

Back to Reality: A Critical Review of Performance of the Export Oriented Manufacturing in Ethiopia

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Abstract

This article critically reviews the performance of the export oriented manufacturing industry in Ethiopia and its role in deriving the industrial development and structural transformation of the economy. Detail analysis of available panel of data indicates that overall performance of the manufacturing sector, as measured from plan targets and the move towards structural transformation, is not promising. The more export promotion deepens, the weaker is the overall industry performance and fate of moving to economic structural transformation is meagre. More importantly, it is a contradiction to find weakening performance of sectors dedicated to exports production while the country deepens the efforts to export manufacturing. Thus, the article argues that export lead industrialization is counterproductive in Ethiopia. Despite this fact, production for local market has not been adequately surfaced in to the intention of the government. The experiences of Latin America and South East Asian countries prove that production for local market is critical for a successful industrialization and ensuring economic structural transformation. Therefore, Ethiopia's industrialization needs to back in to reality of the economic life. The export lead industrial development should be replaced by a comprehensive industrialization where export oriented production and producing for national consumption are implemented simultaneously and one is complementing the other.

Keywords: Export lead industry, import substitution, industrialization, structural transformation

1. Context

The level of development and the fact that countries are at different stages across the development trajectory give birth to the export promotion - import substitution dichotomous industrial policy. It has been argued that exports and imports play different degrees of importance in nurturing/developing the manufacturing industry and overall national economy. Often times export manufacturing has got much attention in the literature and policies. However, in reality, competition in the international market is tough and exports should be competitive enough to be successful. This kind of fierce competition offers incentive for enhancing productivity, quality and innovation in technology. These are important for structural transformation and economic development (Peter, 2002).

Conversely, devoting on import substitution is seen as weakening industrial development and structural transformation. Import substitution usually involves protection of local producers that indirectly incentivizes poor quality and low productivity which leads to high cost of production. As to proponents of export oriented industrial development, import substitution is a hindrance to close the international trade gap. Further it is argued that industry substituting imports lack of exposure to new technologies (World Bank, 1993; Manitra, Shahla and Michael, 2014). Unpromising success with economic development and trade balance of Latin American countries such as Brazil and Mexico in the 1970s and 1980s had been ascribed to their dependence on import substitution (Rhys, 1991). Usually import substituting industries produce primarily final products requiring simple technology. Arguments against import substitution strongly believe that the scale of value addition and technology learning are not promising (Kanayo, Uche and Enwere, 2011).

Often times, the success and/or failures story of Latin American and South East Asian countries has been referred to justify the vitality of each side of the export promotion-import substitution dichotomous theoretical argument. In practice, both Latin American and South East Asian (SEA) countries launched import substitution at the same footing during the end of Second World War. Success difference between the two regions was however, how they nurtured their industries. Latin Americans countries opened their markets as early as the 1950 while the strategy of SEA has been "go as you can compete" (Robert, 2005; Guillermo, 2006).

If export oriented (at the same time FDI dominated) industry is worth for speeding industrialization and economic structural transformation more than production for the local market does, Latin American countries could have proved successful development than the SEA tigers. As to Guangzhe, Michael and Minghui (2015) share of foreign owned firms in Argentina (in 1983) was 27%; Brazil (in 1980) 48%, and in Mexico (in 1977) 42%; and share of GDP of foreign owned companies for those countries were 29%, 40%, 35% respectively. The

importance of foreign owned companies in SEA countries were less than in Latin America. Foreign owned firms in Korea (1987) and in Taiwan (1980) accounted 23% and 19% and respective GVP share of foreign owned firms were 21% and 25% in their sequence (Rhys, 1991). These all entails that import substitution plays a significant role for economic development and industrialization than export promotion does.

Analyzing firm level data John (2005) also disproved the "market leads" assertion for industrial growth. He rather proves that firms/industries search for additional market if only productivity is improved. That is a practical challenge to the priority of export lead manufacturing.

Many other researchers attribute success difference within the two regions is due to ownership difference than a mere import-export dichotomy. Dichotomous analysis of the first tier and second tier industrializing Asian countries provides another conception, towards path dependence industrialization rather than the mere export promotion-import substitution dialogue. To them the key factor in such conception is government's capacity to coordinate and lead the already established/emerged industry (Rhys, 1991).

2. Background

Ethiopia's industrial development strategy, adopted in 2006, clearly states that Ethiopia's pursues export lead industrialization that means prioritizing the international market. Among the prime rationales behind export orientation include (i) earning foreign currency to finance its imports (ii) closing its trade imbalance (iii) extracting its share of the global market and (iv) comprehensive integration of the national economy to the global economy. Among the sectors dominating the Ethiopian export oriented industry include textile, wearing apparel, leather value chain and agro processing (especially food).

The achievement in the manufacturing sector since the adoption of the strategy proved notable progress. Total operational manufacturing enterprises rose to 2424 as of 2015/16 while it was 910 in 2006/7. In the same period; Gross Values of Production (GVP) reached ETB 31.61 billion; export earnings rose from ETB 150,816,000 to ETB 829,361,000.

This being the good thing, success as measured from target yardsticks is proved to be meagre. GVP has remained stagnant below 5% of total GDP. Export earning has always been below half of target. For instance, earnings from textile for the period 2011-2014 was 15% of its target; tanning and leather value chains was 27% and that of food, beverage and pharmaceuticals was 21.3%.

GVP share of chemicals, non metals, basic iron and steel, paper and paper products manufacturers, with higher potential of value addition has decreased. Average employment shrank invariably except in the tobacco industry. Sectors expected to play remarkable role in export earnings, especially leather and tanning and food are undergoing recession in total share.

Government concretized the export lead industrialization through the Planning for Accelerated and Sustained Development to End Poverty (PASDP) and the first Growth and Transformation Plans (I-GTP). But overall performance of the manufacturing industry has not paralleled the commitment towards export orientation. Performance was weak during I-GTP than the previous (PASDEP) period. On the contrary, production for the local market has never got due consideration except a few sectors (metal and cement) which have been at a special intention. Therefore, it can be said that the toddling industry is walking on its single foot.

3. Methodology

The study employs panel data which the Central Statistical Authority (CSA) collects via surveys censuses.¹ Additional data are drawn from the National Bank of Ethiopia, Ethiopian Investment Commission, and Ministry of Finance and Economic Development. In addition, in-depth interviews and Focussed Group Discussions with relevant institutions of industrialists, the business community and government departments the authors held for another concurrent research makes part of this method. Descriptive-type analysis is used to establish the peculiar characteristics of the performance of the manufacturing industry on the ground that the export manufacturing is the organizing framework. The variables for analysis are investment flow, GVP, employment and foreign earnings. More importantly, a critical review of literature marks crucial part of the methodology.

