

Ethiopia's Export Policies and Performance: lessons and implications

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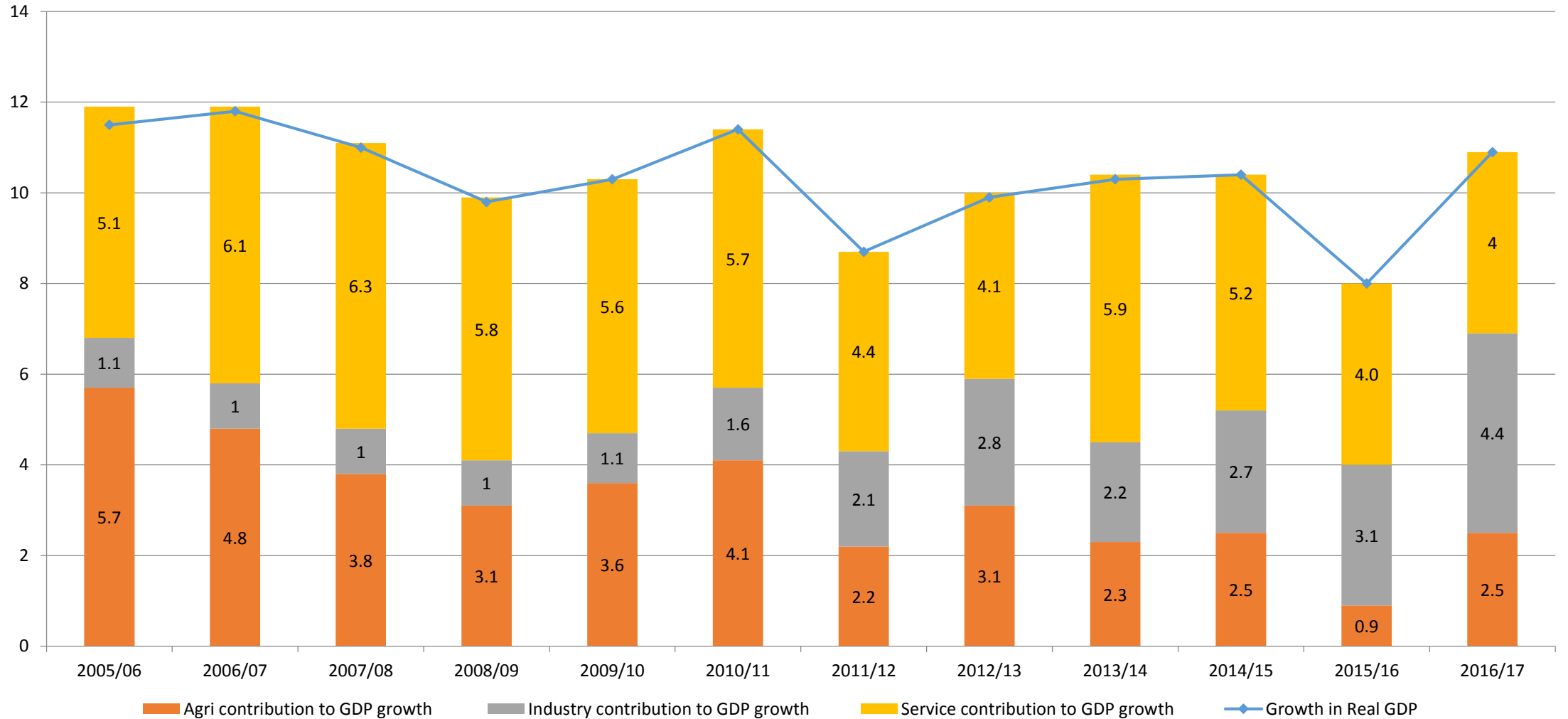
1. Introduction

- The importance of exports in stimulating economic growth and structural change cannot be overstated
- There are several channels through which export stimulate growth
 - increased earnings of foreign exchange → relaxing balance of payments constraints
 - economies of scale,
 - access to new technologies and knowledge,
 - enhances specialization of products that have comparative advantage
- The empirical literature provides evidence that export diversification has considerable explanatory power in per capita income growth in a cross-country empirical model (e.g. Dollar and Kraay, 2001)
- In recognition of this, many countries have made attempts to diversify export product bases

