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Can Ethiopia Become a Manufacturing Powerhouse?



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Note: This Working Paper Series is designed to bring the analytic work of UNDP-Ethiopia and its partners to a broad audience, as a contribution to the policy agenda and debate in Ethiopia. The views expressed here do not represent the official policy or views of UNDP.

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Ethiopia is facing significant development challenges in the aftermath of a series of shocks. While the country has had high growth rates, averaging more than 9 percent between 2000 and 2017, in recent years there has been a slowdown in growth between 2020 and 2023 compared to the years to before the pandemic. The country faces major macroeconomic obstacles, with a combination of an overvalued currency, growing import bills, and depleted foreign exchange reserves. Inflation has been recalcitrant and has reached more than 30 percent in 2023. The twin deficits, fiscal and current account, have been widening, especially in the aftermath of the northern Ethiopia conflict and the Ukraine crisis. The Government has had compressed fiscal space, and defense and debt servicing have eclipsed social expenditures in the budget. The debt-to-GDP ratio has increased to 52 percent, and bank lending is expanding to support the challenging situation. Security challenges in parts of the country impact macroeconomic balances.

The challenge for Ethiopia in the years to come is to fundamentally alter the quality and impact of its growth path. While the country's growth record is undoubtedly impressive by both regional and global standards, it has neither been transformative – that is, associated with structural change in productivity, output, exports, and employment – nor generated good jobs at the scale needed to meet the needs of a young and rapidly growing population. Moreover, a focus on macro dimensions of growth has masked significant microeconomic issues that point to shortcomings in important markets for goods and services, for instance, in agriculture.

The national saving and investment rates remain low at 15 and 25.3 percent of GDP, respectively in 2022.¹ The SSA average during the period 2017–22 has been 22 percent. Both are well below rates achieved in the most dynamic Asian economies where they are at or well above 30 percent of GDP. There is high unemployment, particularly youth and urban unemployment at 23.1 percent and 17.9 percent in 2021 respectively,² high annual inflation of over 30 percent, low human development index (a composite index of a long and healthy life, access to knowledge and per capita national income measures). More than 67 percent of Ethiopia's population are multi-dimensionally poor. Social safety nets have been underfunded, and in real terms, transfer payments to vulnerable households are declining.

Despite multiple interventions to boost manufacturing industry performance in Ethiopia, it has not contributed significantly to the economy and employment. An industrial-park strategy was introduced after 2000 aiming to attract foreign direct investment (FDI) and help create employment through the creation of industrial parks. Currently, there are 13 public and 5 private parks that are built in Ethiopia. On the one hand, in the last decade, the strategy has attracted FDI of US\$740 million from more than 60 foreign investors; boosted employment by more than 150,000 workers, especially women; contributed to manufactured exports of \$500 million in 2023; and reached relatively high occupancy rates at the peak of more than 80 percent, especially in Bole Lemi, Kilinto, and Hawassa industrial parks. Manufactured exports in 2023 have reached \$575 million, which is less than one-fifth of total exports.

The manufacturing sector in Ethiopia has faced several recent challenges, partly linked to the trifecta of macroeconomic pressures, security challenges, and exogenous shocks. First, the share of manufacturing as a percent of GDP has declined from 5.9 percent in 2019 to 4.4 percent in 2022, in large part due to the combined shocks. Close to 450 firms (out of nearly 5000) have ceased production across the country in the last year. In significant part, the deteriorating security situation in the country, with conflict in both Oromia and Amhara regions, creates difficulties for businesses.

1 MOPD (2022)

2 ESS (2021)

There has been an exodus of foreign firms from many of the industrial parks, mainly due to the conflict, the Africa Growth and Opportunity Act (AGOA) suspension, and the security situation. Many firms are operating at close to 30 percent capacity. Second, food products, beverages, non-metallic minerals, and textile/apparel continue to account for more than 50 percent of the total, and there has been no product diversification. Third, there is a reversal of a trend of regional agglomeration away from Addis. The share of Addis has increased from 33 percent in 2017 to 38 percent in 2022, while Oromia region went from 30 percent to 27 percent, Tigray region from 12 percent to 9 percent, and Amhara region from 14 percent to 12 percent. In 2023, the Ministry of Industry noted the departure of 446 industries was motivated by the lack of coordinated government support, together with shortages of labour, lack of resources, finances, and infrastructure. Finally, Ethiopia continues to be dominated by small firms who are not graduating to large size.

Box 1: Why does manufacturing matter?

Manufacturing is important because it is a sector that can provide jobs, foreign exchange, and improved quality of life. Seminal work by McMillan and Rodrik (2011) show that the large gaps in labour productivity between the traditional and modern parts of the economy are a fundamental reality of developing societies. The bulk of the difference between productivity performance across countries is accounted for by differences in the pattern of structural change – with labour moving from low- to high-productivity sectors, such as manufacturing, in Asia but in the opposite direction in Latin America and Africa. In countries like Ethiopia, manufacturing is key to structural transformation. Manufacturing can help provide quality jobs for the 2 million plus youth who enter the labour market every year.

Box 2: Six facts about Ethiopian manufacturing

- > The manufacturing sector is nascent and represents only 4.6 percent of GDP and contributes 5 percent of total employment in 2023 compared to 5.9 percent of GDP in 2022. Close to 450 firms (out of nearly 5000) have ceased production nationwide due to the shocks. Ethiopian manufacturing only satisfies 38 percent of domestic demand, while 62 percent is imported.
- > Participation of manufacturing firms in exports is minimal. Only 5 percent of firms participated in exports between 1995- 2020.
- > Manufacturing firms, local and FDI, are located inside or outside industrial parks. There are eighteen industrial parks, with 5 privately developed and 13 public parks. The IPs have attracted FDI of \$740 million from more than 60 foreign investors and boosted employment by 150,000 people.
- > Larger firms exhibit better productivity performance but smaller employment growth of between 1 and 5 percent, while small and medium firms show low productivity with high employment growth of 20 percent in the last decade.
- > Firms' national average operational capacity is between 50 to 55 percent. However, many manufacturing firms operate at close to 20 or 30 percent capacity with low product diversification. Food products, beverages, non-metallic minerals, and apparel continue to account for more than 50 percent of the total.
- > The domestic private sector in Ethiopia consists of a few large conglomerates (more than twenty), large firms, small- and medium-sized enterprises, and microenterprises. The decomposition shows the following: large (2.2 percent), medium (7.5 percent), small (18.9 percent), and micro (71.4).

Key Findings

The current study focuses on the scale and capabilities of Ethiopia's manufacturing sector. The study also focuses on manufacturing exports, which are a good proxy for what are likely to be significant multiplier effects of a manufacturing spurt on other sectors of the economy. Naturally, this is not the only measure but one that can help focus and drive policy and investment.³

This study, therefore, notes opportunities for Ethiopian exports (including manufactured goods) to reach \$10 billion in overall exports by 2030 provided Ethiopia manages its challenges and undertakes reforms. This metric is important because it will provide Ethiopia with sufficient foreign exchange to handle its imports of fuel, fertilizer, and capital goods without having an unsustainable current account deficit. It does so based on interviews with firms and government counterparts, sector diagnostics, field visits to two industrial parks (Hawassa and Mekelle) and one agro-industrial park (Yirgalem), a small recently commissioned 2023 survey of Ethiopian firms, a review of academic literature, and cross-country comparisons.

A preoccupation with current obstacles to manufacturing growth misses the point. Disadvantages are not the problem; it is what countries do to address them that matters – consistently, pragmatically, and effectively. It is the ability to capitalize on strengths and address shortcomings that determine success or failure. Every country starts from a low base, and it is the ability to overcome constraints through a strategic vision, sustained reform and effective execution that determines success. Every developing country that has succeeded in manufacturing started with imperfect institutions, insufficient factor endowments and other challenges. Some were far from markets (Mauritius), some had a legacy of socialist rule (China and Vietnam), others had excessive bureaucratic licensing and high trade barriers (India) or large domestic markets (Brazil), and many began the process with relatively low levels of human capital.

Ethiopia has several major advantages. First, it has a central economic location in the Horn of Africa and a very good endowment of fertile land and water resources. Ethiopia has 54 million hectares of potentially arable land, with only one-quarter currently cultivated. It is dubbed the water tower in Africa because of its high precipitation volumes and due to its combination of mountainous areas with a comparatively large share of water resources. Ethiopia is completing the Grand Ethiopian Renaissance Dam (GERD) which has an installed capacity of more than 5000 MW. It has the headwaters of ten large rivers. Ethiopia generates 85 percent of its energy from hydroelectric plants. As opposed to many small countries, Ethiopia can capitalize on economies of scale. Second, it is one of the few African countries to have actively tried to industrialize using a developmental state framework. Third, it has a capable state with years of experience in development planning, service delivery and infrastructure development. Fourth, it has the trifecta of competitive wages, subsidized energy, and cheap industrial land that can help spur industrialization. Land leasing rates are among the cheapest in Africa compared to other countries, such as Kenya, South Africa, and Nigeria. Energy costs are cheaper than most Sub-Saharan African countries at \$0.09 per kilowatt hour. Fifth, it can leverage its success in coffee, garments, and floriculture. Finally, it has a reformist government that is committed to policy reform and green industrialization in a world of climate change.

³ Other indicators of manufacturing strength include manufacturing GDP, manufacturing employment, and total factor productivity increases in the sector.

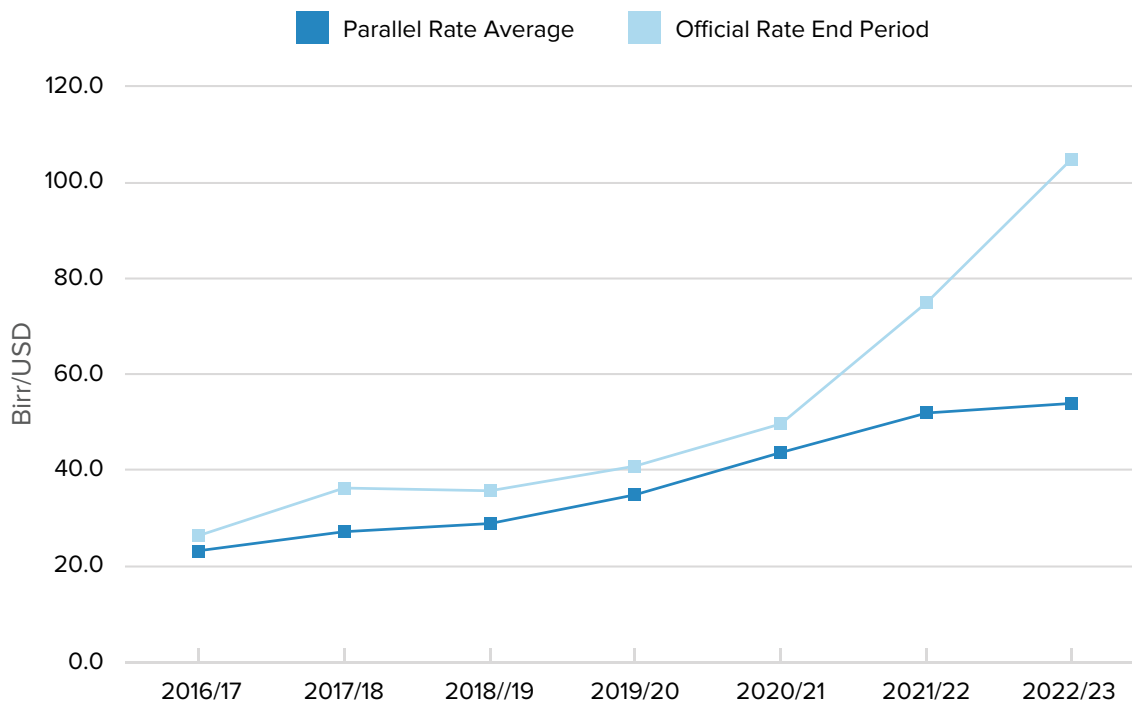
Ten Binding Constraints to Manufacturing

The study finds a set of ten connected challenges that need to be addressed to trigger a manufacturing breakthrough in Ethiopia.

- > **Peace and stability.** The sine qua non for success in manufacturing – indeed, development – will be sustained peace and stability in Ethiopia. This study does not need to tally the direct and indirect costs of conflict and insecurity – especially when they seem to become part of an ongoing cycle – as this has been done very effectively by the Government. To put it in a nutshell, they are the single biggest deterrent to investment from the private sector and, indeed, development partners as well. To take a case in point, a loss of goodwill and a perception in the investor community that Ethiopia may be a ‘country in crisis’ can be very costly in terms of their impact on Ethiopia’s ability to attract desperately needed capital, technology, and skills.
- > **Consensus-building, institutional independence, and consultation.** As Ethiopia makes a major shift from a state-driven economy to one that is more open and market-based economy powered by the private sector, it will be vital to ensure that the direction of travel and reform process enjoys broad support among elites and, indeed, the public. This is key to ensuring the sustainability of reform – and, thus, their consistent and effective execution – without which success in building a strong manufacturing sector will be difficult if not impossible. Experience elsewhere shows that three elements will be critical in this regard all of which require much more attention in Ethiopia.
 - > First, explain to the public how economic reforms can bring about greater inclusion, lower poverty, and higher living standards. And going beyond that, to build a sense of national mission to transform Ethiopia’s capabilities and performance.
 - > Second, paying attention to the development of strong and independent institutions, not least those that regulate markets and the justice system, to avoid the pitfalls faced with many liberalisation programmes in the developing world: the risk of crony capitalism. Few things can undermine the success of reforms than a widespread belief that the playing field is tilted in favour of special interest groups.
 - > Third, establishing a robust, open, and continuing conversation between the Government and private sector is essential. This is not the case in Ethiopia now. The public and the private sectors do not have a regular forum for dialogue despite the formation of the Public-Private Dialogue (PPD) in 2007. According to multiple interviewees, there is an apparent trust deficit between the two sides and the absence of an institutional arrangement that enables both to work together to identify and resolve issues and inform policy to boost manufacturing. Like many other governments, those in Sub-Saharan Africa have tended to rely on public investments financed by development partners – and, often, a network of state-owned enterprises (SOEs) – to finance development and have, thus, felt no pressing need to coordinate closely with their private sector. This needs to change.
- > **Policy uncertainty and weaknesses in private sector sentiment and confidence.** While Ethiopian policymakers have, to their credit, set out their intentions for comprehensive reform on multiple occasions – primarily through the Homegrown Economic Reform Programme (HGER) and the Ten-Year Development Plan (TYDP) – what investors, whether public or private, need now is a detailed road map for implementation that sets out the sequence, scale, and timing of core reforms. In other words, to send a strong and clear signal to the private sector, both domestic and foreign, about what lies ahead and how they can plan and prepare accordingly. This matters when it comes to manufacturing because the latter involves more ‘lumpy’ and complex investments with longer gestation periods, creating immovable capital, compared to the more flexible, movable, financing that goes into trading. A clear and credible road map will go a long way in overcoming uncertainty, boosting transparency, and providing a solid basis for dialogue with the private sector and development partners. Interviews as well as analyses of existing policy documentation and the experience of reform to date, point to this as a relatively ‘quick win’ that can build confidence and boost sentiment.

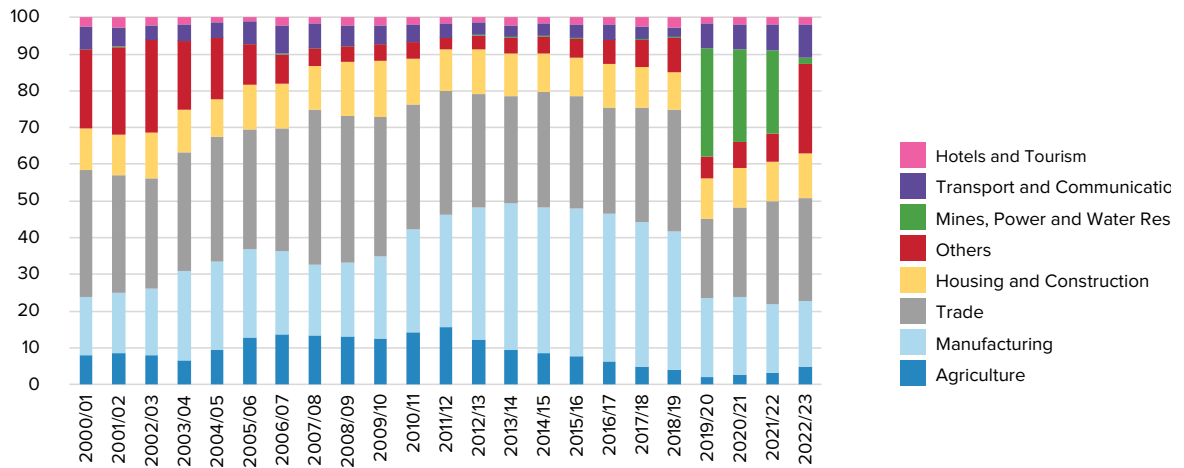
- > **Absence of a single unified domestic market.** Based on interviews and anecdotal evidence, the country is fragmenting into multiple regional markets, especially with different taxes, subsidies, and licenses across regions. This means that Ethiopia is at risk of taking a major advantage – its large potential domestic market – and inadvertently turning this into a disadvantage. Due to a poor security environment and different policy regimes in different regions, there are many internal barriers to the free movement of labour and capital throughout the country. Security checkpoints across the country, the rise of ethnic-branded banking, the difficulty of investors of some ethnicities to relocate to other regions (de facto discrimination rather than de jure), the coexistence of food deficit and food surplus areas, and the wide differential in agricultural prices are testament to a fragmented national market. The coordination between the different levels of government remains a challenge. In the Ethiopian case, although the federal government is empowered to license and administer investments with foreign components, it must depend on states to supply some vital inputs for investment, including land, which they administer. In some situations, states hesitate to provide land to federally licensed investors, as has been seen in the Gambella region.
- > **Unstable macroeconomic environment,** especially in terms of the **acute shortage of foreign exchange** which has deterred foreign investors from repatriating profits, and domestic investors, who do not have sufficient forex to import raw materials. Linked to this, the overvalued currency, which can be measured as the gap between the official rate and the black-market rate, deterring exports and subsidizing imports (Figure 1).

Executive summary figure 1: Official and Parallel Exchange Rates



Source: NBE

Executive summary figure 2: Trends in Banking Credit by Selected Sectors (percent)



Source: NBE

- > **An industrial parks strategy that needs a rethink.** A UNDP field visit to industrial parks noted that despite Government investment of \$1 billion, land availability, low wages, and subsidized energy costs, the parks have underperformed compared to the potential. This depends on location, as the parks closer to Addis have performed better. By 2022, IPs have reached \$163 million of exports and hired more than 150,000 workers. The underperformance is due to foreign exchange challenges, costly logistics, overdependence on imported inputs, lack of global market, especially textiles (due to AGOA suspension), security problems in the country, lack of sufficient domestic investors, and low level of linkages to domestic suppliers. A recent World Bank study finds even though the government has slowed down the development of industrial parks, undertaking multiple industrial park developments at the same time had spread the government's resources too thin, and that Ethiopia's industrial park programme lacked proper planning, robust demand analyses and feasibility studies, and sequencing of development based on occupancy.⁴
- > **Insufficient and costly finance.** As confirmed in the analysis, the surveys, and interviews with entrepreneurs, the insufficiency of credit is preventing firms from expanding in manufacturing. In the past two decades, much of the credit went to the trade sector (32 percent) followed by manufacturing (26 percent), housing and construction (11 percent), and agriculture (9 percent) (Figure 2). The Development Bank of Ethiopia has underperformed. From the perspective of Ethiopian banks, the manufacturing sector remains a risky investment. Ethiopian entrepreneurs have not demonstrated adequate capabilities in manufacturing and are more comfortable with trading than manufacturing due to faster profits, exchange rate incentives, and relatively lower risk compared to trading and services. Interest rates remain higher than in comparators countries, and collateral requirements pose challenges.
- > **Costly logistics.** Ethiopia remains an expensive place to move goods compared to neighbouring countries and Asian countries. Factory gates to port costs are high. Partly due to Ethiopia's landlocked status, the Ethiopia Shipping and Logistics monopoly, and the lack of private sector participation throughout the logistics chain (dry port, trucking, trains). For example, a 20 ft container from Addis Ababa to Long Beach, USA costs more than \$3500 compared to \$3000 from Mombasa to Long Beach and less than \$2500 from Dhaka and Shanghai to Long Beach.
- > **Entrepreneurial capabilities and skills mismatch at several levels.** Though they have improved in recent years, interviews showed that Ethiopian entrepreneur and worker skills could be

⁴ World Bank (2022). According to the analysis, net exports from Ethiopia's IPs grew rapidly pre-COVID, reaching \$163 million in 2019/20 and approaching half of Ethiopia's total manufactured exports.

strengthened. Many entrepreneurs are not well-versed in manufacturing and do not have strong entrepreneurial networks or support from associations. Banks report high loan defaults among manufacturers. The existing Technical and Vocational Training (TVET) graduates have a curriculum which is not linked to the labour market.⁵ Studies have indicated that various factors that explain failures of TVET institutions to deliver their expectations, including mismatch between training curricula and employers' need, quality of occupational standards and assessments, the quality of the trainers, and the lack of a match between the public sector training and private sector skills. At the end of the day, however, weaknesses in skills formation start right at the bottom of the pyramid. The exceptionally low levels of learning and achievement revealed by recent results from secondary school leaving examinations point to severe shortfalls in the quality of education. This impacts not only on the life chances of Ethiopia's young people but also on the quality of human capital and the productivity of Ethiopia's burgeoning labour force.

- > **Bureaucratic red tape and corruption.** Anecdotal and survey evidence suggest delays in licensing, bribe requests, cumbersome processes at the regional level, and inefficient services. There have been complaints by many in the Government against growing corruption in the judiciary, law enforcement and state auditors. International benchmarking and surveys also show evidence of corruption, with Ethiopia ranking 94 out of 180 countries in the 2022 Transparency International Corruption Perceptions Survey, one of the best international indicators of corruption.

Sectoral Scan Summary

Ethiopia's manufacturing sectors are heterogeneous with varying levels of performance. Several Ethiopian manufacturing sub-sectors are exporting. There has been a persistent rigidity in the structure of the foreign trade. In the early 2000, Ethiopia's total export earnings were less than half a billion \$ and it reached \$3.6 billion in 2023. Garments have expanded over the years via the industrial parks as Ethiopia tries to establish itself as a low-wage competitive destination, but Ethiopian exporters are constrained by exogenous shocks, such as AGOA suspension and domestic security challenges. Horticulture has taken off due to a combination of favourable land lease policy and a well-coordinated logistics chain. The leather sector was promising, but internal and external shocks impede the sector's development. Coffee is the backbone of the exports, but it is challenged by poor sector governance and lack of value addition.

Survey Findings

A small qualitative and quantitative survey of 70 firms was conducted from August to November 2023 to obtain the latest information on the challenges facing firms in Ethiopia. Though the sample was not large and was not fully representative, it provides useful insight that match the results of other team interviews.. Though the magnitudes may be different from a much larger survey, the key directions and constraints have been echoed previously.⁶ Based on standard Enterprise Survey, the 35 questions focus on firm size, characteristics, access to finance, corruption, taxation, business-government relations, networks, technology, logistics and infrastructure, and inputs (Annex 1).

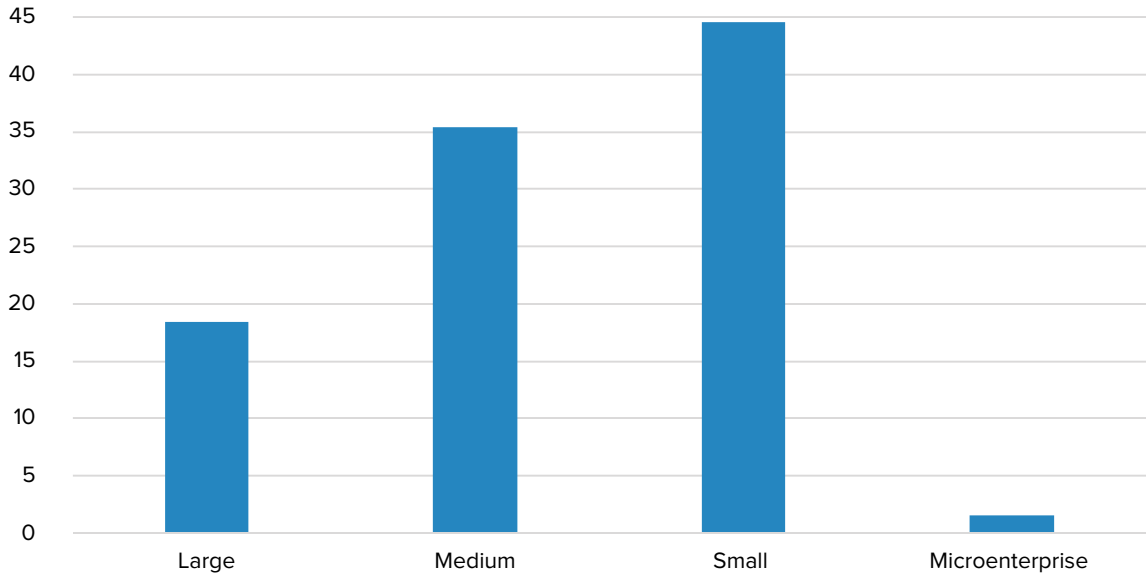
There were some interesting insights. Most firms surveyed (67 percent) were in the trading business. Only 14 percent were manufacturing firms. About 19 percent were identified as firms engaged in manufacturing and trading. While most firms in the survey were in the trading business, 83 percent expressed their interest in expanding into manufacturing. The distribution of firm sizes was approximately 45 percent small, 35 percent medium-sized, and 19 percent large firms (Figure 3). There

⁵ According to Ministry of Education, there were 582 TVET institutions in 2016 of which 86 percent are public and 14 percent private. In terms of regional distribution Oromia has 253 institutions followed by Amhara (92), Addis Ababa (90), and SNNP (74).

⁶ World Bank Investment Climate Survey (2015), UNDP (2018)

were also two microenterprises. These firms represent a diversity of sectors, including trading, food and beverage processing, garments and textiles, pharmaceuticals, and metal/steel. Over 70 percent of the firms have been in business for over 5 years. Approximately 17 percent have been in business for 3-5 years, while 13 percent have been operating for less than 3 years. Most of these firms (57 percent) were run by men.

