Made in Ethiopia

The Emergence and Evolution of the Ethiopian Apparel Export Sector

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ABSTRACT

The apparel export industry in Ethiopia began modestly in the 2000s, but increased significantly by the mid-2010s and will continue to do so in the coming years, positioning Ethiopia to be an important supplier country in the globalized apparel industry. This paper provides an overview of the emergence and evolution of the apparel export sector in Ethiopia. It argues that the EPRDF government's pro-active industrial policy played an important role in the development of the sector. While foreign firms are an important driver behind the growth of apparel exports, there are also locally owned firms exporting apparel, which makes Ethiopia distinct from most other Sub-Saharan African apparel exporter countries. Ethiopian-owned apparel firms exhibit diverse ownership patterns, including state-owned, party-owned, and private sector-owned firms. The first phase of industrial policy particularly focused on incentivizing local investment in apparel production for export while later phases of industrial policy shifted the focus to attracting foreign direct investment, in order to boost exports and generate employment more quickly as well as bring knowledge and global networks into the country. Despite the focus on exports, the EPRDF government simultaneously has pursued import-substitution policies in the textile and apparel sector, which has helped the development of locally owned apparel firms by subsidizing the cost of learning to export as well as building a national supply chain from cotton to textile to apparel. The challenges for the government's industrial policy approach is to retain the focus on local firms given their important role in productive transformation and to ensure incentives and support for local firms to export, and through this to increase their capabilities and value added, despite the existence of a protected domestic market.

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Introduction

The apparel export industry in Ethiopia began modestly in the 2000s, but increased significantly by the mid-2010s and will continue to do so in the coming years, positioning Ethiopia to be an important supplier country in the globalized apparel industry. From around $1 million in the mid-2000s, apparel exports climbed to $12 million in 2010 and up to $70 million in 2015. Textile and apparel exports together were $117 million in 2015, accounting for 23% of total manufacturing but only 3.5% of total exports, and employing around 55,000 people.[1] This take off of apparel exports was due largely to two waves of foreign direct investment. The first was Turkish investment from around 2008-09, as a result of close diplomatic relations, and the second wave of investment starting in the mid-2010s driven by Asian transnational apparel companies from India, Korea, Taiwan and Sri Lanka, as transnational producers and global buyers sought out new low cost countries. The early interest in Ethiopia was consolidated and channeled into specialized apparel and textile industrial parks, with the first park starting operations in 2015/16 and additional parks planned to start operating in 2017 and 2018.

What explains Ethiopia's rise as an apparel exporter? Attractive features of the country are its comparatively low labor as well as electricity and water costs, and the duty-free access it enjoys to the EU market under Everything But Arms (EBA) and to the US market under the African Growth and Opportunities Act (AGOA).[2] If these preferential trade agreements disappeared at this early stage, industrial expansion in the apparel export sector would collapse, as the US and the EU are the main end-markets. Yet, all Sub-Saharan African countries have these trade preferences, and in the case of the EU also all other least developed countries. The factors that set Ethiopia apart are the government's pro-active industrial policy targeting the apparel and textile sector combined with the decisions of some EU and US buyers to convince their core suppliers to invest in, or source from, Ethiopia. These global buyers favor Ethiopia because it is a new apparel location alternative to Asia, where most sourcing is concentrated. In addition to low (labor) costs, Ethiopia is an alternative because of its political stability and safety (although recent protests tarnished this image somewhat) and the foundation

[1] UN Comtrade 2017, International Merchandise Trade Statistics, United Nations Statistics Division; Ethiopian Textile Sector Profile 2016, Ethiopian Textile Industry Development Institute, January 2016.
[2] In August 2001, Ethiopia became one of 39 Sub-Saharan African countries to benefit from AGOA, which grants duty free and quota free access to the US market. In February 2001, the European Union Council adopted the EBA, which granted duty free access to imports of all products for 49 Least Developed Countriess, except arms and ammunitions.

of a national supply chain from cotton to textile to apparel that can be built upon to make production vertically integrated within Ethiopia, as well as the pro-active role of the government. Even though the national supply chain is still nascent in Ethiopia, it has significant potential.