2. Overview of Ethiopia's export promotion policies

- Like many other countries, Ethiopia also started to promote exports particularly since the early 1990s
 - In 1994/95, it formulated ADLI, which embraces export-led development strategy as engine of growth
 - In 1998, it adopted export promotion strategy
 - In, 2002/03, it formulated a full-fledged industrial development strategy (IDS)
 - IDS declares priority industries largely - **export oriented manufacturing** industries (textile and garment, leather and leather products, meat, sugar and other food products)
 - Different types of export incentives and support programs have been provided to exporters in the selected manufacturing sectors
 - The 5-year development plans have attached great importance to promote exports and constitute specific export targets

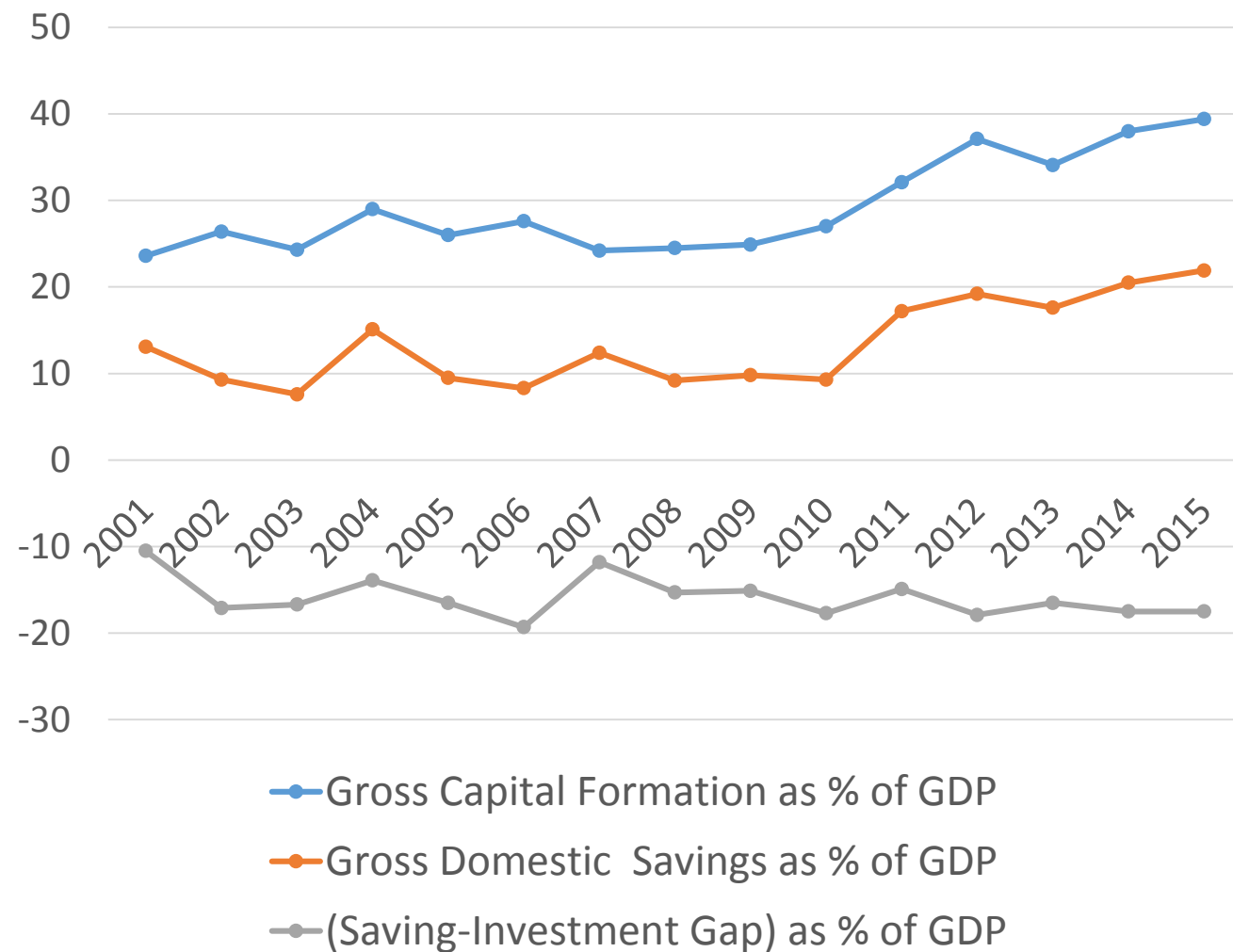
3. Performance: Real GDP growth and contribution of sectors



