

Industrial Policy: Critical Review

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1. Introduction

Industrial commencement in Ethiopia has begun a nearly century ago**,** despite this long time experience; it is still in its dismal status. By all measures, the sector is abysmally gloomy. (EEA, 2005). The national share of the sector in every measure is insignificant up until. (Ibid), (Altenberg, 2010), (Melaku, 2013) and (Amare , 2015). By all the measures the sector posited as poor. Poor productivity (Zerihun, 2008); poor export capacity (Gebreeyesus,2009); poor technology; poor technical capability; poor linkages of both-backward and forward(EEA, 2005); poorly balanced and poor in everything even at today. Due to this, the manufacturing sector is one of the least developed in the world. Absence of sound industrial policy would be the main reason for the unhealthy, distorted and unbalanced status of the industrial sector. Sound industrial policy would guide the holistic strategic efforts of a country thereby to enable the development of diversified industrial portfolios.

Thus, in this chapter we intend to appraise the industrial policy set ups and then point out its drawbacks thereby to add any new policy elements. Modification of the industrial policy would really be the base for sustainable industrialization and industrial development. Industrialization is the social process which impinges directly on people's lives: the way they think and live through changes in technology, environment, and culture etc. (EEA, 2005). Industrial development is the productivity performance improvement.

2. Developmental State and Industrial Policy

The current government of Ethiopia portrays itself as a revolutionary democracy and developmental government. (Altenberg, 2010). Developmentalism is a body of political economic thought that advocates state managed markets in the national interest. The developmentalist creed explicitly rejects the self-regulating market ideal, and the individualism underlying it, calling instead for cooperative relations among government, business and labour under state leadership to speed the adoption of new technology, reduce production costs and expand global market share (Hatch and Yamamura 1996:220).Industrial policy might have different contextual understandings to different governments in different countries. According to (Pack and Saggi,2006) industrial policy is basically any type of selective intervention or government policy that attempts to alter the sectoral structure of production toward sectors that are expected to offer better prospects for economic growth than would occur in the absence of such intervention, i.e., in the market equilibrium. Policies designed to improve the productivity of individual sectors and firms are a subsidiary but often pursued objective. In developing countries like Ethiopia where market failures are persistent, the pathway to economic development requires a prescribed amount of industrial policy.

We may find experiences of a country where government intervention via its industrial policies brings up success. However, on the other hand, in other countries, industrial policy has failed to yield fruits. Ethiopia may represent the first category for its industrial policy has not yet resulted any change on the performance of the industrial sector for more than three regimes. Despite the variation in the economic systems that each regime, Haile Silassie, Derg and EPRDF has used, the contribution of industrial sector to GDP and employment is still unattractive and has been at equal magnitude in all the three.

The Imperial Regime (Haile Silassie regime) in the period 1930-1974 pursued a market-based economic policy. In this regime, an attempt was made to modernize the country through the expansion of modern schools and health facilities, the promulgation of a constitution as a sign of stability for investment attraction, the development of infrastructure, and the beginning of medium-term planning (Five Year plans). The national development policy and the industrial sub-section was pro–private and encouraging. GDP growth averaged 4 percent over the final phase (1960-1974) and the average per capita growth was roughly 1.5%. (Alemayehu, 2006).

The ideology and national policy of the successor, the Derg (1974-1990), has opted for a socialist economic system where market forces were deliberately subdued and socialization of the production and distribution process pursued forcefully. The private sectors were totally ruined. Growth decelerated to 2.3 percent (-0.4 percent in per capita terms). Growth was also extremely irregular given its dependence on the agricultural sector, which is vulnerable to the vagaries of nature (Alemayehu, 2004). The Derg regime was also characterized by intense conflict, which accentuated the dismal growth performance.

The EPRDF adopted the typical structural adjustment policies of market liberalization, with the support of the Bretton Woods institutions. Although these reforms countered the regulatory syndrome characteristic of the Derg, the EPRDF regime can be viewed as displaying the "redistributive" syndrome, with power, policymaking, and resources controlled by, and in the direct interests of, the TPLF, which originated from the North of the country.