The objective of this paper is to give an overview of the emergence and evolution of the apparel export sector in Ethiopia. It is argued that the EPRDF government's pro-active industrial policy played an important role in the development of the sector. Industrial policy targeting the textile and apparel sector can be divided into three phases, with industrial policy evolving over time based on mistakes and learning experiences from previous phases. While foreign firms are an important driver behind the growth of apparel exports, there are locally owned firms producing textile and apparel for export, which makes Ethiopia distinct from most other Sub-Saharan African apparel exporter countries.[3] Ethiopian-owned apparel firms exhibit diverse ownership patterns, including state-owned, party-owned, and private sector-owned firms. These local exporting firms exist primarily because the first phase of industrial policy focused on incentivizing local investment in apparel production for export. However, later phases of industrial policy shifted the focus to attracting foreign direct investment, because foreign firms already have the requisite knowledge and global networks and thus can export large volumes and generate employment quickly. The third phase of industry policy involved channeling foreign investment into specialized industrial parks, supporting locally owned firms to also buy sheds in the parks, and fostering linkages between local and foreign firms. While this phase of industrial policy acknowledges the importance of linking foreign and local firms in order to facilitate learning and capability building among local firms, it remains to be seen how this policy will be implemented, especially if specific measures to support such linkages and local learning should go against the interest of foreign investors.

The Ethiopian-owned firms have struggled to enter and remain competitive in apparel global value chains.[4] As a result, many of them have used production for the domestic market as a strategy to ensure some stability and profits, while trying to learn and become efficient in production for export markets. The domestic market in textile and apparel remains protected, which is an explicit government strategy to allow import substitution in combination with promoting exports. It combines the two strategies by leaving the domestic market protected but offering favorable incentives only to local firms that also export.

[3] For a discussion of the limited local investment in the apparel export sectors in Kenya, Lesotho and Swaziland, see Staritz and Frederick (2016).
[4] A detailed discussion of the technological capabilities of Ethiopian-owned firms in apparel exporting is presented in Whitfield and Staritz (2017).

This sector overview paper is based primarily on new empirical material collected in the course of three research trips to Ethiopia in November 2015[5], June 2016, and November-December 2016. We interviewed 40 textile and apparel firms, including 26 out of the 48 Ethiopian-owned firms (which includes all 14 local firms exporting apparel and made-up textiles[6]) and 14 foreign-owned firms (including one joint venture firm). In addition, institutional interviews were conducted with the Secretary of the Ethiopian Textile and Garment Manufacturers Association (the industry association for locally owned firms); several officials at the Ethiopian Textile Industry Development Institute (the government sector agency), including the Director General, the Technique Sector Deputy General, and the Cotton and Textile Marketing Directorate Director; an official of the Industrial Parks Development Corporation; a special adviser to the Prime Minister, advising on the textile and apparel sector and being Chair of the Industrial Parks Development Corporation; and a researcher at the Ethiopian Development Research Institute focusing on manufacturing exports and industrial policy.

The paper starts by explaining how the foundation of the apparel export sector was laid through import-substitution industrial policies and a gradual privatization process in the 1990s and 2000s. The next three sections present the three phases of industrial policy focusing on export promotion, explaining the emergence of locally owned firms, the two waves of foreign direct investment, and the creation of the industrial parks. The fifth section provides an overview of the sector as it looked in 2016, before the latest apparel industrial parks commenced operations in 2017. It presents data on exports and imports, main end markets and types of export products, and an overview of types of firms. Section six provides a detailed mapping of the locally owned firms, including local exporting firms as well as local firms focusing on the domestic market.

The Foundation: import substitution industrialization policies and gradual privatization

The industrial textile and apparel production in Ethiopia began in the Imperial era after the Second World War, when the government of Haile Selassie encouraged foreign direct investment in industries with the explicit goal of import substitution. The government's policy gave many incentives to foreign investors and largely ignored local

[5] This first research trip was in the context of a research project conducted for the International Centre for Trade and Sustainable Development (ICTSD) by one of the authors, together with Mike Morris and Leonhard Plank. The outcome of this project was a report for ICTSD (see Staritz et al. 2016).
[6] There are 18 local exporting firms, but four of these firms only export yarn and/or fabric. In this study, we focus only on firms exporting apparel or made-up textiles.

investment, and thus most of the manufacturing firms including, textile and apparel, were owned and operated by foreigners during the Imperial era.[7]

The socialist Derg military government (1974-1991) nationalized almost all private industries when it came to power in 1974. Private investments were strongly restricted and state-owned enterprises came to dominate the manufacturing sector, but the focus of industrial policies remained import-substitution. The Derg government established more textile and apparel firms, with the additional objective of creating employment. As part of the import substitution strategy, the textile and apparel sector was protected by high tariffs on imported fabric and apparel.

