Ethiopia in 2025: an up-and-coming industrial hub in Africa?

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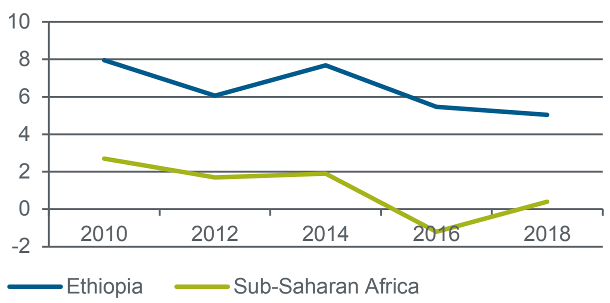
Ethiopia has been one of the engines of Africa's economic growth for some time now. The country has embarked on an economic and social transformation process and plans to join the league of emerging economies by 2025. This vision received new momentum under Prime Minister Abiy Ahmed, who has been in office for the past year. The country is making positive headlines with reforms. The emerging industrial sector occupies a key position in the country's transformation. But whether the fast-growing industrial sector will be able to supply enough employment for the rapidly increasing population and thereby lay the economic foundation for further expansion must be critically assessed with a view to Ethiopia's past and future development.

The Ethiopian lion has awoken

While Africa's previous growth engines, the Republic of South Africa and Nigeria, are stagnating, new economic centres are emerging. They include Ghana, Côte d'Ivoire, Kenya, Rwanda and Ethiopia, which has been achieving high growth rates for some time now. Considering the low starting level, high growth rates in one of the world's poorest countries are not surprising at first but they should not be taken for granted either. The governments of many other poor countries have not yet been successful at setting the necessary impetus for more growth despite their low starting points. Ethiopia definitely stands out as a positive example as the growth rates are high enough to offset high population growth.

Figure 1: Economic growth per capita 2010–2018

In per cent

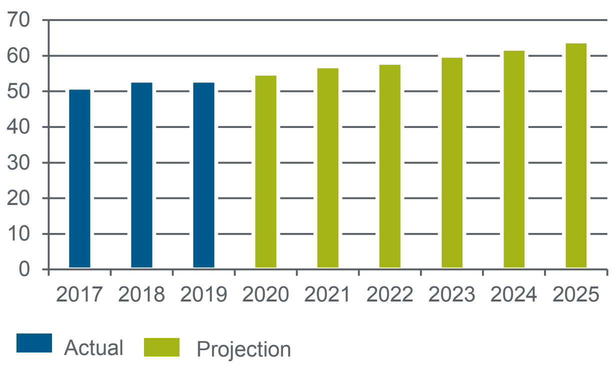


Sources: AfDB, World Bank, own calculations

Under the national development plans[1], the Ethiopian government is pursuing a rigorous development and growth strategy which has achieved a number of successes: Life expectancy has increased as a result of improvements to the health system. Massive investment in education has clearly improved access to education, especially for girls. Investment in agriculture has more than doubled grain harvests within two decades.[2] Joining forces with China and other international donors, the country has undertaken enormous efforts to create the foundation for higher economic growth by expanding infrastructure (water, energy and roads) as well. The industrial sector occupies a key position in the country's economic transformation. Ethiopia wants to join the ranks of emerging economies by 2025 with the support of this sector. It has achieved remarkable growth of more than 10% per annum since 2005. Despite the high growth rates, however, the share in aggregate value added remains low and an employment boom has not occurred either. But this is partly due to the country's rampant population growth.

Figure 2: Development of labour supply up to 2030

In millions



Source: ILO, own calculations

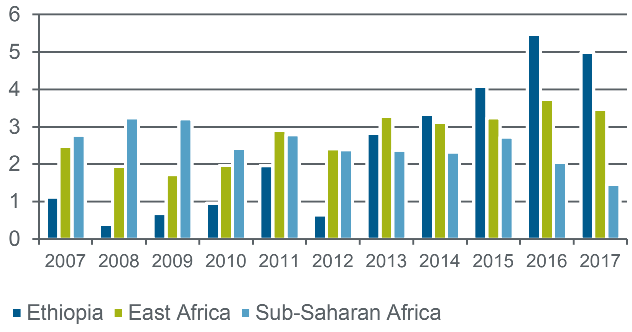
The working-age population will grow by around 2 million new workers each year up to 2030. Jobs have to be found for them. The country is also facing further challenges, such as how to integrate with the global market and overcome low productivity. We will discuss here whether the growth of the industrial sector (manufacturing and energy) and the construction sector will be sufficient to transform the country into an emerging economy with a view to its structural and cyclical challenges.