4. Structure of the National Economy

The economy of Ethiopia has remained predominantly agrarian of the modern history. During the prolonged feudal regime, because of the inherent nature of the economic base, agriculture was important. It was only during the monarch era the importance of industry has surfaced in to attention. At the early times of industrial incubation, share of foreign ownership was notable. In 1971/72 the share of paid up foreign capital in manufacturing industry amounted 41% of the total paid-up capital. For instance, the Dutch's shared 80% in the

¹ Central Statistical Agency (CSA) carries census and surveys basic data from medium and large manufacturing industries employing ten or more persons. CSA samples enterprises contributing 0.6 (threshold value) and above to the overall basic values. In order to do so, it uses a cut-off strategy where enterprises across ISICs. The sample lies between 47-49 ISICs. CSA constructs fifteen domains of estimates (reporting levels) from the 33 ISICs.

sugar industry, Italian and Japanese investors participated in textiles, and Greece maintained an interest in shoes and beverages.

After two decades of 3.1% to 3.8% recession (since 1974) of the manufacturing sector along with the entire economic recession, the industry sector in general and the manufacturing sector in particular gained notional importance following the formulation of the national industry policy in 2002. Much has been done since then, especially for the last two five-year plans. Investment and volume of manufacturing production registered remarkable progress compared to the base time.

Although the government pay due emphasis to the manufacturing sector and total volume of production increase its contribution in influencing the structure of the national economy have been meagre. Further, its Gross Domestic Product (GDP) share has not been promising. The decrease in the share of agriculture from 50.5% (2006) to 39.9% (2016) has not been balanced by the industry sector, the trade-off balance has rather been registered in rising the contribution of the services sector from 39.3% to 45.9% (National Bank of Ethiopia, 2016). The position of the service sector in the national economy has become notable and its total value within the national economy (GDP) has surpassed that of agriculture since 2011. And the gap is on increasing.

During the PASDEP period, the share of industry within the national economy (GDP) was constant i.e. 10.1-10.4%. There was a slight improvement of industry registered during the first GTP. The construction subsector contributed the bulk of this improvement and since continued to show promising progress. Conversely, the achievement of the manufacturing sub-sector has been very weak despite national concern and efforts. The contribution of manufacturing subsector to GDP was as low as 5.5% during the PASDEP period. It further contracted to 4.9% in 2011 (National Bank of Ethiopia, 2016).

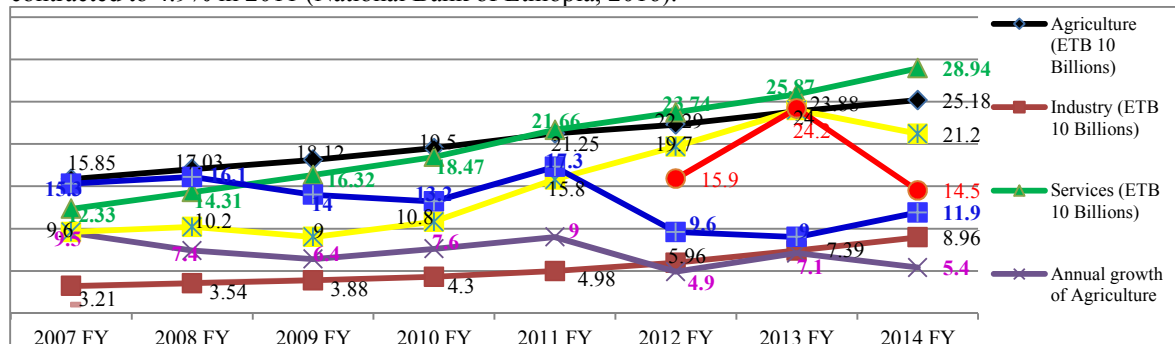


Figure 4.1: GDP share of sectors and their growth rates 2007-2014

Source, National Bank of Ethiopia, 2016

National data shows that neither the PASDEP (2005/6-2009/10) nor the I-GTP (2010/11-2015/16) met targeted plans. In other way the progress to changing the structure of the economy, where manufacturing industry plays significant role in the economy, is lagging behind plan.

5. Performance of Manufacturing Industry

5.1. Investment Flow

Volume of production is critical in moving towards structural change in the economic makeup of a nation. It will be achieved by correcting the balance of investment among the three sectors (agriculture, services and industry) and further favouring manufacturing. Throughout the past 10 years about 4706 (1703 are FDI) projects were registered operational. Among those operational projects, manufacturing accounts for only 1087. In relative terms, flow of new manufacturing projects - both local and FDI, was better during the PASDEP period than the I-GTP period despite government's effort in the latter was more comprehensive.

Table 5.1: Investment trend in manufacturing

Category	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total	% of
Local	29	82	63	55	35	37	33	14	6	24	2	380	34.83
Foreign	0	65	101	106	107	80	75	58	59	51	5	707	64.80
State owned	0	0	0	1	0	3	0	0	0	0	0	4	0.37
Total	29	147	164	162	142	120	108	72	65	75	7	1091	100

Source, Ethiopian Investment Commission, 2015

At the outset of the PASDEP period there were about 910 Medium and Large sized manufacturing enterprises of which the leading sectors were furniture, 25.7%; food, 18.6%; wearing apparel, 11.4%; and fabricated metals, 10.8% (CSA, 2005/6). A notable change was recorded during the period which summed up to 2,674 during the first year of I-GTP (CSA, 2011/12).

It was evident that the structure of the manufacturing industry changed i.e. Food manufacturers took the lead position (32.09%) followed by manufactures of non-metallic producers (24.01%). As of 2015 the total

number of operational manufacturing enterprises amounted 2,424 which showed a net loss (exit) of 360 as compared to 2012/13. The relative importance of food (35.97%) and non-metallic products manufacturers (21.2%) was maintained by the end of I-GTP (CSA, 2015/6).

5.2. Gross Value of production

The structural transformation of any national economy requires two aspects of production. First each sector's productivity and volume of production should be improved. The second, while still maintaining the former, is changing the relative share of the three sectors (industry, services and agriculture). In this case relative production volume (in terms of value of produce) of the manufacturing sector must move rapidly to attain at least 17% of nation GVP as of 2025. Accordingly, the Gross Values of Production (GVP) of the manufacturing industry has increased from ETB 9.39 billion in 2011/12 to ETB billion 31.61 as of 2015/16 with modest decrease in 2012/13 (CSA, 2015/16 3rd Quarter survey). The registered progress doesn't mean success. The total value of manufacturing produce is meagre that remained almost as low as 3% - 4.3% of GDP for the period 1991-2013 (World Bank, 2013). Experiencing a strong inverse relation between GVP and number of enterprises (-0.94) and modest (-0.52) inverse relation between GVP and capacity utilization rate is wild. The explanatory power of cost of production is the strongest over GVP (i.e -1.0)¹.