In sum, the last four decades have witnessed a cyclical evolution of policy regimes in Ethiopia. The environment for growth evolved from a fairly market-oriented one to a highly controlled one before being liberalized in the third period. This cyclical policy stance is associated with a growth cycle which was favourable in the first and third periods, and very poor in the second. For the second group, Japan and anyone of the new emerging economies of East Asian countries experience asserts it. Their industrial policy is vital for their miraculous success.

The purpose of the policy is to co-ordinate investment decisions. But the concept of developmentalist – in the context of government intervention would have to be confined on the laying down of infrastructural and institutional foundations that softens the long run economic development. Thus, the primary objective of the developmentalist government has to be satisfaction of the needs of investors both of domestic and foreign. These include economic and social infrastructures, capable and accessible financial institutions and markets, pro-investment land policy and commencement of special technical institutions that can produce industrial society and inspires individual initiatives. Besides, the developmentalist government has to show itself as a model on some high-tech public federal enterprises. So, through its social over head reproductive engagements, it has to empower individual entrepreneurs and private investors. Industrial investment and expansion choices and possibilities have to be widened for the potential and incumbent activity units.

3. Industrial Policy: a drug for Institutional failure

Either through distortion (externality) or through incompleteness, market failure prevails in developing countries including Ethiopia. The basic theorems of welfare economics, under such market failures asserted that, a competitive market system does not yield the socially efficient outcome-in terms of location, distribution, employment, wage and priority. While in mainstream economics market failure is seen as the entry point for a government to intervene, it has been increasingly realized now that government itself is a key source of failures in realizing the social optima. Skewed distribution of industries among capable regions (Amare 2015); failure to set out principles and standards; failure to smoothen the social overhead capitals, are all witnesses of government failures. The combination of market failure and government failure together is termed as institutional failure-which is much wider and deeper in terms of its implication. There are at least three categories of institutional failures, such as transaction failure, empowerment failure and governance failure. The transaction failure include market system failures covering inefficient markets (or market failure in the strict sense) absence of markets as in the case of industrial pollution and compensation; negotiation failure for non-market transactions or agreements; preference failures due to inadequate knowledge and information.

The second category in the following table related to empowerment failures which have to do with the relationships between different kinds of economic agents viz –a-viz domestic investors , foreign investors, regions and distributors in so far as they deal with the relevant transactions and decisions related to land , finance , tax, foreign exchange. Empowerment failure thus, takes place when there is inadequate or inappropriate mobilization compared to what would be optimal

Table 1: Types of institutional failure

category	Type	Description
1.Transaction Failure	Market failure	Missing markets: market performance failure: low values
	Negotiation failure	Missing parties: All stakeholders are not represented
	Preference failure	Missing knowledge: unable to priotize industries &Time P
2.Empowerment failure	Mobilization failure	Inadequate countervailing power: low power
	Authorization failure	Inadequate mandate of regions: sub-optimal public choice
3.Governance failure	Correction failure	Missing policies: for all types of compensations and damages
	Coordination failure	Lack of agent agreements: deficiency in inter-state integrity
	Intervention failure	Policy failure: inadequate objectives and instruments
	Administrative failure	Intervention level failure: enforcement failure

Source: Opschoor (2005) and own translation to industrial context

The third category of failure is the more familiar one of government failure. These include at least four categories: correction failure: lack of policies to address exit preconditions and equity: coordination failure: deficiencies in arriving at inter-region balance or agreements to deal with investors, industrial labours and regions: Failures in intervention itself: inefficiencies in enforcement and implementation.

This comprehensive visualization is useful to disentangle causes and to find more holistic and appropriate industrial policy. Thus, sound industrial policy is a medication for all such industry related malfunctions.

