic and conference travel.

4.6 Constraints and policy challenges for further development of tourism

Major progress has already been achieved in the development of international tourism to Ethiopia. Business travel has been the fastest growing segment in recent years, and it is set grow further as a result of Ethiopia's increasing international trade linkages and the presence of foreign firms in the country. Regarding holiday and leisure tourism, Ethiopia's considerable potential has to be nurtured further. Looking ahead, it will be necessary to elaborate a clear strategy in regard of defining the type(s) of tourism Ethiopia wants to offer, analysing the most binding constraints, and identifying promising and feasible entry points for tapping the international tourism market. This requires setting up clear priorities and sequencing in the development of different segments and areas of tourism. Since the objective of tourism development is to generate benefits for the Ethiopian economy and population as a

¹³⁰ The state-owned, but privately-managed, Ethiopian Airlines is Africa's fastest growing and most profitable airline. It offers passenger flights to 83 international destinations, 34 of which outside Africa. See M. Tafirenyika, "The changing face of Ethiopia", *Africa Renewal online*, August 2015. At: <http://www.un.org/africarenewal/magazine/august-2015/changing-face-ethiopia>.

¹³¹ 21 national parks, 2 wildlife sanctuaries, 3 wild life reserves, 6 community conservation areas, 2 wild life rescue centres, 20 legal hunting places and 68 specially conserved forest areas.

whole, it is also necessary to ensure that additional inbound tourism is linked to the development of other sectors of the economy and generates benefits for small and medium-scale enterprises around tourist destinations.

4.6.1 Visa requirements

The travel visa regime on inbound travel has a strong impact on tourism (AfDB 2013a, 2013b, 2014; European Commission 2013; Lawson and Roychoudhury 2013). Ethiopia has a reciprocal visa exemption protocol with the Republic of Kenya while visa-on-arrival is granted to nationals of 35 countries. However, travellers, especially from developed countries, are not comfortable with the idea of visa on arrival. Even worse, for all other nationals advance visa is required and processing may take considerable time. Visa requirement and long delays of processing are likely to be counterproductive and may lead to a competitive disadvantage of Ethiopia vis-à-vis other destinations.

4.6.2 Accommodation, auxiliary services and public utilities

Although investment in hotels and restaurants in Ethiopia has grown over the years, driven by the strong demand for accommodation and certain incentives for investors, there is apparently a big gap in supply and demand for accommodation in star-designated hotels throughout the country. So far, the total number of accommodations in protected and eco-tourism areas is dismally low. Eco-tourism is becoming ever more popular, especially among potential travellers from Europe, but there are at present less than 15 eco-lodges in the entire country.

Despite huge efforts by the Government to upgrade public infrastructure in all areas, infrastructure problems are still putting constraints on the development of tourism. Appropriate public transport infrastructure within the country matters not only for the accessibility of tourist sites, but also because it is a precondition for viable private investments in hotels and restaurants around these sites. Insufficient regional and local transport infrastructure is also a constraint at a time when the speed of transport from the capital to tourist destinations in the countryside impacts on the planning of tourist trips. This is particularly the case of tourists from Asia and those visiting several African countries during one single trip, which tend to travel under a certain time pressure.

Intermittent supply of water and electricity, and inadequate sanitation and hygienic equipment, including the public toilet system in many parts of Ethiopia represent other constraints to the development of the sector. Even in Addis Ababa, basic enablers for easy movement of tourists, such as tourist information bureaus, reliable city maps and a standardized and well-regulated taxi system, are lacking. Also, internet connectivity (though improving) and processing of international payment cards are two cardinal sources of complaints of tourists. Convenient places for eating and drinking in the countryside are seriously lacking, although they could easily be developed as decent sources of income in local communities.

Additional and better quality hospitality services require additional investment and adherence to international standards, together with innovative approaches that take into account the specificities of the country and its regions.

With regard to expanding and upgrading accommodation and hospitality capacity, a central challenge is to strengthen the willingness to invest and to improve access to investment finance. While the willingness to invest can be influenced by the provision of fiscal and financial incentives and facilitation of access to land, the profitability of such investment rests to a large extent on infrastructure improvements in and around tourist sites. Thus, the provision of incentives and infrastructure development has to be well coordinated: transport infrastructure is necessary for tourist to get to the tourist sites, accommodation is necessary

for them to stay and to generate income and employment. On the financing side, attracting additional FDI may fill part of the gap, but except for the hotels belonging to international hotel chains, existing and possible new tourism establishments in Ethiopia are small- and medium-sized enterprises, which are generally suffering from limited and complicated access to finance.

Another key issue for the hospitality sector is absence of official professional standards. The hotel industry undertakes self-star-rating, but in the absence of third-party standards incentives to continuously upgrade service quality are weak. The MoCT has started to tackle this challenge, with the technical support of the United Nations World Tourism Organization. In this context, guidelines and criteria for hotel grading have been developed, and some 400 hotels have been subjected to rating of standard in April and May 2015.¹³² In order to support the grading process and to build domestic capacity for follow-up controls and ratings, Ethiopian staff has been recruited and undergone a rigorous month-long training. The MoCT is also currently preparing manuals for the grading of tour operators, tour guides and interpreters. The next challenge will be to ensure compliance by the rated establishments and regular controls by designated institutions.