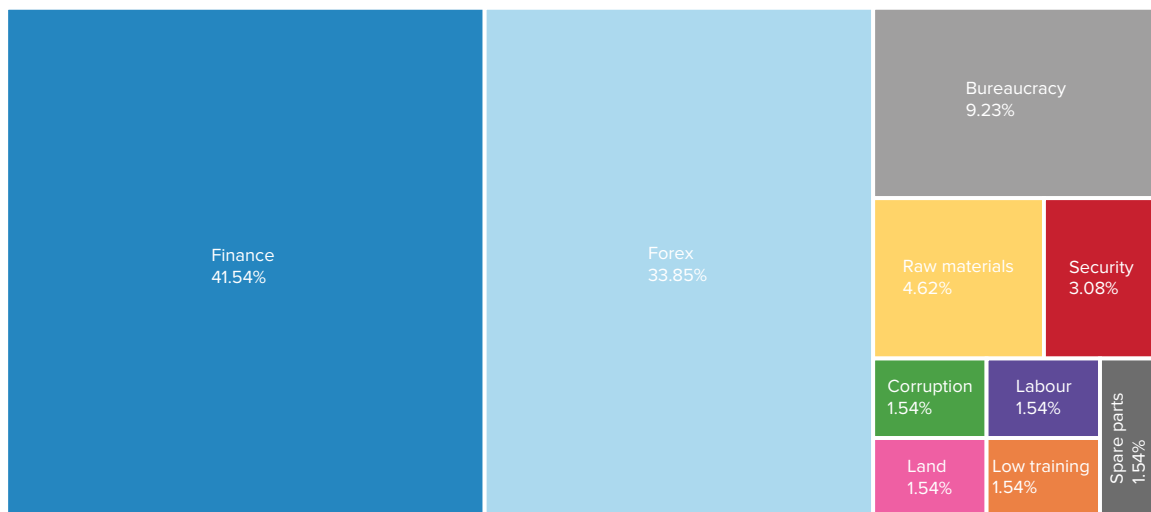
Executive summary figure 3: Size of Firms Surveyed Size of Firms Surveyed (percentage)



Source: UNDP Survey

For most firms (nearly 42 percent), the single top challenge they face is access to finance, which is also reported as the main challenge preventing them from expanding (Figure 4 and Figure 5). Only 23 percent manage to get loans from banks as a primary source of finance. More than half of the firms use their savings to finance their business. Approximately 17 percent use the savings of family and friends as their primary source of finance. In general, personal savings serve as a primary source of finance for 68 percent of firms. To generate finance, 70 percent of the firms asked for a bank loan, but fewer received loans. Collateral has been a challenge for 75.4 percent of the firms. Other **challenges** reported by firms include a shortage of foreign exchange (34 percent), bureaucratic hurdles and corruption (9.2 percent), raw materials (4.6 percent), and security issues (3.1 percent).

Executive summary figure 4: Top Challenge to Doing Business (percentage)



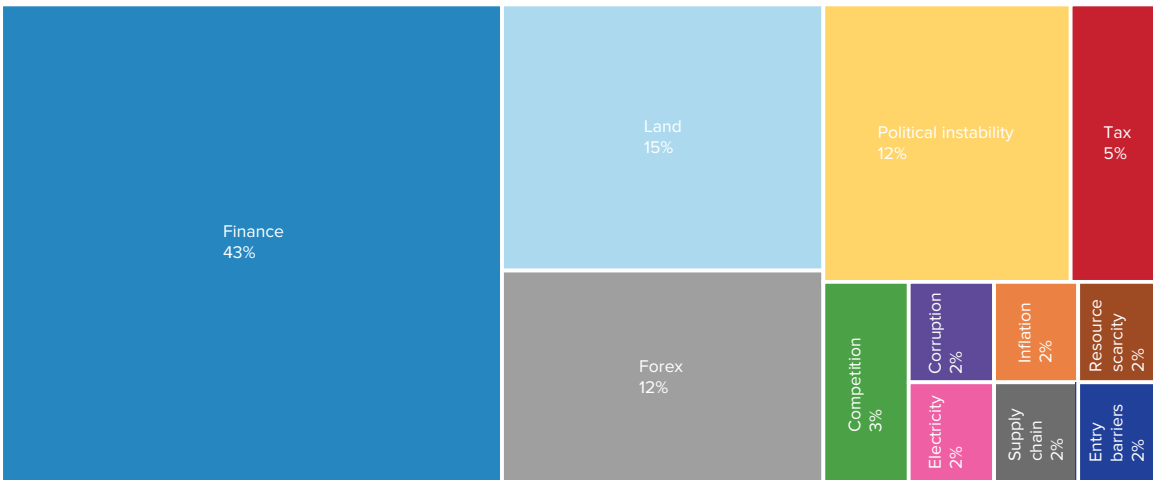
Source: UNDP Survey

Various factors are preventing firms from expanding their business (Figure 5). The prevalent

business expansion-hindering factors firms face include lack of finance, land access, foreign exchange, and political instability. About 41.4 percent claimed that access to finance is the major challenge, and 81.5 percent of the firms noted that the first four challenges prevent them from expanding their businesses. Other firms have mentioned tax rates, difficulty penetrating the international market, and informal competition as the top hindering factors.

There are concerns among the business community. Over half of the respondents (55.4 percent) believe the country’s **business environment** has greatly worsened in the last few years, while 15.4 percent said it worsened slightly. In general, a majority (70.7 percent) believe that in the last few years, the business environment in the country has been deteriorating. Only 20 percent of the surveyed firms reported they benefit from **government support**, usually in the form of access to infrastructure (25 percent), regulation (20.8 percent), policy (12.5 percent), and skills training (12.5 percent). In comparison, 63 percent of the surveyed firms said they have not benefited from government support.

Executive summary figure 5: Top Challenge Preventing Firm Expansion



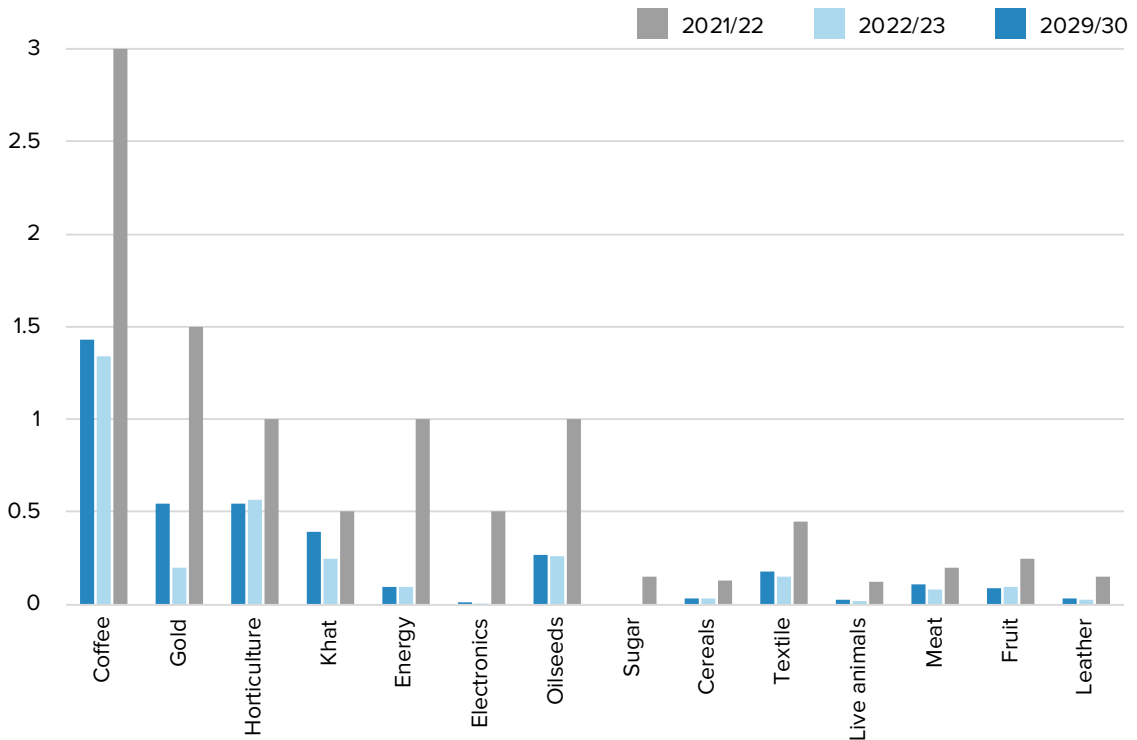
Source: UNDP Survey

Box 3: Can Ethiopia Become a Manufacturing Powerhouse?

The answer to the question is a qualified ‘yes’. First, as shown above, Ethiopia has huge advantages that it can leverage to become a success, more so than most other Sub-Saharan economies. Second, the world economy will continue to need goods and services driven by low-cost advantages and many supply chains are being reorientated for geopolitical reasons. Ethiopia can benefit from this. Third, Ethiopia should be able to overcome its challenges and constraints, but this will require political and macroeconomic stability, strategic vision and coherent, consistent, and sustained policy and institutional reform. Execution of reforms and changes in public sector attitudes to the private sector will be at the heart of credibility and eventual success. Fourth, Ethiopia will need policy predictability and not reversals that create unsettling policy discontinuities for both private and foreign investors. Finally, Ethiopia will have to learn from its own past successes and failures as it moves forward.

Ethiopia has potential to more than double exports and improve production for domestic market. A projection based on several parameters shows that Ethiopia has the potential to more than double its exports to \$10 billion by 2030 (Figure 6). Some traditional products, such as coffee, flowers, leather, and gold can increase significantly with the appropriate policies and better governance, while some new sectors have tremendous potential. Cement and pharmaceuticals are promising for domestic production but not for export as the former is bulky and the latter lacks the quality standards. The three parameters are: perspectives of sector experts, the Harvard Growth Lab assessment based on both current and potential comparative advantage, and the competitiveness of the product (including cost and global demand).

Executive summary figure 6: Ethiopia Export Potential 2030 (\$million)



Source: UNDP projections

Lessons from Asia

In the post-WWII decades, several predominantly East Asian economies (most notably Japan, South Korea, Taiwan, China, Hong Kong, and Singapore) have recorded unprecedented levels of economic growth. This catapulted their nations toward vastly improved living conditions and a seat at the international table. Much of their success is based on one element: the rise of export-oriented manufacturing. East Asia had higher rates of growth of manufactured exports, with their share of world exports of manufactures leaping from less than 10 percent in 1965 to more than 20 percent in 1990. The lessons are:

- > Asian economies maintained macroeconomic stability and competitive exchange rates to support the development of a strong manufacturing sector.
- > They targeted exports early on, exposed domestic industries to international competition and used subsidies to support exporting firms (Korea) leading to manufactured goods becoming the main export item.
- > Effective land management and a clear policy involving extensive government regulation (Taiwan), subsidized industrial land (China)
- > East Asia had directed credit programmes to industry but had performance criteria.
- > There was heavy investment in infrastructure and logistics in all East Asian countries.

Strategy and Reform Roadmap

Considering this, the country should develop a strategic reform roadmap based on five key principles that help it move forward. First, a policy framework should send sustained and consistent signals to both the private sector and foreign investors. Second, predictability, rather than radical policy shifts, should be one of the core foundations. Third, the strategy should focus on having immediate short-term actions and deeper and longer-term structural reforms that will require more planning and time to yield dividends. Fourth, Ethiopia needs to transition from a discretionary approach to a rule-based approach and reorient the political economy away from large established players and traders to new nascent firms. Fifth, the strategy should support the modernization of both the public and private sectors so they can handle the new development paradigm. This includes openness, transparency, and accountability.

Six Keys to Unleashing Manufacturing

There is no silver bullet to manufacturing success. The countries that have succeeded in becoming manufacturing powerhouses have done so over decades, maintaining a stable policy focus on the subject, being pragmatic and flexible in their approach, ensuring effective delivery of reforms and investments, and engaging the private sector as partners.

This study proposes six keys to manufacturing success:

- > First, focus on providing a **stable political and macroeconomic environment** that generates confidence. In the former case, settling outstanding issues in different parts of the country, not least Amhara, Oromia, and Tigray regions, will be vital, with the National Dialogue potentially playing a pivotal role in finding pathways to peace that enjoy broad public support across Ethiopia. It is not a coincidence that these three regions account for close to 40 percent of Ethiopia's GDP. Together with Addis, this rises to close to 80 percent. The implications for growth and development – and the prospects for a manufacturing boom in the country – are obvious. Regarding the macro economy, a policy regime which aims at a competitive exchange rate, a low rate of inflation (well into the single digits), a well-defined fiscal and monetary policy framework and sustainable debt will benefit both broader economic activity and manufacturing specifically. In other words,

a policy regime that avoids the most damaging distortions in the economy – especially price signals in different markets and the allocation of capital labour – and offers positive predictability to investors.

- > Second, **remove the main constraints to the private sector in terms of access to finance, labour, logistics, and engagement.** Several things need to change here.
 - > Improve coordination between federal and regional governments to remove obstacles to the functioning of a single, unified, national market for goods and services and to ensure that domestic investors, in particular, can invest anywhere in the country without any discrimination, whether by ethnicity, faith or any other socio-economic characteristic, thus, able to fully exercise their rights of citizenship.
 - > Shift focus to the development of small and medium-sized enterprises (SMEs) as key drivers of growth in output, productivity, exports and employment.
 - > Deepen and accelerate financial sector reforms to reduce the cost of capital and substantially improve access, especially for SMEs. Increased competition, a larger role for non-bank institutions, de-risking (for example, through innovative forms of credit scoring) and a more determined regulatory push to increase lending from banks will be essential.
 - > Urgently open the logistics sector to reduce costs that are currently prohibitive by regional and international standards. This is a long overdue yet vital reform.
 - > While TVET remains important, invest scarce resources to strengthen the bottom of the education and health pyramid, building basic skills in science, maths and languages (including English) as well as a healthy population. This will be more consequential for development generally and manufacturing in particular.
 - > Sixth, establish public-private sector dialogue to build trust and work together to solve problems, not least to propel essential business climate and regulatory reforms.
- > Third, **deal with the issue of land ownership.** It is high time to unfreeze action on this issue and to begin policy experiments to see how improvements in access to land can serve to boost investment. Constitutionally, land in Ethiopia is owned by the state, and it has been at times a contentious issue. There have also been competing claims by different regions. The coordination between the different levels of government on land issues remains a challenge. There is a lack of clarity on the identity of major investors, the size and location of land allocated by the federal government, and the investment generated. However, there have been experiments with user rights and land leases by both domestic and private investors, including in the development of floriculture farms.
- > Fourth, **address sector-specific binding constraints through a new type of industrial policy.**⁷ This will be a more targeted industrial policy that will be strategic in design and objectives. One useful definition is from a recent paper arguing that successful industrial policy uses a broader range of policies that can be more effective than the classic instrument of subsidies (or of trade policy), including customized public services and inputs that are tailored to firms' needs and target specific obstacles to productivity-enhancing investments. This approach capitalizes on synergies between government actors and private firms and addresses key sectoral constraints that inhibit industrial expansion. Pharma, horticulture, leather, and steel each have different binding constraints, and policy should be tailored accordingly.

The question remains about what to do with the industrial parks. The recommendation here is to modify the approach with these parks in three ways: first, reduce the number of parks to

⁷ Industrial policy in Ethiopia has focused on industrial parks and export promotion, trade protection, industrial financing and directed credit for state-owned enterprises to champion commanding sectors, and other administrative measures.

increase their likelihood of success; second, shift the balance between foreign and domestic investors towards greater emphasis on the latter; and third, connected to the last point, build better, especially backwards, linkages with the local economy with an emphasis on building supply chains that pull in domestic SMEs. These are exactly the kind of measures that fit well within a 'new industrial policy'.

- > Fifth, **strengthen the technological capabilities of firms.** Technology is a key ingredient of growth. Firms are important innovators and can help catalyse technological catch-up. ICT can help modernize companies, support more efficient logistics, and improve manufacturing productivity. Digital technologies can help expand and penetrate new markets. The UNDP survey indicates that 60 percent of Ethiopian firms are modifying their technologies, while 20 percent of firms are not modernizing.
- > Sixth, **design trade policy to align with industrial policy.** Ethiopia has historically been a relatively closed economy. Ethiopia's openness has been declining, measured by trade to GDP ratio, which fell from 40.4 percent in 2011 to 24.3 percent in 2021. It has had high tariffs (which have been liberalized recently), restrictions of FDI in services due to SOE dominance, and some degree of capital controls. The country is, however, quite open to FDI in agro-processing and manufacturing. Ethiopia has also ratified the African Continental Free Trade Area (AfCFTA), but implementation has been slow, and Ethiopia has not submitted the list of tariff reductions to the coordinating body. Ethiopia's WTO Accession is still in progress as well. In each of these areas, there is considerable potential for Ethiopia to liberalize further, especially in the areas of FDI in services and tariff policy.

The question that lurks at the centre of the issue of trade policy is whether there are legitimate grounds for some restrictions based on the infant industry argument. To take a case in point, the import intensity of basic consumption in Ethiopia's cities and towns suggests a market ripe for domestic manufacturers that has yet to be tapped fully, although there are signs of increased local production of consumer goods. Experience in both developed and developing countries argues both for and against trade and industrial policies based on the infant industry argument. Several Asian countries, for example, have built up strong manufacturing industries using this approach yet other countries have become trapped in a complex web of subsidies, taxes and tariffs that have become enmeshed in vested interests and failed to create a competitive manufacturing sector. The recommendation of this study is to focus on improving domestic competitiveness principally through macro and supply-side reforms with some targeted protections in certain sensitive or core sectors that are compatible with Ethiopia's AfCFTA and WTO obligations.

Table 1: Key Priority Constraints and Recommendations for Policy Reform

Focus	Short-Term (2023-25)	Second Wave (2025-30)	Agency Involved
Macro-Policy/ Exchange Rate	<ul style="list-style-type: none"> > Progressive unification of exchange rates to the close gap between the official and parallel rate > Improve the FX regime for investors by reducing the surrender requirement > Ensure a stable monetary framework with limits on central bank deficit financing 	<ul style="list-style-type: none"> > Rebuilding of reserves buffers > Development of auction market for forex > Maintain sustainable fiscal deficit with the protection of social safety nets > Effective coordination of fiscal and monetary policy to ensure consistency 	<ul style="list-style-type: none"> *MOF *NBE
Public-Private	<ul style="list-style-type: none"> > Government revamps industrial parks strategy by 1) providing aftercare for existing FDI; 2) bringing in domestic investors into IPs 3) link IP investment to demand assessments and feasibility studies 4) repurpose IP's to improve links with local input suppliers > Development of a regular public-private dialogue and consultative forum annually > Continued liberalization of banking and telecoms sectors with allowance of FDI 	<ul style="list-style-type: none"> > Establishment of national minimum wage in the IPs > Allowing the private sector greater participation in the management and operation of IPs > Address critical infrastructure and utility gaps faced by the private sector in IPs > Privatization of selected companies, including sugar factories and bringing in private sector competition to SOE's in finance, telecom, and utilities 	<ul style="list-style-type: none"> *NBE *MOF *EIC *IPDC
Business Climate/ Regulatory	<ul style="list-style-type: none"> > Improvement of security situation > Streamline administrative and licensing procedures for firms > Government launches investment promotion initiative in overseas markets 	<ul style="list-style-type: none"> > Oversight of both domestic and foreign investors to ensure compliance with proposed projects and adequate governance standards > Transparent provision of all relevant information by the Government to the private sector 	<ul style="list-style-type: none"> *MOF *EIC *MoT
Logistics	<ul style="list-style-type: none"> > Implementation of the 2021 Council of Ministers decision to private participation Multi-Modalodal Logistics, Warehouse Management, and Dry Port establishment > Safeguard security along logistics corridors > Develop port feasibility studies and strategic roadmap 	<ul style="list-style-type: none"> > Introduction of the PPP model in the Modjo and Hawassa dry ports to improve efficiency and reduce delays > ICT modernization along the logistics chain (ports, airports, roads) > Development of an e-portal showing available logistics and land (size of plot and investment) the in country for private sector participation. 	<ul style="list-style-type: none"> *MOF *ESL

Focus	Short-Term (2023-25)	Second Wave (2025-30)	Agency Involved
Financial Sector	<ul style="list-style-type: none"> > Modernization of DBE through an asset quality review, corporate governance, and robust risk management system > Maintain financial stability, including capital adequacy ratio and low NPL's > Put in place specific collateral estimation and loan processing time for manufacturers (15 days) plus 	<ul style="list-style-type: none"> > Introduction of foreign commercial banks to Ethiopian banking sector > Diversification of medium- and long-term loan products, including -supply chain finance and export finance > Entrepreneurial training in project preparation and risk management 	<ul style="list-style-type: none"> *NBE *DBE *CBE
Skills Training	<ul style="list-style-type: none"> > Training to develop entrepreneur capabilities in project preparation, risk management, and global industry > Selected joint ventures with foreign firms to support skills upgrading and productivity enhancement 	<ul style="list-style-type: none"> > Vocational training for workers in line with private sector relevant skills > Partnerships between industries and TVET colleges with modernized curriculum > Recruitment of foreign experts in the tech industry to help modernize Ethiopian manufacturing 	<ul style="list-style-type: none"> *MOF *MOLS

*MOF - Ministry of Finance

*NBE - National Bank of Ethiopia

*EIC - Ethiopia Investment Commission

*IPDC - Industrial Parks Development Corporation

*ESL - Ethiopia Shipping and Logistics

*DBE - Development Bank of Ethiopia

*MOLS -Ministry of Labor and Skills

*MOT - Ministry of Trade

Ethiopia is facing significant development challenges in the aftermath of a series of shocks. While historically, the country has had high growth rates averaging more than 9 percent between 2000 and 2017, in recent years there has been a slowdown in growth between 2020 and 2023 compared to the years before the pandemic. The country faces major macroeconomic obstacles, with a combination of an overvalued currency, a growing import bills, and depleted foreign exchange reserves. Inflation has been recalcitrant and has reached more than 30 percent in 2023. The twin deficits, fiscal and current account, have been widening, especially in the aftermath of the northern Ethiopia conflict and the Ukraine crisis. The Government has had compressed fiscal space, as defence and debt servicing have eclipsed social expenditures in the budget. The debt-to-GDP ratio has increased to 52 percent due to the public investment boom during the mid-2010s and high associated financing costs. Recent security challenges in several parts of the country continue to impact macroeconomic balances.

The challenge for Ethiopia in the years to come is that its growth has not been job-rich. The national saving and investment rates remain low at 15 and 25.3 percent, respectively in 2022.⁸ The SSA average during the period 2017–22 has been 22 percent. There is high unemployment, particularly youth and urban unemployment at 23.1 percent and 17.9 percent in 2021,⁹ high annual inflation of over 30 percent, low human development index which is a composite index of a long and healthy life, access to knowledge and per capita national income measures. More than 67 percent of Ethiopia’s population is multi-dimensionally poor. Social safety nets have been underfunded, and in real terms, transfer payments to vulnerable households are declining.

Despite multiple interventions to boost manufacturing industry performance in Ethiopia, it has not contributed significantly to the economy and employment. An industrial-park strategy was introduced after 2000 aiming to attract foreign direct investment (FDI) and help create employment and generate foreign exchange through the creation of industrial parks. Currently, there are 13 public and 5 private parks that are operational in Ethiopia. On the one hand, in the last decade, the strategy has attracted FDI of \$740 million from more than 60 foreign investors; boosted employment by 150,000 people, especially women; contributed to exports of \$500 million in 2023; and reached relatively high occupancy rates of more than 80 percent, especially in Bole Lemi, Kilinto, and Hawassa industrial parks. Textile and garments account for around 95 percent of exports from public-owned Industrial parks.¹⁰

Several factors have been noted as reasons for the low development in manufacturing. First, there are the traditional problems: excessive regulation, foreign exchange shortages (to access essential inputs and to repatriate profits), lack of incentives, and a private sector that is averse to risk-taking outside trading, services, and construction. Second, the industrial parks have not been able to fully deliver on their promises, partly due to logistics, conflict, and design. Third, there has been a combination of microeconomic failures (land market, credit market, input market) that have undermined the macroeconomic progress that has been made. Fourth, the lack of policy integration in a country fragmenting into multiple regional markets, especially with taxes, subsidies, and licenses across regions has been a deterrent to manufacturing. It becomes difficult to capitalize on economies of scale. Fifth, administrative processes tend to be cumbersome in Ethiopia. Sixth, the country faces security crises that impede manufacturing development.

⁸ MoPD (2022)

⁹ ESS (2021)

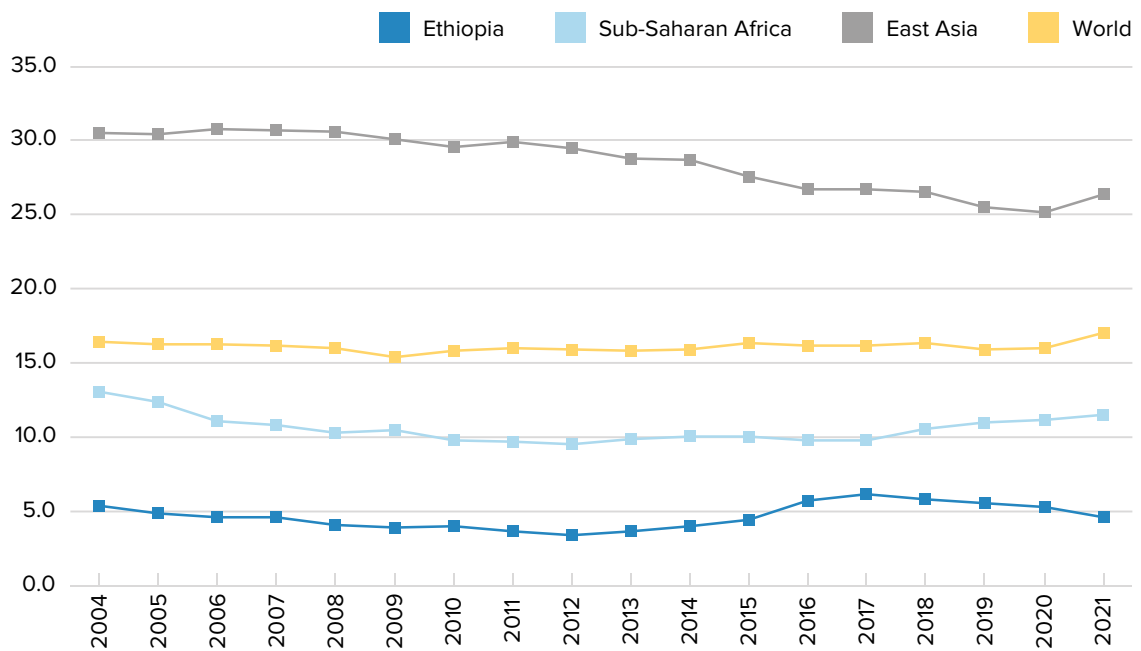
¹⁰ ESS (2021)

Outline

Chapter 1 introduces the macroeconomic and socioeconomic context of the country and provides a framing of the analysis. Chapter 2 provides the core argument of the report. Chapter 3 discusses the methodology of the work. Chapter 4 identifies the analytical framework linking manufacturing, jobs, and structural transformation. Chapter 5 provides an anatomy of the private sector, exports, and industrial parks, and analyses the various players: conglomerates, large enterprise, medium and small enterprises, and foreign investment. Chapter 6 assesses the sectoral dynamics and Chapter 7 looks at the results of the qualitative and quantitative survey, with focus on the constraints. The focus will be on constraints to manufacturing including 1) macro policy and exchange rate; 2) access to land; 3) access to inputs; 4) access to finance; 5) trade logistics; 6) skills. Chapter 8 examines the lessons from Asia in the transition from trading to manufacturing. Chapter 9 concludes the report.