By the early 1990s, the public textile and apparel sector consisted of 14 firms engaged in the spinning, weaving, dyeing, and finishing of cotton and other fibers and the cutting and sewing operations to produce apparel. Eight firms were integrated textile factories, two dealt primarily in yarn, and four were in apparel manufacturing.[8] There were another four public enterprises in cotton production.

After winning the war against the Derg regime in 1991, the government of the Ethiopian People's Revolutionary Democratic Front (EPRDF) switched to more market-led economic policies, but it did not pursue rapid deregulation, liberalization, and privatization, as most African countries did in the 1980s and 1990s under conditions in structural adjustment loans from the World Bank and IMF. In contrast, the EPRDF government pursued a gradual economic reform program. It was able to do so because it had a clear position in negotiations with the Bank and Fund that it wanted to keep the 'commanding heights' of the economy guarded from full liberalization, and there was a consensus on this position among top government officials (Weis 2016: 191-196). The government had greater leverage in the negotiations around structural adjustment lending because it was willing to walk away from the table (and thus the financing), unlike most African governments. This position was also made possible as Ethiopia had a much less severe external debt and macroeconomic crisis during the time of the negotiations (Whitfield 2009: 336-7). For example, the EPRDF government walked away from the IMF in 1996 and 1997 because it refused to meet IMF demands for greater liberalization and privatization in return for further financing. The most well known example is the government's refusal to liberalize the financial sector, which still does not allow foreign investment in its banking sector.

Therefore, Ethiopia did not experience the rapid trade liberalization that led to de-industrialization in many African countries. The EPRDF government undertook six

[7] Report on the Ethiopian textile and apparel industry, 2014, accessed from the Ethiopian Textile and Garment Manufacturers' Association, Addis Ababa, June 2016.
[8] Ethiopia Textile Sector Study: Final Report, Chemonics International, 1996, produced for USAID Addis Abba office.

rounds of general tariff reforms between 1993 and 2003 that gradually reduced the maximum tariff rate from 230% to 35%. In the privatization process, state-owned enterprises considered strategic by the government were excluded, and the selling of public enterprises was guided by the objective of finding viable investors. The privatization process was also important as it saw the entrance of Mohammed Al-Amoudi, a Saudi billionaire with Ethiopian roots and owner of MIDROC group of companies, as a major investor in the Ethiopian economy (Weis 2016: 204). During the second half of the 1990s, Al-Amoudi's diversified business group acquired twenty privatized enterprises, which represented only 13% of the public enterprises put up for sale but almost 80% of the total value of the public enterprises. The role of MIDROC in the privatization process was just the beginning, as the business group also entered many greenfield investments in Ethiopia, including in the textile and apparel sector as well as floriculture exports.

The government's position on economic liberalization and the gradual pace of the reforms had important consequences for the evolution of the textile and apparel sector. The state-owned textile and apparel firms were gradually sold to local and foreign investors. Table 1 summarizes information on the state-owned firms in textile and apparel, when they were sold and who bought them. Some firms were sold, and then reacquired by the government if the investor did not meet the terms of the privatization contract in terms of performance. For the two textile factories for which the government could not find buyers (Bahir Dar Textile and Kombolcha Textile), the government financed major renovations of the equipment and pushed the factories to increase exports of yarn, fabric, and made-up textiles such as bedsheets.[9] The continued protection of the domestic market with a 35% tariff on imported fabric and apparel, and a further 10% surcharge and 10% excise tax, provided firms with a safe haven. All of the privatized firms that began exporting also engaged in production for the domestic market, because it provided an important source of capital accumulation while the new investors renovated the old state-owned firms, reducing the amount of losses they incurred.