The more remote protected areas of the country may benefit from the increased interest in ecologically sound and sustainable forms of tourism and extension of related community-based activities. So far, ecotourism in Ethiopia is a rarity and community-run accommodations and supplying of food items to tourists are far in between. Improvements in this area would help to increase benefits arising from tourism for local communities with a clear impact on poverty reduction in the rural areas. The challenge here is to sensitize rural communities, especially those in the proximity of major tourist attractions, about the gains that can be gained from sustainable tourism and to support them to benefit from it.

4.6.3 Availability of trained labour

The tourism sector employs a large number of semi-skilled and skilled labour. In Ethiopia, human resource development remains to be a major critical issue for the expansion of tourism. Generally, there is unfulfilled demand for trained labour in the hospitality profession, especially for hotel middle-level managers, receptionists, housekeepers, cooks and tour guides. Interpreters are also in short supply.

Several new university faculties offer undergraduate programmes in Tourism and Hospitality Management, and some exchange programmes with European and United States universities are exposing young professionals to foreign experiences and bringing in international expertise. There is also hospitality training in private sector training institutes as well as in the state-run tourism institute in Addis Ababa, and vocational schools have mushroomed in the last decade. Yet, all these institutions combined still fall short of supplying the necessary manpower with the right level of skills to satisfy the needs of a growing tourism sector.

Addressing this issue will require a duplication of the training and retraining opportunities for existing employees and by improving the level of hospitality and tourism schools and degrees through teachers exchange programmes and collaboration with international universities. International exposure and internships abroad will also give students a better feel for what international tourists expects in terms of service and of the level of exigencies that international hotels require. In this way, the level of service in the hospitality industry would improve as well as its efficiency and better remuneration of it for the locals. It would contribute positively to tourism development, hence to the generation of more decent employment in Ethiopia.

¹³² Results for Addis Ababa have been published in November 2015. For the rest of the country they will be published by the end of 2015.

4.6.4 Preservation and presentation of historical sites and heritages

While some of the humanity landmarks are apparently well preserved¹³³, other monuments are in bad shape as result of erosion, uncontrolled vegetation and inappropriate human activity. Well-conceived museums and trained curators are rare, and there is a lack of storage facilities and documentation systems. The quality of presentation of the cultural assets is often poor; methods and language of presentation and interpretation are below international standards and partly inadequate to meet the curiosity of tourists.

Natural reserves in Ethiopia are partly in a neglected state as human settlements and the related activities of humans and domesticated animals in protected areas are playing havoc to the natural environment and wild life.

4.6.5 Visibility of Ethiopia as a tourism destination

International outreach is essential to creating awareness about the tourism attractions in Ethiopia, but has been deficient in the past. The promotion of tourist sites and destinations to big international operators is inadequate; information for potential tourists about Ethiopia is not easily available in the most important source countries. The websites of important agencies engaged in tourism are not sufficiently informative and attractive. Nor is the manner in which Ethiopia and its destinations appear in tourist guidebooks. Besides, Ethiopia, as a destination, is not promoted in first class media, and the country does not have tourist information centers in major source countries.

In marketing Ethiopia as a future tourist destination, it will be important to take account of the trends and structures that have been discussed above, and to capitalize on the designation as the “World’s Best Tourism Destination 2015” (see sub-section 4.3). It is important to provide better information on the offerings of Ethiopian tourism to international tour and travel operators. While focussing this information on the country’s unique cultural and historical assets, the aspects of nature and adventure should not be neglected (see, for example, Biazen 2009).

To be sure, broad dissemination of information about the possibilities of tourism in Ethiopia will help to lift the overall image of the country, but information about and promotion of specific tourist attractions should focus on targeted groups of potential travellers. Such promotion could take the form of family-oriented trips for specialized tour operators.

Given the specific circumstances of Ethiopia, its chances to attract a significant amount of “specialized tourism” are much greater than to attract mass tourism. A precondition for the latter is that there is an attraction that has the carrying capacity to host thousands of tourists at a time, coupled with an array of hotels and accommodations that are specifically designed to serve large number of tourists. By contrast, special interest tourism usually serves tourists that are relatively well off and better educated and relatively matured in age. A growing number of tourists nowadays loathe being part of mass tourism. They seek to find their own niche and optical experiences, emphasizing own individuality. The challenge is therefore to successfully reach out to these groups and to the intermediaries in the tourism business that influence their choice. Policy makers in Ethiopia should carefully consider implementing a strategy of high yield tourism in view of the varied and experiential attractions of Ethiopia.

4.6.6 Benefitting from global tourism trends

¹³³ The ECTT points especially to the ruins of the city of Aksum, the heart of ancient Ethiopia, Fasil Ghebbi, the residence of the Ethiopian emperors during the 16th and 17th century, Harar Jugol with a large number of mosques and shrines and unique interior design in the townhouses, as well as Lalibela, a holy site with many medieval stone carved churches dating back to the 13th century.