First, there has been very limited structural transformation and associated lack of job creation in the economy of Ethiopia over the last two decades. Despite attempts to industrialize, manufacturing has yet to achieve scale and significance – representing just below 5 percent of GDP. (Figure 1). Manufactured exports in Ethiopia are characterized by low-value products, generated the leather and leather goods, textiles and apparel, and meat. On top of that, there is the numerical dominance of small firms.¹¹ The share of agriculture has declined partly, and the share of the services sector has increased. This is low compared to other countries. Global experience suggests that structural transformation is key for getting good export growth and jobs (Box 1). Data for the period from 2000 to 2020 show that productivity growth was either negative or very low in all sectors which should be an anomaly in a developing economy that is successfully shifting its most abundant factor of production – labour – into more productive sectors. Productivity growth has been low in industry over the past two decades, with only construction reaching scale and significance.

Figure 1: Manufacturing Share of GDP Across Countries (percentage share)



Source: World Bank

Box 1: Structural Transformation

Structural transformation is defined as the transition of an economy from low productivity and labour-intensive economic activities to higher productivity. Generally, structural transformation involves a range of phenomenon that are linked to each other: a declining share of agriculture and a rising share of services and industry in total output; increased productivity in modern sectors; increasing rural-urban migration; demographic shifts; and increasing use of technology.

Seminal work by Rodrik and McMillan¹² show that the large gaps in labour productivity between the traditional and modern parts of the economy are a fundamental reality of developing societies. Since 1990 structural change has been growth-reducing in both Africa and Latin America, with the most striking changes taking place in Latin America. In their analysis, the bulk of the difference between these countries' productivity performance and that of Asia is accounted for by differences in the pattern of structural change – with labour moving from low- to high-productivity sectors in Asia, but in the opposite direction in Latin America and Africa. Another study¹³ analysed structural transformation in 11 Sub-Saharan African. One aspect of structural change is labour and the other is the opportunities in a modern sector. They found that the expansion of manufacturing activities during the early post-independence period led to a growth-enhancing reallocation of resources, but the process of structural change was stalled in the mid-1970s and 1980s. However, when growth rebounded in the 1990s, workers mainly relocated to services industries rather than manufacturing.

Despite some increase in manufacturing outputs, the growth in manufactured exports and employment in Ethiopia has not been large. Exports have been low and still focus on primary products, especially coffee and gold. It is starting to export leather goods textiles and apparel, and electricity which is envisioned for substantial increase with the completion of GERD. Nonetheless, at this stage none of these exports are at scale. A recent study notes that the manufacturing sector currently plays a marginal role in employment creation, exports, and output, and falls short on stimulating domestic linkages.¹⁴ The sector remains dominated by small firms and resource-based industries, low-value and low technology products, and weak inter-sectoral and intra-sectoral linkages. Ethiopia must deal with two distinct features: low level of industrialization in terms of the sector's share in GDP, export earnings, industrial intensity, and competitiveness and an industrial structure dominated by small firms and resource-based industries concentrated around the capital.¹⁵

Second, manufacturing is key to structural transformation. Manufacturing can help provide quality jobs for the 2 million plus youth who enter the labour market every year. Labour-intensive light manufacturing led the economic transformation of many of the most successful developing countries, especially in Asia. This transformation has yet to take place in Ethiopia as the manufacturing sector has been unable to create the jobs that are necessary. Global experience elsewhere shows that this change cannot be sustained without a move that lifts workers from low-productivity agriculture and the informal sector to higher-productivity activities.

¹² Macmillan and Rodrik (2011)

¹³ De Vries et. al. (2013)

¹⁴ Oqubay (2018)

¹⁵ Oqubay (2015)

Third, Ethiopia is an eligible candidate for structural transformation gives its multiple assets. First, Ethiopia has a favourable location in the Horn of Africa and helps connect sub-Saharan Africa with the Middle East. It is situated near the strategic Suez Canal, representing close to one third of total container traffic. It is also a potential entrance for trade into sub-Saharan Africa. Second, Ethiopia has a relatively strong state given its long history and some success in development performance in the last decade. Third, as a country with a relatively young population, Ethiopia has a relatively favourable demographic. Fourth, it has abundant and fertile land. Finally, it benefits from low wage and energy costs, amongst the lowest in the continent.

Fourth, based on the experience of other countries, there is a practical roadmap for Ethiopia to achieve greater manufacturing success. Reform is possible, and there exists a practical role for industrial policy based on international experience and domestic political economy. The Government of Ethiopia has attempted to develop an industrialization strategy over the years, but the results have not materialized. The Government adopted an export promotion strategy in 1998 to diversify exports and promote high-value exports, including horticulture, textiles, and leather. The government has resorted to a multiplicity of instruments to achieve this, including fiscal incentives, favourable land lease rates, soft loans, and convenient access to foreign currency. The Growth and Transformation Plan (GTP I) in 2010 had a vision to establish an industrial sector that plays a leading role in the economy. The Government has consistently set ambitious targets for manufacturing, but they have not materialized.

The focus of this study is to analyse Ethiopia's transition from trading to manufacturing and to suggest reforms that will help Ethiopia become a manufacturing powerhouse. Overall, the goal is to understand how to increase the performance and productivity of medium and large formal firms in Ethiopia and jump-start manufacturing. The country has an economic policy framework that is highly favourable to importing and trading. Its large current account deficit is a testament to this gap between exports and imports, which reached \$14 billion in 2022 and \$13.5 billion in 2023. Currently, light manufacturing in Ethiopia is characterized by a few large manufacturing firms providing for domestic markets and many small, low-productivity informal firms providing low-quality products to the domestic market. These enterprises are failing to provide quality jobs and wages to urban graduates and rural to urban migrants. This study examines policy options to help develop Ethiopia's nascent manufacturing sector and overcome the various constraints. Within this framework, this study asks:

- > What are the current constraints to manufacturing?
- > What are the best ways to improve incentives for manufacturing compared to trading?
- > How can the economy create more productive jobs in manufacturing paying higher wages?
- > How can manufacturing in Ethiopia be inclusive for women and across regions?
- > How can governance be improved so that manufacturing performs better?

Manufacturing has underperformed for several reasons. This study will investigate the role of several factors, including some of the factors presented below.

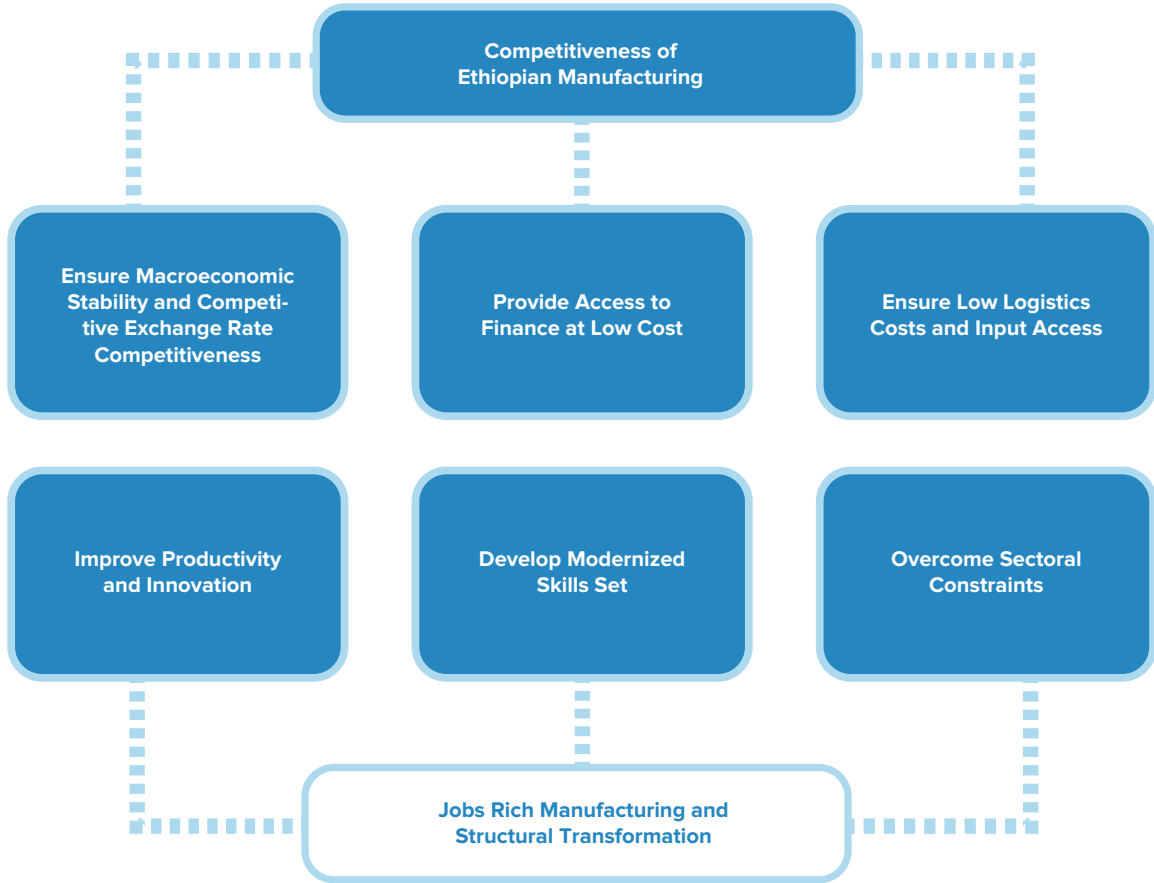
- > Macroeconomic factors (macro policy, forex, industrial policy, FDI policy, regulatory framework)
- > Microeconomic factors (cost and reliability of utilities (water, electricity), taxation and incentives, credit and finance, input markets (raw materials and supply chain), access to land, administrative barriers and red tape, infrastructure, and logistics)
- > Labor (wages, skills, networks, human capital)
- > Business climate (conflict, federalism, federal/regional coordination, fragmented markets)
- > Public-private interface (entrepreneurial capabilities the of private sector, crony capitalism and corruption, institutional forum for public-private discussions, preferential treatment of SOEs, including de jure or de facto monopolies in key sectors)

Research Tools

The study used a variety of analytical tools to help inform and guide the research.

- > **Literature review.** Review of existing research, including academic studies, firm level surveys, and the World Bank Enterprise Surveys and Harvard Growth Lab
- > **Quantitative survey.** Quantitative and qualitative interviews with about 70 enterprises (both formal and informal) of all sizes based on a questionnaire designed by the UNDP team. This looked at questions from Investment Climate Assessments. The questionnaire is in Annex 1.
- > **Case studies of selected firms.** Qualitative interviews with selected enterprises, including private companies, and foreign firms (conducted by the study team and based on a questionnaire designed by Professor John Sutton of the London School of Economics). The focus was on the constraints to manufacturing, including access to land, access to inputs, access to finance, customs and trade policies, and skills (entrepreneurs and workers). Select Government agencies were interviewed.
- > **Field visit.** A field visit to selected industrial parks (Hawassa, Mekelle) helped provide a comparative analysis.

The following provides the conceptual framework for the study.



A. Overall

The Ethiopian economy is a hybrid economy with a nascent private sector. It is a hybrid economy, with a mixture of state enterprises of varying performance. There are currently 40 state-owned enterprises, with a heterogeneous record of performance. Ethiopian Airlines, Ethio Telecom, and Commercial Bank of Ethiopia are quite profitable, while others such as sugar companies have lower profitability. There have been significant shifts in corporate ownership due to privatization in the 1990s and 2000s, and the government has now refocused on several strategic sectors - aviation, logistics, telecommunications, power, utilities, petroleum import, and railway. There has been SOE retreat from manufacturing, which is occupied by domestic firms and FDI. The SOE's have considerable advantages compared to private firms, such as access to land, credit, and foreign exchange. There appear to be unequal levels of market competition.

B. The Anatomy of the Private Sector

Like many emerging markets, Ethiopia has a heterogeneous private sector. The formal private sector comprises private corporations, households and non-profit institutions and broadly consists of all economic activities performed outside of the public sector which includes informal economies and subsistence production of agriculture and allied products. More precisely, the private sector in Ethiopia consists of a combination of a few large conglomerates (more than twenty), large firms, small- and medium-sized enterprises, and microenterprises. although corporate governance remains a challenge and it is hard to have a precise understanding of the various holding companies.

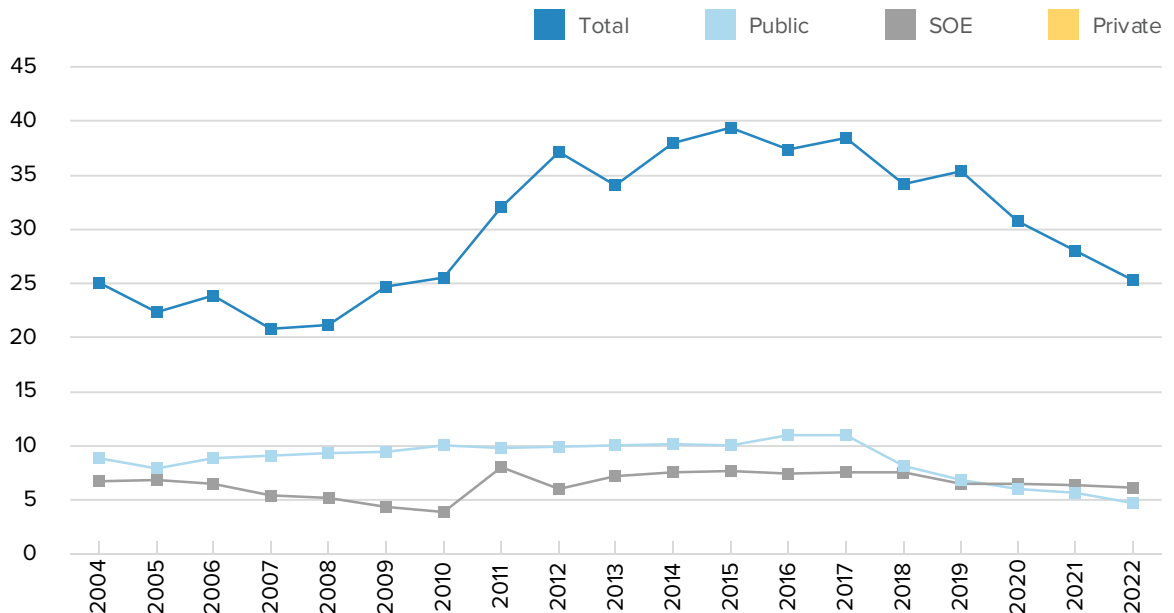
- > There are a range of firms. The decomposition shows the following: large (2.2 percent), medium (7.5 percent), small (18.9 percent), and micro (71.4). In terms of value-added, medium and large firms accounted for 75 percent of manufactured value-added output.
- > Ethiopia's private sector is heterogeneous. One study finds that the broadly defined private sector in Ethiopia accounts for 84.8 percent of 2008/09 GDP, 95.8 percent of employment, and 46.1 percent of the investment. Considering the narrow definition that excludes informal economies and subsistence agriculture, it contributes 25.1 percent of GDP, 5.8 percent of employment and 40.5 percent of investment.¹⁶ The informal private sector contributes 59.7 percent of GDP, 90 percent of employment and 5.6 percent of the investment. This indicates that Ethiopia's economy is dominated by informal private agriculture and service sectors and there is untapped potential in Ethiopia to expand private sector investment in industry (manufacturing).
- > At the apex of the pyramid are over 20 conglomerates, most of which are private. Some of these are government affiliated. They tend to not have consolidated balance sheets and occupy a range of industries, ranging from manufacturing to services to real estate. Like most manufacturing, they are family-run. In the past, EFFORT was a conglomerate that spanned multiple businesses, ranging from mining, manufacturing, banking, and brewery with some estimates that suggest it was \$4 billion. Mostly emerging as family businesses in the early 1990s, their activities span multiple sectors, including real estate, manufacturing, finance, and retail. It appears that most of the conglomerates are profitable. Anecdotal evidence suggests that conglomerate's value ranged from \$100 million to more than \$1 billion.¹⁷

¹⁶ Kolli (2010)

¹⁷ These companies are not listed on any exchange, and their financing has been mostly from: domestic state banks, including Commercial Bank of Ethiopia (CBE) and Development Bank of Ethiopia (DBE); external loans, especially China and the US, and reinvested earnings. There are private conglomerates, such as MIDROC and Petram, and state conglomerates, which includes both civilian and military-affiliated state-owned enterprises.

- > The private sector is dominated by the trade sector. For a variety of reasons that point to persistent disincentives in the economy, about two-thirds of Ethiopian enterprises operate in the trade sector, as there are many benefits to trading compared to manufacturing.
- > There is a unique Ethiopian phenomenon called “endowment companies,” companies that are owned by an endowment fund. Endowments are established by funds from a few companies or institutions. Some endowments operate under regional governments, which also operate SOE’s. They are usually affiliated with the state.
- > The emphasis of many large firms is on diversification rather than growing and developing a single business unit.¹⁸ Historically, many big firms have had expansion projects in place, but the lack of finance available from banks has been limited, and they also remain dependent on imports of spare parts, supplies, and raw materials. Small entrants to manufacturing are different from larger entrants. There appears to be little graduation of firms. Net employment creation by the formal private sector is low despite strong GDP growth rates.¹⁹
- > Both public and private investment have declined in recent years (Figure 2). There was a boom in public investment and private investment from 2011 to 2019, and after that, there has been a decline in both types of investment, in large part due to the combined shocks and difficult macroeconomic environment that resulted.
- > First, the share of manufacturing as a percent of GDP has declined from 5.9 percent in 2019 to 4.4 percent in 2022, in large part due to the combined shocks. Close to 450 firms (out of near 5000) have ceased production across the country in the last year. Many firms are operating at close to 30 percent capacity. Second, food products, beverages, non-metallic minerals, and textile/apparel account for more than 50 percent of the total. Third, there is a reversal in a trend of agglomeration away from Addis. The share of Addis has increased from 33 percent in 2017 to 38 percent in 2022, while Oromia went from 30 percent to 27 percent, Tigray from 12 percent to 9 percent, and Amhara from 14 percent to 12 percent.

Figure 2: Investment (percent of GDP)



Source: UNDP estimates based on CSA

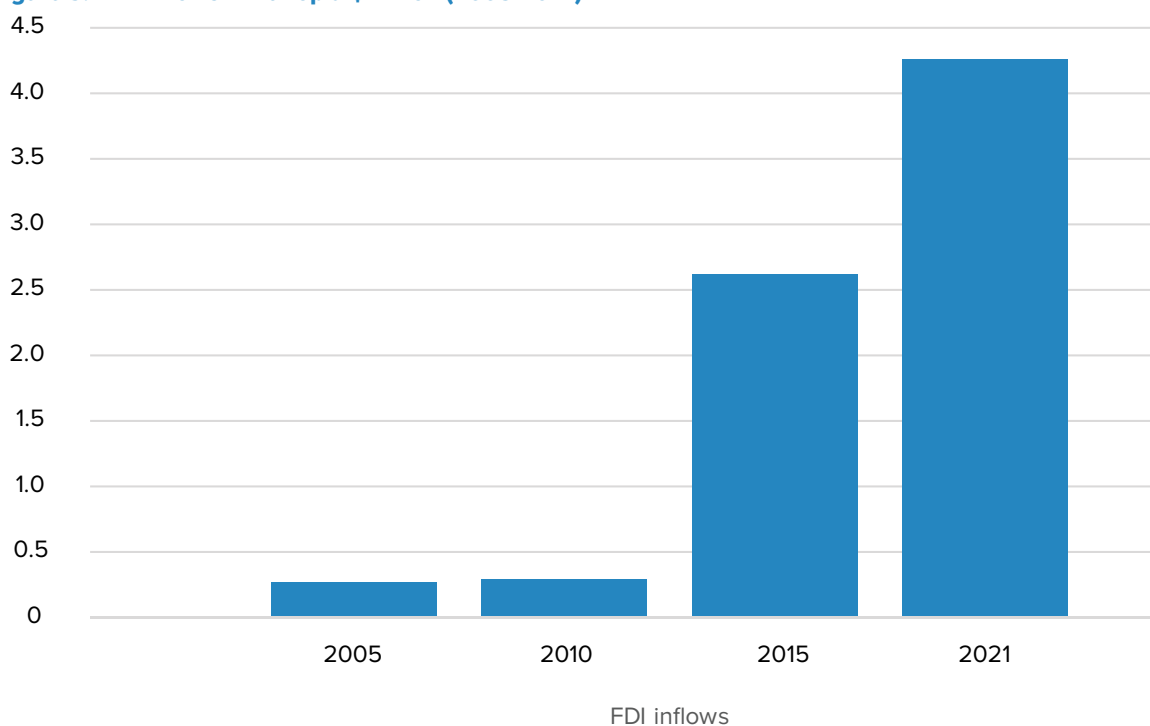
¹⁸ Sutton and Kellow (2010)

¹⁹ Shiferaw, Söderbom, and Zewdu (2020)

C. Foreign Direct Investment

FDI in Ethiopia has been increasing in recent years despite fluctuations due to shock. According to UNCTAD's World Investment Report 2023, FDI inflows to Ethiopia increased to \$4.2 billion in 2021 (Figure 3), up from \$2.4 billion one year earlier; and the total stock of FDI stood at \$31.6 billion, around 31.8 percent of the country's GDP. In the past two decades, the manufacturing sector attracted 1676 projects with an investment capital of Birr 105 billion followed the by real estate sector which that attracted 881 projects with a capital of Birr 19 billion, agriculture 333 projects with a capital of Birr 12.8 billion and hotels and restaurants 149 projects with capital of Birr 2 billion. The Ethiopia FDI Policy Report indicates that there are over 3000 FDI projects in Ethiopia in the various sectors with investment capital of Birr 144 billion and generated about 375 permanent jobs.²⁰

Figure 3: FDI Inflows in Ethiopia \$million (2005-2021)



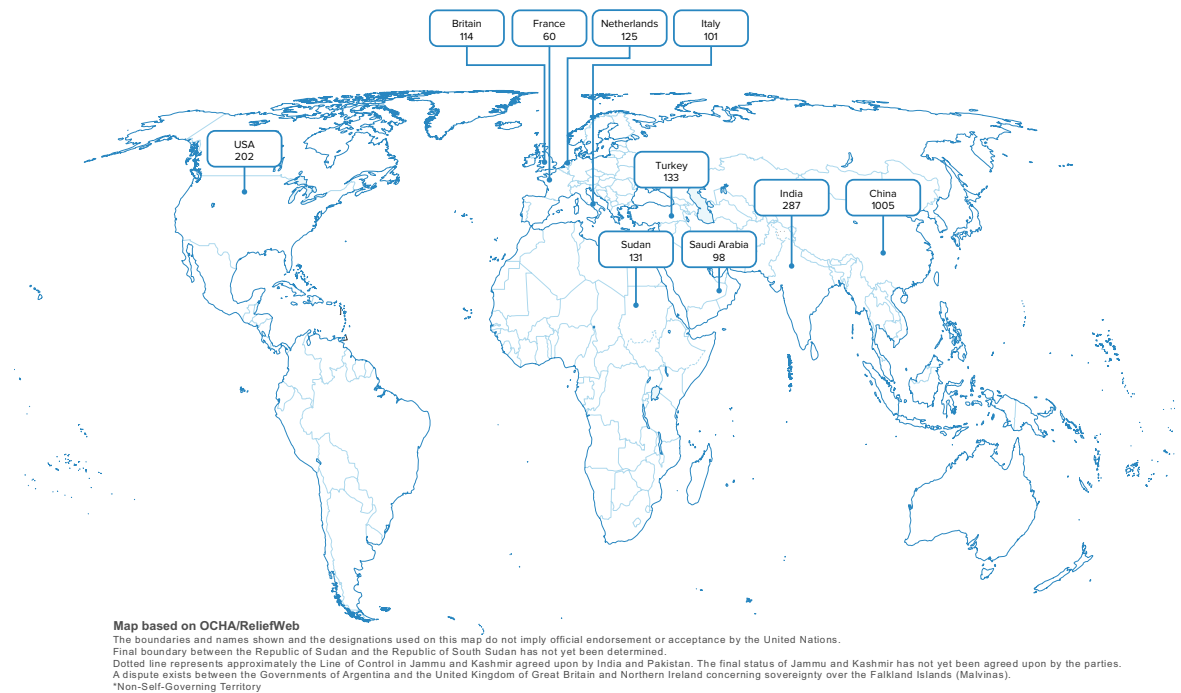
Source: UNCTAD

The most striking feature of the current wave of FDI projects in Ethiopia is their range in terms of sectoral diversification. The main investing countries are China, India, Saudi Arabia, the United States, and Turkey (Figure 4). In terms of focus, most FDI is oriented in the manufacturing, real estate, energy, and agriculture sectors (Figure 5).

- > China's FDI projects span every sector of Ethiopian industries, but four industries together account for the larger part of China's investment in Ethiopia: clothing and textiles, building materials, plastics and metals and engineering. The stock of Chinese firms' investment in Ethiopia in the past two decades is estimated at \$4 billion and generated over 100 thousand jobs. China is one of the largest investors, accounting for 60 percent of new FDI projects approved.
- > FDI from India is focused on food processing and plastics. Indian firms have invested in agriculture and floriculture, engineering, plastics, manufacturing, cotton and textiles, water management, consultancy and ICT, education, pharmaceuticals, and health care. The Indian ambassador to Ethiopia said that there are about 400 Indian firms in Ethiopia as of February 2022 and their cumulative investment is about 5 billion \$ and 3 to 4 billion \$ on the ground.