Industrialisation in an international context

The industrial sector, particularly manufacturing, is intended to play a key role in transforming the country. The aim is to emulate the success of the Asian Tiger States (Republic of Korea, Taiwan and Hong Kong). In contrast to the Tiger States, which support their own enterprises, the Ethiopian Government is relying on foreign investors – and this is working. Foreign direct investment in Ethiopia has grown significantly in recent years. At times it has been above the Sub-Saharan African average. In this way the country is catching up with its East African neighbours, which have benefited from high direct investment for some time now (Figure 4). Around 85% of investment in Ethiopia is going to the manufacturing sector.

Figure 3: Direct investment inflows

In per cent of GDP

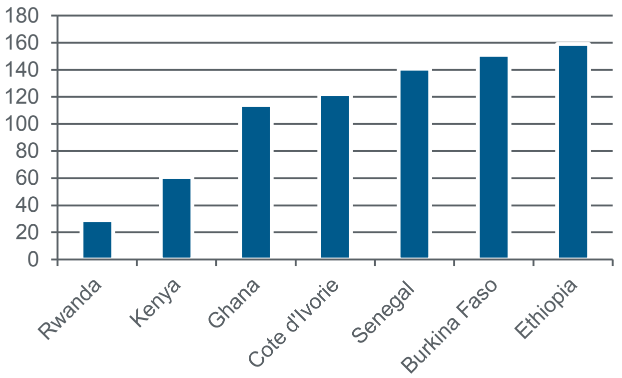


Source: World Bank, own calculations

Ethiopia currently benefits from the constant search for locations with low labour costs. Labour costs in Kenya and Tanzania are considerably higher than in Ethiopia (Figure 4), where the textile industry is one of the drivers of the current development. However, labour costs in Bangladesh, one of the main locations of the textile industry today, are slightly lower still. Other locations with lower production costs are Myanmar, Cambodia and Vietnam, all of which are in competition with Ethiopia.

Figure 4: Minimum wages in the global textile industry

In USD per month



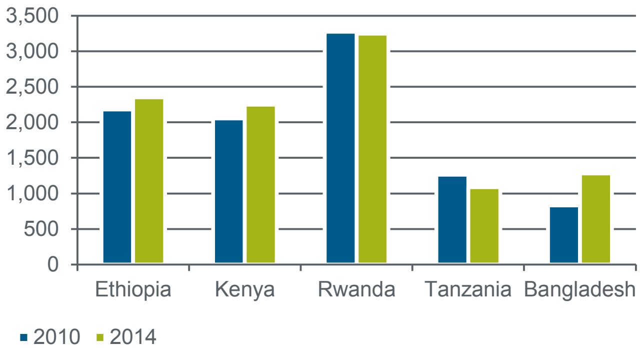
Source: Textile Excellence 2018

Investors from China and Turkey in particular are using Ethiopia as a new location to manufacture goods for the large sales markets in the US and Europe at a lower cost. Investors not only benefit from favourable labour costs but also from privileged market access under trade agreements with Europe (EBA – Everything but Arms) and the US (AGOA – African Growth and Opportunity Act).

Unlike its competitors Tanzania and Kenya, Ethiopia is challenged with infrastructure deficits that make physical market access more difficult. These affect the cost of dispatching goods by sea and transshipment times. The cost of transporting a standard container is relatively high for Ethiopia (Figure 5). Its geographical position and transport infrastructure constraints also affect transshipment times of manufactured goods. For example, it takes at least 21 days to move a standard container from the Hawassa industrial park in the south-east of the country to the port of Djibouti, while a container from Bangladesh to Europe takes only around 19 days. Privileged market access and favourable labour costs must therefore be seen in perspective.

Figure 5: Cost of transporting a standard container

In USD per standard container



Source: World Bank, own calculations

Expanding transport routes to the sea and improving links to ports in Eritrea, Somaliland or Sudan would be important measures to further strengthen Ethiopia as an industrial location. Developing further seaports would reduce the country's dependence on the port of Djibouti, which handles around 90% of imports and exports and tends to charge increasingly higher handling costs and which is now fully controlled by China. The emerging competition between seaports and its owners from the United Arab Emirates, Turkey, Saudi Arabia and Qatar, however, may have a positive effect on transport costs. Ethiopia could exploit this situation to its advantage. Access to the seaports in Eritrea, Somaliland or Sudan would also reduce the strategic importance of what is currently the sole transit route and railway to Djibouti. The latter was recently blocked by demonstrators.