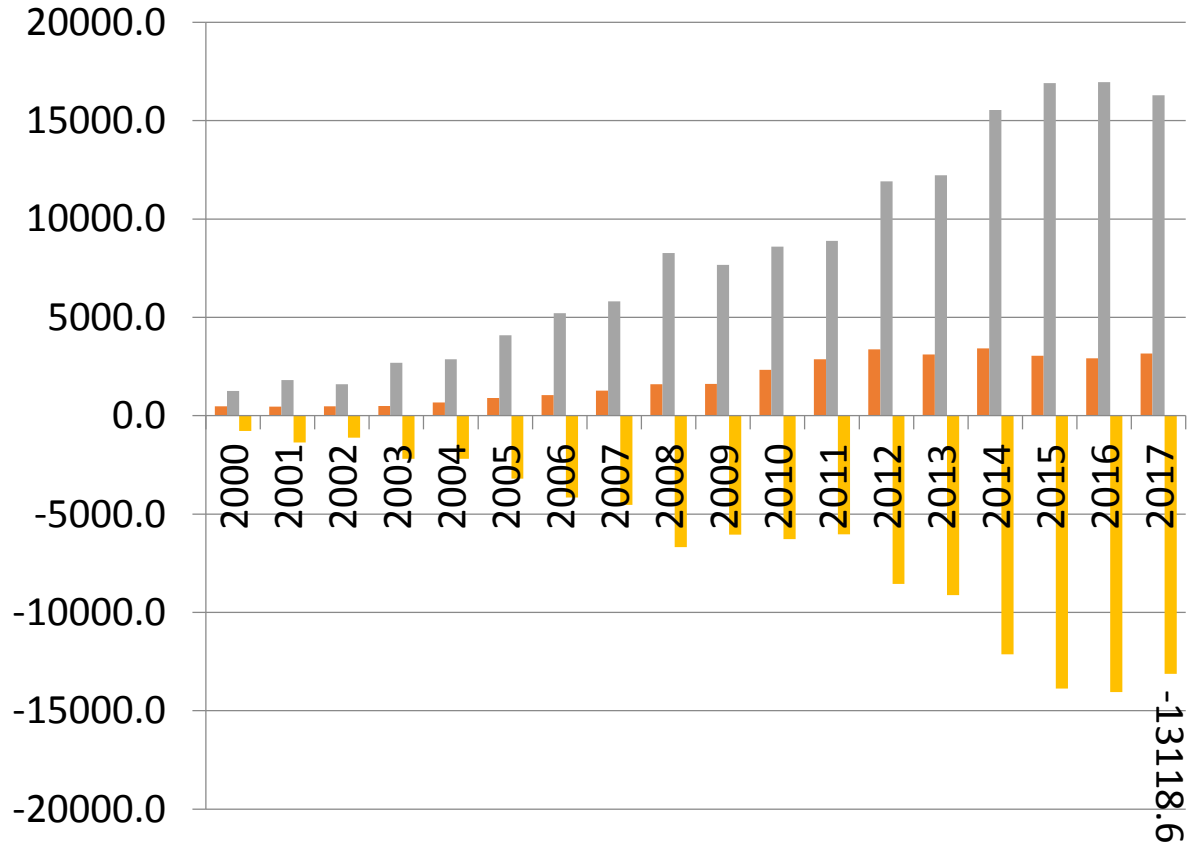
Performance conti.: Saving-investment gap