3.1 The infant industry Protection:

The small industry of less industrialized economies dresses the weapon of protection. The infant industry protection is one of the oldest arguments for trade protection and is perhaps the only such argument that is not dismissed out of hand by trade economists. The most popular (and the simplest) version of the argument runs as follows. Production costs for newly established domestic industries in a country may be initially higher than those of well-established foreign competitors due to their greater experience. However, over time, new domestic producers can experience cost reductions due to learning by doing (i.e. they enjoy dynamic scale economies) and can end up attaining the production efficiency of their foreign rivals. However, due to the initial absence of experience, if domestic industry is not protected from foreign competition, it would never take off and if dynamic scale economies are strong enough, temporary protection of the domestic industry can be in the national interest.

A stronger version of the argument states that the domestic industry might even be capable of attaining production costs below its foreign rivals if it is given sufficient protection. In this version of the argument, true comparative advantage lies with the domestic industry so that temporary protection may actually be in the global interest – consumers in the rest of the world can also benefit from the eventual lower production cost of the domestic industry. In an influential paper, Baldwin (1969) provided an incisive criticism of the infant industry argument. He argued that "if after the learning period, unit costs in an industry are sufficiently lower than those during its early production stages to yield a discounted surplus of revenues over costs (and therefore indicate a comparative advantage for the country in the particular line), it would be possible for firms in the industry to raise sufficient funds in the capital market to cover their initial excess of outlays over receipts." In other words, as Baldwin points out, the period of learning during which domestic firms are unprofitable can be treated as an initial fixed cost that can be recovered once the industry is globally competitive. If future returns indeed outweigh initial losses, capital markets would finance the necessary investment needed by the domestic industry. It is obvious, but worth stressing, that if future returns fall short of initial losses, the industry should not be established in the first place. A frequently cited counter to Baldwin's criticism (and one that he acknowledged) is that capital markets might be imperfect and therefore the industry may fail to gain the required financing. For example, a proponent might appeal to the presence of informational asymmetries: unlike producers, investors may not know that the industry is profitable in the long run and therefore fail to provide the capital needed to cover the initial costs. However, such an argument defies credibility since it requires one to believe that firms that have not even begun to produce the good in question know more about their prospects than those whose main objective is to find profitable uses for their excess capital and have analyzed and financed similar projects. Even if one grants the presence of asymmetric information, why cannot potential producers convey such Information to likely investors?

3.2 Elements of the New Industrial Policy

3.2.1 New industrial policy

Recent discussion of "new" industrial policy including the desirability of fostering learning and obtaining benefits from agglomeration economies offered by industrial clusters has received little systematic empirical evaluation. In principle, the development of clusters could facilitate growing productivity through the provision of overhead services by the organizers plus the interaction of the firms choosing to enter the cluster. Thus clusters could offer an alternative to dependence on either buyer or manufacturer led networks. The benefit of clusters may arise from face-to-face interactions that are productivity enhancing (interactions between software writers and chip manufacturers), a pool of workers with the relevant skills, and reduced transportation costs. Individual market agents may not be aware of the externality they generate for others and this provides an additional market failure that could in principle be addressed by public intervention. In the U.S., where there is a favourable environment for the policy-induced generation of agglomeration, many states and metropolitan regions have attempted to attract firms in similar industrial niches in order to achieve a "critical" mass. More generally, state governments and region wide efforts to attract firms to science parks have not been generally successful. The difficulty of replicating Silicon Valley in the U.S. is paralleled by the absence of major success stories in developing countries. The rapid development of the software sector in Bangalore and other cities in India appears to be the outcome of the existence of a large group of well educated English speaking students and the entrepreneurial abilities of a small group of residents combined with the awareness of their existence on the part of the large Indian expatriate community, particularly in Silicon Valley. Government participation is non-existent – a critical communications satellite is financed by Hewlett-Packard. Positive government efforts followed the "takeoff" of the sector. Of course, publicly financed education institutions generated the fundamental resource, educated workers. This might be considered a generic policy not specifically targeted to the software sector but there is no explicit effort to galvanize the agglomeration economies that have since developed. There are interesting descriptions of a number of clusters in OECD nations but few normative evaluations of their success employing social cost benefit analyses or even grosser measures such as growth of exports relative to firms outside of the cluster but in the same sector.

