Industrial Policies in Low Income Economies: The Cases of Leather and Cut-flower Industries in Ethiopia

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# Outline

1. **Aims of Presentation**

2. **Industrial Policy in Low Income Economies**

3. **Methodology and Data**

4. **Case Study: Leather Sector**

5. **Case Study: Flower Sector**

6. **Lessons Drawn**
Aims of the presentation

• Briefly review the existing policy framework in both sectors
• Profile key institutions and their role
• Sector performance
• Shed light on main constraints that have impeded growth
• Draw policy implications
Industrial Polices in Low Income Economies

• The debate on whether industrial polices are needed or not is largely unproductive
  – Ubiquity of market failures
  – Historical evidence (e.g. Amsden, 2001 & Wade, 2004)

• More productive debate is on the appropriate extent of industrial policies
  – Should polices follow country’s comparative advantage (Lin, 2009) or defy it (Chang, 2002, 2009, 2010)?

• Focus is increasingly on enabling learning through experimentation (Rodrik, 2004) and creating knowledge (Cimoli et al., 2009), with the state taking an active role (Mazzucato, 2011)
Core Principles of Industrial Policies

• No single formula for Industrial Policy design
• Core principles are
  – Experimentation
    • Culture of transparency and flexibility
  – Embeddedness
    • Autonomy and open public consultation processes
  – Coordination
    • Real decision making and coercive power
  – Strategic awareness and vision
    • Ready to correct weaknesses, reallocate resources and leverage learning efforts
Methodology and Data

• Industrial Polices not amenable to the conventional statistical or mathematic treatment
  – Absence of counterfactual
  – Cross-country regression informative but inconclusive
  – Country-level studies selection bias—still useful

• Semi-structured Interviews
  – with investors at different layers of products value chain
  – With representatives of regulatory and service providing state institutions

• Published and unpublished manuscripts from a variety of institutions.

• Analysis is largely descriptive
Case study: LEATHER SECTOR
Brief History

• Two leather soaking and tanning companies started in 1918 and 1927
• Two footwear factories in the 1930s
• Trading was traditional and inefficient
  – Livestock Meat Board (1964)
• Nationalization in 1974
  – The National Leather and Shoe Corporation
• 1990s privatization and liberalization
Institutions, Industrial Policy and Performance

Institutions

• Regulation is diffused

• Three important institutions
  – The Leather Industry Development Institute (LIDI)
  – The Ethiopian Leather Industries Association (ELIA)
  – The Ethiopian Raw Hides and Skins Suppliers Association (ERHSSA)
Industrial Policies (1)

• Generally ‘business friendly’ policies
• First act was according the sector priority status in the export promotion strategy (1998) and the Industrial Strategy Paper (2002)
• In line with the wider push (ADLI, PASDEP, GTP) to generate foreign exchange to fund large scale development projects in other sectors
• Objective was to create a fully vertically integrated sector from slaughter to the export of high quality leather.
Industrial Policies (2)

• Government employs policies that do not sit easily within a strictly market-conforming framework.
  – The ban on the export of raw skins and hides
  – The ban on foreign companies engaging in the soaking stage of leather production
  – 150% export tax on semi-processed leather

• Policy responses to local conditions
  – Capacity building
    • Raw hides and skins marketing system proclamation no. 457/2005
    • Technical benchmarking
    • The ‘Made in Ethiopia’ project
    • Integrated shoe cluster development, EIFCCOS
    • LIDI a twining arrangement with lead leather research and development institutes in India
Performance

LLPTI established

Intention to tax unfinished leather export announced

150% export tax

Export revenue Leather & Leather Products (Millions of USD)

Export revenue footwear (Millions of USD)
Challenges

• Mix of heterodox policies
  – has achieved strong growth on a variety of measures but remains severely below target

• Main challenges
  – Market problems in the hides and skins trade
  – Working capital and liquidity problem in tanneries
  – Limited regulatory and enforcement capacity
  – Limited processing capacity
  – Constraints on international market penetration and competitiveness
Case Study: CUT FLOWERS
Brief History

- SOE flower farms in 1980s
- Two Ethiopian investors in 1990s
- Led by private sector initiative & lobbying
- Government then recognized the importance of the sector
  - Former Prime Minister Meles initiated dialogue with sector representatives in late 1990s
- Major breakthrough in the sector in terms of size and technology with an FDI in 1999
- Entry of by-far the largest Dutch Company in 2003
Institutions, Industrial Policy and Performance

Institutions

• Regulation is diffused

• Three important institutions
  – The Ethiopian Horticulture Producers and Exporters Association (EHPEA)
  – The Development Bank of Ethiopia (DBE)
  – Ethiopian Horticulture Development Agency (EHDA)
Industrial Policies(1)

In the initial phase of the industry

<table>
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<tr>
<th>Major constraints identified</th>
<th>Policies</th>
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| • Access to suitable land for floriculture development | **A Land**
| • Regular and dependable airfreight at reasonable cost | Suitable land located close to the airport is provided to investors at nominal lease rates |
| • Limited capital for investment | **B Transport logistics**
| | Subsidized rates and Shipment on credit basis using EAL |
| | **C Capital**
| | Cheap Credit based on the 70/30 modality from DBE |
Industrial Policies (2)

• Identified as a priority sector in PASDEP II (2006-2010)
  – Highly subsidized credit with low collateral requirement at DBE-Project Rehabilitation and Loan Recovery Sub-process at DBE
  – Duty free imports of machine and equipment
• Capacity building, investment support and market promotion (EHDA)
• Transport infrastructure and access to land
  – Incentive package that increases with distance from Addis
  – Land in “Development Corridors” fitted with power, cold storage facility and transport link to the nearest airport
Performance

Number of exported stems in 10 millions
Exports in millions USD
Share in total export

Number of stems exported (10^7) and export revenue in millions USD
Share of flower export in total export


- Number of exported stems in 10 millions
- Exports in millions USD
- Share in total export
Challenges

• The sector has evolved from being private sector-led to “big followership” (Wade)

• Main challenges
  – Low demand in key export markets
  – High labor turnover
  – Unpredictable and inconsistent regulation
  – Access to land
Lessons Drawn

• Mixture of general incentives and targeted interventions
  – Pragmatic polices may not necessarily follow the fault lines of academic debate
• Building implementation capacity early
• Responsive regulation
• Differentiate companies
• Continuous dialogue
Thank you for your attention