Challenges of the Ethiopian manufacturing sector under the GTP II

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The strategic pillars of the GTP II (Growth and Transformation Plan) related to manufacturing include (1) developing light and small manufacturing enterprises that are globally competent and leading in Africa (2) establishing a foundation for further growth of the strategic heavy industries which ultimately enable Ethiopia to become an industrialized country by 2025 (source: GTP II, PP 38). This is, however, an over ambitious plan. First of all, our experiences over the past ten years tells that, despite the sector level growth, the much needed structural transformation has never even showed a sign of change. The industrial base of the country has remained low contributing only 12-14% to GDP of which the medium and large factories as well as the light and small manufacturing shared respectively 4% and 1.2% throughout the past decade.

Industrial transformation is not merely about increasing the number of manufacturing enterprises or number of employees working in there and/or earning hard currency from manufacturing exports. Such targets can be achieved through short-term campaigns sometimes at the expense of other sectors' growth or heavy public subsidies or depressing local consumption. To some extent, this was what happened in Ethiopia about 10-15 years ago. By then, the Ethiopian government announced that, for those who would need to establish manufacturing enterprises, it would provide the very expensive urban land for free or at a very minimal prices and extend long-term loans at a subsidized rates. Following this regulation, many merchants who had the money have jumped into the manufacturing, particularly textile and garment as well as agro-processing. In no time, the number of manufacturing enterprises and the number of employees working in these sub-sectors increased tremendously. There was also a time when the government used to export sugar by depressing local consumption to get the much needed hard currency. However, other than meeting the short-term goals, all these attempts have hardly brought industrial development in the country.

There is no surprise that the GTP II has already started facing the hurdles which it's preceding two five-year industrial development plans including the PASDEP and GTP I couldn't pass. Over the last 10 years, there were efforts made by the government aimed at bringing about structural transformation of the economy, albeit not successful. Understanding the weak performance of the industry under the PASDEP (i.e., 2005/06 - 2009/10), the Ethiopian government had developed another five-year plan (i.e., the GTP I) that spans between 2010/11-2014/15. In that GTP, the manufacturing industry was planned, among others, to earn 2.3 billion US$ per year. Out of the planned 2.3 billion US$, the two strategic sub-sectors (i.e., textile and apparel as well as tannery and leather) were supposed to earn 1.0 billion US$ and 500.0 million US$ respectively per year by the end of the GTP I. Again after five years (i.e., in 2014/15), industrial export was only 402 million US$ with textile and garment and tannery/ leather contributing 98.1 million US$ and 133 million US$ respectively (source: MoI, 2014/15 Annual Report). For the third time under the GTP II, the Ethiopian government has made another five-year industrial transformation plan to bring about several folds of new jobs, increase foreign currency earning. To realize this, the government has budgeted, among others, over 103 billion Birr of loan through the Development Bank of Ethiopia (DBE) for the establishment of new and expansion of agricultural and manufacturing sectors including SMEs. Such sum of money if supplemented by the private sector investment is tremendous. However, the fate of the current industrial transformation plan will be similar to the preceding three consecutive plans. Here is why?

1. Absence of transformational leadership qualities within the sector leadership. Beyond developing systems and policies or regulations, industrial transformation (particularly in the

type of Ethiopian manufacturing industry) requires strong leadership who has the required transformational qualities. The existing leaders in the industrial sector despite their long years of experience and adequate knowledge, they have hardly the qualities of transforming sectors and reform it anew.