At the same time though, the government pushed the private investors leasing or buying the textile and apparel public enterprises to enter the export market. Some of the privatization contracts included an agreement that the investors would export a certain percentage of their production after rehabilitating the firms. The export push within the privatization process was part of the government's larger export promotion strategy that was adopted in the late 1990s and strengthened through the first Industrial Development Strategy of Ethiopia in 2002-03. This Strategy emphasized the need to privatize the public textile and apparel enterprises, or enter joint ventures with foreign investors on

[9] It was reported on some online Ethiopian news sources in January 2017 that these two state-owned enterprises had been sold to Tiret Corporate, the endowment of the Amhara National Democratic Movement party, but we have not yet confirmed this.

contract management arrangements, as a means to address the firms' productivity and management problems, as well as bring technology, market and management skills and knowledge into the country.[10] The government clearly wanted to use privatization to make these firms profitable, to enter export markets, and to bring wider benefits to the sector. The government was only marginally successful in achieving those objectives. Not many foreign investors were interested, and in the case of Addis Garments and Bahir Dar Textiles, the foreign investors left and local investors or the state took over. Furthermore, some of the firms are no longer exporting, and others are only exporting a small amount, as Table 1 shows.

[10] Industrial Development Strategy of Ethiopia, Federal Democratic Republic of Ethiopia, Addis Ababa, 2002, English version, p.17.

Table 1 Privatization of State-owned Textile and Apparel Firms

SOE name	Year privatized	Investor	Status	Exporting
Addis Garment	2006 2016	Foreign Local	Italian investor, 2007-13 exporting garments CMT. One buyer, Italian, different end markets. Sold to the owner of an existing local garment firm producing for the domestic market.	No. Used to export
Akaki Textile and Garment	2004/05	Local	Produces garments for domestic market. Owner Local has a separate garment factory for export called GG Super Garments.	No
Gulele Garment	2005	Local	Exporting from 2005 to 2010, but then stopped because lost buyers. Only producing for local market.	No. Used to export
Adei Abeba Textile block 1	2000 2010 (now called Yirgalem)	Foreign Local	Turkish investor, leased factory for 2 years. Closed down spinning department. Rehabilitated knitting and dyeing. Expanded garment factory. Exporting CMT and now FOB with own fabric.	Yes
Adei Abeba Textile block 2	2011	Foreign	Joint venture between government and Korean investor. Closed spinning section. Exporting garments.	Yes
Nazareth Garment	2006 2014	Local Joint venture foreign-government	Ran into problems. Government took over. Israeli firm bought majority share. Firm is a player in global garment industry, with factories in Asian countries. Renovating factory to export suits.	Yes
Awassa Textile	2010/11	Local	Sold to Dukem Textile. The company produced bed sheets and foam mattress covers, school uniforms, workers' uniforms and threads. Undertook rehabilitation and expansion project with DBE loan in 2015.	Yes, but exports declined
Arba Minch Textile	2005/06	Local (tbc)	Sold to Evergreen Textile (tbc).	Yes, but exports declined
Bahir Dar Textile		Still SOE	Leased to Turkish investors in 2005/06, but government terminated the contract and then invested in major renovation between 2008 and 2012.	Yes
Kombolcha Textile		Still SOE	2011-2012, government invested in a major renovation of textile factory.	Yes
Dire Dawa Textile	2007	Local	Local owner struggled with financing for renovation. Produce yarn and woven fabric.	Yes. Some yarn
Edget Yarn & Sewing Thread	2006	Foreign	Sold to Crown Textile Weaving, a local firm.	--
Debre Berhan Blanket Factory	2008	Joint venture	--	No

Source: Collated from various interviews with firms during research in Ethiopia in 2016. Years of privatization and buyers confirmed with privatization data from the Ethiopian Privatization and Public Enterprises Agency accessed via Toni Weiss, and translated from Amharic by Ayelech Tiruwha Melese.

Government encouragement of apparel exports: industrial policy phase 1

From the first Industrial Development Strategy in 2002-03 onwards, the EPRDF government identified textile and apparel as a priority sector. The Industrial Strategy was part of a broader shift in government policy in 2001 towards an approach that recognized the need for active industrial policy to get the country out of its 'low productivity trap', which markets could not do on their own (Weis 2016: 226-233). The Industrial Development Strategy identified a number of sectors for targeted government support, including textile and apparel. Prime Minister Meles Zenawi was the intellectual driver behind this approach (de Waal 2012). Interviewees for this research indicated several times that it was Zenawi who decided to make the textile and apparel sector a priority, because he knew that the sector historically had been a first step in economic transformation and industrialization in almost every now industrialized country.