- Ethiopia has seen a **remarkable growth in capital formation** in recent years
 - ❖ **GFCF to GDP** share about doubled in the last 15 years
 - ❖ Ethiopia's GFCF to GDP ratio is about double than the average GFCF in the SSA and LDC Countries
 - ❖ But comparable to the East Asian countries (e.g. S. Korea and Taiwan) at their takeoff stage
- **But saving-investment** balance remained negative and even slightly deteriorated
 - Domestic saving growing in slower pace
 - This contrasts to the E. Asian experience

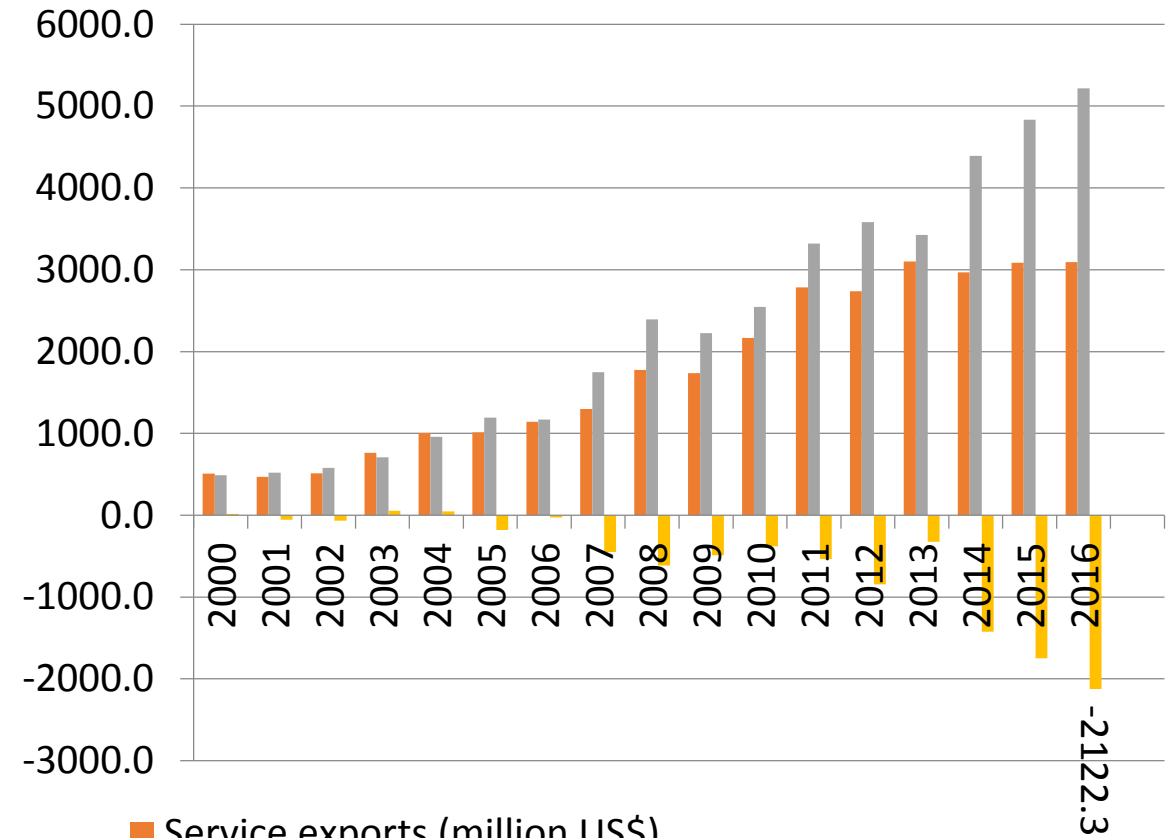
Fig. 1. Gross Fixed Capital Formation and Saving: Ethiopia



Performance cont. Deteriorating overall trade balance



- Merchandise exports (million US\$)
- Merchandise imports (million US\$)
- Trade balance (export - imports) (million US\$)



- Service exports (million US\$)
- Service imports (million US\$)
- Service trade balance (export - imports) (million US\$)