The first challenge on the way to expand Ethiopia's tourism industry will be to identify those trends in international travel and tourism which offer the greatest and easiest opportunities for Ethiopia. One of these trends is the rapidly growing share in global tourism of travellers from emerging-market economies, especially China, Russia and Brazil. This share is expected to rise from 47 percent in 2013 to 57 percent by 2030 (UNWTO 2013) and is likely to increase further in the subsequent decades. International tourism expenditure from China is already the highest in the world.¹³⁴ It is therefore worth noting that Chinese tourists are changing their travel behaviour: while in the past they were mostly travelling in tour groups, they are currently increasingly undertaking individual and family travel.

A discernible trend among international tourists is also their increased interest in "authentic local experience", which is related to culture, history, nature, social life and cuisine. There is a growing demand for specialist and niche products, including various forms of ecologically sound tourism and adventure holidays (Christie et al. 2013).

Related to these trends in travel interest and behaviour are changes in the organization of travel on the part of tourists. Tourists from emerging markets increasingly book trips on mobile telephones. Union Pay card, of a Chinese origin, has become the most used bank card worldwide. Moreover, younger people entering the tourism market in great numbers are showing strong propension to use and trust the social media for identifying alternative, relatively cheap accommodation holiday homes, bed-and-breakfast arrangements and hostels.

As 40 percent of all international leisure tourism has a cultural component, where the interest is to acquire greater knowledge and experience of other cultures, a specific challenge for the design of the Ethiopian tourism strategy is to use its considerable scope to benefit from this type of tourism while at the same time promoting nature experience as a complement.¹³⁵

4.6.7 Integrating Ethiopian tourism in the regional setting

Tourism arrivals in Africa from the rest of the world are expected to double between 2013 and 2030 from 65 million to 134 million. But tourism within Africa is also expected to increase fast. Already 63 percent of tourism flows in Africa and 32 percent of tourist arrivals in Ethiopia are intra-regional (table 14.9). This represents both an opportunity and challenge for scaling-up tourism in Ethiopia. The expansion of global and regional tourism to and within Africa and benefit from potential spillovers from tourist travel to East African countries represents a clear opportunity. But it is also a challenge because such spillovers will not occur automatically and require that the Ethiopian tourism development strategy takes account of and integrate the strategies and tourism offers of other African countries.

Specifically, tourism to Kenya and the United Republic of Tanzania is primarily based on these countries rich wild life and natural reserves, and, like Djibouti, they are also marketing the beauty of their beaches. Ethiopia, despite its own rich natural endowment will have difficulties or be unable to compete in these areas, but it can complement the touristic offer in East Africa with its historical and cultural heritage. Ultimately, Ethiopia does not stand to benefit from positioning itself as a single tourism destination as opposed to a regional destination. Therefore, linking Ethiopia's tourism strategy with that of other countries in East Africa and the creation of one big tourism space could be of mutual benefit. Ethiopian Airlines and its tour-operating subsidiary "Ethiopian Holidays" are already promoting regional tourism packages and marketing it to outbound operators around the world.

4.6.8 Linking tourism with the development of other prioritized sectors

¹³⁴ Expenditure of Chinese citizens on foreign travel and tourism has grown almost tenfold since 2000 (Christie et al. 2013).

¹³⁵ For examples, see Christie et al. (2014).

In order to maximize the benefits of tourism development for the Ethiopian economy, the strategy should aim to integrate it with the value chain of this and other sectors. This is of particular relevance for the food sector, but also for the textiles and clothing, and furniture industry that can supply inputs to the hospitality sector.

Linkages do exist between food wholesalers on the one hand and restaurants and hotels on the other, but there is a lack of organisation on the side of suppliers. Hotel managers recognise that the main challenge, when it comes to purchasing local food, is the inconsistency of its quality and the absence of traceability, even when they are prepared to pay substantially higher prices for quality food. Food safety, a main concern for hotel and restaurant managers, is generally also not guaranteed. Best quality coffee, flowers, and meat are reported to be available only for export. Similarly, Ethiopian Airlines meets with constraints in buying more food items locally, due to insufficient quantities, quality, consistency and traceability.

Due to the absence of linkages between local production and tourism operators, massive imports are the norm in tourism value chains. This is a loss of income for small and medium-sized domestic enterprises and a leakage of foreign exchange for the Ethiopian economy as a whole. A challenge is therefore not only from to strengthen the value chains within the different industrial sectors (see chapters XI and XII), but also across sectors in order for small-holders to reap the benefits of tourism linkages. This also has a regional dimension. A large share of the food supply to Bahir Dar hotels, for instance, is coming from Addis Ababa rather than from local sources. From the perspective of integrating tourism into the overall development strategy, value chains need restructuring and reorganisation not only at the national, but also at the local level.