2. The labour/ skills market in Ethiopia is highly underdeveloped. Hence, the labour market couldn't allocate this important industrial input properly. And developing a properly functioning labour market in the country takes time. For instance, breaking the vicious circle of the low wage leading to low productivity and there by to low enterprise profit which again yielding to low wage takes time. Presently, wages and salaries in the strategic manufacturing sector is very low which is not adequate to finance daily subsistence. Because of this, many of the hardworking labours are forced to migrate to other sectors primarily to the service sector that in turn leads the manufacturing enterprises to stay in the lower productivity and competitiveness trap. Since profit of the manufacturing enterprises is low they cannot raise the salary of their employees. Breaking this vicious and developing a freely operating industrial labour market is time, finance and energy consuming which is hard to attain them all within the coming 4-5 years.
3. Import and distribution of manufactured goods is a highly profitable business in Ethiopia compared to producing them locally which the latter is much onerous and has longer pay-back period. Hence, those in the merchandizing business want to stay in their heavens. Hence, the expected investment flow from merchandizing business into manufacturing is unlikely to happen at least in the short run.
4. The much expected industrial parks are facing different problems from the start and addressing them will take several years. Bole-Lemi I, the only operating industrial park in the country, is the case in point. The service sector in Addis Ababa is growing at a much higher speed than the manufacturing. Hence, it pays labour higher than many of the manufacturing enterprises operating in the industrial parks and zones which in turn hinders labour flow into the manufacturing. Second, the factories operating in the park repeatedly express their dissatisfaction of the repeated power cuts, erratic water supply, poor custom procedures and long visa/ work permit procedures, etc. Third, even though we optimistically assume that the other industrial park under construction in Hawassa and the planned one in Dire Dawa will start operation in the GTP II period, they will surely face shortage of skilled labour. This is because the pool of labour that have completed the lower secondary level (i.e., 9th and 10th grades) which is also considered as the potential industrial trainable workforce are not available in sufficient quantity in these towns. And each of these parks require several tens of thousands of such skilled labour. Please note that Ethiopian secondary education enrolment is 17% as of 2011/12 (recent data available) which is far below the required level to support industrial transformation (source: Education Statistics, Annual Abstract of 2011/2012. Poor quality of the TVET education system together with the higher expectation of graduates have also contributed to the poor supply of appropriately skilled labour in the country.
5. Lack of clarity on the implementation of the industrial development strategy. The Ethiopian industrial development strategy clearly puts that local enterprises primarily the micro and SMEs are the bases for industrial transformation in the country while the GTP II focusses mainly on the development of industrial parks to attract and house the FDIs (Foreign Direct Investment) to meet manufacturing targets. In other words, the industrial strategy of the country is about developing suitable industrial environment where numerous locally owned micro and small enterprises will be emerged, incubated and grew all over the country. Despite this, GTP II has no clear direction as to how it will solve the constraints that have hindered the development of the vast industrial enterprises and micro and SMEs in the country and bring

about the needed manufacturing transformation. For instance, how will the GTP II solve the critical shortage of industrial inputs, shortage of foreign currency, under developed trade logistics, how to improve the management and technical skills of local entrepreneur and enhance their competitiveness, technology transfer, research and dissemination, poor coordination and communication platforms of the federal MoI with regional bureaus, creating backward and forward linkages as well as the large enterprises with micro and SMEs, improving industrial relationship (employer-employees), etc. are not properly addressed. Of course, there are some attempts such as the establishment of industrial inputs import and distribution corporation (i.e., EGLD- which its effectiveness is doubtful) and the development and promotion of lease financing. But, these are not sufficient. And from its few FDIs, Ethiopia is practically experiencing the fact that despite all the privileges given to them there are tendencies of conspiring with their affiliated companies in their home countries through illegal transfer pricing. Hence, promoting and incubating these FDIs other than creating some jobs and earning hard currencies, their contribution to the national manufacturing value addition, generating government revenue, creating industrial base, and bringing the needed structural transformation in the country is not as expected.