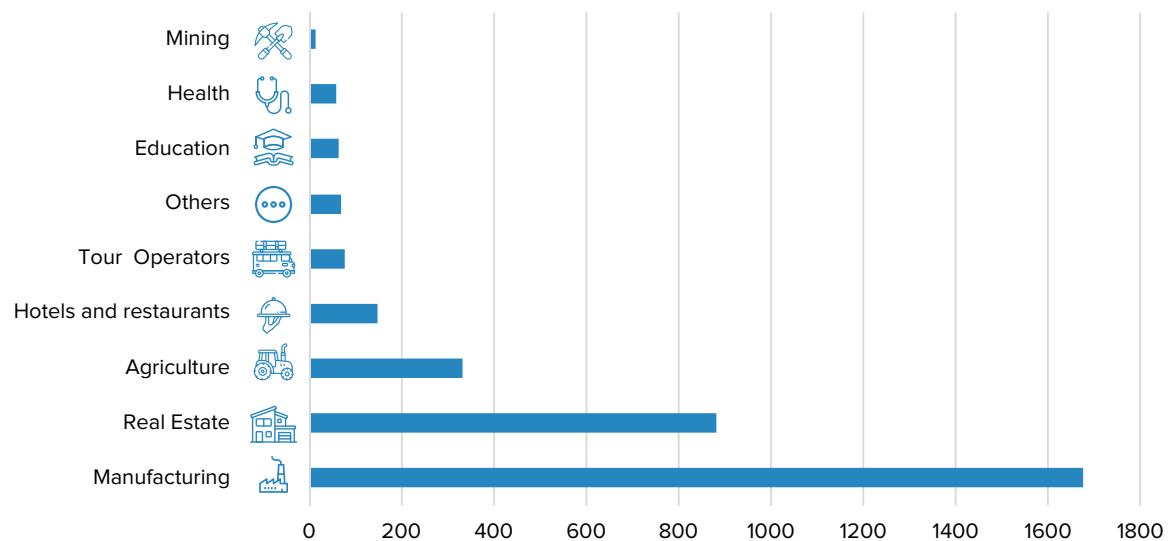
- > Saudi Arabian FDI is widely dispersed in agriculture, manufacturing, mining, education, health, hotels, tour operations, real estate, and water well drilling, among others. A total of 124 investment projects are operational with a capital of Birr 19 billion which generated over 20 thousand permanent jobs. Ethiopia is the recipient of most of Turkey’s investment in Africa. \$2.5 billion of the total \$6 billion Turkish investment in Africa came to Ethiopia.
- > Turkish investors are engaged in textile, construction, food processing, power generation and others. The total Turkish FDI in Ethiopia has over 130 investment projects, a capital of Birr 12 billion, and generated close to 20 thousand permanent jobs.
- > Italy’s FDI in Ethiopia is dominated by projects in clothing and textiles, leather and engineering and metals. There are over 100 investment projects with a total capital of Birr 1.1 billion which created about 15 thousand permanent jobs.

Figure 4: Top 10 countries of origin for FDI in Ethiopia by No of projects



Source: Policy Studies Institute, 2022

Figure 5: Number of FDI projects by sector



Source: Policy Studies Institute, 2022

There is an institutional setup to manage FDI, but it can be improved. The Ethiopia Investment Bureau, chaired by the Prime Minister, is the highest investment policy-making body on investment in the country, while the Ethiopia Investment Commission (EIC) is responsible for the day-to-day promotion and regulation of FDI projects. The EIC is the primary interface for investors and handles the One Stop Shop services (OSS), dealing with investors regarding land investment, residence permits, environmental impact assessments, and utilities in industrial parks. The Industrial Parks Development Corporation (IPDC) operates industrial parks. In relation to manufacturing outside industrial parks, the regions are the primary body. Many investors discuss land leasing with both regional and federal authorities. To strengthen oversight, in January 2021, the EIC announced a new FDI tracking tool. This FDI oversight can be improved as there have been many cases where FDI has committed to do a project but there has not been sufficient government oversight.

D. Industrial Parks and the Private Sector

In the mid-2010s, following the East Asian experience, Ethiopia started an ambitious industrial park programme as a strategy to attract FDI and maximize foreign exchange revenue. Industrial parks are established to act as catalysts for investment, trade, and employment. The country is aiming to build more than thirty industrial parks over the coming years, but so far there are thirteen, most of which are publicly owned. Table 1 below presents industry park establishments in Ethiopia with respective total area allotted for the park, number of sheds and sector of engagement. There are currently 13 public industrial parks in the country with a major focus on textiles and garments. They have varying levels of occupancy and success.

The parks have had a mixed success. The parks have generated more than significant export earnings from products manufactured there. Textiles and garments, shoes, pharmaceuticals, and ICT are among the main manufactured items from the parks, with textiles and garments accounting for around 95 percent of exports. The active industrial parks in Ethiopia have created jobs for over 150,000 people thus far. A recent comprehensive World Bank study finds that with modest inward investments, net exports from Ethiopia's IPs grew rapidly pre-COVID, reaching \$163 million in 2020 and approaching half of Ethiopia's total manufactured exports. Ethiopian public IPs have attracted 66 investors and an estimated \$740 million in inward investment since 2015.²¹ Since 2015, net exports (gross exports minus imports) from publicly owned IPs sustained an impressive average growth rate of 50 percent a year. By 2020, industrial park account for close to 40 percent of manufacturing exports by 2020.

However, the parks have not yet contributed significantly to the economy. Practically, the industry parks in the country face challenges, which include financing, skill development, linkage with the local economy, technology transfer, limited infrastructure, and utility supply. On top of that, most of the inputs are imported, and the parks have been unable to attract large Ethiopian firms. Some of the FDI firms in the industrial parks left the country due to COVID-19 shock and the Agricultural Growth Opportunity Act (AGOA) suspension.²² Several issues have impacted the parks.

- > Some of the parks are located near the major cities and have high occupancy rates – Bole Lemi and Kilinto, several of the parks are in remote regions, facing high logistics and transport costs.
- > There appears a de facto discrimination against domestic firms in the industrial parks, in part due to the desire to obtain foreign exchange. Domestic firms have not been encouraged to participate in the parks and there is no clear package of incentives for them.

²¹ World Bank (2022)

²² AGOA provides eligible sub-Saharan African countries such as Ethiopia with duty-free access to the U.S. market for over 1,800 products.

- > Labour absenteeism has been a challenge as some parks have low wages and high turnover. The wage issue will be discussed in the sectoral analysis.
- > There has been difficulty creating strong links with SMEs. The parks are better linked to global textile value chains than domestic clusters.
- > There has been a significant public finance cost, with the borrowing of \$1 billion at a non-concessional rate. Even though the parks have made significant foreign exchange earnings, the financing was still expensive.
- > Security in the country is worsening, especially in Amhara and Oromia regions, but it is improving in Tigray region.

One major challenge with the parks has been the inability to attract domestic investors. Out of almost 180 industrial park enterprises, there are currently five operational domestic enterprises. A recent World Bank study of 92 firms (consisting of companies operating in industrial parks/agro-industrial parks, in the pipeline to join the parks, or domestic firms which had shown interest in joining parks in one way or another but were not successful in setting up) has several interesting findings.

- > Domestic investors are deterred by a combination of high export requirements (with firms expected to export 100 percent of the production), high land lease shed rental rate, inconsistent loan to equity requirements (requirement that domestic investors cover at least 25 percent of the project cost from the investor's pocket), and lack of organized information provision have adversely impacted domestic investors interest in coming to industrial parks.²³
- > Despite a solid legal framework,²⁴ there have been implementation issues with regulatory and compliance services and incentives towards domestic investors.
- > The challenges of government procurement, incomplete infrastructure, and unavailability of loans (despite the DBE providing 75 percent of the project cost as a loan) have deterred domestic firms.

²³ World Bank (2023)

²⁴ The World Bank study notes that with respect to domestic investors, the existing framework does provide for: exclusive reservations of certain areas of investment for domestic investors; conclusion of Export-oriented Non-equity Enterprise Collaboration Agreement; and financial loan/grant as a source of capital and cover the cost of capacity development in recruitment and training of expats.

Industry Park Establishment in Ethiopia

Name	Total Area (land in hectare)	Number of Sheds	Sectors	Characteristics
Bole-Lemi I	156	20	Textile & Garment	Fully operational; one of the major parks outside Addis;
Bole Lemi II	171	2		
Hawassa	140	52	Textile & Garment	Operational but at low capacity due to AGOA and security; distance from Addis leads to high logistics cost
Kombolcha	75	9	Textile & Garment	Located in Amhara; damaged by conflict; Operational after the government provided finance to restart production
Mekelle	75	15	Textile & Garment	Not operational due to conflict; however, skeletal administration is present; under discussions to resume production
Adama	120	19	Textile & Garment	Located 100 km east of Addis; fully operational; a park with considerable potential;
Dire Dawa	150	15	Textile & Garment	One of two chartered cities; operational; near the port of Djibouti; proximity to the special economic zone
Debre-Birhan	75	9	Textile & Garment	Located 120 km from Addis; partly operational;
Jimma	75	9	Textile & Garment	Started in 2019; located in Oromia region; west of Addis; park with potential; logistics challenge high; Chinese companies dominate
Bahir-Dar	75	8	Textile & Garment	Not operational because of AGOA; difficult logistics due to location; recent conflict
Semera	50	8	Multisector	Located in a developing region; open but not operational; used as storage for food for IDPs; logistics advantage to port and railway
Addis Industrial Village IV	10	8	Textile, Garment & Leather Products	Not a park
ICT park	200	6	ICT	Not operational; ICT
Kilinto	280	-	Pharmaceutical	Fully operational; ideal location in Addis near Bole Airport; serviced land available; unique as only pharma park; donor-supported

Source: IPDC; UNDP

Box 2: Visit to Hawassa Industrial Park and Yirgalem Integrated Agro-Industrial Park (YIAIP)

The Hawassa IP is one of Ethiopia's leading industrial parks. It was built and started operation seven years ago and the sheds are built on 130 hectares of land, but the potential is 300 hectares of land. The park aims to attract foreign investment and as a result, over 80 percent of the companies are foreign. Currently, there are 22 companies and only 4 are domestic. The park is specializing in the textile and garment sector with 100 percent for export mainly to the US market due to the AGOA duty-free initiative. According to the interviews, Ethiopian investors are not investing in the textile and garment sector because they do not have global knowledge about the sector. Most of the inputs of the companies are imported due to high quality and lack of domestic inputs. The total jobs created by the IP was 34,000 and over 80 percent of employees are women with the range of 18 to 24 years of age. Staff turnover is high and seasonal. During coffee harvest, staff will leave the Park. Labour productivity appears is not an issue as the workers are easily trainable in 15 days to one month, and their learning curve is high. There is no minimum wage policy in the country.²⁵ There has been effort on this but not materialized yet. Basic salary varies with the companies and depending on skills but there are various incentives or benefits such as attendance benefit, productivity, and incentives. Housing for the IP workers is a problem. There was an attempt to build houses for workers in the park but only 7 thousand workers are accommodated.

Its oversight is by the Ethiopia Investment Commission (EIC). It has three roles here in the park: 1) licensing and regulating the companies here; 2) providing services to the companies here and 3) coordinating the one-stop-shop service that there are about 12 services provided here. EIC coordinates these services and relations between the federal and regional government. Although the Park belongs to the federal government, the regional government cooperates closely with the Park, especially in issues around labour.

The IP faced recent shocks. Due to the Covid pandemic, Ethiopia's ban from AGOA and foreign exchange shortages, 11,000 employees are laid-off. The lack of orders due to Ethiopia's ban from AGOA led to a slowdown in production and employment. The occupancy rate has been scaled down recently. Most of the inputs come from abroad and government cannot allocate adequate foreign exchange to import these inputs. Logistics cost is high and increasing from the factory gate to Djibouti Port due to increase in price of fuel and security issues. The companies are using trucks from factory to Mojo dry port and then the railway to Djibouti port. Logistics is a problem in both time and cost. The Ethiopian Shipping and Logistics Enterprise is a monopoly, especially in the importation of goods from abroad, in local transport and dry port services.

A visit to YIAIP in the Sidama Region showed a park built on 294.5 hectares of land. Eleven model sheds are built and 152 farmers around the park catchment area are going to be integrated. Currently SMEs and companies are installing their machineries into the model shades to start operations. Hebron coffee from Italy is currently installing coffee processing plant. The YIAIP sectors include coffee (accounting for one-third of the park), fruits and vegetables, honey, cereals, dairy, and meat.

²⁵ There has been effort on this but not materialized yet. Basic salary varies with the companies and depending on skills but there are various incentives or benefits such attendance benefit, and productivity incentive. The total annual salary paid to workers is Birr 250 million, and the region gets Birr 2.5 million in annual tax.

Box 3: Mekelle Visit

The Mekelle Industrial Park is one of the more promising industrial parks in Ethiopia. It was conceived in 2012 and financed from the \$1 billion Eurobond. It was officially launched in July 2017, with fifteen sheds. It is built on 75 hectares of land and can potentially expand up to 1000 hectares with the objectives of generating foreign exchange, creating jobs, and transferring technology. It is a well-designed IP with a range of facilities, including factory sheds, health clinic, one stop shop, customs, and banking. The IP specializes in textile and garment and for export. The successes were palpable. Before the war fourteen of the fifteen sheds were occupied, with mostly FDI (China, Bangladesh, and Turkey) except for one local investor. Close to 4,500 people were employed at the IP from Mekelle city and neighboring areas. Around 95 percent of them are women within the age range of 18 to 25. The IP generated more than \$10 million in export annually, and it was doing well before the Northern Ethiopia war started in November 2020.

The war had a negative impact, and the IP was forced to retrench. However, all the investors have left the IP towards the end of the 2020. Currently, all the sheds are closed. IPDC is providing the auxiliary services like electricity, banking, customs, security etc. and trying to bring the investors back. It is interesting to note that foreign exchange has not been a problem unlike other IPs given that the investors themselves use their own foreign exchange. Staff turnover was not considered a challenge, and expenses per worker are about Birr 2,200 including basic salary, benefits, and other incentives. According to a manager interviewed, the advantage of Mekelle IP compared to others is the work culture, productivity, and trust. The land issue has not been a problem since the regional government avails the land for investment.

As of November 2023, the IP faces challenges. The investors are willing to come and restart operations in the IP even with the suspension of AGOA given there are other markets in EU via the Everything But Arms (EBA) initiative. However, the investors are asking for extension of the incentives policy such as tax holidays. Also given the difficult situation in Tigray region, they are asking for more favourable treatment compared to other IPs. Security situation is difficult along the logistics corridors to the port, and investors are asking for financial guarantee. Logistics cost is high as the only means of transport is trucks. There is a dry port in Mekelle, but it is not operational.

A small and medium size enterprise located outside the park provided an interesting perspective. It is a private garment factory graduated from small scale to a medium enterprise in 2019. It is housed in a government building. It was producing for local markets in Addis and other markets. Because of the war, property of the private limited company (PLC) was looted by local thieves with losses worth Birr 1 million. It restarted operations two months ago. Currently, three machines are operational, and six employees are at work. The firm has good network with other companies and regional authorities and work closely with them in exchanging ideas and inputs. The firm has its own recruitment policy and procedure and has its corporate social responsibility. In terms of challenges, the company faces a difficult peace and security situation, shortage of inputs, difficult finance (as the debit/credit cooperative halted support), and high transport costs to Djibouti port.

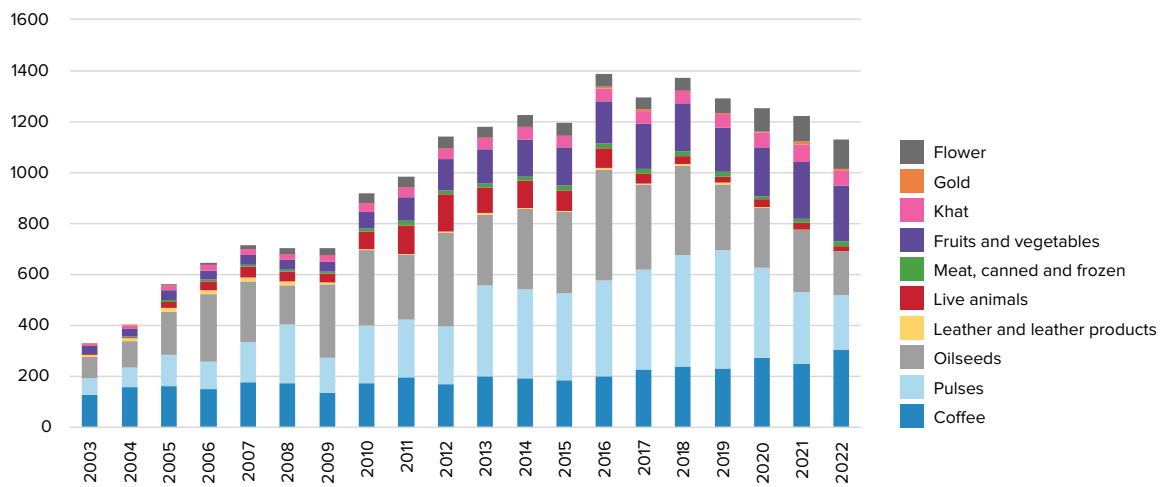
E. Exports Under-performance

Ethiopia had been trying to promote its export trade and reduce dependence on imports for more than half a century. Nonetheless there is persistent rigidity in the structure of the foreign trade, export earnings were stagnant while imports continue ballooning. Among other things, low productivity within the economic sectors and dominance of unprocessed or minimal value additions have also kept the export earnings low. In the early 2000, Ethiopia's total export earnings was less than half a

billion USD. This has shown a gradual increase to reach \$4.1 billion in 2022, the highest in the past twenty years. The factors contributing to the increase are partly policy related and partly due to a consistent increase in commodity prices in the global market. According to World Bank study, Ethiopia had shown one of the highest growth rates in exports in the 2000s among the sub-Saharan African countries due to global commodities price windfall during this period.²⁶

There have been some changes in recent years. Following the policy incentives of the early 2000s, new entrants to the export market were seen contributing to the total export volume: flower, oilseeds and pulses, gold, fruits and vegetables (Figure 6). Despite export promotion schemes, such as the abolishing of all export taxes as well as incentives through provision of land and financial capital for investors entering the horticulture industry, there is still a lack of diversification in Ethiopia’s export sector. The Economic Complexity Index, which measures diversification, has not improved. Coffee has been one of the most important export items in Ethiopia, However the increase in coffee export earnings was mainly coming from increase in prices.

Figure 6: Export Volume (Thousand MT)



Source: UN Comtrade

Exports remain a challenge for many reasons:

- > **A relatively closed economy:** Despite Ethiopia being found to have a comparative advantage for over 80 export commodities based on Revealed Comparative Advantage (RCA) values,²⁷ it remains a relatively closed economy. Degree of openness measured by country’s trade with the rest of the world indicates that Ethiopia is a relatively closed economy when compared to comparable African countries. For example, Kenya’s export and imports of goods and services as a ratio to GDP stood at 10.6 percent in 2021 while that of Ethiopia’s was 7.1 percent, which is also much lower than the low-income countries average (23.1 percent). Under-export of goods and services have been estimated to reach more than 10 percentage points of GDP, if attained which would have made export of goods and services of about \$15 to 20 billion.
- > **Weak contribution for structural transformation:** The case of other countries, East Asia for example, has shown that export of manufacturing goods has contributed to triggering shift of labour from low productivity sectors to the modern sectors, but this is not happening at the required scale in Ethiopia. Ethiopia has the lowest merchandise export to GDP ratio as well as the share of manufacturing to GDP has stagnated between 4 percent to 6 percent in past two decades.

²⁶ WB (2014)

²⁷ RCA value exceeding one, calculated by comparing the relative share of Ethiopian export sectors with corresponding shares for the world for that specific sector (WB, 2014).

- > **Weak governance:** Despite the broad range of incentives government has put in place to promote exports, the sector is suffering from weak governance.²⁸ Certain commodities such as coffee and gold are prone to illicit trading activities, leading to price distortions. Ethiopia has put a ban for the sale of export quality coffee on local markets. Legislative differences between regions and the federal state have created a loophole in enforcing the laws at the regional level. As a result, coffee is smuggled and sold on the local market at a price which is significantly higher than its farm gate prices as well as higher than the international export price of coffee.
- > **Lower entrance of new firms:** Fewer firms have been entering the export market since the year 2008 while more are exiting. According to UNDP calculations, less than 10 percent of firms account for more than 70 percent of exports.
- > **Deteriorating competitiveness:** according to the Global Competitiveness Ranking of the World Economic Forum, Ethiopia in 2019 has ranked 126 out of 140 countries, down from 122 in 2018.²⁹

A recent Harvard study finds Ethiopia has great potential to export products. Characterizing the Ethiopian economy using a Complexity Index (Annex 2), it is a relatively low-income and low complex.³⁰ This implies that the existing export commodities will not bring growth, and capability sets are distant from valuable commodities. Hence, a long jump to more complex products and diversification around the existing capabilities will benefit the country. In the country's product space in 2020, coffee, oil seeds, vegetables, dried legumes, and cut flowers are major exportables that are distant from complex products. The country should focus on the type of FDI it targets, based on feasibility and economic benefit.

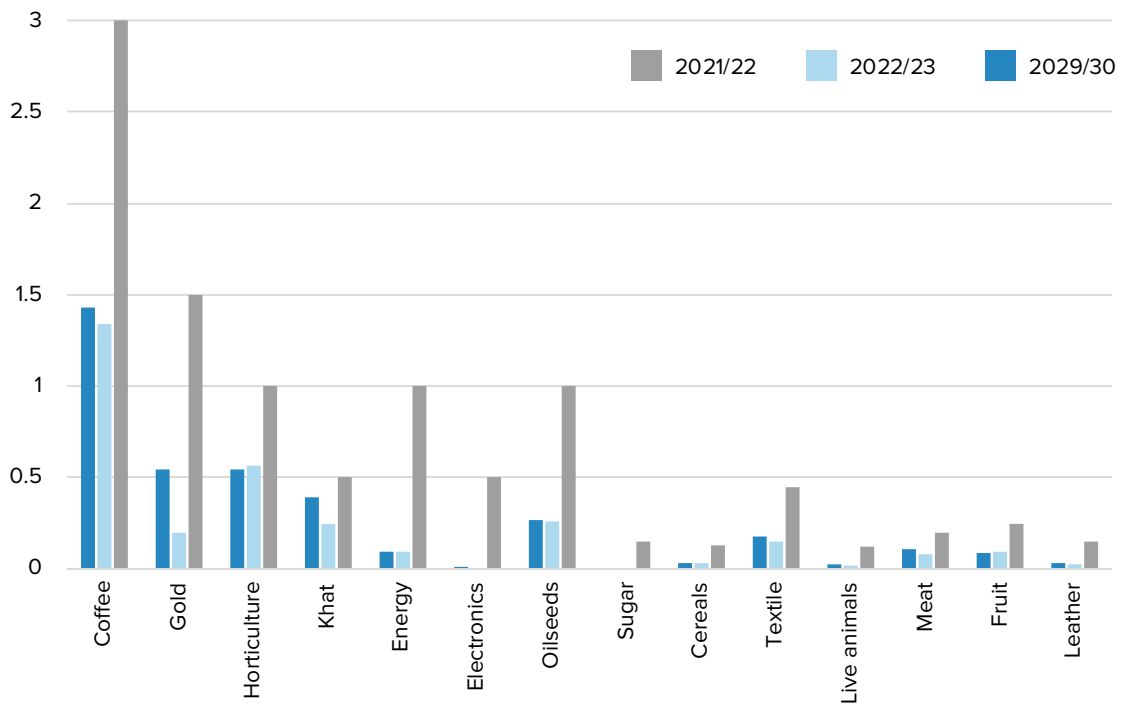
The analysis shows that Ethiopia can diversify exports. Key products include coffee, gold, horticulture, qat, energy, oil seeds, electrical products, agro-processing, textile, and garments, known as “low-hanging fruits.” In addition, except for agricultural products, most of these commodities are less sensitive to distance and crucial for import substitution. The country has the potential not only to continue to produce these products but also to diversify around them. Electronics, pharmaceuticals, metal, and motor vehicle parts are recommended for “the longer jump” to more complex products. Removing bottlenecks and introducing and applying incentives for the FDIs and local producers that have shown interest in these areas is imperative. Therefore, considering Ethiopia's current product space, complexity, and diversification, the country's exports are estimated to reach \$10 billion by 2029/30 (Figure 7). The three parameters are: perspectives of sector experts, the Harvard Growth Lab assessment based on both current and potential comparative advantage and the competitiveness of the product (including cost and global demand).

²⁸ ISS (2022)

²⁹ The World Economic Forum has adopted a methodology to calculate the ranking since 2018. The methodology identifies human capital, innovation, resilience, and agility, defining features of economic success in the 4th Industrial Revolution. The GCI scale which is from 1 to 7, with higher average score meaning higher degree of competitiveness.

³⁰ Harvard (2022)

Figure 7: Ethiopia Potential Exports 2030 (\$million)



Source: UNDP projection

Note: This projection is conditional on the government’s reform roadmap. Annex 3 provides evidence on each of the products.

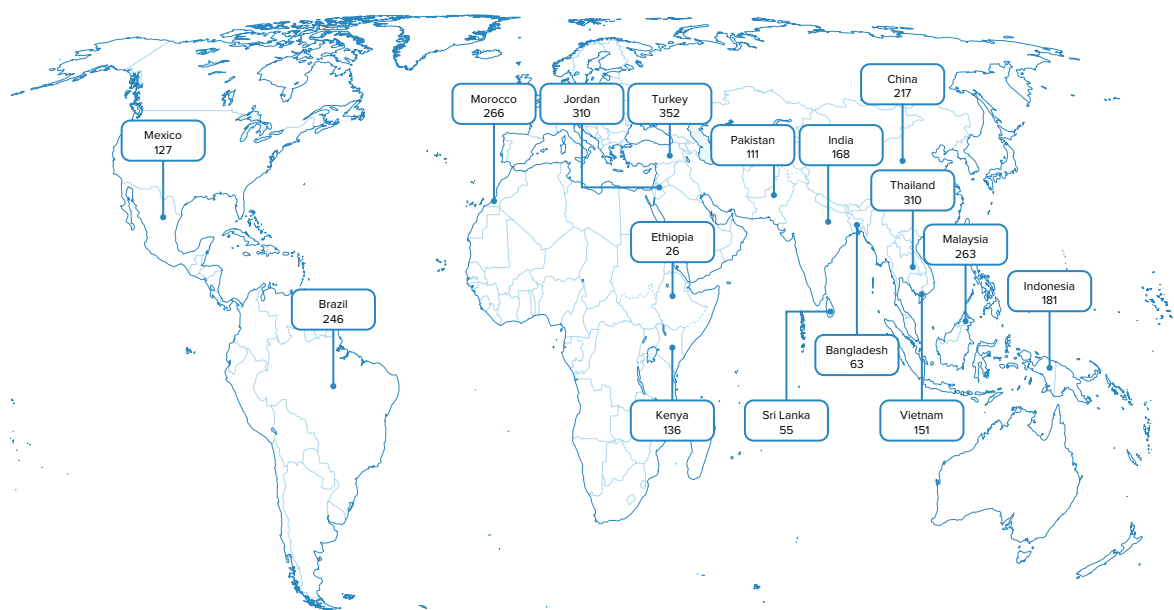
A. Garments

One sector that has been growing in importance in recent years has been the ready-made garment (RMG) sector. The first factory dates from the 1960s, but in the last two decades, the sector has really grown supported by favourable government policy, the creation of a network of industrial parks, and low-cost labour. The government supported FDI through tax and duty-free imports, low-interest finance, and subsidized energy. Also, there is low-cost energy as Ethiopia provides ample power from hydroelectric and geothermal sources. A plethora of government incentives helped catalyze the sector. Under the developmental state model, Ethiopia became one of the first countries to move towards industrialization and court foreign investors in garments. Both from a macroeconomic and microeconomic perspective, policies were put in place to help to support the sector's development.

The stylized facts tell a positive story. Garment exports to the European Union and the US have steadily grown from \$5 million in 2007 to \$70 million in 2016 to more than \$220 million in 2020. Due to the northern Ethiopia conflict and the consequent January 2022 suspension from the United States' tariff-free African Growth and Opportunity Act (AGOA), the production has slowed due to the loss of the largest customer. The hope is for RMG to increase significantly in the years to come in the aftermath of the Pretoria peace accord ending the conflict in the north.