Performance cont.: Manufacturing export performance

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16*
Actual Values (in millions of USD)									
Total Export	1,465.7	1,447.9	2,003.1	2,747.1	3,152.7	3,081.2	3,300.1	3,019.3	2,861.0
Manufac. export	135.9	116.8	114.9	230.3	277.9	297.8	317.8	326.3	344.4
Manufc. exports share merchandize export	9.3	8.1	5.7	8.4	8.8	9.7	9.6	10.8	12.0
GTP target & achievements									
Manufac. export GTP targets				2089	685	1075	1570	2479	864.6
(%) achieved of targets				11.0	40.6	27.7	20.2	13.2	39.8

4. Why has the export sector failed to deliver?

- Why has the export sector failed despite wide support and expectations from the government?
- Major factors that impede the development of the export sector;
 - Policy related issues
 - Structural issues (diversification, quality and productivity of export products)
 - Institutional quality (export bureaucracy, logistics, ...)
- Here we focus on four important issues
 - Little attention to the industries with out smokestack (tourism, horticulture ...)
 - Policy inconsistency (tariffs, exchange rate management ...)
 - High trading costs
 - Poor quality of institutions particularly the export bureaucracy

Why export underperformance cont.

This presentation is drawn from four previous own work

- Gebreeyesus, Mulu and Alekaw Kebede (2017). “Ethiopia’s export promotion and the misalignment of the tariff and exchange rate regimes”. EDRI Working Paper 19, Addis Ababa: Ethiopian Development Research Institute.
- Gebreeyesus, Mulu and Ashagrie Demile. (2017). Why export promotion efforts failed to deliver? Assessment of the export incentives and their implementation in Ethiopia. EDRI Working Paper 17, Addis Ababa: Ethiopian Development Research Institute.
- Gebreeyesus, Mulu. (forthcoming). “The private sector in Ethiopia’s transformation” chapter 39 (in eds.) Fantu Cheru, Christopher Cramer, and Arkebe Oqubay. The Oxford Handbook of Ethiopian Economy.
- Gebreeyesus, Mulu, (2018). “Industries without smokestacks: Implications for Ethiopia’s industrialization”. (in eds.) John Page, Finn Trap and Richard Newfarmer. *Industries without Smokestacks and Structural Transformation in Africa*, Oxford University Press.

(a) Less attention on the industries without smokestack

- The manufacturing sector is known to have unique role towards structural transformation
- But the industries without 'smokestacks' that include tradable services (for example, IT, tourism, and transport), horticulture and agro-industry can also provide new opportunities for export development
 - through resolving the shortage of foreign exchange, lack of inputs and poor logistic and infrastructure services
- **In fact currently Ethiopia's export earnings comes mainly from non-manufacturing exports**
 - service sector share is about 50%
 - Agriculture constitutes about 70% of the remaining 50% of merchandize export
 - Manufacturing export is only about 12% of merchandize export
- However, to date the importance of the development of the industries without smokestack has received little attention at least in practice
 - Ethiopia has emerged as a global player in the cut flowers business.
 - However, the success in the flower export has not thus far replicated in the fruits and vegetables sector despite huge potential.
 - The tourism sector is not attracting sufficient attention despite its potential

(b) Policy inconsistency – tariff and exchange rate management

- Despite various export incentives and support programmes firms have become increasingly interested in the domestic market rather than export market as the former is more lucrative and attractive than the later
 - Then the question is that **why is the domestic market so much lucrative in comparison to exporting**
 - Gebreeyesus, Mulu and Alekaw Kebede (2017) **argue that the tariff and exchange rate policies are inconsistent with the export promotion strategy of the country**

(a) We calculated the anti-export bias generated by tariff and non-tariff protections or trading costs

(b) We also look at the impact of overvaluation of exchange rate

Tariffs

Despite reforms, Ethiopia is still characterized by higher rates of import tariff in comparison to other countries

Duty Type (2015)	Simple Average duty rate				Weighted Average duty rate			
	Ethiopia	All countries	LDCs	Sub-Saharan Africa	Ethiopia	All countries	LDCs	Sub-Saharan Africa
Raw materials	14.85	4.53	10.92	7.76	9.89	1.72	7.87	1.85
Consumer goods	23.95	7.69	16.03	15	15.42	3.9	12.23	10.55
WTO HS Industrial	17.49	5.3	11.2	9.89	12.88	2.24	10.53	6.71

- In fact the export oriented sectors such as textile and garment as well as leather industries are the most protected sector reaching up to 35% nominal tariff rate

Non-tariff trade barriers

Required time and cost in trading across borders is very high in Ethiopia

2015	For exports		For imports	
Stages	Time (in days)	Cost (in US\$)	Time (in days)	Cost (in US\$)
Customs Clearance and inspections	7	290	5	390
Documents Preparation	27	520	29	700
Inland Transport and handling	7	1300	7	1600
Ports and terminal handling	3	270	3	270
Total	44	2380	44	2960

Source: Doing Business 2015: Ethiopia.