At normal circumstances, total volume of production or GVP increases when additional firms join production. However, the inverse relation is wild. At the same time GVP has not moved in tandem with capacity utilization rate.² In such a case the figures should be interpreted with caution. Inverse relation between GVP and number of firms entering production is due to low capacity utilization rate instead of a mere increasing operating firms. New firms entering production perform below the average for the entire enterprises. In regards to the second, the odd comes not from mere capacity utilization rate but from market prices. The global market has fluctuated for the entire I-GTP period. Sliding export earning was also partly due to the shrinking price at the global market for many of the export products manufactured.

Table 5.2: Distribution of industrial groups based on share of Gross Value of Products

Industrial Cluster/Group/	Share of total				Rate of change			
	2011/12	2012/3*	2014/15	2015/6***	2011/2 to	2012/3 to	2014/5 to	Average
Food products	28.41	21.28	19.72	28.95	-0.3	-0.1	0.47	0.05
Beverage	13.29	10.01	13.3	16.05	-0.2	0.33	0.21	0.1
Tobacco products	0.59	0.68	1.54	1.42	0.2	1.26	-0.08	0.45
Textiles	14.08	2.12	5.16	4.51	-0.8	1.43	-0.13	0.15
Wearing apparel	2.77	2.03	1.32	2.75	-0.3	-0.3	1.08	0.16
Leather value chine	4.19	4.35	6.64	5.77	0	0.53	-0.13	0.14
Paper & paper products	3.94	8.78	12.31	3.5	1.2	0.4	-0.72	0.3
Chemicals and chemical	6.95	16.37	6.73	10.38	1.4	-0.6	0.54	0.44
Rubber products	4.99	4.34	8	9.53	-0.1	0.84	0.19	0.3
Other non-metallic products	7.19	6.64	7.34	6.66	-0.1	0.11	-0.09	-0.02
Basic iron and steel	7.1	11.33	6.14	2.5	0.6	-0.5	-0.59	-0.15
Fabricated metal products	2.59	5.88	2.55	2.64	1.3	-0.6	0.04	0.25
Motor vehicles and	1.91	4.29	6.19	4.2	1.2	0.44	-0.32	0.46
Furniture	2.02	1.91	3.06	1.17	-0.1	0.6	-0.62	-0.02

Note that: * denotes data was available for first quarter; *** denotes data was available for 1st, 2nd & 3rd quarters

Source: compiled from CSA, 2005/6; 2007/8; 2008/9; 2010/11; 2012/13; 2014/15; 2015/16 industrial survey reports

Share of GVP under food (except for 2015/16), chemicals, basic iron and steel, other non-metals, fabricated metal products, textile, furniture, wearing apparel (except for 2015/16) clusters shrank down through the I-GTP. On the other hand, the groupings under beverage, rubber, tanning and leather value chain, paper and its products (except for 2015/16) motor vehicles and (semi)trailers, tobacco, increased. The whole picture markedly indicates that export oriented (prioritized) clusters are losing their position.

The manufacturing industry, producing at a very low capacity means its contribution to the total national economy is only 55% of its potential. About 45% of the value it should have added is left somewhere. Therefore, it seems natural that the share of the manufacturing sector within the national GDP is stagnating at 3-4.3%.

¹ See annex 1

² Average capacity utilization ranges 45.48% for furniture to 75.17% for paper and its products while the combined average for the last 10 years is 55.15%.

But, why did firms perform at about 55% of their capacity? Firms reported that demand is at the forefront of the three leading challenges. This is due to three facts. First exporting firms are not officially allowed to sell in the domestic market. Second, exporting firms face competition in the global market further consolidated by the prevailing global economic instability. Third, non-exporting producers encounter high price competition from imports of same products (usually inferior quality) in the domestic market.

Table 5.3: Reasons firms produce below their installed capacity

Reasons	2006/7	2007/8	2008/9	2011/2	2012/3	2014/5	2015/6
Shortage of raw materials	15.70	20.60	19.40	38.80	34.00	31.50	24.30
Shortage of spare parts	3.57	2.21	2.08	2.00	2.00	2.00	2.33
Foreign exchange	0.00	0.00	1.14	1.50	1.00	7.50	3.67
Demand	53.52	43.62	26.91	27.25	35.00	14.50	31.33
Working capital	4.74	6.50	11.10	6.25	1.00	3.00	5.67
Elec. & water outage	13.60	5.53	27.60	10.25	8.00	28.75	23.00
Machinery breakage	2.89	6.02	3.75	6.50	10.00	6.50	2.67
Skill problems	0.00	4.76	0.00	1.50	1.00	1.00	1.00
Government rules and regulations	0.60	2.83	0.37	1.00	0.00	0.75	1.00

Source: compiled from CSA 2006/7-2015/6 industrial survey

Shortage of inputs, the second ranked challenge firms reported, has persisted for years. With annual variation of 79.4% to 90.1%, on average 85.53% of firms surveyed have reported that they depend on imported inputs due to either its unavailability in the local market or the local market has insufficient inputs to source. This has led to huge portion of share of imported inputs in the country. This is worrisome. To mention a few, 92% for rubber and plastics, 85% for fabricated metal, 80% for basic iron and steel, 70% for chemical and its derivatives, 60% for paper and paper products, to mention (Ministry of Industry, 2015).

The aforementioned five sectors shared 25.57% to 46.7% of total GVP for the period 2012/3-2015/6. This implies that the size of value addition is very small and it gives caution as to how commanding is input sources to the overall performance of the manufacturing industry. It must be further understood that share of inputs sourced from imports for food, beverage, textiles, motor vehicles etc. is also significant. It is questionable then as to whether the export oriented industry, sourcing imported inputs, can be appealing and sustaining the overall economic development of the country.

5.3. Employment

The size of total employment in the manufacturing sector registered visible progress. At the beginning of the PASDEP the total size was 125,634. The number rose to 175,000 as of 2010/11 (out set of I-GTP). Of the total employment, the portion of food and beverage manufacturers' portion was more than 38% followed by manufacturers of non-metal, 11% and textile, 8% (MoFED, 2011/12). Leading sectors in creating permanent employment for the last (2006/07-2015/16) have been food producers (21.1 - 23.71%), wearing apparel (7.38 - 21.78%) and tanning and leather value chain (8.3 - 8.5%) in their order of importance. Wearing apparel realized a miracle growth especially during I-GTP (from 3.75% to 16.8%). Rubber and plastic industries (with a share of 3.88 to 7.84%) also recorded promising progress. To the contrary, textiles (12.3 to 6.37%) and beverages (14 to 9.79%) have decreased continuously.