The RMG sector has also benefited from the increase in labour cost in many countries globally, which has led to migration of industries to cheaper destinations such as Ethiopia. Many apparel manufacturers in Bangladesh, China, Turkey, and India moved to Ethiopia in the mid-2010s, spurred by the availability of low-cost labour, the availability of industrial land, and relative stability. The shift in global manufacturing in response to cost has been a consistent pattern over decades. Some of the earliest investors were Turkish and Western companies who were interested in the growth potential of Ethiopia and the investment possibilities. The overall sentiment of many investors towards Ethiopia has been quite positive. Many retailers, such as H&M, PVH, and JC Penny have relocated to Ethiopia. A state-of-the-art facility in Hawassa Industrial Park south of Addis is the nucleus of the Ethiopia garment industry. At least 34,000 people are employed in the industrial park there.

Figure 8: Monthly Wage Comparison in Garment Industry by Country (USD)



Map based on OCHA/ReliefWeb

The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations.

Final boundary between the Republic of Sudan and the Republic of South Sudan has not yet been determined.

Dotted line represents approximately the Line of Control in Jammu and Kashmir agreed upon by India and Pakistan. The final status of Jammu and Kashmir has not yet been agreed upon by the parties.

A dispute exists between the Governments of Argentina and the United Kingdom of Great Britain and Northern Ireland concerning sovereignty over the Falkland Islands (Malvinas).

*Non-Self-Governing Territory

Source: NYU, 2019

One of the characteristics of Ethiopia is the abundant availability of labour at a core monthly wage between \$26 and \$45 for skilled labour. It is noteworthy that Ethiopia has the lowest wages of any garment-producing nation. Figure 8 shows Ethiopia's low wage rate in comparison to other countries. This is significantly lower than competitors around the world. The salary appears to have been decided to correspond with that of the public sector. While in theory both the Government of Ethiopia and foreign apparel manufacturers have recognized the importance of having an official minimum wage that allows an affordable life, in practice this has not happened, partly due to fear of deterring some investors.

The sector faces several challenges. First, there is a labour issue. The combination of low wages and lack of adequate training were obstacles. Cultural differences abounded between Ethiopia workers and foreign managers. Managers noted low levels of worker efficiency, while workers noted low wages that could not meet the costs of transportation and living. The lack of money for room and board led to a high attrition rate for workers. During its first year of operation in 2017-2018, overall attrition at Hawassa park was around 100 percent, meaning that, on average, factories were replacing workers every 12 months.³¹ The study notes that in place of traditional union representation, 'workers' councils' are supposed to promote factory employees interests at Hawassa, but in practice, active councils operate in only a handful out of 21 manufacturing companies. An important research study of five Ethiopian firms (water-bottling plant, vegetable farm, flower farm, shoe manufacturer, and garment factory) found a 77 percent annual attrition among employees of five Ethiopian firms with workers complaining of difficult, low paid, and rigid jobs.³² The researchers noted that informal work opportunities, such as selling goods at street markets or doing construction, paid about as much as formal industrial jobs.

Other challenges are the supply and logistics chain, coupled with factory inefficiency. There is the absence of a domestic supply chain for textiles and garments, and much of the raw material, especially cotton and fabrics must be imported. There are no accessory suppliers and no washing and printing operations. On top of this, there are high freight costs that are deterring some foreign manufacturers from using the railway to the seaport in Djibouti. Finally, there is slowness in customs that does not allow speedy importation of raw materials. Factory efficiency is as low as 45 percent in production both in textile or garment assembly and as compared to other countries, production in Ethiopia takes about 45 to 60 days longer.

B. Cement

Ethiopia has been one of the top cement producers in sub-Saharan Africa in the last two decades, and its local industry has been growing rapidly, with double digit annual growth and close to 17 million tons in capacity. The rapid growth in the economy has been driven by and benefited from heavy investment in public infrastructure and a sustained construction boom as the Government invested in infrastructure and transport. In fact, according to World Bank Data, the construction sector in Ethiopia had been expanding rapidly contributing and was constituted about 21.5 percent of the national GDP in 2018; it constitutes about 72 percent of the GDP share of industry in the country. The construction sector has also been one of the most important sectors in terms of generation of employment opportunities for the burgeoning youth population in the country. Cement is a key intermediate input in construction and is used abundantly around the world and has few, if any, substitutes and certain types of infrastructure, such as dams, cannot be built without it. Therefore, for Ethiopia, the availability and quality of cement is critical for the booming construction industry.

³¹ NYU (2019)

³² Blattman and Dercon (2018)

It has an interesting history. The manufacturing of cement is said to have begun in Ethiopia in 1936 with the first cement factory was by occupying Italians in Dire Dawa town with 30,000 tons of yearly production. Two cement factories were built by the Ethiopian government in 1960's at Massawa (Eritrea) and Addis Ababa, with 70,000 tons each per year. In the year 1984 and 1991 two production lines were installed at Mughher with an installed capacity of 600,000 tons. Following the boom in the construction industry and the overall rapid economic growth, the cement sector has also been registering rapid growth over the past two decades or so. According to some estimates, Ethiopia's cement industry is the largest in Eastern Africa and the 7th largest in Africa though production is less than 10percent of that seen in Egypt, which tops the ranking.

It is predominantly run by the private sector. With 13 companies operating 23 plants, Ethiopia's domestic cement market is led by a mix of international and local players, of which Derba Midroc Cement, Dangote, Mughher Cement, Messebo Cement, Habesha Cement and National Cement (parent company East African Holdings), are the largest. Except for Muger which is a state-owned enterprise, the major players in the sector are private enterprises. Production is concentrated in and around Addis Ababa, which is home to over 40 percent of plants, with the remainder spread among five of Ethiopia's 11 regions. As of 2021, production was 5.5 million tonnes short of domestic demand and capacity utilization is a major challenge, with manufactures on average using less than half of the installed capacity on average. Total production was approximately 7.7 million tons per annum (Mt/a) during the FY21, despite 19.7 Mt/a of combined capacity. Dangote Cement owned by the Nigerian tycoon Mr. Aliko Dangote has a capacity of 2.5 million ton per year and capable of producing high-quality cement with the latest technologies and production techniques.

While capacity utilization in the sector is very low (around 50 percent on average), many existing market players such as Derba Midroc and Dangote have announced plans for major expansion projects to meet growing demand in the market. The rapidly growing demand in the market coupled with low-capacity utilization by the existing cement factories has meant rapid and consistent rise in the price of cement across the country. For instance, the price per quintal of cement which was around Birr 450 in June 2020 has increased to around Birr 1800 in August 2023. Several factors have been mentioned for the rapid and consistent rise in prices of cement in the country, especially availability of forex to purchase spare-parts and coal are basic impediments to cement factories to produce with their full capacity that led to 30percent reduction from the past. For instance, to the conflict in the northern part of the country, Mosobo Cement Factory, located in Tigray region, with annual production capacity of 900,000 tonnes, terminated its production for almost two years.

The sector has received state support but still faces challenges. Government has prioritized the industry since it is central to its growth agenda. A series of measures, such as easy regulation, allocation of foreign currency, fiscal incentives for domestic firms, and easy access to mining resources have helped the sector. Low- cost energy has helped the sector. However, ever since the signing of the Pretoria peace agreement, operations have continued to be disrupted. As of September 2023, the factory was operating at half capacity due to a lack of forex to replace damaged spare parts. Unhealthy market practices by retailers and distributors, market distortions as well as frequent changes to regulations applied by the Government on price and distribution of cement are also said to have contributed to the price hikes. Finally. another challenge is that regional governments have supported measures to increase the share of local content in foreign-backed cement projects.

C. Leather

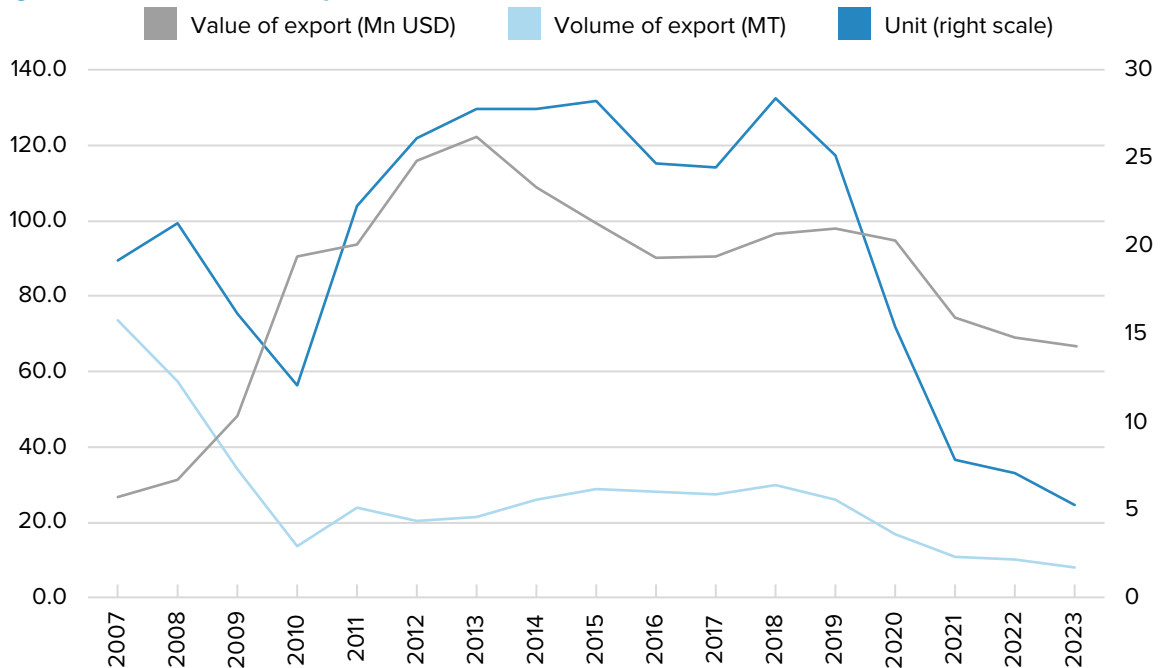
Leather is a promising sector. Ethiopia has a huge livestock potential consisting of 58 million cattle, 28 million sheep and 24 million goats which makes the country 2nd in Africa and 8th in the world, indicating an untapped potential. About 8 million cattle hides, 12 million sheep skins, and 8 million goat skins are

used annually. Moreover, Ethiopia’s hides and skins are known for their natural qualities of clarity, flexibility, strength, thickness, and compact fixture. The leather and leather products sector is promising due to its strong backward linkages with the rural economy it has a potential for poverty reduction).³³

Cognizant of this potential, government polices considered the leather sector as one of the priority manufacturing areas. Ethiopia has pursued a state driven industrial policy aimed at linking the leather and leather products sector to the global value chain. Through improving productivity and technology capacity, attracting investments, and creating market system, the Second Growth and Transformation Plan implemented during 2016 to 2020, targets to manufacture gross production worth of \$2.1 billion, generate export earning of \$707 million and creating over 300 thousand jobs from the leather industry cluster by end of the plan period. With policy attention and support from the Ethiopia Leather and Leather Products Development Institute (ELLPDI), established in 1998 to provide training and capacity building to tanneries and footwear companies, there has been significant growth in the value of leather product exports during 2010 to 2020. The value of leather exports increased from \$56 million in 2010 to reach \$132 million in 2015 but slowed to \$117 million in 2019. In the past four years however, the value of leather and leather products export drastically declined, and only \$25 million was obtained in 2023. Both unit prices and volume of exports have also been steadily declining which attribute to the decline in the value of exports. (Figure 9).

The sector has some major constraints that should be addressed. Major challenges of the sector include low quality of hides and skins due to poor management of the livestock, tanneries cause considerable environmental damages and not meeting international standards, lack of finance, there are numerous micro producers with diseconomies of scale, shortage of foreign exchange to import essential raw materials and lack of other inputs. Finally, there is a need to reaffirm policy commitments and addressing the critical bottlenecks to tap the potential. With its good quality and genuine leather products Ethiopia can claim a share of the global leather market size valued at \$32.5 billion in 2022 and expected to grow to \$48 billion in 2028.³⁴

Figure 9: Trends in Leather Export Values and Volume



Source: CSA

³³ Altenburg (2010)

³⁴ <https://www.linkedin.com/pulse/leather-market-booming-trends-global-outlook-2023-2030/>

D. Fertilizer

Fertilizer is another product which has considerable potential in Ethiopia. Given the country's large land endowment and agriculture potential, farmers are very dependent on fertilizer to have a successful planting season and good agricultural output. Unfortunately, the Ukraine crisis has led to a surge of fertilizer prices by more than 70 percent in the last year due to a spike in natural gas prices, a key component of urea-based fertilizers. The concern is that the sharp rise in input prices, such as fertilizer, could have a detrimental effect on food production in Ethiopia. The United Nations funds that the amount of fertiliser available globally has almost halved, while the cost of some types of fertilizer have nearly tripled over the past 12 months. The UN World Food Programme (WFP) has warned that the fertiliser shortage could push an additional seven million people into food scarcity, leading to declining cereal production in 2022 and 2023 by more than 10 percent.

There is a lack of adequate fertilizer production in Ethiopia. First, there has not been a concerted effort by the Government until recently, partly due to the ability to import fertilizer at cheap prices. Second, there are certain raw materials that are essential for production that the country lacks. Third, there are high capital requirements for investment in production. To remedy the situation, the Government of Ethiopia has taken some steps. Most important, in 2021, the Government signed a Joint Development Agreement with Morocco's OCP Group to implement a fertilizer project in Dire Dawa. However, as of August 2023, the plant has still not been built.

One challenge for Ethiopia has been to improve the efficiency of fertilizer distribution. Ethiopia will have to significantly increase its consumption of fertilizer products to meet the Growth and Transformation Plan targets. This will require dealing with existing constraints and improving the value chains so that these larger volumes of product can be handled without significant problems, including tackling bottlenecks in the procurement arrangements, macro- and micro-economic environment, infrastructure and logistics, and research and extension services. The research notes that estimation of annual national fertilizer import requirements can be a challenging exercise that can lead to over- or under-estimation of the actual demand that will prevail during planting of crops.

E. Horticulture

The Ethiopian horticulture sector has been quite successful in the last decade and has emerged as one of the new export sectors. Blessed by a favourable climate and diverse agro-climatic zones, the country has produced a diverse range of flowers, fruits, and vegetables. The country is noted for high-quality flowers and quality mangoes, banana, papaya, and avocados. The availability of abundant water for irrigation and the geographical location of Ethiopia have been positive elements. There are now cold chain facilities at three Ethiopian airports – Bole, Hawassa, and Bahir Dar that allow agro-processing to continue. The introduction of mechanized agricultural practices, coupled with accessible water for irrigation, has been transformative. The country's location with good freight links to Western Europe, the Middle East, and USA has also been important. The top export of Ethiopian floriculture is the Netherlands, one of the world capitals of flower auctions and distribution.

The empirics confirm a successful industry. The industry is worth more than \$568 million in 2023 in terms of exports. According to the Ethiopian Horticulture Producer Exporters Association (EHPEA), the business membership organization established in 2002, Ethiopia now has over 130 active flower-growing farms and is the fourth largest non-EU exporter of cut-flower to the European Union and the second largest flower exporter from Africa. Farm ownership is made up of local investors (46), direct foreign investors (76), joint venture partnership (3) and Development Bank of Ethiopia (1). There are more than 10,000 hectares of suitable land. The sector has created close to 200,000 jobs, out of which 70 percent are for women.

However, in recent years, the sector has faced both challenges and opportunities. The global financial crisis of 2008 led to a decline in global demand, with the number of domestic firms falling from 38 in 2007 to 15 by 2016. Moreover, a combination of poor selection of investors, lack of a problem oversight and control mechanism, and lack of capabilities in institutions to finance and monitor relatively new projects, adversely impacted the sector.³⁵ But the sector has benefited from government incentives and private initiative. Investors in horticulture are exempted from income tax for 8-10 years and from duties and other taxes on imports of machinery, construction materials, and raw materials and vehicles. An agency called Ethiopian Horticulture Development Agency (EHDA) and set under the Ministry of Agriculture and Rural Development became the one-stop shop for services required by investors including capacity building, investment support, and market promotion. The EHPEA was the conduit for the successful collaboration between the private sector and the state in the sector. Loan processes were streamlined. Long-term subsidized credit was also made available through the state bank (Development Bank of Ethiopia accounting for two-thirds of loans) on generous terms that included low interest rates (in fact negative real interest rates given the high level of inflation at the time) and low equity-debt ratio (30:70). The private sector also lends to these firms. Starting from 2003, land held by the government was made available at a very cheap price near Bole airport, leading to the creation of flower enterprise clusters.³⁶ Long-term leases of 99 years were given to farmers, and an efficient logistics chain was established using trucks to transport flowers and cargo space on Ethiopian Airline flights to Europe. Flowers are transported from local farm to foreign auction within 72 hours, reflecting the strong supply chain.

Foreign investors have played a key role. Many Dutch companies arrived to become investors in the floriculture space. Since 2004 many Dutch companies have started joint ventures in Ethiopia, bringing the total to about 130. These investors have helped upgrade skills, technology, and marketing expertise, and the industry has emerged as a world-class producer. There has been an investment in a sophisticated post-harvest cold chain infrastructure. From cutting to market takes about 72 hours, and flowers are delivered to the airport in refrigerated trucks about four hours before departure and then flown to auctions in the Netherlands.

Several lessons emerge from an analysis of the floriculture industry. First, the two binding constraints – land and logistics – were overcome through the development of land leases and a modern transport chain from farm to Bole international airport. Second, government generous fiscal incentives and soft loans from state-owned DBE, and removal of tariffs and duties on capital goods had a positive effect. Third, there was strong political support at the highest levels of the Ethiopian government, coupled with active involvement of the association.

F. Pharmaceuticals

The pharmaceutical industry is a sector which has had great potential in Ethiopia. Given the high population size, the rising middle class and rapid urbanization as many rural residents move to the urban areas, the sector is bound to grow. Given the huge demand for medicine, the sector has considerable potential. The African pharmaceutical industry is now valued at close to \$15 billion, which represents 3 percent of the global market. Historically like many other African countries, Ethiopia imported most of the pharmaceuticals. Other emerging markets like China and India have made major strides. In China, there are around 5,000 drug manufacturers that serve about 1.4 billion people, while in Africa, there are only about 375 drug manufacturers that serve 1.1 billion people. Almost all the vaccines consumed in Africa are produced outside the continent.

³⁵ Melese (2019)

³⁶ Gebreeyesus (2014)

The Ethiopian pharmaceutical industry is nascent. Currently, there are 20 pharmaceutical and medical supplies manufacturing industries in the country, many of them near Addis Ababa. The local market has been growing at more than 15 percent per year and there are projections that the industry can reach \$1 billion within the next decade from the current \$400 to 500 million. There are 11 manufacturers, with about half jointly owned by international and local investors. There is the emergence of both China and India in the pharmaceutical sector, with several joint ventures. There are currently three Chinese pharmaceutical companies operating in Ethiopia. Despite this, Ethiopia continues to import more than 70 percent of its medicines. These imports are mostly sourced from India (22 percent), Netherlands (20 percent) and Belgium (13 percent).³⁷ One important thing to note is that given the efficiency of Ethiopian Airlines, pharma products can be safely transported by air to ensure adhere to temperature standards.

The Ethiopian government has supported the industry in several ways. First, it has helped establish the state-of-the-art Kilinto pharmaceutical industrial park (KPIP). The park is on the outskirts of Addis, and it has 136 hectares of land for pharmaceutical manufacturing. It is governed by a proper legal framework and has a well-equipped facility. Second, unique among African governments, the Government has prepared a 10 - year national strategic plan of action (NSPA) for pharmaceutical manufacturing from 2015 to 2025. The core of the strategy is to grow exports, substitute imports, and improve access to medicines. The aspiration is to become a pharmaceutical manufacturing hub of sub-Saharan Africa. Third, the Government provides incentives for local production, including loans of up to 70 percent for new investments (so the investor needs to invest only 30 percent of the project capital at inception) and up to 60 percent for upgrading projects during the first five years.

The sector faces several challenges. First, there are capacity constraints. Local manufacturers have limited product portfolios and are thought to be able to supply only 90 of the more than 380 products on the national essential medicines list. Around 35–40 percent of their total output is supplied to the private sector at a price premium of 10 percent. Second, there are some sub-standard products in the market, with some estimates suggesting that 10 percent or more of products are substandard. Third, Ethiopia does not have favourable fiscal incentives for exporters.

G. Metals

The metal industry is an important and promising industry in Ethiopia. The Basic Metal and Engineering Industries (BMEIs) were identified as a priority sub-sector for industrial development in the Growth and Transformation Plan (GTP). The goal was to replace Ethiopia's expensive imports with domestic production. The sector has had a mixed record. On the one hand, it has scaled up significantly over the years and is projected to continue to grow. According to the Ethiopia Metals Industry Outlook 2022 – 2026, the country's metal imports are set to increase by approximately 400,000 metric tons by 2026. The demand has grown at an average rate of 2.8 percent each year since 1998, reaching 2.3 million metric tons in 2021. New factories have been built in recent years. In Amhara, given its proximity to iron ore reserves, a new factory was built in 2021.

On the other hand, it faces several challenges. First, there is a tariff structure which favors imports over domestic production and a difficult taxation regime. There is a 5 percent import duty on scrap metal exports while the finished product is imported duty free. Second, there is the perpetual shortage of finance. Even government organizations favour imports over domestic production. Third, there are infrastructure challenges in the sector, including frequent power cuts. Finally, there is the monopoly of

³⁷ Some 60 percent of total pharma spend in Ethiopia is public and social sector related, making the Ethiopian Pharmaceutical Supply Agency (EPSA) the single most powerful buyer in the country (How We Made It in Africa, 2022).

Ethiopian Shipping and Logistics Enterprise. Finally, the supply of the inputs is done under the Metal and Engineering Corporation, depriving industry of quality inputs.

Box 4: Case Study

The Company X is converted from a family business and initially it was a textile accessories import business. In 1996 the first industries were established. In 1999 wire processing industries was established. In 2004 it become a big company with \$45 million investment which was later expanded by \$78 million investment with a production capacity of 120,000 tons per year. It has 11 Private Limited Companies of which five are manufacturing plants. It is a Holding company though there is no legal framework for holding companies in Ethiopia in terms of listing, consolidation etc. It has also 5,000 employees focusing on steel production and for domestic market. Its major challenges include inadequate workers skills, raw materials supply, foreign exchange shortages and power outages and access issues. The steel producing company has installed capacity of producing 500,000 tons per year but currently producing only 50,000 tons because of shortages in raw materials. Technology, high logistics cost and monopoly are key challenges.

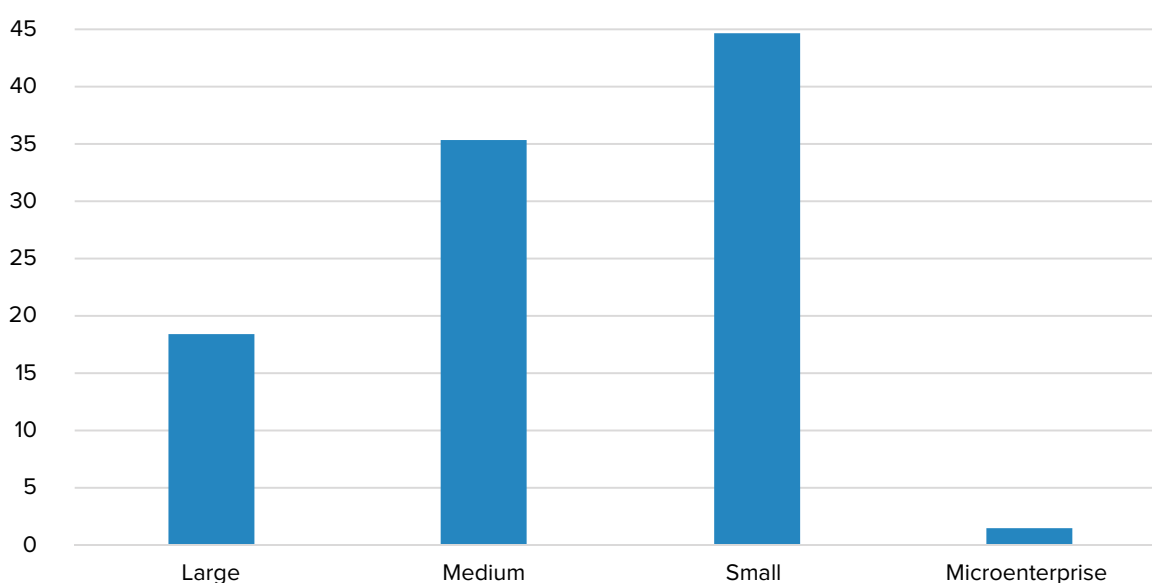
Over ninety percent of steel industries are FDI in Ethiopia except for 3 or 4 companies. A capital-intensive industry and finance is critical, so the company is working with all banks in Ethiopia. Since commercial banks cannot give long term loans, they are also working with DBE. Foreign exchange is a challenge. The interest rate charge ranges between 16 to 18 percent from commercial banks and 12 percent for DBE loans. Land policy has no problem, but practicality is a challenge due to bureaucratic hurdles and corruption at lower level of land administration. Customers are private sector, government, real estates, construction companies etc. Government policy advantages include duty free privileges to machinery except VAT; tax holidays benefit; and priorities in getting services as a good taxpayer.

A. Survey Results

A small qualitative and quantitative survey of 70 firms was conducted from August to November 2023 to obtain latest information on the challenges facing firms in Ethiopia. Though the sample was not large and was not fully representative, it provides useful insights that match the results of other surveys and confirm team interviews. Though the magnitudes may be different from a much larger survey, the key directions and constraints have been echoed previously.³⁸ Based on standard Enterprise Survey, the 35 questions focus on firm size, characteristics, access to finance, corruption, taxation, business-government relations, networks, technology, logistics and infrastructure, and inputs (Annex 1).

There were some interesting insights. Most firms surveyed (67 percent) were in the trading business. Only 14 percent were manufacturing firms. About 19 percent were identified as firms engaged in manufacturing and trading. While most firms in the survey were in the trading business, 83 percent expressed their interest in expanding into manufacturing. The distribution of firm sizes was approximately 45 percent small, 35 percent medium-sized, and 19 percent large firms (Figure 10). There were only two microenterprises. These firms represent a diversity of sectors, including trading, food and beverage processing, garments and textiles, pharmaceuticals, and metal/steel. Over 70 percent of the firms have been in business for over 5 years. Approximately 17 percent have been in business for 3-5 years, while 13 percent have been operating for less than 3 years. Most of these firms (57 percent) were run by men.

