

Cross-cutting Issues in Industrialization

In the Context of Broadening the Policy Scope in Ethiopia



**Kenichi Ohno (GRIPS)
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Background

- In the last several years, Ethiopia has learned and implemented various industrial policy tools and improved its policy capability.
- Ethiopia has had some success in promoting a few export-oriented industries.
- Ethiopia is expanding its policy scope to include import substitution. This will entail new challenges and risks, and policy capability must be further strengthened.



Our Purposes

- Raise issues and stimulate policy debate as Ethiopia expands its policy space.
- Ideas for drafting the industrial chapter of next PASDEP.
- Finding concrete issues to be studied in the subsequent bilateral policy dialogue.

(Urban industries only; rural industrialization is beyond the scope of this paper)

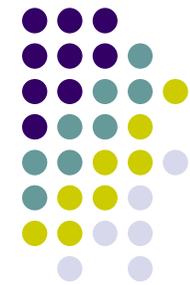


Topics

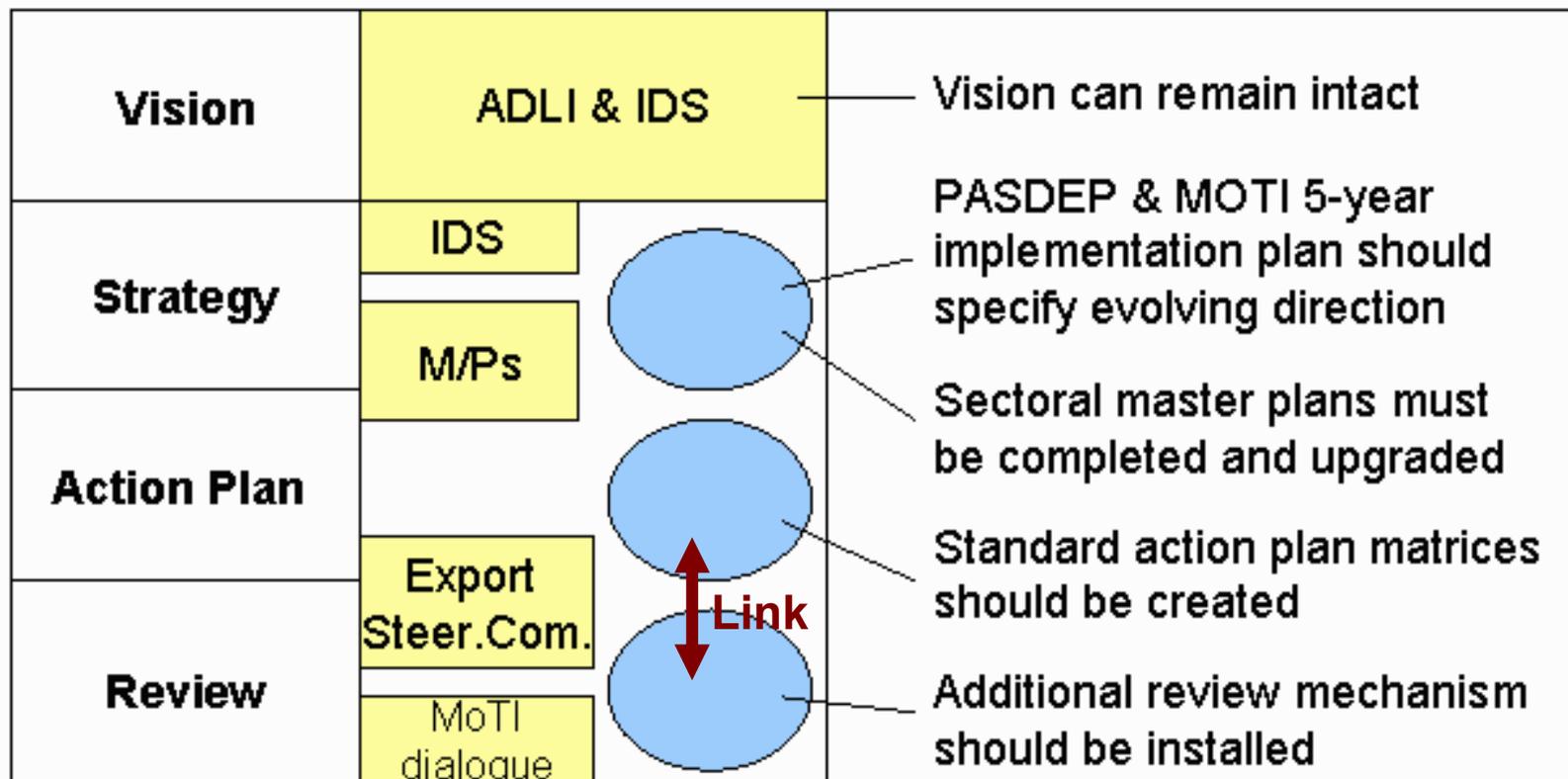
1. Policy framework and structure
2. Past review and future evaluation
3. Time dimension of industrial promotion
4. Import substitution
5. Industrial clusters and corridors
6. SME promotion