However, some insights can be obtained about whether some recent success stories in Asia conform to the contours of the new industrial policy. We consider in detail the evolution of the Indian software sector centered in Bangalore. The development of the software sector is attributable primarily to activities of private actors. Its success reflected a complex set of interactions between domestic and foreign responses to perceived opportunities. Many of the same patterns, with different details, can be documented for other success stories such as the Hsinchu Science Park in Taiwan (Saxenian 1999, 2001), the Special Economic Zones in China (Rosen, 1999), and Bangladesh's rise as a clothing exporter (Rhee, 2000). In the Indian software sector and the Bangladeshi apparel sector, the initiating force is private, the government playing almost no role except for the fundamental one in India of providing good education, a policy that does not fall into the domain of selective industrial policy.

In Taiwan (China) the establishment of a science park and legislation in China to allow special economic zones to attract FDI are due to an initial government stimulus. A critical input for the success is foreign participation that dealt with some of the roles cited above as requisites of industrial policy (source of new technology, facilitation of learning, source of new product ideas, centralized marketing allowing economies of scope, coordination of entry of complementary firms). The decision to foster a science park by Taiwan (China) comes closer to a proactive industrial policy. Unfortunately, the experience at Hsinchu has not been systematically evaluated. Many nations have attempted to use export-processing zones of one form or another to catalyze foreign direct investment and perhaps generate agglomeration economies. Evaluation of these suggests that while potentially a useful instrument, they have had indifferent results. Success stories can be pointed to in Korea and Taiwan (China) in the 1950s and early 1960s, and of course in the special economic zones of China.

The Ethiopian experience in agglomeration and economic zone demarcation is a recent phenomenon especially after Growth and Transformation Plan. Ethiopia, following growth and transformation plan, has distinguished economic zones for FDI intensification on a wider context. However, the technical diffusion would be immense if both foreign and domestic firms co-existed in the same economic zone. So, with the adoption of agglomeration experience from others, determination of whom to cluster in a way that hastens the intimidation period of the local industries.

3.2.2 Industrial Finance

Industrial Finance is the main challenge in developing countries like Ethiopia where their retained earnings cannot generate enough re-investible funds for expansion and growth. (EEA, 2005). To provoke manufacturing investment, separate and capable financial institutions excluded for industrial sector has to be set up. The existing development and commercial banks' of Ethiopia have very limited capacity of lending medium and long term loans for investors. The research on "Industrialization and industrial policy" by Ethiopian Economic Association (2005) has shown that the existing bank loans are able to satisfy only 26.2 percent of private investment demand in 2000-2002. This would have an implication on the underutilization of production capacity which in turn adversely affects their productivity. The internal finance weight is a great deal which is more than 73 percent. Of course it has shown increment as 46% of firms have access to a line of credit or loans from financial institutions, compared to 22% on average in Sub-Saharan Africa in 2006. (World Bank, 2006). The study concluded that this is the precise reason for why investment in manufacturing sector remained so low and the large majority of firms are in the category of micro and small scale.

Thus, if the next growth and transformation plans (subsequent GTPs), are to be capable of making the industrial sector stand at the frontline , industrial banks and industrial financial corporations have to be set up so as to serve exclusive industrial medium and long term loans for investment. In a net shell, 1) such corporation is expected to grant loans and advances to industrial investors; 2) granting of loans both in local currencies and foreign currencies (if the autonomy is to this extent) and 3) the corporation underwrites the issue of stocks, bonds, shares etc. This is of course the experience of India as similar banks and corporations[1] have been established since 1948 and has been authorised to issue bonds and debentures in the open market, to borrow foreign currency from the World Bank and other organisations, accept deposits from the public and also borrow from the Reserve Bank.