Figure 10: Size of Firms Surveyed (percentage)



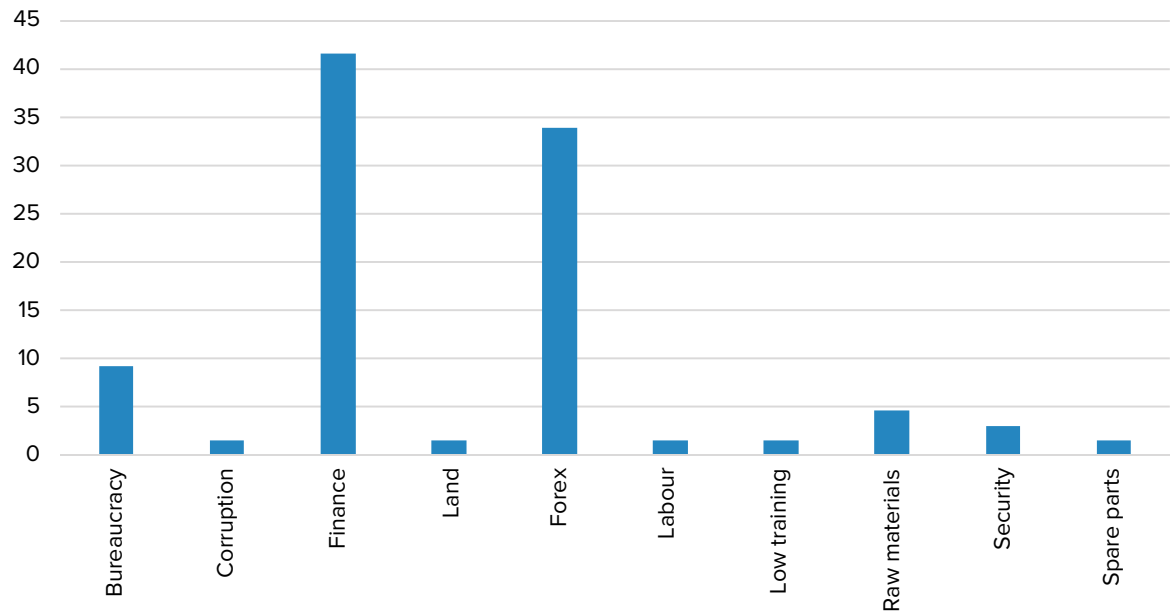
Source: UNDP Survey

For most firms (nearly 42 percent), the single top challenge they face is access to finance, which is also reported as the main challenge preventing them from expanding (Figure 11 and Figure 12). Only 23 percent manage to get loans from banks as a primary source of finance. More than half of the firms use their savings to finance their business. Approximately 17 percent use the savings of family and friends as their primary source of finance. In general, personal savings serve as a primary source of finance for 68 percent of firms. To generate finance, 70 percent of the firms asked for a bank loan, but fewer received loans. Collateral has been a challenge for 75.4 percent of the firms.

³⁸ World Bank Investment Climate Survey (2015), UNDP (2018)

Other **challenges** reported by firms include: a shortage of foreign exchange (34 percent), bureaucratic hurdles and corruption (9.2 percent), raw materials (4.6 percent), and security issues (3.1 percent).

Figure 11: Top Challenge to Doing Business (Percentage)

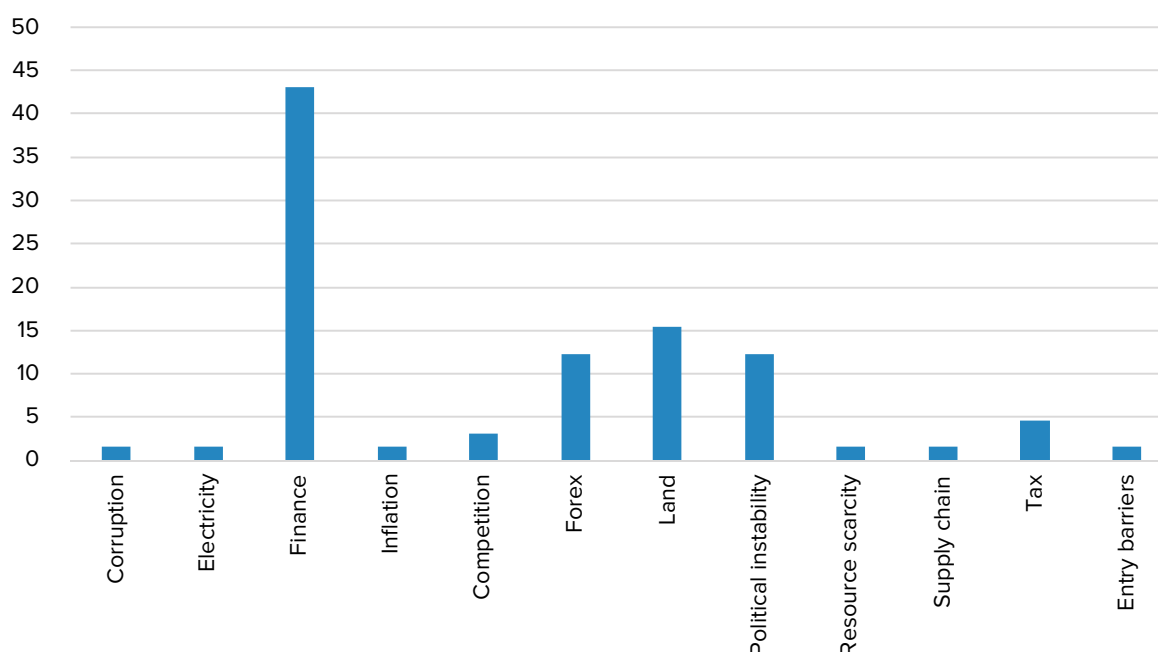


Source: UNDP Survey

Various factors are preventing firms from expanding their business (Figure 12). The prevalent business expansion-hindering factors firms face include lack of finance, land access, foreign exchange, and political instability. About 41.4 percent claimed that access to finance is the major challenge, and 81.5 percent of the firms noted that the first four challenges prevent them from expanding their businesses. Other firms have mentioned tax rates, difficulty penetrating the international market, and informal competition as the top hindering factors.

There are concerns among the business community. Over half of the respondents (55.4 percent) believe the country’s **business environment** has greatly worsened in the last few years, while 15.4 percent said it worsened slightly. In general, a majority (70.7 percent) believe that in the last few years the business environment in the country has been deteriorating. Only 20 percent of the surveyed firms reported they benefit from **government support**, usually in the form of access to infrastructure (25 percent), regulation (20.8 percent), policy (12.5 percent), and skills training (12.5 percent). In comparison, 63 percent of the surveyed firms said they have not benefited from government support.

Figure 12: Top Challenge Preventing Firm Expansion (percentage)



Source: UNDP Survey

Access to land, taxation, and corruption. Land is an important resource and shall be available for businesses at market prices. The survey found that 43 percent of the surveyed said they paid a market price for land, while 30.8 percent said they had not paid the market price. However, it was not relevant to their business for the remaining firms. Regarding tax rates, more than 63 percent of the firms perceive that they are liable to high taxes in the country. Only nearly 5 percent believe that tax is low. This tax perception will directly link with firms’ economic decisions³⁹ Corruption is also one of the factors that has an implication on the cost of doing business. Nearly 34 percent of the respondents believe other firms in the country are corrupt, while 47.7 percent said other firms are corrupt only partly. Respondents generally believe other firms’ corruption is prevalent in the country, as only 18.5 percent of respondents believe otherwise.

Entrepreneur skills. The survey showed some inadequacy in skill. In theory, entrepreneurial capabilities and skills help firms locate opportunities and commit resources and activities to utilize those opportunities. These skills can be learned from a variety of sources. However, more than half of firms claimed they are self-taught entrepreneurs, while 20percent took training. Nearly 14percent learn the skills from their families. Entrepreneurial network was also a source of skill and capacity for only 9.2percent of the firms considered in this survey suggesting a shallow network.

B. Macro Policy and Exchange Rate

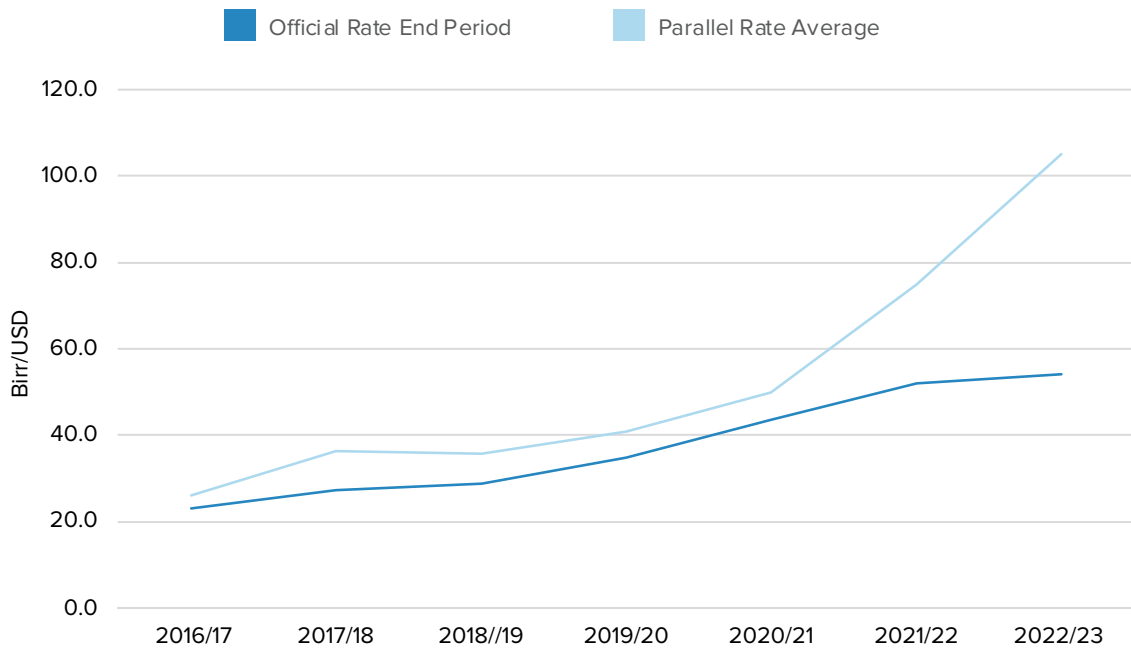
The key macroeconomic challenge for industry is the overvalued currency and the shortage of forex. Over the years, exchange rate overvaluation, as measured by the gap between the official and the parallel market, has widened (Figure 13).⁴⁰ Exchange rate overvaluation can be thought of as a tax of exports and a subsidy on imports. An artificially overvalued currency introduces distortions in an economy and discourages domestic production since the price of imports is artificially cheaper. It can have a negative ripple effect on the entire economy. The consequence of a widening black-market

³⁹ Fochmann et al. (2010)

⁴⁰ There are many ways to measure exchange rate overvaluation. The one used here is a useful first approximation.

premium is an acute shortage of foreign currency. A more competitive currency can correct this distortion. But a complex political economy of traders and importers supports an overvalued currency. Devaluations can be useful to achieve a less misaligned currency. Furthermore, the requirement that FDI surrender at least 50 percent of forex has been an obstacle to investors.

Figure 13: Official and Parallel Exchange Rate



Source: NBE

C. Access to Land

Land availability is key for manufacturing. In Ethiopia, land has been cited as a constraint for business. It is high time to unfreeze action on this issue and to begin policy experiments to see how improvements in access to land can serve to boost investment. Constitutionally, land in Ethiopia is owned by the state, and it has been at times a contentious issue. By Article 40 of the Ethiopian Constitution, all right of ownership of all urban and rural land is vested in the state. Technically, this means regional governments, but when it comes to industrial parks, it is the national government. As a former socialist economy, Ethiopia does not have a tradition or legal framework for private property rights, and there is no land market. It is the Federal and regional governments who are responsible for land allocations. There have also been competing claims by different regions. The coordination between the different levels of government on land issues remains a challenge. Although millions of acres of land have been allocated to domestic and private investors in recent years, there has not been a transparent assessment of the development impact of that investment. A recent study finds that there is scope for improvement of information sharing about regulations, land allocations and investors, particularly between federal and regional governments, and between the government and the public.⁴¹ There is a lack of clarity on the identity of major investors, the size and location of land allocated by the federal government, the lack of maps showing the exact areas for land leases, business plans related to investments, environmental impact assessments, and monitoring reports on the progress of different investments need elaboration.

However, land is available to investors according to certain parameters. However, there have been experiments with user rights and land leases by both domestic and private investors, including in the

⁴¹ Gates Foundation (2013)

development of floriculture farms. The provision and availability of land for investors is a major factor influencing investment decisions. Land is made available for investment on leasehold and rental basis, with land available for up to 99 years. This can be considered a form of de facto property rights. This is according to the Urban Land Leasehold Proclamation No 721/2011 and FDRE Rural Land Administration and Land Use Proclamation No 456/2006, which govern land administration. Industrial parks have different land modalities in that investors can lease land and can rent or buy factory sheds from developers.

Many domestic and smaller firms have not been able to find land for industry. Qualitative interviews suggest that problems acquiring land often prevent firms in Sub-Saharan Africa and Ethiopia with 4–5 employees from growing into businesses with more than 10–15 employees. To do so, they would need a larger workspace connected to affordable and reliable utilities and offering reliable transport links to markets for inputs and outputs.⁴² More generally in Sub-Saharan Africa, industrial zones are usually reserved for large exporters.

D. Lack of Single Unified Market

In parallel, there is the absence of a single unified domestic market. Based on interviews and anecdotal evidence, the country is fragmenting into multiple regional markets, especially with different taxes, subsidies, and licenses across regions. This means that Ethiopia is at risk of taking a major advantage – its large potential domestic market – and inadvertently turning this into a disadvantage. Due to a poor security environment and different policy regimes in different regions, there are many internal barriers to the free movement of labor and capital throughout the country. Security checkpoints across the country, the rise of ethnic-focused banking, the difficulty of investors of some ethnicities to relocate to other regions (de facto discrimination rather than de jure), the coexistence of food deficit and food surplus areas, and the wide differential in agricultural prices are testament to a fragmented national market.

The coordination between the different levels of government remains a challenge. In the Ethiopian case, although the federal government is empowered to license and administer investments with foreign components, it must depend on states to supply some vital inputs for investment, including land, which they administer. In some situations, states hesitate to provide land to federally licensed investors, as has been seen in the Gambella region.

E. Access to Inputs

Access to inputs is a key requirement for the transition to manufacturing. A stable and reliable supply of inputs, whether raw materials or intermediate goods, ensures manufacturing efficiency. Ethiopia has a uneven quality of inputs, depending on the sector. Textile and apparel sector specialized enterprises operating in different IPs sourced less than five percent of their raw material and input needs locally in the year 2020. Moreover, even intermediate inputs and goods are imported as there is a lack of domestic supply chain development. For sectors such as pharmaceuticals and cement, much is imported from outside.

In the domestic market, inputs in horticulture, agro- processing, and coffee are good, and these sectors have well-developed competitive supply chains. On the other hand, inputs for selected sectors are quite weak, especially leather, metals, and meat. In fact, the Ethiopian industrial inputs development enterprise has been supplying these inputs at low quality. Besides, the forward and backward linkage between the manufacturing industries and different sectors is weak. However, there is a significant amount of potential for the primary sector to supply inputs both in quality and quantity.

⁴² Dinh et al (2012)

F. Access to Finance

Limited access to finance is a critical bottleneck for manufacturing in Ethiopia.⁴³ In the past four years, there have been rapid growth particularly in the stock of credit which went up fourfold from Birr 0.5 trillion in 2019 to Birr 2 trillion in 2023. However, the amount going to the manufacturing sector has been low. A disaggregated breakdown of sectoral credit indicates that bank loans are skewed towards trade finance (both domestic and international trade) (Figure 14). In the past two decades, much of credit went to the trade sector (32 percent) followed by manufacturing (26 percent), housing and construction (11 percent), and agriculture (9 percent). In the past four years, the productive sectors (agriculture and manufacturing) jointly accounted for close to a quarter of total loans, while the trade sector alone accounted for nearly one-third of the stock of credit advanced by banks.

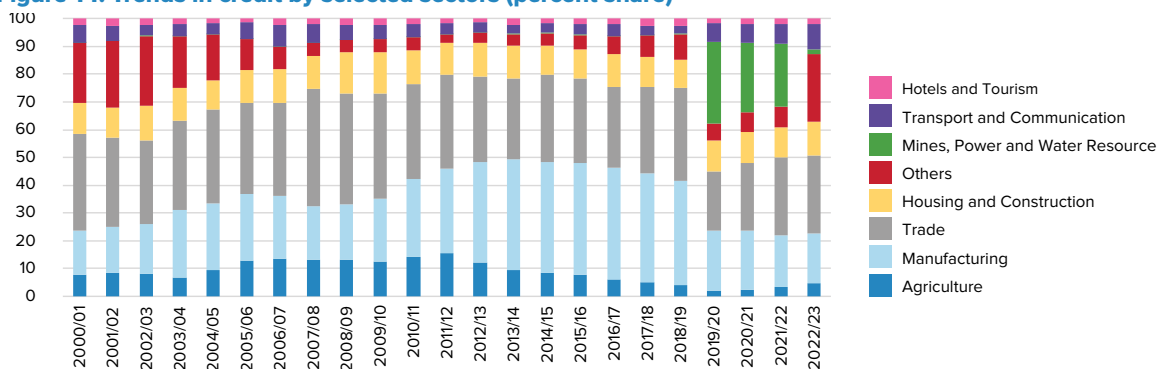
The share of credit to manufacturing has been increasing briefly during the Growth and Transformation Plan (GTP I and II) period (2011 to 2019). During this period as part of the strategy, up to 40 percent of the total credit of the banking system went to the manufacturing sub-sector. However, after 2018 the share of credit to manufacturing declined to about 20 percent of total credit. In the past three years, there has been the rise of new sectors, such as mining, power, and water resources sector, which received a quarter of bank credit. In terms of loans by sector, trade sector loans reached Birr 544 billion in 2023 followed by manufacturing at Birr 351 billion, housing and construction at Birr 239 billion and transport and communications at Birr 176 billion (Figure 15). Agriculture has remained negligible in terms of getting credit.

A detailed analysis of the loans of Development Bank of Ethiopia (DBE), a specialized state-owned bank providing loans to policy prioritized sectors, provides some notable patterns. The Bank focuses on the productive sectors in agriculture, manufacturing, and microfinance. The total stock of credit advanced by DBE to the priority sector reached Birr 63 billion in June 2022 compared to Birr 51 billion in 2019. In the past four years nearly on average 60 percent or Birr 33 billion went to manufacturing followed by 17 percent or Birr 10 billion to agriculture and 12 percent to micro financing. Figures 16 and Figure 17 depict the credit to each sector and the percentage share.

Several factors have been cited to explain why bank financing is skewed towards the trade sector in Ethiopia. Banks have conservative risk models and prefer to lend to the trading and services sector than to the productive sectors such as manufacturing and agriculture for several reasons. First, banks largely have short term deposits and must match their assets and liabilities implying that they prefer to lend short term loans to trade while manufacturing requires relatively longer-term loans and associated risk of default is higher. Second, trade has quick turnover and is less risky. Third, banks have stringent collateral requirements, and the manufacturing sector firms have inadequate collateral. Four, many of the manufacturing firms do not have clearly bankable projects. Manufacturing industries do not appear to have a good track record in repayment of loans.

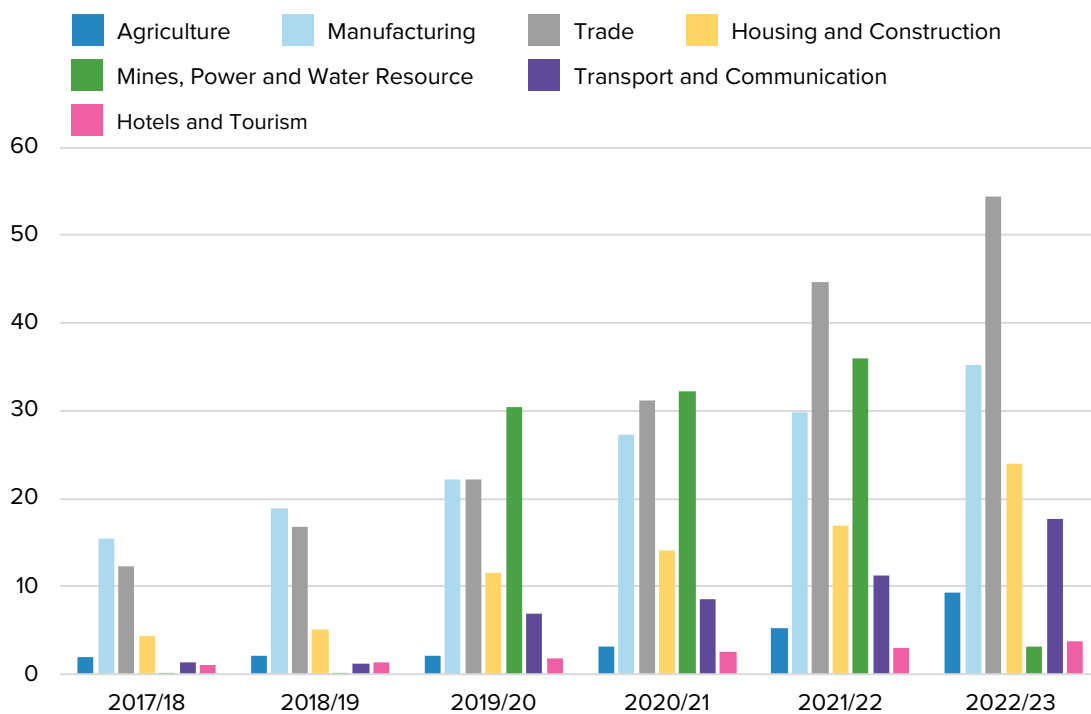
⁴³ The financial system in Ethiopia includes both formal and informal institutions. The formal financial sector currently includes 30 banks (29 commercial and one development bank), 18 insurance companies and 43 microfinance institutions as well as several credit unions providing micro-credit to their members.

Figure 14: Trends in credit by selected sectors (percent share)



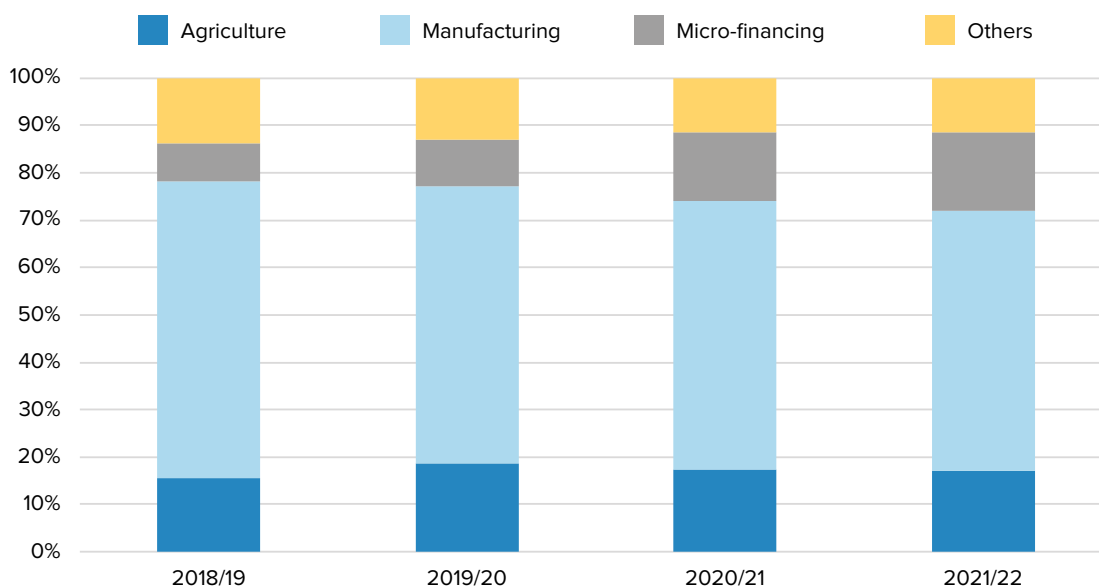
Source: NBE

Figure 15: Trends in Outstanding Loans by Sector (billion Birr)



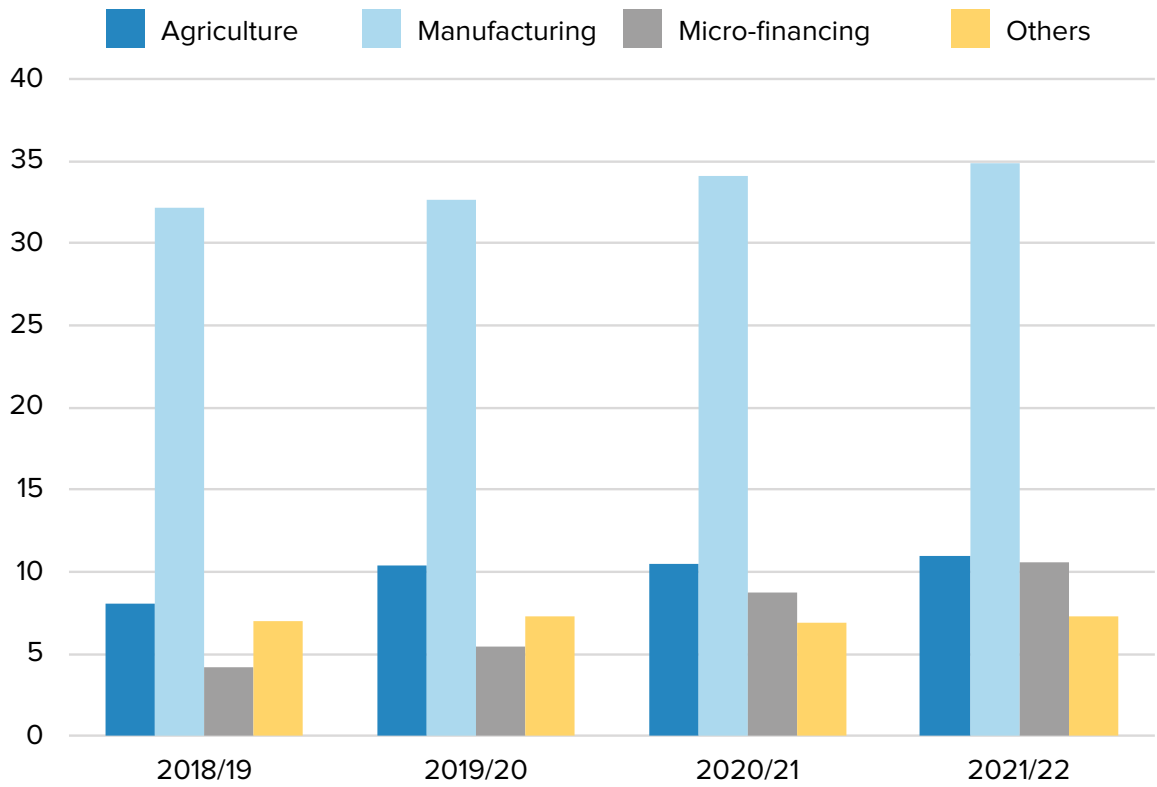
Source: NBE

Figure 16: Share of DBE loans by Sector (percent)



Source: DBE

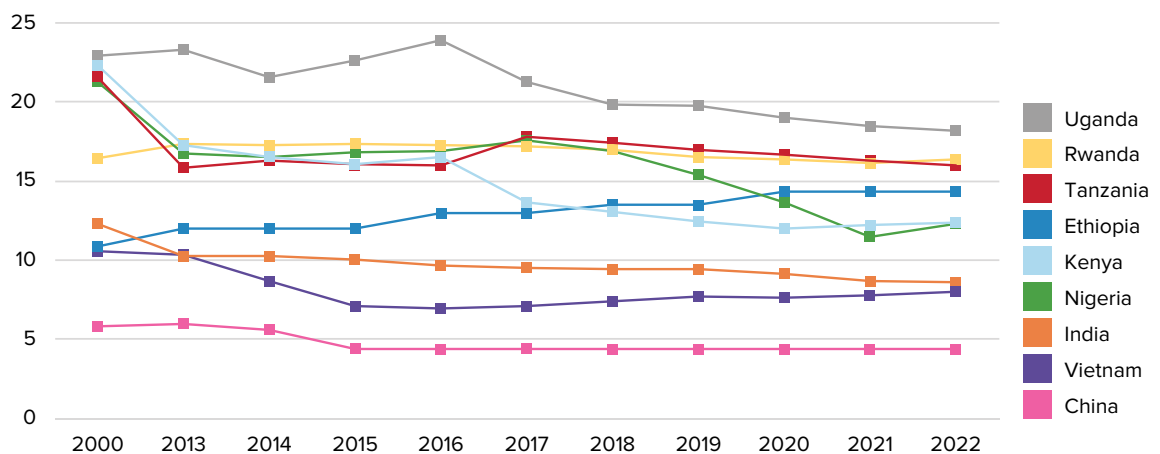
Figure 17: Trends in DBE Credit by Sector (Billion Birr)



Source: DBE

On top of this, interest rates are relatively high. A cross-country benchmarking exercises notes that the cost of capital for firms in Ethiopia lies at the midpoint among comparators (Figure 18). While countries like India, China, and Vietnam have lower lending rates in the single digits, Ethiopia's rate of 14 percent in 2022 is lower than that of competitors such as Rwanda, Tanzania, and Uganda. The data show that finance for manufacturing and other sectors is higher in sub-Saharan Africa than other parts of the world. However, sectoral allocations for other African countries may be higher than that of Ethiopia.