(Each issue contains 2 or 3 sub-issues)

1. Policy Framework and Structure



1-a. Ethiopia has an industrial vision but strategy, action plan, and review remain incomplete.



Sample Format of Thai Automotive Master Plan

Strategy	Action Plan	Output	Key success indicator	Main resp. org.	Cooperative org.
1.2 Automotive Human Resource Development	3. Automotive training center project	Standardized automotive training center	1. Number of trained persons	TAI	OIB/TAIA/TAPMA/F TI
	3.1 Provide Systematic training to the industry from workers to management level		2. Number of companies sending employees for training		
	3.2 Skill training		3. Increased income of trained persons		
	3.3 Provide training to engineers in the field of advanced engineering and specialized technology		4. Cost reduction and profitability		

Source: Executive Summary (English), Master Plan for Thai Automotive Industry 2002-2006, page 10.

1. Policy Framework and Structure



1-b. The industrial chapter of the next PASDEP, and the five-year industrial implementation plan to be prepared by MOTI, should state clearly the direction of industrialization strategy in the next five years.

For example:

- Review of export-orientation strategy
- Directions and targets for the next five years
- Import substitution
- New industrial strategies and tools

1. Policy Framework and Structure



1-c. All three levels of industrial policy should be strengthened.

Basic – Stable, transparent, and business-friendly environment

Intermediate – Responsiveness to business needs and problems

Advanced – Pro-active creation of dynamic comparative advantage under state guidance and effective PPP

2. Past Review and Future Evaluation



2-a. There should be an *ex post* review of export industry promotion.

Medium-sized reports should be prepared quickly for leather, garment, floriculture, (food processing?):

- Quantification of direct and indirect costs
- Benefits and performance of industry
- Was intensive support effective? Worth the cost? Lessons and directions for future?

2. Past Review and Future Evaluation



2-b. There should be *ex ante* analyses of proposed import substitution industrialization.

- Preliminary studies of key import substitution industries within a few months (to be followed by full M/Ps or F/S).
- These studies (past & future) should be preferably conducted by private Ethiopian experts to build government-academic link.
- Cooperate with International Growth Center (UK) for data, analyses.

3. Time Dimension of Industrial Promotion



3-a. Industrial promotion must always be temporary with pre-announced graduation schedule.

- Proper balance between globalization and domestic industry promotion is required.
- Assistance must be reduced over time, regardless of success or failure.
- Leather, floriculture: continued promotion but with graduation schedule.

3. Time Dimension of Industrial Promotion



3-b. Time-bound support measures should be available to all producers, whether pioneers or copycats.

Dani Rodrik: “Promote *new* activities only, not export. Assist *pioneers*, not emulators.”

- Impractical and unfair – impossible to identify pioneers (not necessarily first movers).
- Distorted incentive for “license hunting.”

3. Time Dimension of Industrial Promotion



3-c. A long-term liberalization roadmap should be prepared in anticipation of WTO accession.

- There should be a long-term roadmap to link industrialization and integration strategies.
- Without industrialization plan, WTO entry negotiation will be driven by paper works and political/diplomatic battles.
- Study “order of economic liberalization” for proper sequencing to avoid crisis.

4. Import Substitution



- 4-a. Import substitution must avoid the risks of *policy misjudgment* and *political capture*.
- IS is more risky than EP because gov't has power to regulate domestic markets (prices, subsidies, entry, standards, etc.)
 - Anne Krueger says IS is nonoperational because (i) gov't cannot distinguish infants from dying industries; (ii) politics will always hijack good intention.