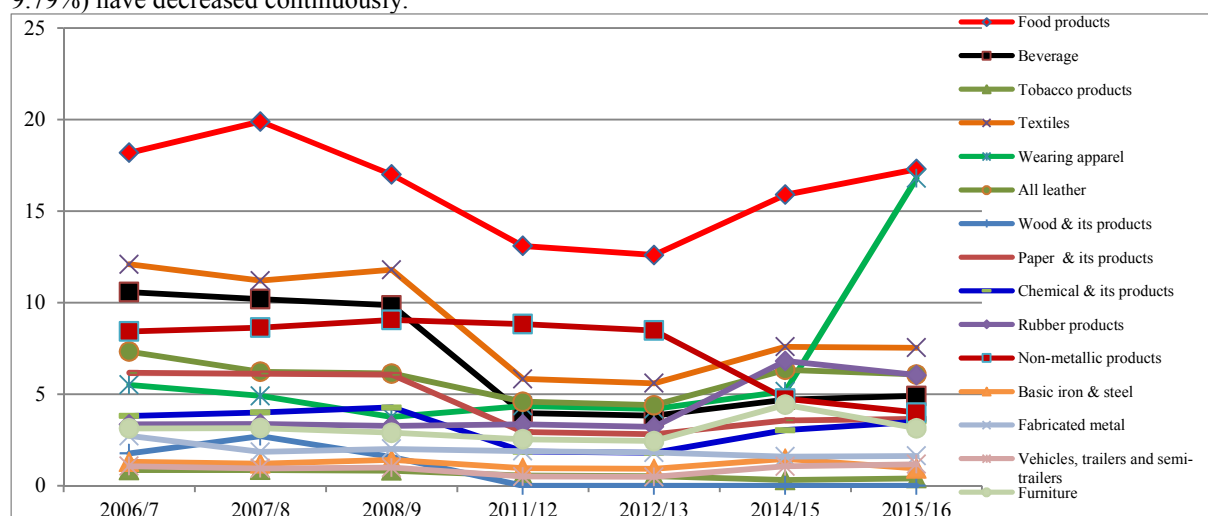


Figure 5.1: Trajectory of permanent employment against industrial groupings

Temporary employment, as of 2015/16, accounts for 24.21% of total employment within the

manufacturing sector. Manufacturers of food (25.2 - 52.21%) and that of non-metallic producers (4.21 - 5.52%) are top contributors and have consolidated their significance for the last two five-year development plans.

Increase in total employment in the manufacturing sector however, does not give the real conclusion because the average jobs per firm have continuously decreased. The rate of decrease is sharp especially in food, textile, beverage, paper and its products and non metal sectors. Vehicles and (semi)trailers; wearing apparel, rubber and its products; and fabricated metal producers are the only sectors where average permanent job increased.

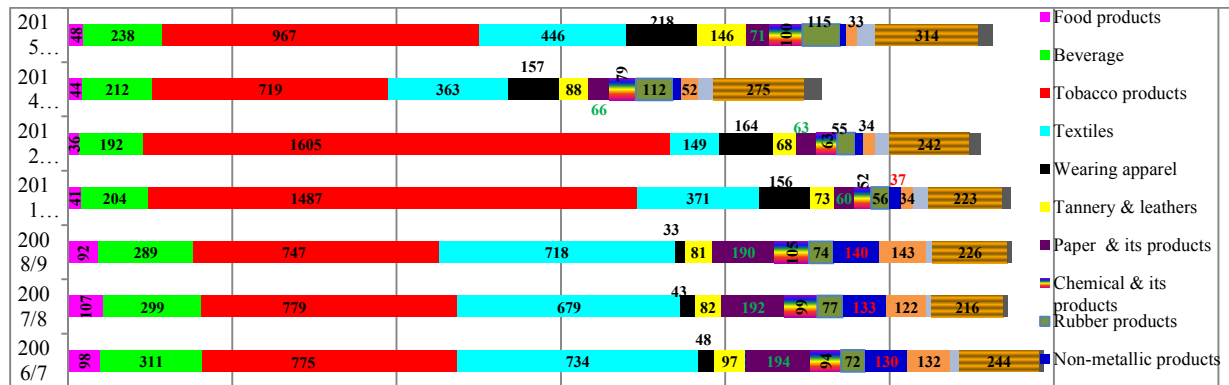


Figure 5.2: Average permanent employment by major industrial clusters

Due to the fact that capacity utilization rate vary only modestly among sectors and across time, its explanatory power in determining employment is found to be weak. At the same time, cost of production is unable to determine employment conditions.

Increasing total size of employment along with new firm entry while a firm's average jobs decrease poses two propositions. The first hypothesis one may cite could be that a firm's average job offer can decrease as firms' efficiency improves (Wang, 1994). Nevertheless, efficiency is unlikely possible because capacity utilization rate of enterprises do not justify gains from scale of economies. Yet, the relation between increasing firm entry and size of employment is not proved to be perfect (0.889) match¹. This leads to the second proposition that the change in the size of total employment is mainly the function of net firms' entry and exit. A research conducted by the World Bank in 2013 proved that job creating capacity of new firms entering manufacturing sector is weak - instead incumbents create additional jobs better than the new ones.

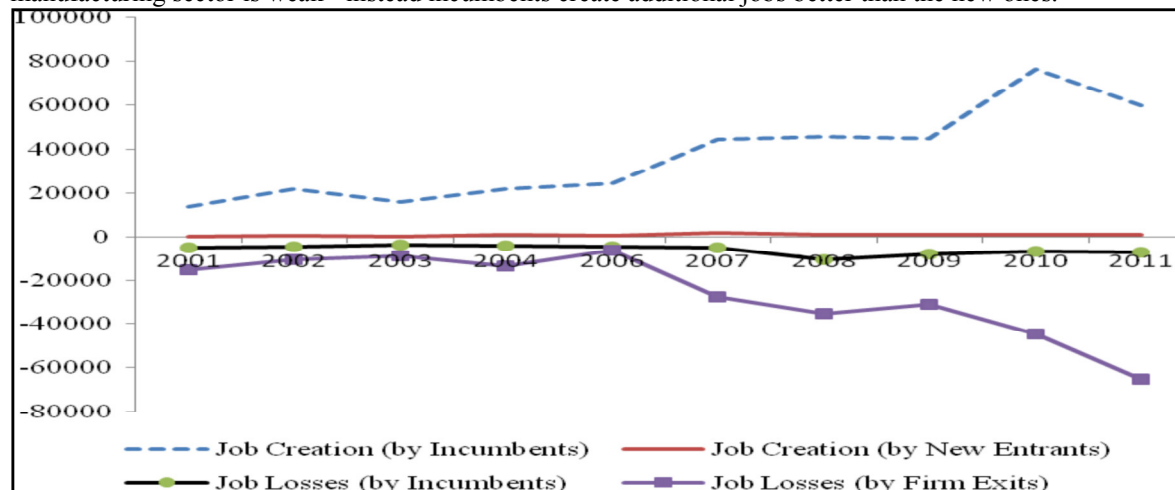


Figure 5.3: Jobs gain from existing and new firms and jobs loss due to firms' exit

Source: Adopted from World Bank, 2013, Table 11, pp 21.