4.6.9 Improving coordination amongst actors in the tourism sector and with other sectors

In the past, coordination among different public entities in the Ethiopian tourism sector has been less than optimal. For example, a policy for the redistribution of revenues from tourism remains to be elaborated to ensure site preservation and rehabilitation. Also, local governments from different regions have been disputing with each other on the settlement of communities in national parks and use of the parks; tour guides accompanying tourists from Addis Ababa to the regions enter into disagreements with local tour guides as to who is legitimate to show tourists around; and the church has taken decisions of great interest for tourism, such as fees for visiting church heritages, without proper consultation with other stakeholders. The establishment of ETTC has been an important step towards improved coordination and distribution of responsibilities amongst actors in the tourism sector. The Institution now has to be used effectively to advance in coordination, both horizontally (among the different government actors at the federal, regional and local levels) and vertically (among the different actors in the tourism-specific value chain).

Another challenge is to integrate tourism into Ethiopia's overall development strategy and to coordinate activities aimed at scaling up tourism with the implementation of policies in support of other sectors in order to avoid conflicts between different objectives. Sites that are identified as high potential sites for tourism may well be targeted for commercial agriculture, manufacturing or power generation at the same time. There are several examples of such conflicting situations in Ethiopia.

4.7 Recommendations for the tourism sector

- Ethiopia needs to finalize its master plan with an ambitious yet realistic implementation strategy and time frame. Besides, the master plan must be worked out with the goal of extending the tourist season and attracting tourists during the out-of-season period. Implementation of the master plan must be subjected to a wide consultation of stakeholders and should serve as an anchor document to prepare tourist

itineraries as a guide for the selection of priority projects and for the design of a tourism promotion strategy.

- Existing and possible new destinations must be developed in terms of both tourist service and content, like for example in the Great Rift Valley in the Afar Region and in many sites around Addis Ababa. The state of amenities and auxiliary services in Ethiopian tourist destinations has to be upgraded with priority. Restoration of sites of historical significance is also essential. At the same time, the development of tourist destinations must give adequate attention to estimating the carrying limit of tourist sites.
- Potential investors should be given greater facilitation support and additional incentives to risk their capital in protected areas. This should start with close coordination between the building of infrastructure, the regulation on land lease and private investments, similar to the practices in the establishment of industry parks. In this context, consideration should be given to extend privileges for land acquisition (Lease Proclamation 721/2011) to the construction of hotels and lodges. Moreover, efforts to attract FDI to the tourism sector may be focussed on the more remote areas that are of particular touristic interest. Public-private partnerships in investment in new accommodation establishments should be considered as a possibility to make up for the deficit of private investment in the sector.
- A vigorous well-coordinated effort must be put into place to train more semi-skilled and skilled labour in hospitality professions. Model teaching hotels and other state of the art vocational schools need to be built and given the proper resources to train students following international standards. Besides, certification of skill and standard setting for tour guides, chefs, interpreters and hotel hosts/hostesses needs to be speedily undertaken. In this respect, closer cooperation between public vocational education institutions and training by private institutions should be considered.
- Easing visa policy could generate quick gains in tourism arrivals at little cost. If abolishing visa requirements for travellers from “secure” states cannot be considered as an option, the visa application process needs to be facilitated and accelerated, for example by offering e-visas, and visa-on-arrival practices should be scaled up.
- An elaborate and well researched marketing strategy should be drawn and put into effect. The marketing strategy should respond to the fast changing trends in global trends and focus on meeting the interest of specific target groups. Branding of Ethiopia as a destination that is primarily attractive for its cultural heritage, but also has to offer nature and community experiences, should be considered.
- Marketing of Ethiopia as tourist destination must be based on more and better information about, and promotion of, its tourist attractions in selected media and for targeted categories of potential visitors. Quality documentation should also be available at airports, hotels, tourist information centres and other public places. ETO is to lead this initiative with the collaboration of other public and private tourism actors. It should be noted in this context that further development of products and destinations does not necessarily have to precede promotion of specific forms of tourism. Both can and should be done in tandem. There are types of tourists, especially in Europe and North America, who are attracted by the possible experience of visiting an interesting destination even when they know that access and facilities are not easy, as long as they are not insecure.

- Serious consideration should be given to the options and possible advantages of strengthening the integration of tourism in Ethiopia into combined tourism packages for countries in the East Africa, as they are already sold by some tour operators. Ethiopian Airlines, especially through its subsidiary company, Ethiopian Holidays, could be instrumental in arranging package trips to the East African countries and considered as a model for replication. In this context, it would be useful to explore, within the framework of COMESA, how movement of people from one country to the other could be facilitated. Meantime, the simplest measure to take is to ease up visa requirements. Ethiopian Air Lines could be instrumental in arranging package trips to the East African countries. While joint marketing may help to attract additional tourists, it is also important not to lose sight of marketing Ethiopia's uniqueness.
- A proper mechanism of tourism taxes collection and redistribution should be put in place in order to complement the identification of sources of funding necessary to implement the SMTP and ensure continuity and sustainability of some key tourism responsibilities like site preservation and conservation.