4. Import Substitution

4-b. Technical details are key to the success of IS. A high-quality F/S or M/P should be prepared for each IS industry to be promoted.

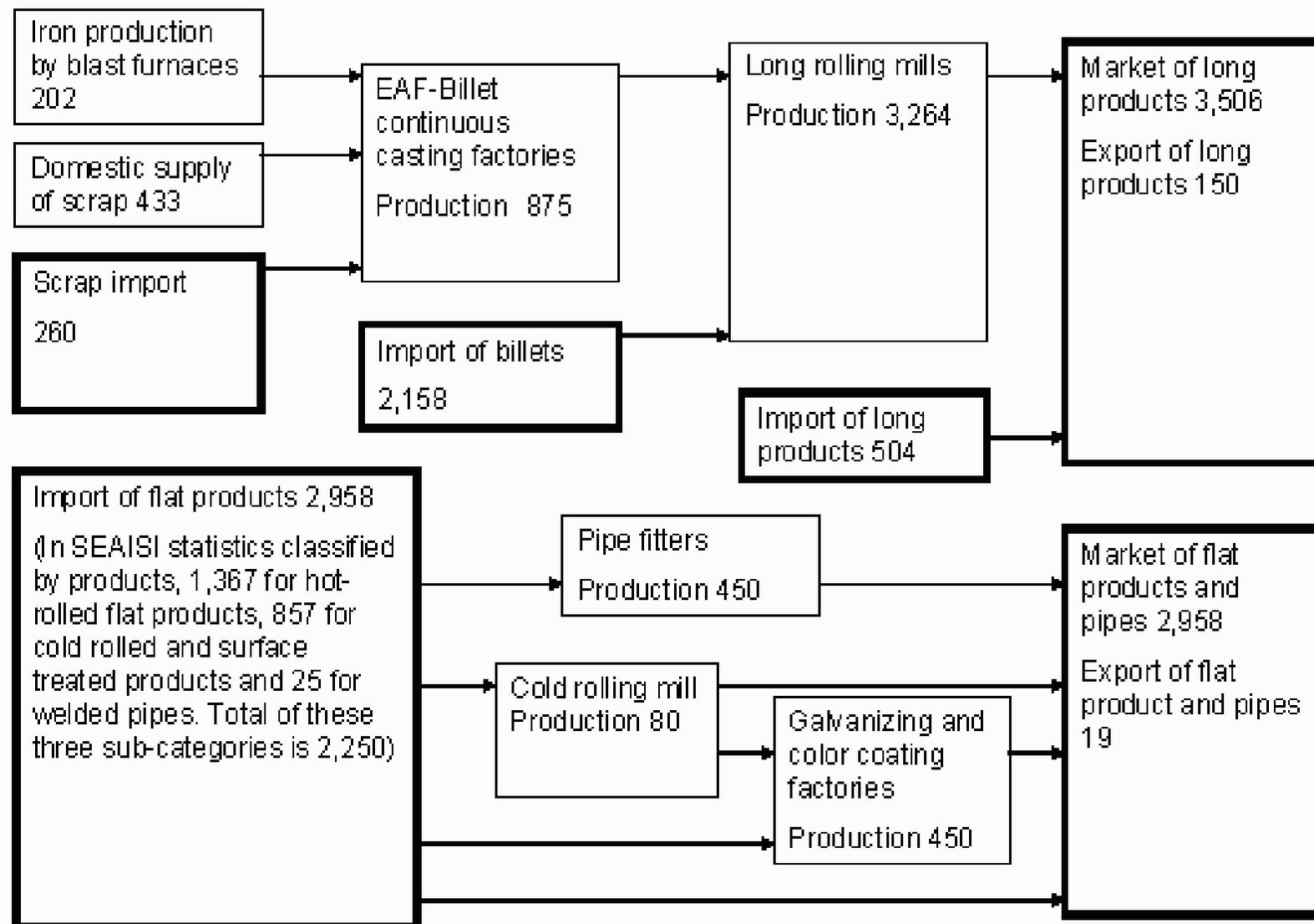
- Markets and gov't are both imperfect, but it is gov't that must be the agent for change in development (=developmentalism).
- Krueger's conclusion is unwarranted: improve policy capability to avoid these well-known risks in advance, not abandon IS entirely.