The net change in jobs because of firms' entry and exit is a loss. This loss is offset by gains in jobs expansion by firms who continue to exist. Nonetheless, job gains from new and from existing firms is small to maintain average jobs per a firm.

5.4. Foreign Earnings

Balance of payment, the main component of trade balance, is one of the key national economic development indicators. Hence, export trade is a tool available in which countries finance their imports in order to maintain at

¹ See annex 2

least equilibrium in boarder trade. That is why the contemporary global motto on industrial policy is "Export Promotion". There are countries/regions exporting primary products while their advanced counterparts import these primary products and they add value and are able to export secondary and tertiary products. In due arrangement, differences in values of primary goods and producer goods, if not balanced by volume of production creates trade imbalance. This is true of Ethiopia.

In 1988 the national trade balance of Ethiopia was ETB -1.5 billion. Escalating year after year, it picked to ETB -199.7 billion as of 2014. Earnings from international (cross boarder) trade grew from ETB 773.6 million to ETB 62.084 billion in the same period but the volume is far below the volume of imports. While earnings from export trade grew 84.6 folds, the trade imbalance grew by 133 folds. Therefore, if export trade is the only means to correct the gap, aggressive engagement in export trade is justified in Ethiopia.

Total size of export earnings from manufacturing products has increased for the last 10 years period; except for 2008/9. Within this general picture, sector wise differences are unavoidable. Manufacturers of wood and its products as well as paper and its products never exported for the last 10 years. Basic iron and steel products joined foreign earning sectors only for ones (2010/11). Fabricated metal producers did not export for consecutive seven years (2008/9 - 2014/15).

During the PASDEP period, export earnings from tobacco, wearing apparel, leather, rubber, fabricated metal, food manufacturers was in a continuous and at high rate decline. Except earnings from beverages and textiles almost all other sectors had undergone recession. The government targeted US\$ 1.5 billion earnings from manufactured exports at the end of I-GTP (2015/16). Result has been disappointing for the whole period if measured from target yardstick. For example, as of 2014/15 the total earning was US\$ 398 million which is only 27% of the target for that fiscal year (Ministry of Industry, 2015). In absolute figures and trend, achievement during I-GTP has been promising for most sectors except for leather (in 2012/13 and for rubber producers (in 2015/16).

Table 5.4: Export earnings trend by major industrial groups

Major Industrial Groups	Rate of change in total amount							Rate of changes in firms' average earning						
	2007 /08	2008 /09	2011 /12	2012 /13	2014 /15	2015 /16	Avg. rate of change	2007 /08	2008 /09	2011 /12	2012 /13	2014 /15	2015 /16	Avg. rate of change
Food products	5.0	-0.3	-0.1	0.66	-0.8	0.65	1.0	5.1	-0.3	-0.1	0.66	1.0	1.0	2.0
Beverage	1.0	1.46	0.58	-0.8	3.47	5.93	2.0	1.49	1.21	0.58	-0.8	1.0	1.0	2.0
Tobacco products	-1.0	3.06	15.6	-0.97	32.8	2.0	9.0	-0.98	3.07	21.1	-0.97	1.0	1.0	5.0
Textiles	1.0	-0.2	6.68	-0.82	8.7	0.33	3.0	2.77	-0.6	9.24	-0.86	1.0	1.0	3.0
Wearing apparel	1.0	-0.9	171	-0.77	3.6	14.8	31.0	2.53	-1	84.8	-0.77	1.0	1.0	16.0
All leather	0	-0.1	4.39	-0.79	2.58	-0.2	1.0	-0.15	-0.3	4.39	-0.79	1.0	1.0	2.0
Chemical & its products		ent	3.49	-0.27	0.17	-0.2	1.0			3.49	-0.27	1.0	1.0	2.0
Rubber products	0	-0.7	0.17	ext	ent	ext	-1.0	-0.38	-0	0.17	ext	ent	ext	1.0
Non-metallic products	ent	-1.0	1.0	-0.64	1.07	10.9	3.0		-1		-0.73	1.0	1.0	1.0
Basic iron & steel			ent	-1.0	ext	ext	-1.0	up	up	up	up	up	up	Up
Fabricated metal	-1.0	-1.0	ext	ext	ext	ent	-1.0	-0.56	-1	up	up	up	up	-1.0
Vehicles & (semi)trailers	up	up	up	up	up	ent	up	up	up	up	up	up	ent	Un
Furniture			ent	ext	ent	-0.5	up		ent	ext	ent	up	up	Up

Note that: "ext" denotes exit; "ent" denote entry; "up" denotes unpredictable

Within the weak performance, total amount of export earnings from the manufacturing increased throughout the I-GTP period, except for 2012/13 – where all sectors went down. The leading sectors were tanning and leather value chain (48.3%), textile (25%), wearing apparel (7.45%) and food (6.8%) in their order of importance. But consistency in most sectors has not been maintained. At times many sectors failed to maintain amount of earnings they secured the preceding year. The food sector is a peculiar example. Ones and off has been common in rubber and furniture sectors. And while basic iron and steel appeared only for the first fiscal year, fabricated metal and vehicles and (semi)trailers joined during the last year of I-GTP. The worse thing is that many industries exit foreign earning altogether.

Increasing size of export earnings from tannery and leather products; textile, beverages; motor vehicles and (semi)trailers; furniture and tobacco has been the function of volume of production. The increase in GVP since 2012 could be due to an increase in volume of production or price improvements or combination of both.¹ The GVP for other sectors show irregularity throughout the period but tending to decrease for the last five years. GVP for basic iron and steel actually shrank from ETB 6.7 billion in 2011/12 to ETB 2.8 billion in 2015/16 (and its share from 11.33 to 2.5%). Therefore, the realized increase in export earnings from sectors that experience contracting GVP could be due to price changes in their destination markets.