PART V:

The way forward

Chapter XV:

The way forward

Ambitious objectives require bold policies

In going forward, it is important to draw the right lessons from experience and, where necessary, to adjust policies and measures for their implementation. Ethiopia's exports are expected to triple within the next five years and their composition to shift increasingly to light manufactures. In light of these ambitious objectives and the desire of the Ethiopian government to become a middle-income country by 2025, the speed of growth and structural transformation will need to be accelerated in the coming years. This will require not only heightened managerial and workforce efforts at the firm level, but also enhanced policy and institutional efforts at the sectoral and national levels.

Generally, Ethiopia's challenges in the coming years lie not so much in the design of policies and reforms but mainly in achieving greater coherence between the various areas of economic policy in support of international trade integration, and more effective implementation of the measures aimed at accelerating structural transformation. The domestic setting for continued fast growth in Ethiopia is broadly favourable. Recent and ongoing large public infrastructure investments will no doubt have a considerable impact on growth and export capacity in the coming years. Macroeconomic policies have been cautious in recent years, keeping fiscal and current-account deficits within manageable limits. But as the Ethiopian economy keeps on growing rapidly, it will be crucial to pay due attention to maintaining internal and external stability. Borrowing in foreign currency should be restricted to the financing of the foreign exchange component of strategically important investment projects, on the one hand, and to the capacity to meet the resulting debt service obligations with foreign exchange income generated by the respective investments, on the other.

A comprehensive trade strategy to guide future policy making

A key element in institution building, necessary to accompany Ethiopian producers on their way forward towards international trade integration, will be the design of a comprehensive Trade Strategy and a framework for better coordination of all trade-related policies. These have to take full account of the nexus between international trade integration, the creation and upgrading of productive capacities for industrial development and the strengthening of domestic supply chains, especially agriculture-industry integration.

The Trade Strategy must clearly identify not only the Government's trade policy objectives, strategic goals and directions, but also the interaction and synergies between trade policy in a narrow sense and all other trade-related policies. Of special importance is greater coherence between trade and industrial policies aimed at upgrading productive capacities in strategic sectors. In order to achieve this, the functions and performance of existing policy coordinating mechanisms need to be reviewed and a single overarching high-level coordinating council under the direct responsibility of the Prime Minister should be created.

Since many stakeholders and parts of government are involved in both the design and implementation of Ethiopia's export-oriented industrialization strategy, it is necessary that coordination between the different actors is not left to ad hoc arrangements. Rather, such coordination will have to be institutionalized in a leading governmental body, such as a Trade Policy Coordinating Council (TPCC). This Council should be given a clear mandate from the highest level of country's leadership to consult with all public and private stakeholders in order to achieve policy consistency and coherence of its implementation. TPCC should ensure

that all agencies that are responsible for trade-related policies – line ministries, regulatory bodies and support agencies, sectoral institutes, regional or provincial governments, the Development Bank (DBE) and the National Bank of Ethiopia (NBE) – know what their respective roles are in the overall trade strategy, are fully aware of the national development priorities, and use the Trade Strategy as a framework that guides their activities.

Use trade preferences for the benefit of industrial development

The Government should take steps that would help Ethiopian producers to benefit from preferential market access for LDCs, especially those provided under the American Growth and Opportunity Act (AGOA) and the European Everything-but-Arms initiative (EBA). Moreover, measures should also be taken to use the regional market potential in Africa and the Middle East, by accelerating accession to the COMESA FTA, which is also a necessary step towards full participation in the proposed Tripartite Free Trade Agreement among COMESA, the East African Community (EAC), and the Southern African Development Community (SADC).

Since Ethiopia's exporters, still meet with considerable trade barriers in other fast-growing developing countries, as well as non-tariff barriers and regulatory requirements and rules of origin in developed countries, it is essential that Ethiopia gives higher priority than in the past to trade agreements, at both the multilateral and regional levels. It will be important that the negotiations on Ethiopia's access to WTO are accelerated, but also that the outcome of these negotiations is consistent with the country's development strategy.

An integrated trade and industrial strategy will have to promote and facilitate exports wherever possible, but also to support the substitution of imported by domestically produced goods especially raw material and intermediate goods, where this is reasonable. This will strengthen backward and forward linkages within the economy and free scarce foreign exchange for the import of strategically important goods that, for a foreseeable future, the Ethiopian industry will be unable to produce, namely technology-intensive intermediate and capital goods.

Improve workers' skills, managerial know-how and entrepreneurial competence

In order to advance the skills and competences of workers, managers and entrepreneurs in the manufacturing sector the number and enrolment capacity of technical and vocational training institutions and the relevant high-school and university faculties should be further increased. Equally important will be a better alignment of the instruction offered by these institutions with the specific workforce and skill requirements of the prioritized sectors. The promotion of on-the-job skills training as well as sustained and comprehensive intra-industry collaboration in the areas of technical and managerial training is also critical. All this requires that the training capacities of the relevant institutions are reinforced and the competences of the training staff upgraded.