3.2.3 Calibre of Industrial labour

The calibre and economic competence of the labour force has notable impact on the productivity of industrial sector. The observation of Silcock (1985, p. 293), among the most acute academic critics of Asian development, is telling: The number of those who made the difference and enabled Singapore to make so much of a not very obvious opportunity is probably not above fifty. They have meant far more to Singapore than any spreading of

[1] The authorised share capital of the Industrial Financial Corporation of India is Rs. 10 crore at the initial stage and rose to Rs. 250 crore in the 1986 Amendment Act and subjected to fixation by the government at different times.

economic doctrine among the population in general or even among the educated parts of the population. In Singapore, distinguishing features of its post-1959 political and economic leaders are their personal integrity, a high level of formal education and, often, extensive training in economics. Although this last did not extend to Lee Kuan Yew, his approach to economics is "that of a person recognising that he has some training in the subject, he uses it to appraise the judgement of fully professional economists and use their advice to check some of his own ideas" (Silcock, 1985, p. 315).

Industrial transformation has be unless complemented by industrial society wouldn't be sustained. For this reason, industrial society must associate with the emergence of industrialization which transformed much of the economy by replacing essentially agriculture based societies with industrial societies based on the use of machines and non-animal sources of energy to produce finished goods. Industrial societies are in a continual state of rapid change due to technological innovations. The high level of productivity of industrial societies not only ensures the sustainability but also hastens the growth of the industrial sector in particular and the economy in general. So, provision of moulding training to university graduates (since most of them are from the rural society),to make them structurally fit with the industrial demand. They are only then called industrial society with the following characteristics. The division of labour becomes more complex with the availability of specialized jobs. The statuses are achieved rather than ascribed. The family and kinship as social institutions are relegated to the background. There is breakup of joint family system and nuclear family units become prominent. The influence of religion diminishes as people hold many different and competing values and beliefs. Industrialism is associated with the widening gap between two social classes of 'haves' and 'have nots'. The rich or the capitalist class is seen as exploiting class and the poor class known as working class is seen as exploited. However, in most of the industrial societies there is steady reduction in social inequalities. Industrial societies have given rise to number of secondary groups such as corporations, political parties, business houses and government bureaucracies, cultural and literary associations. The primary groups tend to lose their importance and secondary groups come to the prominence.

Despite this productivity prompting character of industrial societies, industrialists are not wilful to offer training for their employees in fear of turnover. If the employees are well trained they would be demanded by different industrial groups perhaps by high paying ones. The government ought to arrange a centralized training institution to fill the gap of industrial society fabrication.

3.2.4 Equitable Distribution

Balanced industrial development could be achieved by means of equitable distribution of industrial bases and industrial zones in all regions which are capable of running it. Otherwise, the skewed distribution would be a cause for social and political turmoil of the country which ruin the lifetime built up assets. Therefore, the definitions of balanced industrial development policy must contain the element of equity which encapsulates the distribution of existing and potential firms to be established. So, the element of equity in industrial policy framework is to signify inter-regional equity (fair distribution).

The main stumbling block hampering development in Africa, where Ethiopia is one notable example is the continued poor integration of the state and society. Governments should focus less on direct substantive support for and the organisations of specific projects and rather organise, facilitate and support the interface between public, private and community-based development initiatives. This requires an open, adaptive, accountable and responsive state.

The political parties, which are organised along ethnic lines, control large business groups, so-called endowment-owned firms. The ruling EPRDF and its member organisations stand out in this regard. Under the law on political organisation, political parties are not allowed to invest in business. To comply with this law, businesses are owned by endowment funds run by party members or close allies, or those persons hold company shares directly. The business group controlled by the EPRDF is said to be one of the largest conglomerates in Sub-Saharan Africa. (Altenburg, 2010). Within this group, the Endowment Fund for Rehabilitation of Tigray (EFFORT) is the most powerful. It is established by the Tigray People's Liberation Front in order to generate income for the families of 'martyrs' and to advance the industrialisation of Tigray. EFFORT is engaged in a large number of industries, including building materials, tannery, textiles, apparels, pharmaceuticals, industrial engineering, mining, banking, insurance, trading, construction services, and livestock. Although EFFORT operates as a non-governmental public charity organisation, it has never been audited since its launch in the mid-1990s. There is no transparency with regard to management structure, or profits and losses. The companies run by the EPRDF are reported to have made extensive use of the credit facilities of the state-owned Commercial Bank of Ethiopia. Private competitors claim that heavily indebted EPRDF companies have been bailed out, and despite mismanagement in some of them, there have been no cases of foreclosure. This really shows the cost of in equitability on productivity. The productive ones produce at less production capacity due to financial , material and land in accessiblity while the less productive ones with biased state support stayed in the market even at huge real loss. Moreover, EPRDF-related companies are said to get preferential treatment with regard to government licenses, allocation of foreign exchange, and contracts with the Ministry of Defence. Given the discretionary character of many government policies, however, it is not possible to verify these allegations. (Altenberg,2010).