¹ Shares of GVP for beverages 10.01 to 16.05%; textiles 2.0 to 4.5%; tanning and leather 4.35 to 5.77%; rubber and its products 4.32 to 9.53%; motor vehicles and (semi)trailers 1.91 to 4.2%; tobacco 0.59 to 1.42%

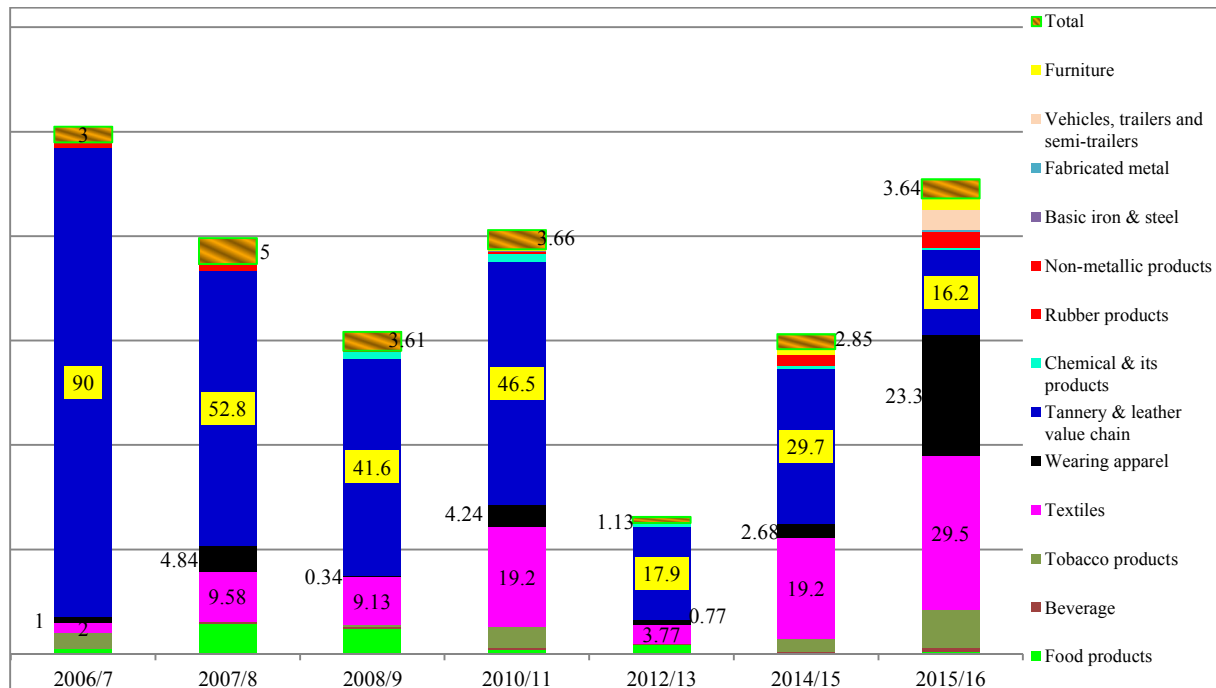


Figure 5.4: Share of export earnings by industrial groups

A unique trend is shown with food manufacturers. The sector's GVP and its share from the total of all industries increased from 17.4 billion (2012/13) to 32.8 billion (2015/16) in the past four years; and its share increased from 21.8% to 28.95%. Nonetheless, its export earnings declined both in absolute volume and share of all industries' earnings. The total volume, which was ETB 191,641, 000 in 2008/9 declined to ETB 63,038,000 in 2014/15. As of 2015/16, its share of export earnings became negligible (only 2%).

In general, export earning is strongly correlated to volume of production - evidenced by a correlation coefficient of 0.961. Furthermore, it is worth mentioning that a mere volume of production does not determine export earnings. The correlation coefficient between number of manufacturing enterprises and export earnings is weak (0.586) implying exporting enterprises in each industry category and/or firms within a given industry are relatively less in number than the non-exporting. Furthermore, average rate of export earnings for most sectors for I-GTP period is negative except for non-metals (0.28) and chemicals (0.005). This shows that total amount of export earnings is not just the result of existing firms' performance improvement and addition but also because of joining of new firms.

6. Discussion and Commentary

6.1. Summary of the Export Manufacturing

Sectors dedicated for export performs below the non-export producers. New enterprises joining export manufacturing accounts 44.33% of total operational investment flows (number of enterprises). GVP for export producers is 38.7% of the total manufacturing. The sectors are rather better in employment (52%) and export earnings (87.11%) on average.

- Both level of investment and GVP imply the sectors are not more productive and hence their sustainability is in question.
- Supporting more than half of total manufacturing employment means the sectors are key labour intensive. It is argued here that export manufacturers hosts more than half total labour in the manufacturing industry is not the result of increasing returns to scale; it is rather the opportunity cost of jobs in the disfavoured sectors. It needs further caution that the share of employment in the textile sector (the most prioritized labour intensive) decelerated from 12.3% to 6.37% in the course of 10 years. Still employment sustainability is prone in case of firm exit because most firms are foreign owned.
- The absolute amounts of foreign earnings that increased through time never beat half target. The size of export earnings is less helpful in leveraging the country's trade imbalance. Trade imbalance of Ethiopia grew 133 folds in the last 27 years (ETB -1.5 billion in 1988 to ETB -199.7 billion in 2014). The growth of export earnings, 84.6 folds (ETB 773.6 million to ETB 62.084 billion in the same period) can never overtake if the prolonged experiences continue; the prospect looks so. Moreover, share of the sectors' export earnings is on a decrease due to two factors i.e. small size of volume production and attraction of the protected local market.

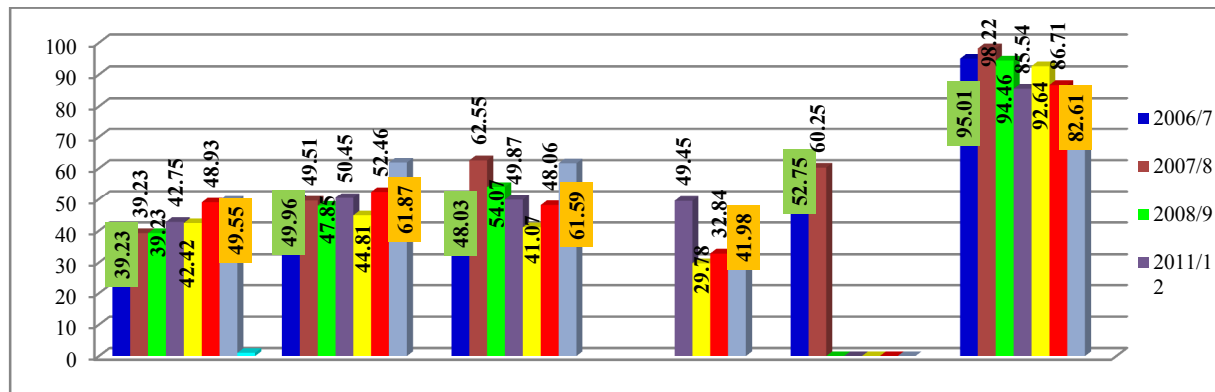


Figure 6.1 Performance of export oriented industry as percentage of the entire manufacturing industry¹

In general, the panel of data shows the performance of industries producing for export is lower than those under import substitution category. Industries under import substitution category on their turn perform lower than the neglected (uncategorized) sectors.

6.2. Why export? The drift of fashion

When to export?

Export is the result of surplus production above the carrying capacity of local market. This reality has perpetuated for centuries. History witness earlier developments were the outcome of production for local market and intercity trade of the manufactured products. For instance, America's domestic trade accounted about 95% of total national trade for long. Its export trade reached only 15% in as late as 1980 (Jacobs, 1985). Recent industrial and economic development also confirmed the logic.