The Case of Steel Industry



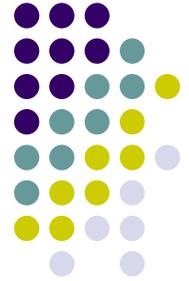
- A complex industry with different products, processes, market segments.
- Identification of material flows and problems.
- Key to profitability - location, technology, capacity, equipment, input procurement, I/O linkage, factory management, training, timing of investment, taxes and tariffs, finance, role of distribution intermediaries, etc.
- Start from long to flat steel; from downstream to upstream; from low to medium quality.

Material Flows of Steel Industry in Vietnam, 2005



Unit:1000 tons. Source: Author compiled from SEAISI (2006a, 2006b).

Source: Nozomu Kawabata, "Iron and Steel Industry in Viet Nam: A New Phase and Policy Shift," Vietnam Development Forum Discussion Paper, no.9(E), August.



4. Import Substitution

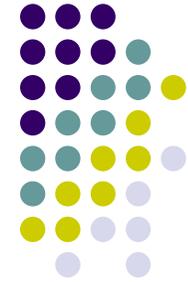
To avoid **policy misjudgment**:

- For each IS industry, learn technical and market details in advance.
- Prepare good F/S and M/Ps.

To avoid **political capture**:

- *Democratic Developmentalism*: maintain strong and effective state guidance to punish rent seeking and encourage value creation.

5. Industrial Clusters and Corridors



5-a. There are many definitions of industrial clusters and corridors. Applicability of each to Ethiopia should be carefully examined.

Industrial clusters:

- (1) Interaction between top researchers and high-tech firms to create innovation and new products (Porter, Japanese METI).
- (2) Promote industrial agglomeration with I/O linkage (Flowchart Approach of Kuchiki).

(3) Concentration of SMEs in the same industry such as shoe, ceramics, etc (Otsuka-Sonobe).

Industrial corridors:

(4) International road linking port with hinterland and landlocked countries.

(5) Creation of new industrial regions by providing transport infrastructure through PPP, HRD, logistics, electronic customs & trading (Japanese METI).

(6) Food processing industrial zones (“growth corridor” idea in Ethiopia).

5. Industrial Clusters and Corridors



5-b. The idea that related projects and programs should be implemented collectively in certain geographical areas is useful in building *agro food parks* and other industrial zones.

- If the Food Processing Industry M/P is finalized and approved, MOTI and MOARD should work together to execute it.

- { Enhancing Core ADLI
- { Inter-ministerial coordination



6. SME Promotion

- 6-a. SME promotion should clarify targeted firms and activities.
- 6-b. Ethiopia should re-organize and strengthen SME policy as the core of industrialization strategy.