Average Nominal and Effective Rates of Protection (duty, freight and trading time cost 2010-2015)								
	<u>Nominal Rate of Protection (%)</u>				<u>Effective Rate of Protection (%)</u>			
Sector	<u>Duty related effects</u>	<u>Freight Cost effects</u>	<u>Time delay cost effects</u>	<u>Total effects</u>	<u>Duty related effects</u>	<u>Freight Cost effects</u>	<u>Time delay cost effects</u>	<u>Total effects</u>
Cereals & Grain Milling	10.9	17.2	60.7	80.2	16.4	17.1	110.7	148.0
Vegetables and fruits	20.8	19.2	66.3	93.4	21.5	19.0	68.6	96.7
Diary & Animal Prod.	17.1	20.2	59.8	92.9	24.9	19.3	97.1	155.4
Prepared Food	19.5	14.1	21.9	43.6	34.2	14.2	40.2	89.6
Textiles	31.9	8.9	60.6	98.7	39.1	17.7	100.5	185.4
Apparel	34.9	8.9	60.6	98.7	46.5	10.0	92.9	161.1
Tanning & leather prod.	33.6	10.8	49.8	93.8	55.2	11.1	101.0	223.5
Footware	34.1	10.8	49.8	93.8	50.1	10.0	91.0	205.4
Wood & Paper Prod.	11.1	21.1	22.4	52.8	8.4	20.9	42.4	131.7
Chemicals & medicines	11.9	19.5	22.0	44.6	-0.4	22.9	18.8	43.9
Metals & mineral Prod.	10.0	19.7	20.8	47.3	12.5	19.6	34.8	88.6
Other manufacture	23.4	14.9	13.8	35.2	38.8	14.3	19.5	63.2

Table 3: Anti-export bias % (duty, Freight and trading time cost) (2010-2015)

	<u>Duty related effects</u>	<u>Freight cost effects</u>	<u>Time delay cost effects</u>	<u>Total effects</u>
<u>Sector</u>				
Cereals & Grain Milling	21.1	16.8	119.4	158.8
Vegetables, and fruits	21.6	19.0	68.7	96.8
Diary & Animal Prod.	38.5	19.1	111.7	178.7
Prepared Food	49.5	13.3	44.2	98.4
Textiles	68.2	6.5	120.1	201.7
Apparel	70.7	8.2	107.6	184.7
Tanning & leather prod.	148.1	10.3	160.4	353.9
Footwear	145.3	10.0	148.4	335.5
Wood & Paper Prod.	42.6	19.8	55.4	171.4
Chemicals & medicines	17.0	22.8	34.6	79.5
Metals & mineral prod.	23.0	19.1	38.3	97.5
Other manufacture	52.7	14.0	21.3	69.2

Main results

(1) The overall (tariff & non-tariff) anti-export bias is very large [in some sectors e.g. textile & leather the anti-export bias reaches up to 200-300%]

- This suggests that value added obtainable in the domestic market is greater than **2-3 times** that obtained in exporting
 - Makes more attractive the domestic market in contrast to exporting

When comparing by sector – the most protected sectors, thus, with higher anti-export bias are the export oriented such as **Leather, Footwear, Textiles and Apparel**

- These are export oriented sectors which are preferred and receive high attention and support from the government. ← **so far with dismal performance**
 - **The implication is that you can't simultaneously promote export and protect domestic market for a given product as there is tradeoffs**