6. The SMEs that have been expected to be graduated and joined the medium and large scale are still hampered by many and intertwined problems such as access to finance and market, high cost of entry into and exit from businesses, lack of production facilities, etc.
7. The logistics services including cheaper transportation options cannot be ready or resume operation within the GTP II. And without developing these, industrial competitiveness will stay far behind global levels. This in turn affects the intended industrial transformation.
8. Power interruption will stay longer ahead. Even though, Ethiopia has the capacity to generate sufficient power to run its present and future manufacturing facilities the power distribution system and facilities are old and hence hinder industrial power supply. For this reason, the power outage problem is increasing its scale and intensity in recent times. Power failure and fluctuations are getting worse even in those industries which the government has allotted mobile power-substation and in those factories that have gotten dedicated power line. And replacing and renovating these will take longer time and huge resources which the country cannot do it within the GTP II period.
9. Developing internationally competitive product quality, creating a mass of disciplined and skilled industrial labour force, innovation (such as adoption of best technologies, marketing networks and organizational practices and structures, etc.), developing internationally competent managers, marketers, etc. are the fundamentals in transforming manufacturing industries. However, these are not covered sufficiently and the how part is not addressed either.
10. The poor performance of the export sector together with the higher demand for foreign currency by the government is keeping the private sector out of access to hard currency needed for the purchase of machinery and equipment as well as raw materials and inputs. At present, manufacturing industries have to wait for an average of 6-8 months after opening LCs to get approval for their foreign exchange application. Thus they are exposed to various problems including repeated L/C expiry, high cost of L/C renewing and bank charges, low productivity and capacity utilization. This situation is also expected to continue in the near future. This together with the relative depreciation of Birr to US currency have the tendency to inflate the production cost of the manufacturing enterprises which in turn hamper competitiveness.
11. The continued shortage of local raw materials and inputs supply cannot be solved within the GTP II period. The upper-stream of the economic sub-sectors in the country is

underdeveloped. For instance, the cotton sub-sector is the most confused market system and livestock development was hampered by various problems including poor livestock management, absence of feed, pervasive parasitic skin diseases, poor slaughtering and flaying of animal skin, poor hides and skins treatment and storage, etc. Government and its development partners have been working through decades to improve the supply chain albeit the result is discouraging. And all these can't be changed in just five years. Underdevelopment of the upper stream sub-sectors means that raw materials and inputs cannot be available in sufficient quantity to feed manufacturing industries. The paradox is the fact that the quality of the local source of raw materials and inputs fall below the standards while their prices tend to be above the international markets. This is exactly what is happening in the cotton and hides and skins markets of the country. The price of the poor quality locally produced cotton and the poor quality hides and skins are in many cases higher than international prices.

12. Last but not the least is the impact of el-Nino and the complicated political and security issues of the Horn of Africa that may worsen the doing business situations in the country, the volatile nature of local commodity market and its pressure on inflation have all the potential of obstructing the promises of the GTP II.

In conclusion, structural transformation is the result of well-functioning markets at all nodes of the value chains and macro-economic stability. Therefore, addressing the aforementioned constraints will surely improve the results under the GTP II. Below are some recommendations.

i) Bring in leaders who have the leadership qualities and passion to the forefront of the industry management. Bring best persons like Tewodros Adhanom who has transformed the health sector and Arkebe Oqubay who engineered Addis to be one of the best African metropolis or Fetlework G/E who has excellent experience in leading regional industry bureau.
ii) Re-orient the implementation strategy of GTP II towards improving the manufacturing business enabling environment and mobilizing resources for the development of local owned manufacturing enterprises.
iii) Expedite the development of skills market system which is being undertaken by EP (Enterprise Partners) and scaling it up through complementing by the efforts of other actors operating in the industrial parks to develop joint training model and skills performance improvement schemes.
iv) Provide accommodation facilities for the labours working in the industrial parks.
v) Provide special incentive mechanism for potential investors who can invest in the production of industrial inputs and accessories as well as for the development of large-scale animal farms.
vi) In the medium term (i.e. up to ten years) it is good for the government to invest in irrigation based large-scale cotton farms. In addition, the government should undertake close follow-up and provide support for those commercial farms who have taken land to grow cotton.
vii) Revise the bank's regulation which limiting commercial banks not to provide loans for more than 20% of their aggregate loan and for MFIs more than 5% of their capital.
viii) Expedite the development and promotion of the lease financing which is under formation. This includes clarifying the relationship and difference between SME lending and lease financing, i.e., whether lease financing scheme includes total project cost (which is advisable) or is only limited to machinery and equipment cost.
ix) Revise the just implemented DBE's regulation which denies working capital for its long-time customers. Pushing long-term customers who faced shortage of working capital to commercial banks is not practical and will cost a lot for both.