6. SME Promotion



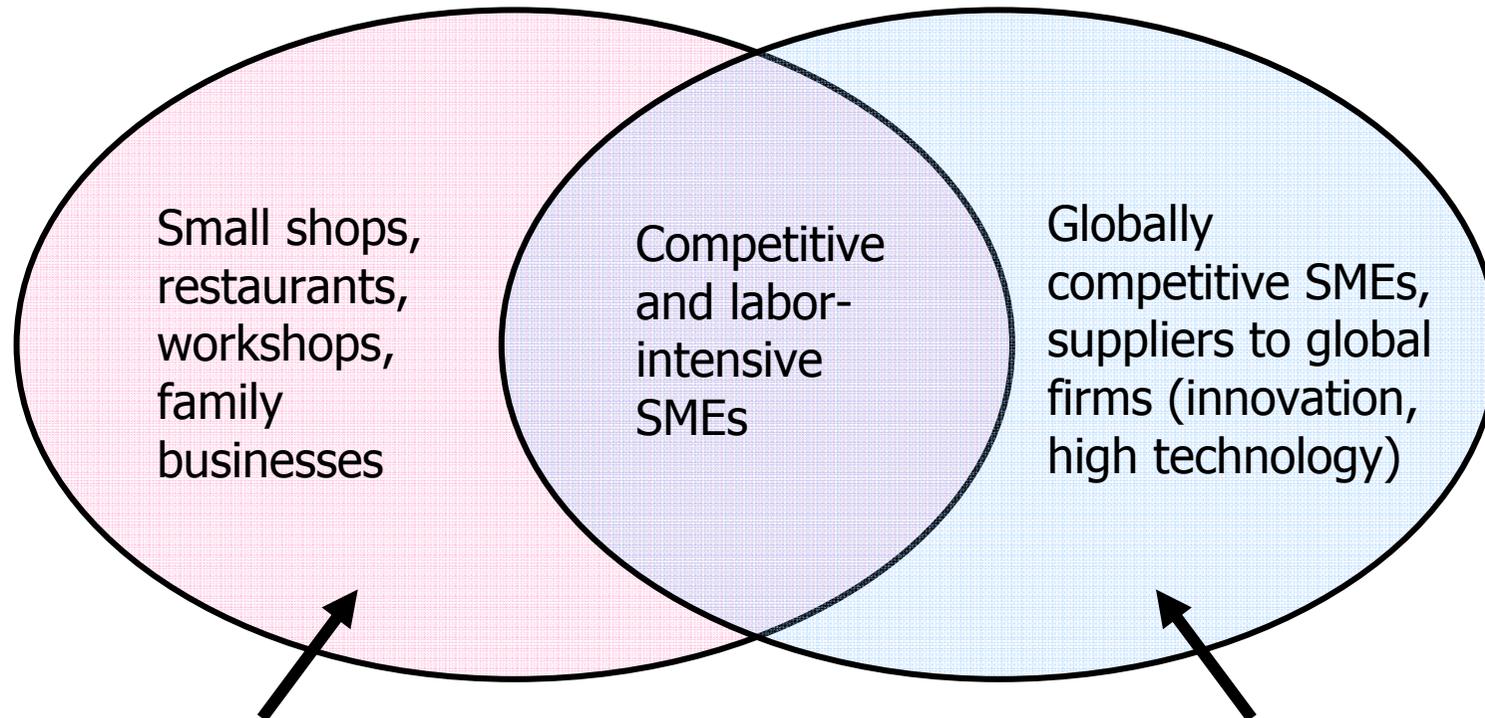
- SME promotion is very popular but purpose, content and outcome differ across countries.
- In Ethiopia, almost all local manufacturing firms are micro & small (the missing middle).
- In Ethiopia, SME policy should separately target *poverty reduction* and *competitiveness*.
- Selectively learn from concrete and diverse international practices in SME promotion.

Two Purposes of SME Policy



**SMEs for poverty reduction
(generating jobs & income)**

**SMEs for international
competitiveness**



General support to all eligible SMEs nationwide

Support innovative activities with selection criteria and monitoring

Different Objectives of SME Policy



- **Malaysia, Thailand** (FDI-led industrialization):
 - Reduce reliance on foreign technology and management
 - SME promotion and internal value creation as the core of industrial policy
- **Japan** (many large firms and SMEs):
 - Protection of SMEs from exploitation by large firms → Encouraging innovation by SMEs

Malaysia's SME Support Programs

Small and Medium Industries Development Corporation (SMIDEC)

Eligibility	Enterprises with more than 60% local capital, with annual sales less than RM25m, employees less than 150.
Grants	Provided for industrial linkage, business planning, product and process improvement, logistic services, overseas marketing, obtaining quality certification, improved packaging, design, labeling, halal products, etc.
Soft loans	Provided for factory relocation, ICT, etc.
Selection	“Concept papers” submitted by enterprises are evaluated by SMIDEC within 14 days and benefits disbursed within 20 working days.
Monitoring	Proposed actions are monitored after 3, 6 and 12 months, and benefits may be withdrawn if they are not implemented.
Industrial Linkage Program	Database of 18,000 companies; annual matchmaking events with the participation of over 250 local suppliers and MNCs; pioneer status with 100% tax exemption for five years and other tax privileges.