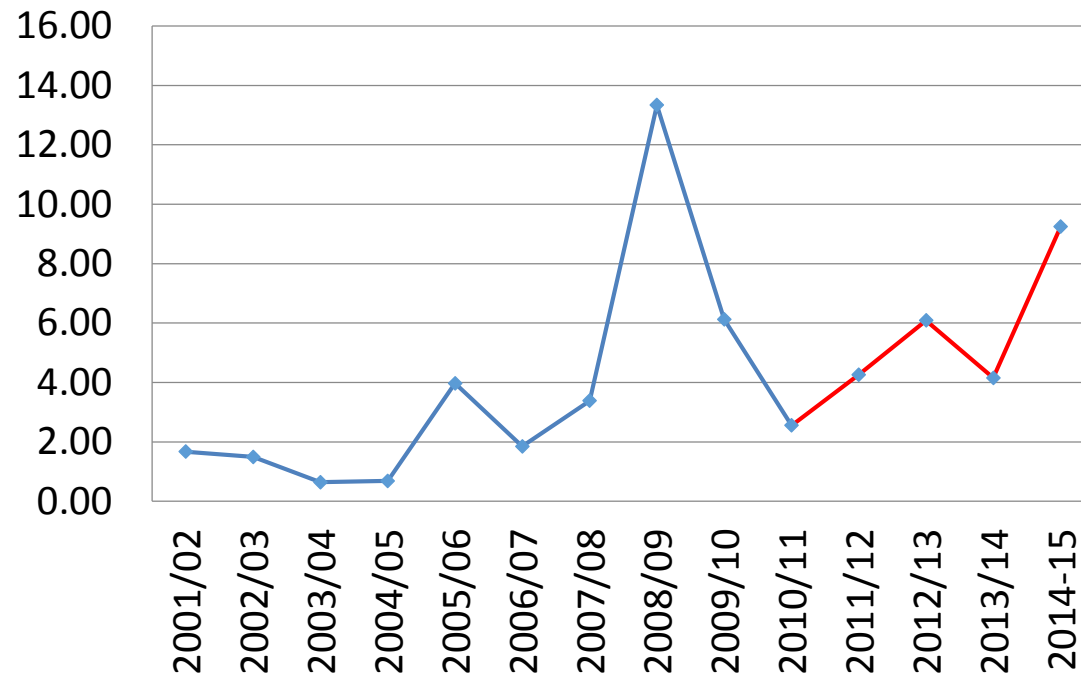
(2) Among the different sources – **trading costs** and particularly time delay caused by logistic inefficiency and customs procedures is the largest source of anti-export bias

Exchange rate overvaluation

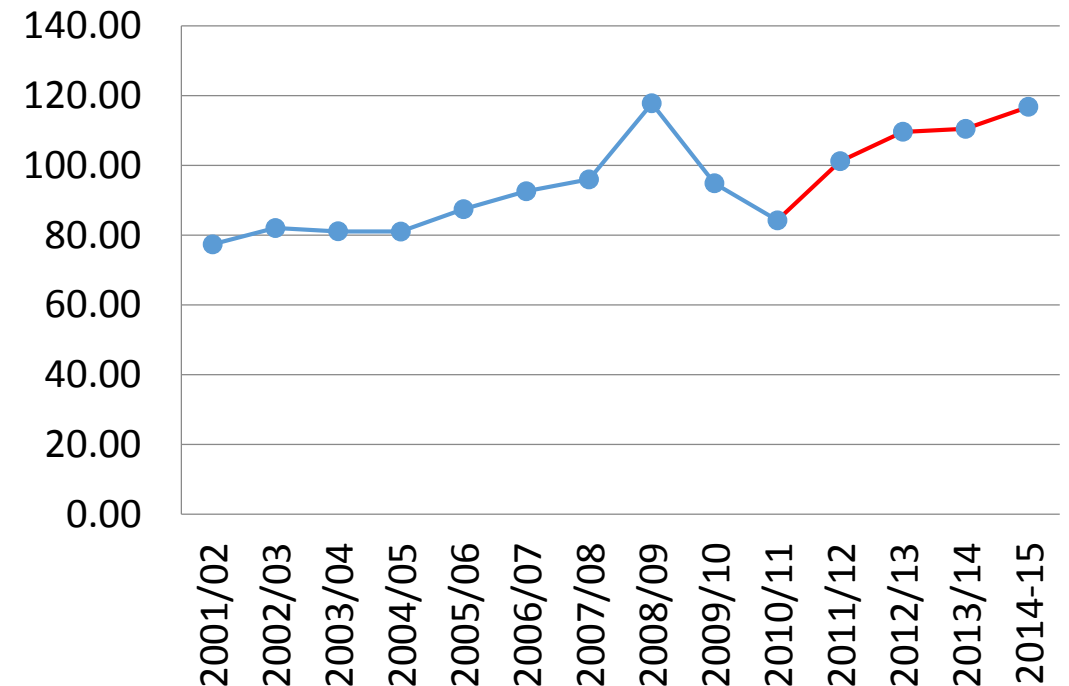
The Birr appreciates significantly since 2010/2011, official exchange rate responds to the change in the parallel exchange rate slowly. During this period;