Industrialisation is stagnating

In the same way as in the Asian Tiger States' economic policy, the government is playing a key role in the development and expansion of the manufacturing sector. It has created the Ethiopian Investment Commission, a one-stop shop tasked with significantly reducing bureaucratic hurdles for foreign investors. The development of industrial parks operated by the state or by private investors is another important step. Five state-owned industrial parks are currently in operation and a further seven are being planned or built. The government is lowering the investment costs for international enterprises by building and operating industrial parks. Although such a policy provides greater investment incentives for enterprises, the economic risks of the industrialisation strategy remain with the Ethiopian state. Where enterprises have invested in developing the location themselves there is less of an incentive to quickly close down the facility when problems arise, as in the event of a protracted economic downturn or structural problems.

Industrialisation is generally developing at a slower rate than forecast by the government in its national development plans (see table). This is having an impact on employment, the share of export revenue and its contribution to value added.

Table: State of development of the manufacturing sector

	Target (GTP II) Nominal 2017	Actual 2017
Share of GDP	5.1%	4.8%
Employment growth	570,000	450,000
Employment share	4.9%	4.5%
Contribution foreign trade	USD 1,852 million	USD 1,464 million
Share of exports	18.0%	10.0%

Source: IMF, MOFED, own calculations

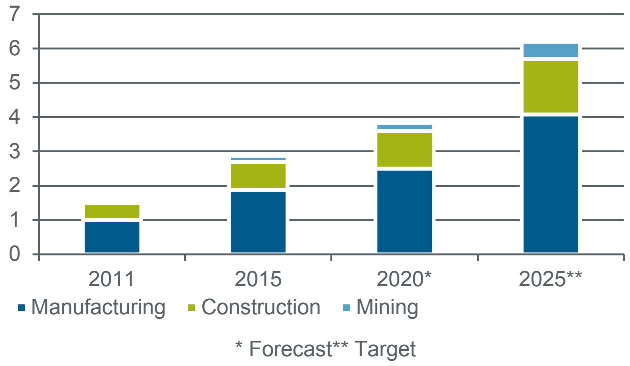
As the rate of industrialisation has slowed, it is doubtful whether Ethiopia can reach its goal of raising the share of the industrial sector to 18% by the year 2025. Closer integration in the global market creates new dependencies on the global business cycle – particularly that of China, the destination of some 20% of all Ethiopian exports. The construction of an industrial park operated by Chinese investors has currently been suspended as demand growth in China is slowing. Global economic developments have repercussions on the country's development and thus determine its further ascent to the status of emerging economy. The current phase of weakness in international trade is a major risk to its rapid industrialisation. Its already small contribution to the country's transformation could thus weaken further.

The working-age population will grow by around 11 million by the year 2025. Under the Ethiopian Government's assumptions and in view of the growth rate of the sector in the past years, the expansion of the industrial sector would not be sufficient in any case to meet the additional demand for employment. The sector's demand for labour is set to grow by an estimated 1.3 million jobs by 2020. According to the plan, another 2.5 million jobs are to be added by 2025 (Figure 6). On the basis of previous experience, particularly with a view to the weaker dynamic despite the long period of global economic growth, these figures are unrealistic. But even if this development were to eventuate, the majority – some 7.2 million people – would need to find employment in other economic sectors.

Investment could also decline in the construction sector. As the country's debt levels have grown substantially (to around 66% of GDP as opposed to the Sub-Saharan African average of around 57% of GDP), the government can no longer invest as heavily in infrastructure development as it has in the past (around 20% per annum of GDP in the past 10 years). China, the leading investor in Ethiopia to date, has also announced its intention to roll back its investment in the country because of the debt situation and the global slowdown. Chinese firms, banks and the Chinese government itself invested around USD 13 billion between 2006 and 2015. Whether the intention to invest more in the real estate sector announced by investors from Saudi Arabia and the United Arab Emirates will be able to offset this decline remains questionable.

Figure 6: Employment in the industrial sector over time

People in millions



Sources: World Bank, USAID, own calculations.