Figure 18: Bank Lending Rates Comparison (percent)



Source: World Bank WDI

Box 5: The Development Bank of Ethiopia

The Development Bank of Ethiopia (DBE) is the second largest bank in Ethiopia with key focus on export oriented and import substitution projects in large scale manufacturing, agroindustry, and mining sectors. More particularly, its operation focuses on promoting structural changes in priority sectors, textile and garment, horticulture, pharmaceuticals, cement, state owned enterprises and small and medium enterprises (SMEs). Since close to 90 percent of its loans go to the manufacturing sector, this policy bank is uniquely positioned. It has a long banking experience and has passed through a difficult history. The bank has undergone several restructurings, recapitalization processes, and has been renamed eight times over the past sixty years. It is reputed to have among the lowest lending rates in the business, at an average of 8.5 percent for priority areas.

DBE's record has been mixed. While it has supported projects in horticulture and garments, it has also faced multiple challenges. First, it has many bureaucratic inefficiencies and slow loan approval and disbursement process. Many loan applicants do not have the 30 percent equity required to get 70 percent funding, and there are unsettled land issues of loan applicants. Second, it favors foreign investors in terms of loan allocations. Third, it purchases Treasury bills and continues to constrain private commercial bank operations. Finally, it does not have a professional culture of structuring project finance and professional risk management, and it has given loans to large agricultural and industrial firms that have defaulted on these loans.

Non-performing loans have been a concern at DBE. NBE had NPL's averaging 10 percent in 2010, but that went up to over 40 percent in 2019. Recently, it has come down to less than 15 percent. An assessment of DBE loan book shows a never-ending restructuring of loans or debt rolling under various names. This has led to the creation of zombie firms with very bad debt/equity ratios and low profitability. The bank has been accumulating nonperforming (NPLs) due to a combination of weak project analysis capacity, inability to administer loans according to their original loan covenants, weak leadership, and government intervention targeting to reward politically connected firms.

DBE could benefit from reform. DBE also should be subject to the same prudential qualitative and quantitative requirements as private banks including effective governance arrangement and robust risk management standards, particularly credit risk management prerequisites. Given the role of a well-structured and performing development bank could play in countries such as Ethiopia where financial intermediation level is very limited, and availability of long-term finance is scarce, it is essential to undertake a serious review of DBE's balance sheet and subsequent restructuring and recapitalization that would enable the bank to achieve its policy bank objectives.

G. Trade Logistics

Logistics is another Achilles Heel for Ethiopian exporters.⁴⁴ Since the country is landlocked, it has difficult access to the sea and relies on foreign ports, especially Djibouti, together with a few dry ports. Efficient logistics is an important element of a supply chain. Expanding the accessibility and ensuring the quality of infrastructure such as road, railway, dry port, air transport, energy, telecommunication,

⁴⁴ By definition, logistics is the process of planning implementing and controlling procedure for the efficient and effective transportation and storage of goods including services and related information from the point of origin to the point of consumption for the purpose of confirming to customer requirements (Global Logistics Institute 2020). This definition assumes the three flows associated to the logistics chains: a flow of information, a flow of cargo and a flow of transactions (including regulatory compliance).

and water and irrigation schemes contribute to the expansion of investment and boosting regional economic integration. International evidence suggests that the performance of logistics services is normally measured based on cost, time, and reliability—and reliability is generally measured as the variability of the time. No country has become a strong manufacturing exporter without a strong logistics supply chain.

By a variety of metrics, Ethiopia’s logistics is poor, with concerns about supply chain reliability and predictability of service delivery. Ethiopia’s logistics facilities, especially distribution, packaging, warehousing, and inventory management are missing or inadequate, undermining export competitiveness. According to the World Bank Logistics Performance Index, which compares logistics status of countries, Ethiopia’s performance is not only the lowest, but also lagging compared to other countries, indicating the logistics challenges for the Ethiopian economy. Ethiopia’s LPI ranking declined from 104 in 2020 to 145 in 2022 and its value from 2.59 to 2.35 in the same period (Table 1). Table 2 shows the time required to import TEU (twenty-foot equivalent unit) cargo for both multimodal and unimodal transport systems and Table 3 documents the transit time required in days. The total time required for import of containerized general cargo under multimodal system has reduced and saving 86 days from 198 days under unimodal to 112 days under multimodal. The decline largely came from the time required to submit foreign currency permit and LC opening (by 15 days), waiting time for ship at port of discharge (by 31 days), and dwell time at dry port (by 41 days).

Table 1: Logistics Performance in Light Manufacturing

Countries	2022		2020	
	LPI Rank (160)	Overall LPI (out of 5)	LPI Rank (160)	Overall LPI (out of 5)
China	22	3.86	28	3.53
Botswana	60	3.00	120	2.49
Vietnam	58	2.88	48	3.15
Cambodia	77	2.80	83	2.74
Bangladesh	87	2.66	108	2.56
Ethiopia	145	2.35	104	2.59

Source: Maritime Affairs Authority (EMAA), 2022, World Bank, 2020

Table 2: Logistics time for import cargo under unimodal and multimodal

Activities	Unimodal		Multimodal	
	Time (days)	percent	Time (days)	percent
Submit foreign currency permit and LC opening	60	25	45	40
Waiting time for ship at the port of loading	10	0.05	10	9
Shipping at sea	25	14	25	23
Waiting time for ship at the port of discharge	37	20	6	5
In land transport	3	0.016	3	2
Dwell time at dry port	60	33	19	17
Customs clearing and shipment delivery	3	0.016	4	4
Total	198	100	112	100

Source: Maritime Affairs Authority, 2022

Table 3: Transit Time (Days)

Activities	Unimodal			Multimodal	
	Bulk	container	RoRo Roll on/ Roll off/	container	RoRo (Roll on / Roll Off/
Get transit permit from customs in Ethiopia	2	2	2	2	1
Customs clearance at Djibouti	3	2	2	1	1
Get delivery order from ship agent at Djibouti	2	1	3	1	1
Receiving goods at port	3	1	1	1	1
Carrier assignment and getting port gate pass	2	1	1	1	1
Loading and documentation for land transport	1	1	3	1	2
Inland transport	3	3	3	3	3
Customs clearance at the destination and shipment delivery	4	1	2	4	4
Total	20	12	17	13	16

Source: Maritime Affairs Authority, 2022

Ethiopia has expensive logistics costs. In terms of the cost incurred in shipping and land transportation, cargo handling operations at seaports and dry ports until the shipment is delivered to the consignee, Ethiopia has a costly logistics chain, especially when compared to competitors. The costs and time that it takes for a 20-foot light container to be imported from to Addis Ababa through the Port of Djibouti, based on the several diagnostic studies, demonstrates the major bottlenecks and cost drivers.

- > One of the major costs is obtaining a letter of credit for the importer of the goods which would cost 3 percent of the value of the goods or \$3000 (41 percent of the total cost). The sea and truck transports are very similar, and each represents about 25 percent of the total cost. Both the cost of the LC and the cost of truck transport are high by international standards.
- > For the transit time, the dry port and customs clearing accounts for 53 percent of the total time.
- > The total cost of logistics declined from \$2,438 under multimodal to \$2,602 under unimodal indicating a 6.3 percent decline.
- > Port service at Djibouti and land transportation to Ethiopia are considered very expensive and account for more than two third of the logistics cost (Table 4). The average cost for 20ft and 40ft containers at Mombasa, Dar es Salaam and Port Sudan respectively are \$65 and \$87 (Table 5).
- > The cost of 20ft container at Djibouti port is \$275 which is over fourfold higher (323 percent) than the average cost for the three ports. Similarly, the 40 ft container at Djibouti port costs \$550 which is over sixfold (532 percent) comparing with the average cost of the three. Ethiopia is paying more than \$1.5 billion in port fees to Djibouti per year.
- > Though they declined by \$50 and \$127 under multimodal compared to unimodal, the inland dry port cost has increased by \$13 under multimodal system.

Table 4: Logistics cost

Cost List	Unimodal		Multimodal	
	Cost (USD)	percent	Cost (USD)	Percent
Shipping at sea	725	28	725	30
Port service at Djibouti	650	25	600	25
Land transportation to Ethiopia	1127	43	1000	41
Inland dry port	100	4	113	4
Total	2602	100	2438	100

Source: EMAA, 2022

Table 5: Comparative cost shore handling for import containers

Container Type	Mombasa	Dare Selam	Port Sudan	Average	Djibouti	Djibouti compared to Average
20 feet	85	70	40	65	275	+318 percent
40 feet	85	95	80	87	550	+525 percent

Source: EMAA, 2022

A disaggregated data shows the cost breakdown. The export logistics cost is calculated by taking a representative cargo - textile product with a 40 feet container from the port of Djibouti to Istanbul port (Turkey) and coffee with a 20 feet container from port of Djibouti to Hamburg (Germany). The comparison is depicted in Table 6. The total estimated cost of a 20 ft coffee container is \$1950 and nearly half or 49 percent is cost of shipping and 26 percent of the cost is for land transport Addis Ababa to Djibouti. For a 40 ft textile container the total cost is \$3,160 of which 44 percent is for shipping, 32 percent for land transport and 21 percent for port handling charges at Djibouti port.

Table 6: Logistics cost to export a container under unimodal.

Cost list	Cost 20 feet Coffee (USD)	percent to total cost	Cost 40 feet Textile container (USD)	percent of total cost
Land transport cost (Addis Ababa – Djibouti)	510	26	1020	32
Port handling charges at Djibouti	450	23	660	21
Shipping cost	950	49	1400	44
Commission and other expenses				
Total	1950	100	3160	100

Source: EMAA, 2022

To improve the logistics chain, the Government has started on a reform programme. The Government has a vision of cutting import and export transit times in half and reduce the average length of time imported goods spend in dry ports to only two days. In 2018, the Ethiopian Government decided to open its logistics sector to foreign participation but decided to cap FDI participation. The sector has long been dominated by state-owned Ethiopian Shipping and Logistics Services Enterprise (ESLSE), which is a profitable low-debt monopoly, and which had more than \$100 million annual profits

in recent years, but which has been criticized by investors for being expensive and slow.⁴⁵ Foreign firms will now be allowed to take stakes of up to 49 percent in logistics businesses, ending ESLSE total control of multi-modal transport. The removal of restrictions on foreign investment in packaging, forwarding, and shipping agency services has been a key decision. The Government has also opened multi-modal transport to the domestic private sector, but implementation has been slow. Finally, with the assistance of \$150 million from the World Bank, the Government has built a logistics facility in Mojo and made it a dry port.⁴⁶

H. Skills

Despite significant investment, Ethiopia faces a skills deficit both at entrepreneur level and at worker level. In interviews, the management, and leadership of local firms points to limitations in business planning, market knowledge, and leadership among many entrepreneurs. Ethiopian entrepreneurs are mostly family-run businesses with a limited social network. Anecdotally, bankers have complained about Ethiopian manufacturing having high levels of non-performing loans (NPL's). There is the absence of industry and product knowledge. On top of that, worker productivity is low, including in the industrial park. Even though the labour market in Addis Ababa is tight and marked by high unemployment rates, underemployment, and low earnings, job seekers lack the training and technical skills. Unemployment of TVET graduates averages close to 50 percent in 2022.

The TVET programme has not had a major impact with a continued skills mismatch. The TVET system in Ethiopia has well-organized components namely: an outcome-based system, cooperative trainings, and assessment scheme that operates based on nationally defined occupational standards. Despite its long history in Ethiopia, the TVET system has made some fundamental reforms in the past two decades only. Accordingly, the number of TVET institutions has increased substantially and access to TVET, especially for women, has improved. It helps to facilitate technology transfers and produce mid-level skilled manpower that the country needs to spur its industry-led growth and achieve middle income vision of the country. Though the education policy targets that 80 percent of students who complete secondary education were expected to be absorbed by the TVET stream, the output of TVET institutions falls short of realizing its promise. The result has been a mismatch between the skills needed in the jobs market and the training given by TVET institutions.

Studies have indicated that various factors explain failures of TVET institutions to deliver their expectations. These include mismatch between training curricula and employers' need expressed by weak industry and TVET linkages, the way occupational standards and assessments have been made and administered, the way TVET students are assigned to specific training programmes, quality of instructors, methods of TVET trainings, frequent policy changes, and low quality of primary and secondary education and attitude of TVET trainees. On top of this, there has been a strong lack of sectoral knowledge and sectoral focus in Ethiopia. There is the noticeable absence to associations that provide knowledge and match global suppliers with Ethiopian producers.

I. Political Economy and Governance

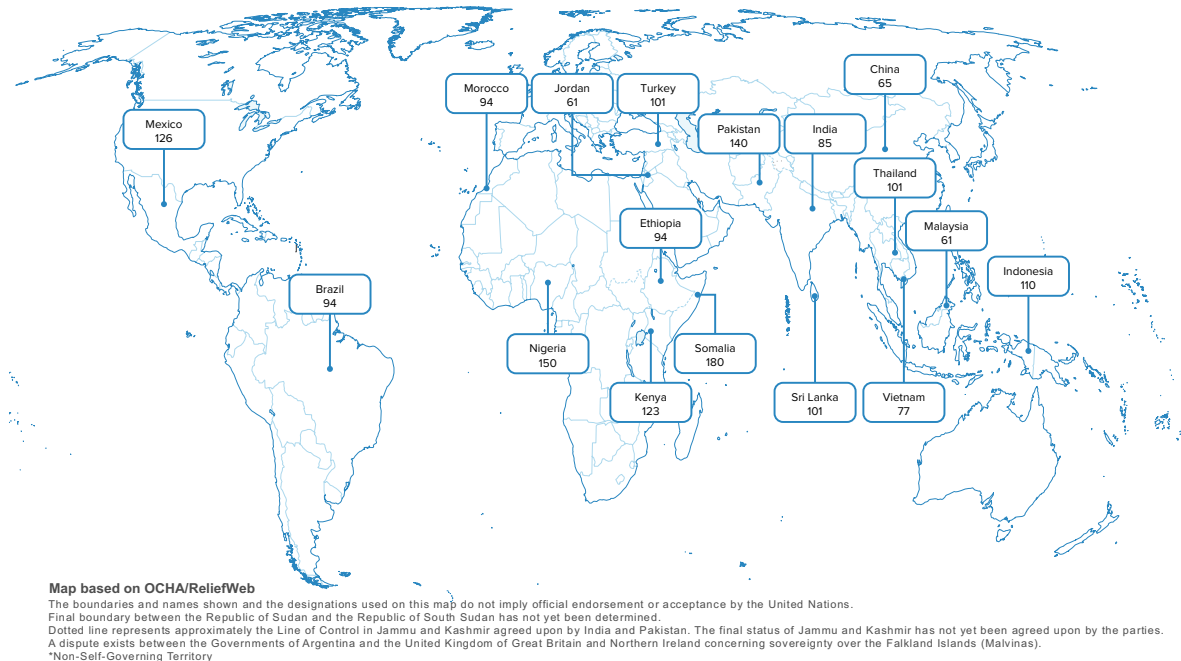
One barrier limiting the active use of industrial policy in Ethiopia has been corruption. There have been complaints by many in the Ethiopian Government against growing corruption in the judiciary, law enforcement and state auditors. According to Transparency International, in a bid to curb high-level

⁴⁵ According to studies, more than 50 percent of Ethiopian customers were dissatisfied with ESLSE's overall delivery performance.

⁴⁶ By definition, a dry port is an inland intermodal terminal directly connected by road or rail to a seaport, used to move sea cargo to inland destinations. It has normal customs facilities and can be considered first port of entry and used for storage and distribution.

corruption, the new National Anti-Corruption Committee has been established at ministerial level, with sweeping powers. However, its remit vis-à-vis existing anti-corruption bodies remains unclear. International benchmarking also shows evidence of corruption, with Ethiopia ranking 94 out of 180 countries in the 2022 Transparency International Corruption Perceptions Survey, one of the best international indicators on corruption (Figure 19). It is interesting to note that Ethiopia is at the midpoint of its international comparators.

Figure 19: Corruption Ranking



Source: Transparency International

Many recent studies have documented the proliferation of corruption.

- > According to Transparency International, corruption in Ethiopia comes in different forms, including state capture, kleptocracy, and political corruption, as well as rent seeking by officials and petty corruption among low level bureaucrats.⁴⁷
- > A recent national corruption perception survey, conducted by the Federal Ethics and Anti-Corruption Commission of 4,018 citizens, finds that close to 85 percent of respondents stated that they use corruption to access services provided by public institutions, and close to half of respondents finds that businesses are generally corrupt. Overall, 92 percent of citizens perceived the level of corruption to be a substantial problem in the country.⁴⁸
- > The Ethiopian Revenues and Customs Authority is considered among the most corrupt public institutions in a survey among foreign businesses.⁴⁹
- > A recent World Bank study finds a nuanced pictures with varying degrees of corruption. Some sectors like construction have corruption, including instances of poor-quality construction, inflated costs, and delays in implementation. Similarly, the extractive industries, especially the mining sector, have a situation where state-owned drilling companies benefit from political favoritism whereas private companies face high market-entry barriers. However, the health sector is found to have very low levels of corruption.⁵⁰

⁴⁷ Transparency International (2023)

⁴⁸ FEACC (2021)

⁴⁹ FEACC (2014)

⁵⁰ World Bank (2012)

- > A 2018 assessment of procurement in Ethiopia found that it is difficult for bidders to access eligibility and evaluation criteria “as a result of deliberate concealment and favouritism.”⁵¹
- > Nearly a quarter of businesses expect to give gifts when obtaining an import license.⁵²
- > There are growing concerns among civil society groups and other that some land deals, especially with foreign investors, do not have the adequate safeguards and scrutiny.⁵³

Recent work confirms the presence of crony capitalism in Ethiopia. A recent study by Professor Alemayehu Geda notes that state-led capitalism, developmental state model, that Ethiopia was experimenting with in the last two decades was ridden by crony capitalism, characterized by significant corruption through establishing a business-government relationship using a myriad of firms that party-owned firms dominated.⁵⁴ Corruption is primarily executed through “state capture” by a minority ethnic political elite, which wants to remain in power by controlling the economic sphere. This work has implications on the future of the business-private sector nexus in Ethiopia.

⁵¹ Global Integrity (2018)

⁵² ES (2015)

⁵³ <https://qz.com/275489/in-ethiopia-foreign-investment-is-a-fancy-word-for-stealing-land>

⁵⁴ Geda, Alemayehu (2023)

In the post-WWII decades, several predominantly East Asian economies (most notably Japan, South Korea, Taiwan, China, Hong Kong, Singapore) have recorded unprecedented levels of economic growth. This catapulted their nations toward vastly improved living conditions and a seat at the international table. Much of their success is undergirded by one crucial component: the rise of export-oriented manufacturing. All four overcome four key obstacles: land, labour and skills, logistics, and finance.

Land

Korea.⁵⁵ A systematic programme of land reform was undertaken in South Korea after WWII. The land reform abolished the feudalistic land tenure system dominated by landlords and set the path for the modernization of Korean agriculture. Pre-reform, the land tenure system greatly hindered agricultural productivity since any increased share of production was returned only to absentee-landlords. Korean farmers' subsistence levels were very low. Tenant-farmers were also burdened by high land-tax. Though only around 70 percent of the proposed land was redistributed, Korea's land reform saw great success in transferring land ownership to tenant-farmers to incentivize agricultural productivity and achieve greater socio-economic equity in rural areas. The Land Reform Act of 1950 designated land owned by absentee-landlords, non-self-cultivators, the government, or any land exceeding a certain size per household to be redistributed. Certain exemptions were granted – for private gardens, land used for education, research or public welfare.

The government compensated landlords by purchasing their land with land-value bills, using 150 percent of average yield of produce over last five-year period as basis. Through paying the landlords in cash, the government helped transform them into industrial capitalists or entrepreneurs. When they used this cash to apply for loans or for industrial capital, they were guaranteed low interest rates. Land was distributed to tenant-farmers who had been actively cultivating prior to land reform, or otherwise families who had experience of agricultural operation. One inefficiency of land reform was that land redistribution mostly just transferred ownership but did not change the size of each farm – leaving small-scale owner farmers and tenant-farmers at an arbitrary disadvantage. The two primary objectives of increasing greater socioeconomic equity and boosting agricultural productivity were mostly achieved. When industrialization got underway, the Korean government developed a “cluster approach”, whereby related industries were concentrated in a single location – machinery complex in Changwon, electronics complex in Gumi, and the petrochemical complex in Yecheon.

Taiwan.⁵⁶ In just a few decades Taiwan made the leap from underdeveloped Japanese colony to leading export economy. One key success factor is Taiwanese government control and management of land use – a legal form of state intervention as long-term Nationalist party policy. First Taiwan saw – and reaped the rewards – of perhaps the single most effective land reform programme in all of Asia, especially given that the proportion of the nation's population engaged in agricultural work at the outset of industrialization was the highest of the Northeast Asian powerhouses. Essential to Taiwan's transition from agriculture to manufacturing, was the state's role in the careful allocation and control of industrial land for use by exporting entrepreneurs. The policy is to have private ownership of land, but nationalized distribution of benefits of land, through extensive government regulation of land.

In relation to industrial land, Taiwan was innovative. The 1960 Statute for Encouragement of Investment, Chapter III established the process of how land is to be made available for industrial entrepreneurs. It allowed for both public and private land to be converted to and designated as

⁵⁵ Shin, Yong-Ha (1976)

⁵⁶ Bishai (1991)

industrial land. Once a piece of land had been selected by the government for industrial use, the government drew up a detailed plan for requisition and development of the land. Then, the owners of designated land decided on the price of the land. The land tax played its part in discouraging landowners from overreporting the value of their land. If they could not come to an agreement, the government assessed a price and announced the price of the land publicly. At the end of a 30-day period in which the government assessment could be challenged, the current landowners submitted all necessary certificates and accepted government compensation for the land. Sometimes, the state would directly buy the land from agricultural owners, develop it for industrial use, and then sell directly to new industrial users.

Taiwan's government was a strong facilitator for the conversion of land from agricultural farmland to industrial land. To facilitate the transition to export manufacturing, and to achieve an even geographic distribution of industrial sites, industrial parks were developed all around Taiwan – 68 encompassing 27,000 acres of land – they were deemed the most cost-effective measure to reduce industrial production costs and increase industrial output. The process for establishing industrial estates was government-controlled – the government selects the specific contractor they see as fit to carry out the given project according to plan. Finances for the development project were obtained through bank loans to the development agency – which would get preferential loan rates and be paid an “entrustment fee” to develop the estate. Attracting industrial entrepreneurs initially proved challenging – the Ministry of Finance didn't want to provide any tax breaks – but ultimately the increasingly prosperous export economy was sufficient incentivized.

Hong Kong⁵⁷ Given Hong Kong's limited land area and absence of a dispersed rural population, there was no need for significant land reform. All land in Hong Kong under British rule was owned by the Crown. Leases for industrial land were sold by government, usually by public auction, but some also by tender or private treaty grant. The principle of selling by auction was to optimize economic use of land. Heavy demand for industrial land meant that the auctions saw high land prices. These sites were then mostly occupied by light-industry capable of operating in multi-story buildings. However, this was not very conducive for heavy industry, which required more land and lower buildings to succeed.

Industrial estates were built in Yuen Long, Tai Po to broaden the industrial base and expand the technological level of industry. Built and managed by the non-profit Industrial Estates Corporation, 135 hectares of usable industrial land were available in each estate. The price of estate land is only 1/17 of that on the open industrial land market. People then apply for this estate land under stringent conditions. The Hong Kong government borrowed \$1 billion to build and develop this cheap and usable industrial land. In the realm of land, Hong Kong's government policy was an interventionist one. Nowhere was this more evident than in the case of the government setting up industrial estates and then selling the land for reasonable prices. The estates themselves have not really been attracting much high-tech industries because the existing estates are too isolated to attract skilled workers and because of stringent leasing rules.

Labour

The shortage of a skilled labour force always poses one of the key challenges facing any newly industrializing society. Two facets of the labour problem are education/training and wages. For industrialization in East Asia, there has been a heavy emphasis on vocational training in the Northeast block, with less emphasis in the Southeast, which has focused its attention on schooling and education.

57 Nyaw, Mee-Kau and Chan-leong Chan (1982)

Joe Studwell in *How Asia Works* observes that South Korea and Taiwan took off economically even when their educational capital was still below average. The literacy rate of South Korea in 1950, was lower than Ethiopia in 2011. The positive correlation between education and GDP growth should thus be considered carefully – greater GDP growth could also be the *cause* of parents increasingly putting their children through school. By the 1980s, tertiary education in Taiwan was 55 percent vocational. The development of new technology was advanced more by firms than by research institutions. Only *once* you are sufficiently rich and technologically advanced, it makes sense to invest highly in formal education, learning, and science.⁵⁸ Intra-firm learning has been important.