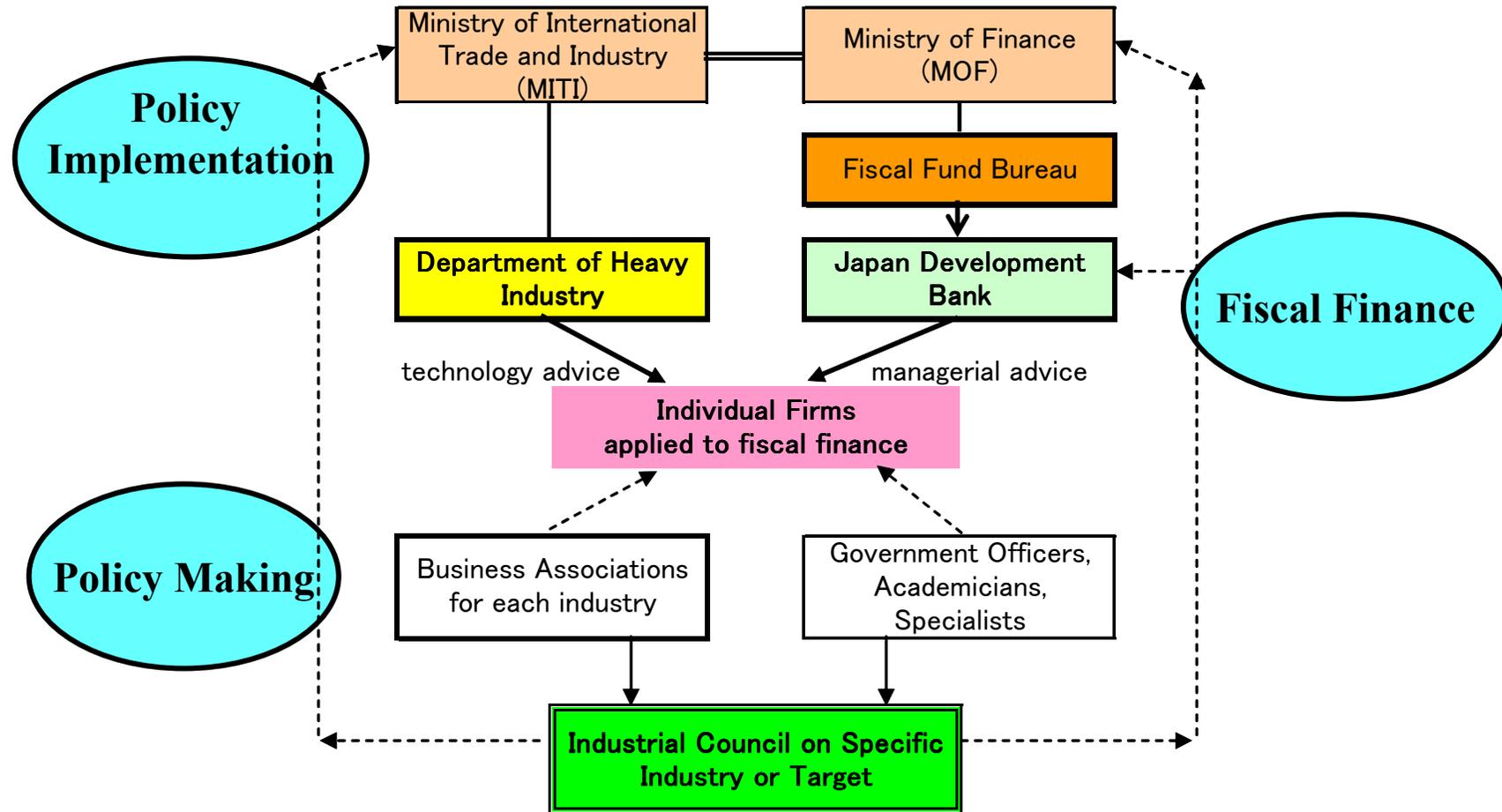
Source: K. Ohno, ed. (2006), *Industrial Policy Formulation in Thailand, Malaysia and Japan*, Vietnam Development Forum, Publishing House of Social Labor, Hanoi. Also see www.smidec.gov.my/index.jsp.

SME Promotion in Japan (Late 1950s to Early 1970s)



- **Cooperative policy formulation** by Industrial Councils.
- **Technical support** by Ministry of International Trade and Industry (MITI), *Shindanshi* (enterprise consultants).
- **Financial support** by MOF, Japan Development Bank (JDB). JDB also offered **managerial support**. This had a catalytic effect on commercial bank loans.
- All these supports were linked.
- Firms could re-apply for JDB and SME loans--MITI and JDB coached them until they passed.

Prof. Akira Suehiro: Japan's Post WW2 Mechanism for Industrial Support



Source: Drafted by Akira Suehiro