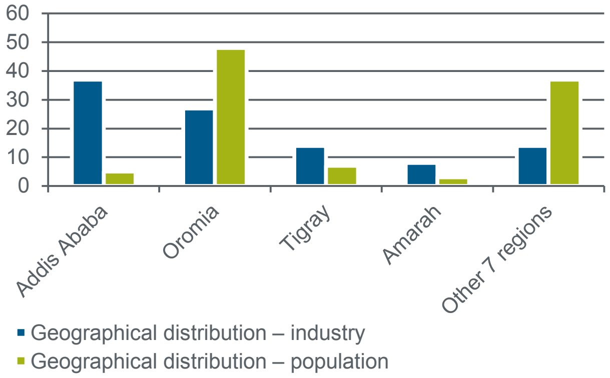
Labour productivity is still a problem

Labour productivity is low, as it is in many industrialising countries. This is also due to the high employee turnover rate. According to local experts, the employee turnover rate is significantly above the international average, which is around 10 to 12%. In Ethiopia it ranges from 20 to 100%. Compared with its international competitors, the country still has considerable deficits in this area which can only partly be offset with lower wages. This constitutes a major risk to labour productivity and hence to the competitiveness of Ethiopia as an industrial location. High staff turnover rates are associated with training costs and create inefficiencies from the loss of learning effects. There are many reasons for high employee turnover rates. First, their expectations of a 'modern' workplace are not fulfilled. Factory work is monotonous and often experienced as being just as hard as farm work. In many industrialising societies, a culture of industrial labour such as the one that has now established itself in Bangladesh and China is only just beginning to emerge. This is leading to high absentee rates. Second, high costs of living, especially in the capital Addis Ababa, lead to high staff turnover rates. Many female employees (as most factory workers are women) feel that their wages are no longer sufficient to make up for the compromises they made in connection with industrial labour (such as living alone in a large city without their families).

With the industrial parks, the government is also pursuing a strategy of balanced regional development. This decentralisation strategy is definitely sound because industrial activity has thus far been concentrated in the capital Addis Ababa and the Oromia region around the capital (Figure 7), exacerbating the problems mentioned above. Regionalising production may contribute to productivity growth.

Figure 7: Geography of industry and population

In per cent



Sources: Central Statistical Office, UNDP 2018, own calculations

Investors and the government hope that the construction of industrial parks at locations where the costs of living and, particularly, rents are lower will encourage women who work in industry to stay in their jobs longer. Building dormitories is now also being considered in some areas to enable them to reside in the immediate vicinity of the factories. Regionalising industrial activity thus provides an opportunity for raising worker productivity. Other measures such as education and training should also be pursued as a means to increase productivity. However, there is less scope for additional investment now as a result of high debt levels.

Summary

Ethiopia is aiming to reach emerging economy status by 2025. In order to achieve this, the government is pushing ahead with opening the country to the global market by building and operating industrial parks. Manufacturing, especially textile production, has come to occupy a key role. However, the country's industrialisation has yet to meet the expectations formulated in the 'Growth and Development Plan II', even though the global economy as a basis for the expansion of an industrial export sector has grown at robust rates for a relatively long time. Structural problems, such as difficulties in accessing the global market through efficient seaports and weak labour productivity, constitute significant barriers to rapid industrialisation, particularly as other countries, especially in Asia, are also attractive low labour cost locations for manufacturing that are in competition with Ethiopia. In order to further improve its position, the country would have to invest heavily on a sustained basis. But high debt levels mean its options are limited. The current slowdown in the global business cycle could put a further dampener on growth. As a result, the capacity of the industrial sector to absorb new workers will probably diminish, which is a challenge given the high population growth rate. Policymakers should therefore focus more closely on the domestic economy in order to generate impetus for more growth. This sector could create many additional jobs and also strengthen the industrial export sector, for which it would be important to reduce bureaucracy. The Ethiopian Investment Commission as a one-stop shop could be a blueprint for this. In addition, further development of the financial sector would be key to strengthening the local economy. The priorities here would initially be to create an interbank market and improve access to hard currency. Only sustained high growth can preserve the population's generally positive attitude towards the many policy reforms. ■

[1] Poverty Reduction Strategy Paper (up to around 2000), Agricultural Development Led Industrialization (bis 2004), Plan for Accelerated and Sustained Development to End Poverty (up to 2010), Growth and Development Plan I (up to 2015) + II (GDP II runs until 2020)

[2] See Heinemann, T. (2018): **Ethiopia – from land of famine to land of hope**, Economics in Brief No. 169, KfW Research.