Korea⁵⁹. To keep industrial exports competitive in the international market, the Korean state tightly regulated labour union activity and wages for workers. Wages were primarily based on education and vocational training, rather than skill level. Koreans prize seniority. Korea's way of rewarding skilled labour in a tight labour market is to assign the skilled workers more overtime, which provides additional incentive for workers to stay, and make the maximum use of the factory machinery. In 1967, the government enacts a "Vocational Training Law", whereby new vocational training institutes were established, many funded by international organizations like the Asian Development Bank and UNDP.

Korea has a model for vocational training. In addition to vocational schools, Korea has 3 kinds of vocational training agencies: public (run by government & KVTMA at dedicated facilities with full-time instructors), in-plant (run by big-enough employers to get their own workers through apprenticeship programmes), and authorized (carried out by social welfare programmes/NGOs). Since it was part of the national industrialization project, each trainee saw the expenses for training waived and received a small subsidy. Around 1 million workers were trained through these vocational training centers (in addition to the already-existing, formal vocational schools) from 1967-1981. Korea reinforced its vocational, technical schools (following the German model), and saw its technical high school split into: mechanical, model, specialized, and general. Research institutes were set up to develop science and technology as were industry-specific institutes and science parks.

Singapore.⁶⁰ Competition between the markets for cheap labour was due to low wages since Singapore found itself competing with South Korea, Taiwan, and Hong Kong. To capitalize on the potential for rapid economic growth and gain the edge in competition with other low-cost labour countries, Singapore took some measures in the 1960s to reduce the capacity for labour to organize. By 1970, Singapore's per-unit labour costs were among the lowest in Asia, partly attributable to female participation in the workforce and "guest workers" from Malaysia. Thus, Singapore enjoyed an elastic supply of labour at a near-constant wage. In 1979 as part of its New Economic Policy, Singapore tried to phase out its low-tech, labour-intensive industries, and encourage entrepreneurs to move toward high-tech industries. As part of this, Singapore abandoned its wage suppression and adopted a high-wage policy, taking large, compulsory wage increases (NWC recommends wage increases of 20 percent in 1979 and 19 percent in 1980). Singapore's Economic Development Board and national Productivity Center have provided on-the-job training. Industrial employers are required to contribute financially to the Skills Development Fund, part of government programme to train manpower for high-technology industries.

Hong Kong and Vietnam. Most of Hong Kong's labour was trained by industry itself. Acknowledging that the expansion of industry requires a large supply of well-trained, high-skilled workforce, the government expanded technical, prevocational education. In Vietnam, public schooling was expanded

⁵⁸ Studwell (2013)

⁵⁹ Bae (1989)

⁶⁰ Huff (1987)

in the 1980s under the Doi Moi reform programme, together with incentives for corporate-sponsored training programs, which are launched by multinational firms to train skilled workers. Private sector educational institutions also designed tailor-made programmes to improve specific skills.

Logistics

Singapore. From 1959 to 1965, Singapore began to implement its planned industrialization under Lee Kuan Yew, initially than rough import-substitution policy to establish domestic industries to supply the home market. Singapore imposes import duties and quotas on goods that are seen as competing with own pioneer industries but have not been as protectionist as others in Southeast Asia: Singapore's tariffs were lower, and these tariffs were removed toward the end of the import-substitution policy. In contrast to other developing countries, the protections were considered only temporary. Since 1965, Singapore's industrial policy has been heavily focused on attracting FDI, which was seen as the quickest way for Singapore to grow economically. The Economic Development Board was established in 1961 as a completely government-owned statutory body, but its financial and technical assistance was extended to the private sector. It successfully promotes investment, assists entrepreneurs and foreign investors, and develops large industrial estates (such as at Jurong). These estates help provide land and factory infrastructure at reasonable prices and reduce investor need for capital.

Hong Kong. The Hong Kong government's role was limited to providing infrastructure. The Government looked to provide technical backup or industrial support only when the private sector could not, setting up some statutory bodies in the 60s, and 70s, to provide technical and information services to firms and investors, to promote HK exports and trade through international conferences, but never offers any subsidies to specific industries. Hong Kong's main industrial products are textiles and clothing. Due to protectionism and uncertain overseas markets, Hong Kong has adopted an explicit policy on industrial diversification. All in all, the Hong Kong government does not adopt a completely laissez-faire approach. They predominantly allow things to run their course, but also are concrete and explicit about setting up their infrastructure to diversify exports, provide industrial support, and market HK to overseas investors.

Korea. Korea's industrial, and economic policy throughout its rapid development can be characterized by an incredible unity of purpose and strong political will. With this single-minded intention, the Korean state heavily subsidized a few big firms that demonstrated to them they had sufficient entrepreneurial skill and potential to succeed and effectively disregarded all the smaller businesses, who handle about half of all the country's exports. The close relationship between Park Chung-Hee's authoritarian regime and the Chaebols saw the country labelled Korea Inc.⁶¹ The switch to an export-led strategy came from an acknowledgement of the limited domestic market, and the large pool of low-wage labour. Initially, firms concentrated on basic assembly of simple goods, produced to the specifications set out by foreign multinational corporations. In the 1970s there was a transition to higher value-added exports, wherein in 1973 Korea set out its heavy chemical industries (HCI) drive.

Laos. One of Asia's poorest nations, Laos is also Southeast Asia's only landlocked nation, a characteristic which disadvantages in its efforts to develop its economy through export-oriented manufacturing. This is a feature that it shares with Ethiopia, which itself must constantly look for methods to circumvent this attribute. Despite being landlocked, Laos has enjoyed some considerable economic growth over the past 20-30 years predominantly due to success in exporting products from the low-cost labor-intensive garment industry. From the period 2010-2018, Laos enjoyed the highest

61 Felipe (2018)

compound annual growth rate (CAGR) in exports in all of Southeast Asia (trailing only Vietnam)⁶² There are a few key ways that Laos has sought to stimulate exports and trade in the face of its landlocked status, chief among them are: active participation in regional, bilateral trade agreements; investment in land-based transport infrastructure, promotion of border-trade; and financial openness, fostering friendly environment for foreign investors⁶³ They allow Laos to take advantage of the rapid growth of China and Vietnam, in the form of increased investment, tourism, and rising demand for products which Laos can supply through manufacturing.

Vietnam. Vietnam historically had a logistics sector dominated by state enterprises. However, it considerably liberalized the sector in recent decades, and several logistics firms and international freight forwarders have, since the mid-1990s, formed JVs with Vietnamese freight forwarders. According to a study from the Viet Nam Logistics Business Association, there are currently more than 3 000 domestic enterprises active in the logistics sector as well as foreign players. Approximately 80 percent of Vietnamese enterprises active in logistics sector have a legal capital between VND 1.5 and 2 billion and are active in warehousing, freight transport, freight forwarding and specific value-added services such as loading and unloading and packaging⁶⁴ Among the top 35 logistics players in the world, thirty of them are currently active in Viet Nam and account for approximately 75 percent of the market, in particular in high added value segments.

Finance

A unifying characteristic of the financial systems of China, Japan, Korea, Taiwan is that they were, in their periods of initial rapid economic growth, kept under state oversight. Controls on international capital flows were put in place, until a sufficiently advanced stage of development had been reached. For these countries, finance was used as a tool to serve the government's broader economic/industrial policy objectives.

Korea.⁶⁵ **From the 1960s, South Korea set out to promote industrial exports as part of its development policy and saw rapid economic growth and industrial development.** State control of banks allowed them to become useful instruments for Korea's economic development policy. Control of the financial sector allowed the state to financially support the industrialists it deemed worthy. Through export performance, the state could determine which of the industrial firms had the entrepreneurial skill to become globally competitive. Tax, tariff incentives and preferential bank loan rates were granted to firms based on exports. Korean industrial, financial policy inevitably led to the development of a few large family-owned conglomerates, the chaebol.

As these became established, they secured loans from banks based on their name alone. Trading/export companies within chaebols had access to credit programmes, and thus the Chaebol was able to establish an internal credit market. With firms in practically every industry, savvy Chaebol managers could respond and adapt to the market. Korean banks adopted the Japanese 'major customer bank system', where the bank that lends most to a particular Chaebol is in charge of monitoring it. Banks were attractive employers, with well-qualified, highly trained staff which they supplied to industrial

⁶² Seno-Alday (2021)

⁶³ Laos actively joined regional partnerships and trade agreements. Its GSP and MFN status have certainly helped Laos' garment sector with its exporting success, though membership in ASEAN and participation in AFTA seems to have had little effect. Laos sees itself as a 'land bridge' – providing land-based transport routes between its seaboard neighbours. The transport routes it has developed – alongside the Laos-China Railway Project and Laos-China highway of China's Belt and Road Initiative – serve as economic corridors facilitating export-import activity, but also investment and enterprise across the region.

⁶⁴ OECD (2021)

⁶⁵ Cho (1989)

firms to develop their relationship. Government policymakers highlighted specific sectors that would be high value-added and help national defense, settling on iron/steel, nonferrous metals, shipbuilding, machinery, electronics, chemicals. The government then encouraged the large chaebols to enter these fields. Funds and loans were primarily provided to these sectors (received by the chaebols) leaving a limited amount of funds for MSMEs.

Key to South Korea's success was the government's close contact with industrialists, both through formal and informal channels. On a formal level, monthly 'export promotion' meetings were held with industrialists, bank managers, and the President, to share information and make financial decisions. The proportion of credit allocated to industrial sector relative to its contribution to GNP, was higher in Korea than other countries, while loans for consumers, services, leisure were rather limited. On a more informal level, a close consultative relationship existed – many retired high-ranking government officials were on industrial firm boards. Furthermore, high-ranking government officials and big businessmen had gone to the same few prestigious Korean schools together. The most important component of government cooperation with industrial firms was its prominent risk-sharing behavior. By owning banks and directing loans to industrialists, the government became an active risk partner of industrial firms.

Singapore. The entry of banks, foreign investment, and foreign exchange into Singapore was the result of the large volume of trade taking place. Without this trade, the growth of financial services would not have happened. There was the rapid development of local deposit banking among Singaporean Chinese trader-entrepreneurs, and later a strong local banking sector emerges. The growth of manufacturing came primarily from foreign multinational companies, who set up vertically integrated industries in Singapore. A lot of basic assembly in electronics was done in Singapore, which began in the 1980s to participate in more complex processes. The extent to which Singapore's economy is dominated by exports does leave it somewhat vulnerable to overreliance on foreign firms and investment. Singapore markets itself heavily to attract this foreign investment. By 1975, wholly/majority-foreign owned firms accounted for 84 percent of Singapore's direct manufactured exports.

Hong Kong. Much of the money that initially catapulted Hong Kong to manufacturing success came from Chinese immigration. Many of the wealthy, industrial class of capitalists of China, who sought to escape their homeland where they didn't have the freedom to establish their firms, settled down in Hong Kong where they had the freedom to pursue their industrial projects. Hong Kong, in contrast to Singapore, adopted a laissez-faire capitalist approach, described by 1970s financial secretary as "positive non-interventionism", as in, the government does nothing. A competitive free-enterprise system is encouraged, with no attempt to direct factor prices to favour any type of industry, nor any tax breaks, investment, or preferential treatment for any particular industry. A brief departure from the 'laissez-faire' approach is Hong Kong's Export Credit Insurance Corporation, which encourages and expands Hong Kong exports and protects policyholders against losses.

Vietnam. Restrictions on foreign investment and firm ownership were relaxed in the 1990s, and FDI increasingly played a role in export growth. The 1990 Ordinance on Banks separated central bank activity from commercial banking (previously shared by State Bank of Vietnam) and led to the establishment of 4 new state-owned commercial banks. The boom of banking services occurred after exports had taken off, and thus was not itself a prerequisite for export growth. Vietnam's economy began its rapid growth with weak banking infrastructure. Supportive exchange rate policy helped fuel Vietnam's export growth, allowing its currency to depreciate. As domestic firms benefited from the devaluation, foreign firms faced higher import costs, but were compensated for this through low wages and the availability of infrastructure facilities. Also, they mostly transacted in foreign currencies.

Ethiopia has significant potential to overcome recent shocks and reach a strong growth trajectory in the medium term. Its total exports can reach \$10 billion. Many emerging markets, including China, Bangladesh, Brazil, and Vietnam, were in similar situations in the past and were able to capitalize on their assets to deeper integration with global markets through manufacturing. Currently on a journey for greater peace and socio-economic development, Ethiopia is well-positioned for serious reform to jumpstart manufacturing. In a world of geopolitical fragmentation, it will be important for a country like Ethiopia to be able to carve a stronger niche in the international economy.

There are many possibilities for Ethiopia in the years to come. Most important, it can strengthen its manufacturing capabilities through policy reform and help develop an economy with more manufacturing value-addition, with focus on green industrialization. Despite being landlocked, it can take advantage of its access to world markets, and it can capitalize on its geographical location between Africa and Middle East and Europe. It can leverage its favourable endowments of agricultural land, its competitive wages, its demographic dividend, and state capacity to implement reforms. It can capitalize on its cheap energy (Annex 4) and its existing industrial base (Annex 5). Its success will depend critically on the quality of the reform program, the investment environment, the security situation, and the degree of macroeconomic stability. Supply-side constraints will have to be overcome, and sector-specific reforms will have to be enacted. The trifecta of challenges of logistics, finance, and land will have to be overcome. The future is bright for Ethiopia provided it engages in successful reform and deepens its industrial capabilities.

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Annex 1: Interview Questions for Firms

The study is analysing six main constraints on the growth of industry using an established methodology developed by John Sutton at London School of Economics (LSE). The Ethiopia analysis will focus on six variables: macro policy; the availability, cost, and quality of inputs; access to industrial land; access to finance; trade logistics and customs; skills (entrepreneurial capabilities and worker skills). Several questions may be articulated around these themes, as follows:

History of firm and entrepreneur: How did the firm start? Who came up with the idea and initial capital? What was the evolution of the firm and how did it scale up? How did the owner acquire the technical, and commercial skills to build the business? What was the network if any? Was there support from the diaspora and foreigners in the initial stages? Did it export first or was it producing for domestic market? What were key challenges the firm has faced? How big is the firm and how many people work there? Who are the competitors?

Role of government. What did the Ethiopian government do to help the firm establish and grow? Are there any major decisions that came to mind? What are legislative actions and policy measures that Ethiopian government has done that impede the firm from even getting bigger? How has macroeconomic policy been supportive? What have been the challenges, especially with foreign exchange? as there industrial policy? Tariff and credit policy? Does the firm have regular dialogue with government agencies and ministries? Are there any regulations that are too hard for firm to comply with?

Inputs. What are the key inputs? How does the firm procure inputs? How does it master the supply chain? Does it use domestic or imported inputs? From which countries? Is it expensive and how costly? Is the firm upgrading its technology? Will automation affect the firm?

Access to industrial land. Does the firm lease the land? How much land at what price? Did firm benefit from government support and subsidies? Is the firm in an industrial park/zone or not? Has land been a problem in terms of firm expansion and profitability?

Access to finance. How did the firm get its initial capital? Did its entrepreneurs rely on personal savings and the savings of family and friends to start up the business? Has the firm benefited from bank loans? If so, at what interest rate? Did the firm use collateral to get good access to formal finance and if so, what kind of collateral? Does the firm have its own bank now?

Trade logistics and customs. How does the poor trade logistics—slow and inefficient transport, border delays, and inadequate communications—penalize the firm? How has the firm overcome the logistics challenges and the customs bottlenecks?

Skills. Where did entrepreneur get skills? Are they educated? Do they have overseas network? What is the biggest challenge they face? How does the firm recruit the workers? Are they educated? Are they male or female or mixture? How does firm train them? Issues with worker retention? What is the average wage? Has it changed over time?

Annex 2: Harvard Economic Complexity

Economic Complexity : This is a mechanism to determine growth in productivity considering capabilities. Therefore, a country is more complex if it produces complex products, and the product is complex if only a few countries produce them. This is based on the revealed comparative advantage (RCA), which measures the export of a specific commodity by a particular country compared to the global average.

$$RCA_{cp} = \frac{(X_{cp} / \sum_c X_{cp})}{(\sum_p X_{cp} / \sum_c \sum_p X_{cp})}$$

X_{cp} is export of country of product .

If $RCA > 1$, the country has a comparative advantage in exporting that product. Therefore, **Diversity** refers to the number of products a country has with $RCA > 1$. **Ubiquity** is the number of countries with an RCA of 1 or greater for a specific product. I.e., Usually, there is a negative relationship between the two. Countries can have diversity because they make low-complex products. I.e., diversity of countries and ubiquity of products create complexity for both.

Considering the above, economic complexity is directly related to the GDP per capita of the country. Poor countries have lower ECI and the reverse.

Annex 3 Sectoral Export Potential

Ethiopia has many sectors that can expand production.

- > Coffee is the primary export commodity in the country, and smallholder farmers mainly produce it. Since 2003, the quality and quantity of production of coffee has increased due to higher domestic supply and reduced domestic consumption. However, the sector faces significant challenges, including climate change and trade barriers. Small-scale production of arabica coffee is susceptible to climate change, resulting in stress on coffee plants and late harvest due to insufficient rainfall. Hence, the relocation of coffee farms and the implementing of climate-smart practices are essential. Governance of the sector is poor. Recently, the domestic market price of coffee was higher than the international market price leading to illegal diversion of export-quality coffee to domestic market. In general, to increase the volume of coffee exports, there is a need to expand commercial coffee production in potential areas and diversifying to multiple varieties of coffee, strictly controlling and removing contrabands, negotiating for preferential access to markets, and adding value to the raw beans (for example, roasting).
- > Gold is the second biggest export in Ethiopia. In 2021, the country produced 3480 Kg of Gold, showing a consistent decline from an all-time high production of 12581 Kg in 2013. More than 99 percent is exported to Switzerland. A decline in the gold reaching the National Bank of Ethiopia has been attributed to illegal gold trafficking, especially unlicensed foreign operators, and the security situation of the mining areas.
- > Horticulture is one of the export-earning products in the country, earning \$567.7 million in 2023. Similarly, the country exported 92.5 million dollars of fruit and vegetables. While it has benefited from land leases and competitive logistics, the flower sector has faced various challenges, including power outages and suboptimal service provision at the warehouses, especially in terms of freight forwarders and clearing agents. Access to technology, finance, and transport systems to facilitate producing and export of fruits and vegetables are among the major challenges. On top of that, seasonality of supply, lack of potential markets and shortage of inputs pose

challenges for producing and exporting fruits and vegetables.⁶⁶ Accordingly, the government and other stakeholders shall work on fair and competitive air freight services, exploring new market destinations, providing technical and training support and long-term loans, and creating new competitive input suppliers.

- > Khat earnings have declined for the last couple of years. In 2022, the earnings were \$391.6 million, which decreased to \$247.5 million in 2023 due to contraband and multiple legal and illegal checkpoints. Moreover, there is no standardization and grading procedure for the product. The country has a potential to produce and export Khat to neighboring countries provided it is legal. However, the government can reduce the checkpoints established along the export routes, which will help reduce the time and cost of transport. Moreover, standardization and grading will also help to market and set prices openly.
- > Energy has emerged as a new export product for the country. Energy export earnings have increased from \$93.5 million in 2021/22 to \$96.4 million in 2022/23 from electricity exports to Sudan, Kenya, and Djibouti. Completing GERD and planned market expansion to Tanzania, South Sudan, Uganda, Rwanda, Tanzania, and even Yemen across the Red Sea will further boost the country's energy exports over the next seven years.
- > Electronics can be expanded as the country's production and export of insulated electrical wire and recently established cell phone assemblies are expected to boost exports. Ethiopia has potential to install assembly plants for mobile phones.
- > Oil seeds (sesame, soya bean, and Niger seeds) are the primary oilseed exports of the country. Abundant availability of land, favorable agro-climatic zones, high demand for Ethiopian oil seeds in the global market, government policy support, and access to abundant and low-cost rural labor have all played a significant role in the growth of production and export of oil seeds from Ethiopia. Despite having potential, these seeds' export earnings have declined from \$265.7 million in 2022 to \$258 million in 2023. These are due to the continued effects of low productivity, local market price distortions, unstable international prices for oil seeds, and volatile politics and security situations.⁶⁷ Improved security conditions in the production areas, market regulation and improvement of productivity can help boost the export earnings.
- > Sugar has underperformed. Although there is potential to produce and export sugarcane, sugar, and molasses products, there has been a failed attempt to establish 11 sugar factories by the government due to corruption, weak administration, and expensive machines. Currently, the government is trying to privatize the sector. With over 4 million hectares of irrigable land for sugarcane, a large labor force, and more than 60 years of sugar-producing experience, there can be an increase in production and export earnings by 2030.
- > The textile and garment sectors are among the priority manufacturing sectors for the country and have managed to attract FDIs through its network of industrial parks. Favorable government policy, the network of industrial parks, low labor costs, duty-free imports, subsidized energy, and Ethiopia's subscription to AGOA helped increase production and export. However, in recent years, Ethiopia's industrial sector's export performance has been unstable due to a shortage of foreign exchange, the country's suspension of AGOA, COVID-19, internal conflict, high labor attrition rate, high logistic cost, low factory efficiency, and high logistics cost.
- > Leather has considerable potential given that Ethiopia is endowed with abundant livestock resources. The country has allowed tax-free import of raw materials needed for export manufacturing, a large, easily trainable, and young labor force and low utility costs promoting the manufacturing. The sector has shown improvement in both production and export. However, since

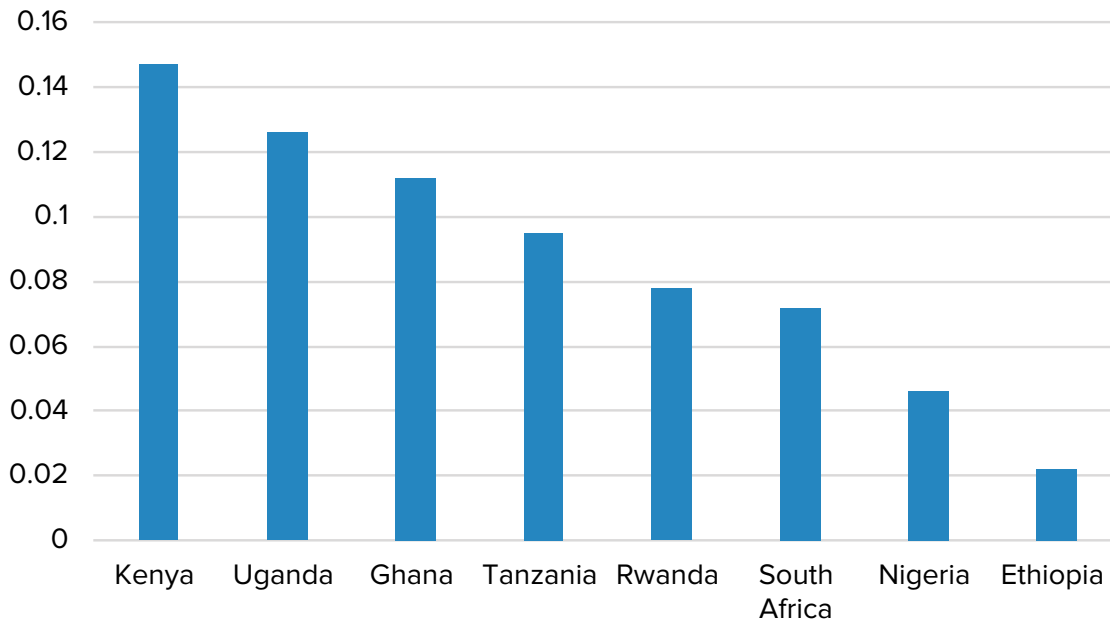
⁶⁶ Mohammed (2018)

⁶⁷ Henok (2020)

2019, leather production and export in Ethiopia have significantly declined due to challenges: the low quality and quantity of raw hide and skin, weak value chain, lack of vertical linkages with chemical and accessory manufacturers, and many intermediaries. The Government can help improve the quality of inputs, value chain, and vertical linkages with raw materials.

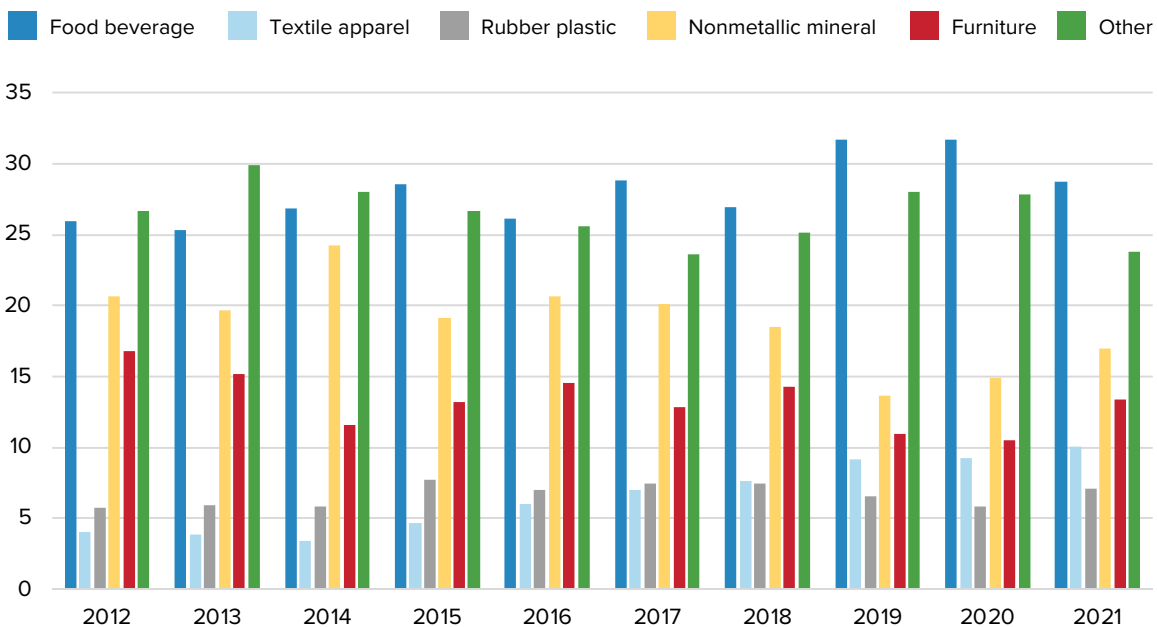
- > Meat and live animal exports decreased slightly between 2022 and 2023 due to informal trade of live animals, low quality, lots of middlemen in the value chain, illegal trade, competition for domestic consumption, and poor infrastructure including cargo service. However, promoting market-oriented commercial animal raising, improving the quality standard of packers, and standardization of quality meat can help expand output.

Annex 4 Average Electricity Tariff for Industry in USD/kwh (March 2023)



Source: Global petrol prices website

Annex 5 Decomposition of Ethiopian Manufacturing (percent share)



Source: CSA

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