- The premium has increased substantially and reached nearly 10% by 2014/15 (current parallel market is even larger reaching about 27 Birr/USD → about 20% premium)
- The REER has also appreciated implying that exports become more expensive and imports become cheaper → overvaluation acts as a disincentive for exporters

Difference b/n parallel and official exch. rate (%)



Real Effective Exchange Rate



Summary cont.

The above shows that exporters are penalized by the increasing overvalued exchange rate → further aggravating the disincentive to export

- **The exchange rate management (and in this case reducing the overvaluation) need to be considered as a critical instrument to encourage exporters**

(c) Effectiveness of Export Incentives and quality of institutions

- Gebreeyesus and Ashagrie (2017) found that all investors in the priority sectors (irrespective of producing for domestic market or exports) enjoy a range of investment incentives.
 - In this regard, the additional incentives provided for exporters are in most cases marginal and not able to compensate the anti-export bias created by the existing policies and non-policy barriers
- The second and major problem is that the different incentives schemes (duty drawback, voucher, BEF/BMW, BISW ... schemes) are underutilized due to implementation and administration related problems – **weak export bureaucracy**
 - ✓ Lack of adequate and skilled staff of the institutions administering the incentives
 - ✓ Lack of motivation and high turnover of the civil service –
 - ✓ A manual based clearance (reconciliation) process instead of fully applying ICT based system
 - ✓ Abuse of the incentives by the private sector diverting the duty and tax free imported material to the local market

(d) Poor management of FDI

- Ethiopia has become one of the preferred destinations of FDI in Africa in the recent years.
- One of the objectives of attracting FDI is to promote exports.
- Gebreeyesus, Beshah and Abebe, (2017) showed that the proportion of FDI manufacturing firms that export is very limited
 - Most are interested in the growing domestic market (market seeking investors instead of efficiency seeking)
 - The study also shows the FDI are also involved in low value added activities – widening instead of narrowing the trade balance gap
- With the opening of new industrial parks in recent years, Ethiopia has attracted companies that exclusively focus on exporting. However, their performance so far seems to be **low and slow** but remained to be seen.

5. Policy considerations

- Below are the main policy suggestions to avoid the existing anti export bias and boost exports
- (1) **Granting additional incentive packages** to compensate the anti-export bias and reduce the deviation b/n subsidy and protection rates
 - A **bold and not piecemeal** policy change is needed to increase the profitability of exporting vis a vis producing for domestic market
 - (2) **Directly addressing the anti-export bias by reducing;**
 - the protection of the domestic market (e.g. tariff),
 - overvaluation of foreign exchange (devaluation or compensating the exporters by paying certain amount of Birr per one dollar export earning)
 - trading costs (e.g. through improving logistics and customs clearance procedure)
- *The trading costs and particularly time delay caused by logistic inefficiency and customs procedures is the **largest source of anti-export bias***
 - Facilitating speedy transport and efficient logistics and customs service can substantially reduce the anti-export bias and improve exports
- (3) Creating a functional and efficient export bureaucracy (staff skill, discipline, remunerations etc.) is critically important in order these incentives and policy changes to have real impact on exporters and exports**
- (4) The selection and management of FDI is toward fulfilling the export promotion objective is also critical in boosting exports.

THANK YOU!

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