Future upgrading and diversification of manufacturing and trading activities will also require greater capacity for national research and development, and innovation in the areas of product design and manufacturing. For this purpose, industry-university collaboration needs to be extended and deepened, with the help of new centres of excellence in relevant industrial vocations. Improvements of product quality and productivity at all levels of the supply chain require structured technical and managerial training for better factory layout, manufacturing design and product development in line with international standards.

Lift supply chain constraints and tighten vertical integration

One of the most urgent tasks for existing public and private institutions and the government in the coming years will be to address the causes for operational inefficiencies and underutilization of the existing productive capacities. One major cause is the serious constraint arising from the inability of the Ethiopia's agricultural sector to supply raw material inputs in adequate quantity and quality to processors in the agro-food, textile, clothing and leather goods industries. It will therefore be crucial to enhance vertical integration between agriculture and industry. This means that industrial policy in support international trade integration must actually start in Ethiopia's agriculture and that there is an urgent need to develop schemes and institutions that link agricultural production more closely with the manufacturing industries, such as the such as Ethiopia Commodity Exchange or centres for the collection of agricultural output, public or private.

Greater efficiency of the domestic supply chain will require changes in agricultural production and marketing structures. Agricultural extension work should therefore be intensified further, with a focus on capacity building among farmers, livestock breeders and agricultural enterprises to better meet the requirements of manufacturers in the prioritized export sectors. Equally important, the infrastructural basis must be laid for an extension of the cultivated land area and an increase in agricultural productivity, including in particular extended irrigation systems.

For agricultural operators and domestic traders, this will imply adapting traditional behaviour patterns to the exigencies of integrating agriculture with manufacturing activities. In order to raise agricultural productivity and the quantity and quality of agricultural output, the promotion of horizontal linkages among farmers, larger operating units, commercialised farming, and contract farming will be essential. At the level of agricultural raw material collection and marketing, greater efficiency could possibly be attained by establishing a number of rural transformation centres linked to industrial zones, combined with the introduction of quality-related price incentives.

Addressing these constraints in a comprehensive manner is at the core of Ethiopia's agriculture-based, manufacturing-led export-oriented development strategy. Better supply chain integration will not only raise operational efficiency in the strategically important sectors, but also help to bring Ethiopia's comparative advantages to bear more effectively on the country's external trade. Strengthening supply chains in the agro-food, textiles and leather industries will require a strategic actions plan, elaborated in cooperation with private sector and standard setting agencies, and an institutional framework for the coordination of government support at all stages of the supply chain. As a certain degree of import dependence will continue in the coming years for a considerable part of the inputs to the prioritized export industries, as well as to agriculture itself, the establishment of a well-functioning national input supply enterprise, or several ones at the sectoral levels, should be accelerated.

Support compliance with international product standards

Closely connected to the challenge of improving the quality of agricultural inputs to the agro-food, textiles, clothing and leather goods industries is the increasing need for Ethiopian producers to comply with international product standards. Identifying and filling gaps in Ethiopia's National Quality Infrastructure will be key to meeting this challenge. NQI institutions should design and implement an outreach strategy providing clear, reliable and user-friendly information to both private firms and the relevant public entities on regulations, conformity assessment services, and quality enhancement services, including through competent SPS and TBT enquiry points.

Promoting the use of international standards, as a key element of a strategy aimed at

enhancing international competitiveness of Ethiopian products, requires training and investment in better farming techniques and structured technical and managerial training for better factory layout, manufacturing design and product development. Existing institutional capacities for testing, inspection and certification services have to be used more extensively. But as Ethiopia's integration into international trade advances, these capacities have to be enlarged and upgraded, and stronger efforts have to be engaged to obtain international accreditation of NQI institutions.

Further improve public infrastructures

Further large investments in public infrastructure will be necessary to enhance the efficiency of production and marketing. They will also help to crowd-in private investment in additional productive capacity by both domestic entrepreneurs and foreign companies.

Augmentation and stabilization of energy supply to the manufacturing sector and the extension of water utilities for both industry and agriculture will continue to be priorities in the coming years. Solving the problem of frequent bottlenecks in telecommunications is essential for increasing the efficiency of private firms as well as the public administration especially in Customs administration and transit procedures.

With regard to transport infrastructure, direct connection of the new Addis-Ababa-Djibouti railway line with the container terminals at the port of Djibouti and at the Modjo Dry Port must be established with urgency and Ethiopia-Djibouti cooperation in transport and logistic matters be strengthened. A continuation of rapid development of rural and regional road systems will generate significant benefits for domestic supply chains and will facilitate the development of country-wide tourism. Furthermore, the Government needs to refine its strategy for industrial zones, where sector-specific infrastructure, logistic, financial and quality management facilities are provided. It needs to be ensured not only that these zones meet the needs of businesses located there, but also that vertical and horizontal linkages, between operators in the zones and domestic firms outside these zones, are created or strengthened.

Strengthen the national logistics system and enhance trade facilitation

Establishing a single Government entity to take the lead on trade facilitation and logistics would greatly facilitate the coordinated implementation of a holistic trade facilitation reform. Prompt implementation of all elements of the National Logistics Strategy will be central to alleviating logistics constraints on the way to achieving the export objectives of GTP II.