The experience of the SEA tigers successfully disproved the "market leads productivity" supposition. Their experience suggests that export promotion is the outcome of production for the local market. Korea's import substitution industrialization - producing basic consumer goods policy began in 1950. Import substitution was more vital to the national economy during 1961-1977 where national savings was limited and foreign aid was decreasing than it did in the 1950. The primary purpose of Korea's shift to "**export in all industries**" policy was earning foreign capital to finance importing capital equipment and buy technology licenses that were critical to the infant import substituting industry that required a large scale production seeking efficiency. It was late in 1980 Korea furthered export for a purpose of commercial gains from the international market. Taiwan also shifted its policy to export promotion in the second half of 1950s following local market stagnation. The experience of the two countries clearly indicates that export is the function of local demand satisfaction and enhanced productivity. Put in other way, firms enhance production and productivity to capture additional markets. John (2005) proves that manufacturing enterprises in SEA search additional market when production and productivity increases, not the reverse direction.

Ethiopia's export oriented manufacturing argument, deviates from such experience and underpinning theoretical logic. Many of the goods manufactured for export are the same as the country imports. Forefront sectors dedicated for export are mainly leather products, textile, wearing apparel, agro processing. Of the total value of imports, food and beverages' (3.1% to 8.1%) remains the top followed by textiles and wearing apparels (2.3% to 5.9%) for the period 2002-2014 (National Bank of Ethiopia, 2014).

While the local market is so solvent, there is no rationale to ignore it in favour of manufacturing for exports. This solvent local market at the same time protected attracts many (including the FDI) export producers in to the local market. This issue becomes an environment of debate between government and such enterprises. Producers argue that serving the local market is indirect export earnings. When manufacturers serve the local market, foreign earning that would have been used to finance imports of same products via the trade are to be saved; hence, theoretically the net balance is zero. It can be argued that unless competition in the local market gets tough, export producers will remain reluctant to export. Furthermore, the protected market incentivizes the few manufacturers serving the local market to compromise quality of product. However, this could be improved by letting flourishing number of manufacturers to serve the local market. Vibrant price competition where products are lower in quality will narrow the current remunerative profit margins in the local market. In due course, the reluctant export producers will not be able to sustain themselves and exit from the local market. Further, price competition among producers to local market is a threat for survival therefore gradually quality will become means of competition to sustain and the learning curve gets shorter.

The effect of staggering to compete in the international market is compromising against speeding broad

¹ Textiles, wearing apparel, tanning and leather value chain, food

based and comprehensive industrialization and timing of structural transformation in economy. The country is losing multiplier effect that would be realized in the service sector that is intercity trade within the country (Jacobs, 1985). Aggressive endeavour in manufacturing exports means leaving local market to imports, mostly from the bulk producing advanced or emerging countries. This is really a contradiction that developed countries are enjoying the Ethiopian market free of competition and is probably true for all developing countries. Recent studies indicate clear clues for nations to wake up to conquer local market. The motive of foreign companies investing in Africa is not only efficiency seeking but the size of market is becoming important (Miria and Wenxia, 2015) among which Ethiopia, with a population of more than 90 million and fast growing economy consolidated by rising per capita consumption, is probably the best destination to produce for the local market. The preference of export to import substitution is a live argument in terms of overall national economic development - specifically the manufacturing industry itself. Proponents of 'manufacturing exports' argue that export is important in closing trade imbalance. Logically, the reverse also holds true. The result of sourcing local consumption from local production is the same as what export does. The FDI dominated export motivated industry in Ethiopia is a borrowed economy, inevitably must be returned to its owner. Its role is then filling the commercial gap, not the gap in industrial development and ensuring structural transformation in the whole economy.

Sustainability of the FDI dominated export

Ethiopia's reliance on FDI for the purpose of foreign earnings has potential danger to the whole national economy. Sustaining employment and even export earnings, is the very reason the country is preoccupied in attracting FDI which is still finding it hard. FDI continues its life in its hosting country so long as the country remains competitive (X.Wu, 2011; Miria and Wenxia, 2015). FDI transfers prices from its country of origin to its hosting country because hosting countries, just like Ethiopia, offer remunerative rents to export manufacturers such as import duty incentives, tax holidays, devolution of local currency, carrying loss forward - all are applicable to Ethiopia, discriminatory exchange rates and so forth. All these are costs to the hosting country and unearned revenue to the country of origin.

Unlike the advanced countries such as America during its early industrialization (Jacobs, 1985), the application of tariffs in Ethiopia is not comprehensive. It is has been in effect only for the purpose of infant industry protection. Application of tariffs in other countries is a tool of making imports artificially expensive to show the local people and producers what is true of their own national/local economies; thereby encouraging to replace imports.

Learning curve in FDI dominated export manufacturing

The spill over benefit FDI accrues to a hosting country is determined by the absorbing capacity (industrial base, technological level, minimum ability to transfer technology, industrial culture, industry management skills etc.) of the hosting country. Latin America and Asia launched import substitution at the same time, at the end of Second World War (Guillermo, 2006). While FDI dominated the industrial structure of Latin American countries since 1970s (Sanjaya, Manual and Mauricio, 2004) and export was preoccupied by FDI, 57.3% of total values (Wilson and Annalisa, 2009) their success is not as significant as South East Asians whose industrial structure has been the reverse of Latin Americans (Rhys, 1991). From the comparative analysis of the success difference of Latin American countries (Brazil, Argentina, Mexico) and South East Asia (Korea, Taiwan, China), one can understand that learning curve is longer in export oriented industry. Indeed it should be. Producing for local market is "do it yourself" so that innovation and improvement, which are critical for development, will deepen and makes the learning curve shorter.

Ten years of sluggish investment while deepening export promotion

Preference of export oriented sectors over a comprehensive manufacturing industry retards manufacturing investment in Ethiopia. The last two decades portray that the more the country deepens the concern on manufacturing exports, the less becomes the flow of total investment to manufacturing. During the PASDEP period, the country was less aggressive in export producers. In the course of the five years a total of 5512 new manufacturing projects were licensed while 735 enterprises realized production. As the country's preference for export deepens further in I-GTP, both new projects licensed (4387) and projects realized production (327) decreased significantly.

Ethiopia's concrete orientation to manufacturing exports means the country is willingly allowing FDI to crowd out potential domestic investment in manufacturing. Of the total 1062 projects joined operation in the course of the ten years, foreign owned account 66.6% (707). Ethiopia follows non-discriminatory loan policy to manufacturing industry on the bases of ownership type (local versus foreign). Every new/expansion enterprise finance 70% of its investment by loan from the Development Bank of Ethiopia. Since average paid up capital of foreign manufacturers is 12 fold or above compared to local enterprises; this means a given single FDI manufacturer crowds out at least 12 potential local enterprises because of the country's preference to export production.