This is why, independent Ethiopian entrepreneurs complain of unfair competition, alleging that state-owned, endowment-owned, and even foreign enterprises have better access to land, credit, foreign exchange and support services.

Investment surveys reveal that SOEs and endowment-owned firms are far less affected by problems in the local business environment. While independent private firms identify the anti-competitive or informal practices of others as their leading constraint and mention tax administration, customs and trade regulations, access to land, cost of finance and corruption as relevant problems, both the state-owned and the endowment-owned firms rank these issues much lower (World Bank ,2009).

3.2.5 Creating favourable conditions for all

One of the main pillars of strategies of GTP is creation of favourable conditions for the industry. The narrow base of the industrial sector is a challenge with significant implication on the country's capacity to generate foreign exchange and create job opportunities for its growing labour force. In the plan period, the industry sector would receive utmost emphasis by way of encouraging export based and import substituting industries. Vertical and horizontal linkages between agriculture and industrial sector would be promoted. The Government's program would also further focus on strengthening the small-scale manufacturing enterprises, as they are the foundation for the establishment and intensification of medium and large scale industries besides creating employment opportunities and accelerating urbanization, it would play supportive role for the development of the agricultural sector. The government also encourages medium and large scale industry expansion. As clearly stated in the Country's Industrial Development Strategy, value adding private sector is considered the engine of the sectors' growth. Over the years the business environment has become friendlier and trade and investment environment have improved rapidly; thus, attracting growing domestic and foreign private investment. As such, the Government would continue to make all the necessary facilitation and support to realize the GTPs industry growth objectives.(MoFED, 2010).

4. Conclusion

This chapter has shown that the industrial sector performance, in Ethiopia has been sub-standard, compared to even with those of other developing countries such as SSA. Since its first inauguration in the country a century ago, three regimes alternated, namely-Imperial, Derg and EPRDF. The liberal-Command-liberal ideologies in these regimes performed differently, the control regime feat being the worst. So, any sort of control and biasness in resource allocation, even in liberal systems, among the same line business actors (private, endowment, and public) results abysmally dismal outcome.

The developmental regime, which has been given emphasis for our case, has to empower individual entrepreneurs and private investors on fair bases. Industrial investment and expansion choices and possibilities have to be widened for the potential and incumbent activity units. But in actual, endowment-owned firms (owned by the party) and other party lobbying firms, get priority and special service for their request. The first mistake is the possession of business firms by political parties and the second is the biasness they made. To comply with this law, businesses are owned by endowment funds run by party members or close allies, or those persons hold company shares directly. The business group controlled by the EPRDF is said to be one of the largest conglomerates in Sub-Saharan Africa.

Thus, the primary objective of the developmentalist government has to be ensuring the balanced satisfaction of the needs of investors both of domestic and foreign. These include economic and social infrastructures, capable and accessible financial institutions and markets, pro-investment land policy and commencement of special technical institutions that can produce industrial society and inspires individual initiatives.

Hence, recognizing the relevance of sound and flexible industrial policy would be the main reason to cure unhealthy, distorted and unbalanced status of the industrial sector. Sound industrial policy would guide the holistic strategic efforts of a country thereby to enable the development of diversified industrial portfolios through the correction of institutional failures.

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