Reliability and efficiency of the logistic services provided by ESLSE, including the multimodal transport system must be further improved. Existing regulations on using that system for all types of loadings should be better enforced, and the hard infrastructure to support this system must be completed with urgency. A more comprehensive implementation of the multimodal transport system is also needed to make customs procedures more efficient. Efficiency gains and a reduction of costs for the Customs administrations must also be sought by way of standardization, harmonization and simplification of trade procedures and documents, including through the creation of a one-stop border post with Djibouti and a coordinated extension of the Authorized Economic Operators scheme. Customs administration should also eliminate to the largest possible extent the need for paper documents; this will require new legislation that allows for the recognition of electronic processing of transactions and payments in the context of automatized customs procedures.

Optimizing trade facilitation is of paramount importance for enhancing the international competitiveness of manufacturing firms operating in Ethiopia, through its effects on the time and costs of doing trans-border business. Efforts to advance trade facilitation should take the

WTO Agreement on Trade Facilitation (TFA) as a reference point. Trade facilitation reform would benefit from the establishment of a National Trade Facilitation and Logistics Council consisting of all the relevant Governmental and non-governmental departments and agencies.

Focus fiscal incentives on investment

The fundamental challenge of strengthening competitiveness and increasing exports is inseparable from the imperative of upgrading and enlarging national productive capacities through capital accumulation and technological progress. The willingness to invest, on the part of both domestic and foreign firms, will largely depend on the extent to which the remaining constraints in terms of availability of technical and managerial skills, supply of raw materials and intermediate goods and the provision of infrastructure and logistic services can be reduced or eliminated. It will also depend on macroeconomic (especially exchange rate) stability and the easiness with which new businesses can be started or existing ones extended. But another precondition for raising the rate of private investment to more than 20 per cent in the coming years, as envisaged in GTP II, is the availability of suitable financing.

Since a large part of investment is financed from retained profits, it will be important that the fiscal and financial environments foster an export-profit-investment nexus in the sectors prioritized under Ethiopia's industrialization strategy. This may require an adjustment in the system of corporate tax privileges by linking them more closely to the re-investment of profits, rather than fully exempting profits from export activities across the board. Yet, at the early stages of a manufacturing activity, profit margins are typically small and insufficient to allow for a substantial increase in self-financed investments. Another measure that would both stimulate the willingness to invest and facilitate internal financing of such investment would be special depreciation-induced allowances that would raise both profits and cash-flows in the early stages of an investment's amortization. But it will also be essential that bank lending assumes a stronger role, than in the past, in financing investment in real productive capacity and technological upgrading: This means that the lending capacity of banks will have to be enlarged and that access for potential investors to bank loans at favourable terms facilitated.

Facilitate access to finance

An improved framework for the availability of long-term investment finance is necessary not only in the prioritized sectors themselves, but - in view of strengthening domestic supply chains - also for the modernization of the agricultural sector and agriculture-related services. Moreover, financing constraints must be alleviated not only with regard to long-term investment finance, but also in short-term financing of current activities. Arrangements for short-term credit facilities by commercial banks need to be adjusted in such a way that in the future the operations of export firms are significantly less constrained by a critical shortage of liquid working capital.

In order to enhance the role of the banking sector in the process of structural transformation, commercial banks should be incited to lengthen their maturities for investment lending and adapt their collateral requirements to the ability of SMEs to provide such collateral. In this context, the Government should consider sharing the overall credit risk of banks by extending credit guarantees or interest subsidies for loans provided in connection with strategically important ventures. The contribution of the commercial banking system to financing structural transformation could also be enhanced by imposing restrictions on lending for consumption or for other non-productive purposes, or by arrangements that facilitate co-financing of certain types of investment projects by private and public banks.

Improving access to finance also means that the DBE should increase its long-term lending, at affordable interest rates, especially to domestic SMEs, across the entire domestic supply

chains. In its lending activities the DBE, and possibly other public banks, should not select borrowers on the same criteria as commercial banks. Rather they should be prepared to assume certain risks that are inevitable in a process of structural transformation but which commercial banks are unable to assume. Possibilities should also be explored for the NBE to assume a stronger developmental role by providing more liquidity to the banking system in a targeted and selective manner, for example by offering specific re-financing facilities for commercial long-term investment loans, or by engaging in direct lending to investors in the prioritized sectors.

There can be no doubt that FDI can make a substantial contribution to meeting the capital needs for structural change and international trade integration. In order to optimize that contribution, the Ethiopian Government will have to make additional efforts to bring the country's potential to bear on actual FDI inflows. Moreover, the Ethiopian Investment Commission should further develop its one-stop-services for potential foreign investors. On the other hand, in order to ensure that FDI generates dynamic benefits for the Ethiopian economy, the Government would be well advised to develop standards and metrics for measuring and monitoring the integration of FDI with the domestic economy, especially through backward linkages, with a view to raise the contribution of large foreign-controlled firms to substitute domestically available intermediate goods for imports.