In addition, despite aggressive national interest to export, local/domestic private entrepreneurs prefer to

produce for the local market. It is obvious that local companies/entrepreneurs lack what foreign manufacturers are advantageous of (experienced in industrial management, cost efficiency, quality control and more importantly international market links). Expecting local entrepreneurs to produce for and compete in the global market is too ambitious and unrealistic in the short and medium times. Therefore, the mismatch between the private entrepreneurs and government is an effective barrier to the local entrepreneurs to join the manufacturing industry. Furthermore, current national priorities of export producers, in most cases, require huge capital investment that is another barrier of entry for local entrepreneurs.¹

In general, the national preference to export oriented manufacturing is a barrier to entry for manufacturing investment in Ethiopia. Hence, the sector's total GVP is not promising and its contribution to GDP remained stagnant. The hope to structural transformation is then less promising at the first gate.

6.3. Import substitution? The missed concept

It is known that countries are not in equal footings of resource endowment and other competitive capabilities. No country is self sufficient in resources and technology that derives development and at the same time even part of local consumption can't be met from local market. Theoretically, a country should import locally unavailable goods and services or if not sufficient or else can't be produced locally.

But, what is import substitution? The theoretical basis of import substitution is 'endogenous growth', an assertion arguing economic growth is generated from within a system as a direct result of internal processes. In its policy practice it involves subsidizing a production of strategic substitutes; barriers to trade, such as tariffs; an overvalued currency that aids manufacturers in importing goods. Very often import substitution in Ethiopia is conceptualized as preference of selected products among which are cement and metal products. The good news is that Ethiopia ensured success in cement. What about other imports draining out hard currency (probably by its source countries) much more than the said import substitutes? We argue that import substitution should not be limited to such specific products. In its very merit, every import commodity must be produced locally to the extent possible. Thus import substitution should be re-conceptualized as "producing all current imports." The narrow interpretation of import substitution is understood as if replacing a few selected imports; this interpretation and understanding is misleading.

6.4. Understanding the underpinning importance of production for local market

Since no country is self sufficient nor are all countries in equal footing in development, interplay of imports and exports can never be avoided. What matters is the net balance. Aggressive and sufficient production for the local market makes development sustainable. Extensive imports means financing the development of the trading partner country institutionalized through exchange rate.

How exchange rate indicates the importance of production for the local market? Let's assume that local currency, the very of it, is a commodity that should be exchanged - and practically it is. Hence, the country exports products to foreign markets so that the earned foreign currency would be utilized to purchase local currency. When volume of exports is small, the amount of currency the economy can purchase is small too. Therefore, the currency can't import sufficient amount- that means the value of the local currency is weak. By same analogy, if the international trade partners produce more and export, their economies can purchase sufficient currency of their own. The sufficient accumulation enables them to finance sufficient imports.

The application of the above theoretical supposition, evident in currency devaluation/appreciation works to the Ethiopian manufacturing. The local currency (Birr) is devaluing continuously relative to currencies of other nations (\$US, Pound sterling, Euro, etc.). In order to afford sufficient imports the economy needs, the country needs to produce more exports to earn sufficient foreign earnings. The more the country is exporting to afford its imports means its exports become cheaper to customer nations (that is a means of price transfer to countries devaluing their currencies). At the same time, imports automatically become more expensive to afford in the local market hence a need to replace with own produce. The final solution is then producing for the local market, not prioritizing exports.

6.5. Beyond the national control

Within the international economic life, many variables are out of the exclusive control of many, especially developing, countries. Often times advanced counties accumulate global capital by raising interest rates, just like the current trend. In due course, saving and the stock market become better investment options than manufacturing or other investment. This is futile to countries seeking to promote FDI based exporting manufacturing. Manufacturing competent nations/regions want the staggering backward nations to continue being economies of primary products. Being agrarian or resource dependent economies source inputs to the

¹ A thorough discussions with the commercial society and Trade and Sectoral Associations in Addis Ababa, Mekele, Bahir Dar, Dre Dawa, Adama, Hawassa in Dec. - Apr. 2015.

developed regions/countries (Jacobs, 1995). The already affluent countries/regions strong tools to install their policies in favour of their economic advantage instead of the well being of the all. The WTO is one through which they control/regulate the solvent markets of primary and resource economies remotely.

7. Conclusion

Ethiopia's dependence on imports is not forced by merit of necessity but denial of producing to local consumption. The rational to rely on imports is not a deliberate strategy devised to seek efficiency. The practice shows that the broad objective of manufacturing industry is being replaced by 'export earning' by default. Despite deepening export oriented manufacturing through time, performance of the past ten years indicates that the manufacturing industry is not catching up national vision. Only 1091 (of which 7070 foreign owned) investment projects realize production. The total GVP of the manufacturing sector is about ETB 31.61 billion as of 2015/16 but its GDP share remains stagnant at below 5%. Average employment is contracting but not because of efficiency. International trade gap is alarming. Even the share of foreign earnings of the extra ambitious export oriented sectors is decreasing continuously.

Despite global historical documents avail ample evidence that indicate trade imbalance can effectively be addressed through both exports and producing for local needs, Ethiopia neglected this default advice at hand. Historical evidences signify that production for local demand is more important than export in closing trade imbalance and economic structural transformation. In Ethiopia, prioritizing manufacturing exports and ignoring production to local market is proved to be wrong as the industry is walking on one leg. Finally, export promotion gives incomplete picture of analysis in the manufacturing industry. Sustainable industrial (economic) development ought to look in to local market in Ethiopia where the local market is sufficient to support threshold of production. A rapidly growing primary economy and solvent market need not be price taker, instead price maker. Therefore, it is worth understanding that the dynamic competence of Ethiopia looks to be feasible if geared primarily towards producing to the local market; that is back to reality.

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Annexes

Annex 1: Relation of GVP against number of enterprises, capacity utilization rate and cost of production

	Number of enterprises	Capacity utilization rate	GVP	Total cost of production	Cost of production(in % of
Number of enterprises	1				
Capacity utilization rate	.148	1			
GVP	-.940	-.516	1		
Total cost of production	-.319	.296	-1.000**	1	
Cost of production as % of revenue	.108	.370	-1.000**	.559	1

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

Annex 2: Explanatory power of number of enterprises, capacity utilization rate and cost of production over employment

	No. of enterprise	Average permanent employment	Average temporary employment	Capacity utilization rate	Cost of production
No. enterprises	1	.889**	.848**	.148	-.319
Avg. permanent employment		1	.891**	.084	.398
Avg. temporary employment			1	.095	-.026
Capacity utilization rate				1	.296
Cost of production					1

** . Correlation is significant at the 0.01 level (2-tailed).