Reinforce international marketing efforts

The success of efforts geared at international trade integration will require more consequent use of existing market opportunities, but also greater international marketing efforts for Ethiopian products, on the one hand, and for Ethiopia as a production or sourcing location by foreign companies, on the other.

Efforts geared at international marketing of Ethiopian products have to start at home: Ethiopian firms have to be provided with better information on, and additional support to make use of, preferential market access for LDCs in the advanced economies, especially the preferences provided under AGOA and EBA. The AGOA Response Strategy should be broadened and implemented more swiftly and consequently. Further, public sectoral institutions and private sectoral associations must step up their concerted efforts to enhance knowledge among Ethiopian producers of demand trends in the global, regional and selected country markets.

For international outreach, internet visibility of Ethiopian export companies and sectoral associations must be substantially improved and rendered more client-friendly, and participation of representatives of Ethiopian producers in international trade fairs should be intensified, with strengthened financial support and strategic guidance from the Government and sectoral institutes. Since domestically-owned firms have little, if any, capacity to undertake international marketing efforts individually, sectoral institutions and associations must play a central role in the design and implementation of collective marketing strategies of domestically owned Ethiopian firms, especially in the clothing and leather goods sectors.

The Government and sectoral institutions should also support firms that are participating in Global Value Chains (GVCs), or aiming at doing so, to upgrade within these value chains, and also help others to identify promising niche markets. Possibilities of branding or labelling Ethiopian products should be pursued for selected products of superior quality or with unique characteristics.

Concentrate on the most binding constraints and generate synergies from all trade-related policies

In order to achieve the ambitious GTP II targets, the principal task for Ethiopian policy makers in the coming years must be to find ways of lifting the most binding constraints for faster structural transformation and manufacturing export growth. These are a rapid improvement in the quantity and quality of raw material inputs to the prioritized export industries, and facilitating access to finance for investors. Lifting these constraints is closely interrelated with progress in the implementation of all other areas of policy discussed in this DTIS. It is for this reason that synergies across all major areas of trade-related policies must be created by achieving greater coherence and coordination of these policies, based on comprehensive trade and institutional reform strategies.

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Interviews

The following people have been interviewed in the context of the work of chapters VI and XV:

Mr Teshale Belihu, Director General, ECAE

Mr Gashaw Tesfaye, Deputy Director General, ECAE

Dr Tarekegn Berhanu, SAPRAS

Mr Yoshio Izawa, Chief Advisor/Pesticide, SAPRAS/JICA

Mr Fikre Markos, Advisor to the Animal and Plant Health Regulatory Directorate, Ministry of Agriculture

Mr Tilahun Esmael Kassahun, PhD Candidate, international Law and Economics, Bocconi University, Milan, Italy

Dr Fasil Reda, National Programme Coordinator, Program for Country Partnership Ethiopia, UNIDO

Mr Asegid Adane Mebratu, National Programme Officer, UNIDO

Mr Janne Oksanen, First Secretary, Head of Cooperation, Trade, Embassy of Finland Addis Abeba

Mr Saleshi Lemma, Director-General, TIDI

Mr Yared Mesfin, Director, Cotton & Textile Marketing, TIDI

Mr G/Hiwot G/Egziabher, President, ECSA (Helsinki, June 15, 2015)

Mrs Romanwork Kassahun, Deputy Secretary General, ECSA (Helsinki, June 15, 2015, and Addis Abeba, July 3, 2015)

Mr Legesse Gebre, Standards Director, ESA

Mr Ageazi Hailemariam, Secretary General at Ethiopian Textile and Garment Manufacturers Association (ETGAMA)

HE Tadelech Dalacho Dando, State Minister of Culture and Tourism

Sisay Getachew, Adviser to the Minister of Tourism

Carmen Altes, Advisor, Ministry of Culture and Tourism

Sisay Teklu, Director, Ministry of Culture and Tourism

Busera Awel, Chief Commercial Officer, Ethiopian Airlines

Jemal Kedir, Director, Ethiopian Sustainable Tourism Development Project, World Bank

Solomon Tadesse, CEO Ethiopian Tourism Organization

Haakon Gaarder-Larsen, General Manager Hilton

Romeo A.Co, General Manager, Grand Resort and Spa, Bahir Dar

Assefa Gebeye, Deputy General Manager, Hotel Capital

Mahder Tewodros, Marketing Manager, SIDRA International Hotel

Ageazi Gebreyesus, Secretary General, Ethiopian Textile & Garment Manufacturers Association

Lude Abiy, General Manager, Hotel Association, Addis Ababa

Romeo A., General Manager, Grand Resort and Spa, Bahir Dar

Wagaw Hailu, Deputy Bureau Head, Culture & Tourism Department, Amhara Region, Bahir Dar

Getinet Fetene, Tourism and Marketing Manager, NABU, Bahir Dar

Leul Yohannes Hailemariam, Lecturer, Department of Tourism Management, University of Gondar