The first phase of industrial policy included preferential credit and access to land schemes. Under the preferential credit scheme, the state-owned Development Bank of Ethiopia (DBE) provided local investors with a loan covering 70% of the investment as stipulated in the project plan, with the investors providing the remaining 30% in cash or in kind. Regarding the latter, local investors buit their factories and then used the value of the factories as the equity contribution to their project loan. The value of the factories were assessed by DBE. The loan was provided at a 7.5% interest rate, for 8 years with a two-year grace period. Local investors used the loans to buy equipment, vehicles, and other materials for production as well as for working capital. The firms also received exemption from company tax for several years. Under the access to land scheme, the government provided access to land at favorable lease rates, particularly in the new Saris and Lafto industrial villages created in the outer areas of Addis Ababa.[11] Access to land was important, as the EPRDF government decided to maintain the state ownership of land, implemented under the Derg regime, and thus land could only be leased from local and regional government authorities for up to 99 years.

Between 2004 and 2006, Ethiopian investors established around 15 apparel export firms as a direct result of these government incentives. Two firms were established in the early 2000s by Ethiopia diaspora as a result of direct linkages with particular US buyers and in response to the establishment of AGOA. All of these local investors came from various occupations and none of them had previous experience in textile and apparel production. It is likely that some of them had political connections to the EPRDF government or were at least considered politically loyal. Several of them had a direct connection to the Tigrayan People's Liberation Front (TPLF).

[11] Later some of these firms and other new entrants moved to Gelan, Sendafa, and Dukem, areas not far from Addis Ababa.

Most of these local investors did not fare well in the apparel export sector. The majority of firms that took the DBE loan could not repay it, and their loans had to be rescheduled. By 2016, some firms had closed down, and some had switched to producing for the local market mainly or entirely. Others were still exporting, with varying degrees of success (see Whitfield and Staritz 2017). Although the incentives were predicated on exporting, one of the local investors did not enter exporting right away but rather built up experience in production for the domestic market and only in 2016 was positioning his firm to enter the US and European markets. One firm had temporarily stopped exporting but was searching for new buyers. In sum, only 6 of the 15 initial investors were actually exporting some proportion of their production in mid-2016, and only two of these firms were exporting 100%.

Buyers from the US and EU favored Ethiopia as a new frontier in apparel sourcing, visiting Ethiopia to screen locally owned firms as potential suppliers or "convincing" their core suppliers to invest in, or source from, Ethiopia (Staritz et al. 2016). This active role stemmed from the importance of maintaining a serious presence, or searching for new low cost production sites, in Africa so as not to concentrate all their buying activities in Asia, particularly in the context of cost increases and compliance issues in the main Asian supplier countries. A first prerequisite for considering a country for sourcing is political stability, and here Ethiopia outperformed many Sub-Saharan African countries. Therefore, many buyers visited Ethiopia to see if it met the criteria for being a new sourcing location. Most prominently, H&M opened a sourcing office in 2012, which boosted the international image of the Ethiopian textile and apparel sector.

Other buyers, however, did not pursue Ethiopia as a sourcing location given the low development of capabilities among local firms, as well as low comparability on infrastructure and total price. Although labor costs were very low, with all costs counted together, the prices in Ethiopia were not comparable to locations such as Bangladesh. The price issue seems to have been a larger problem for European buyers, which compared Ethiopia on a one-to-one basis with prices in Bangladesh. A further problem was that European buyers preferred full package suppliers, but most locally owned firms in Ethiopia could only fulfil assembly functions, or Cut-Make-Trim (CMT), and could not undertake the responsibilities and financing entailed in importing the raw materials themselves. For example, H&M struggled to find suitable suppliers among local firms, given their tight price and other sourcing conditions, including full package supply. For US buyers, prices in Ethiopia were more advantageous than in Asian supplier countries, which had to pay high tariffs for synthetic apparel products (up to 32%) while Ethiopia had duty free access under AGOA. This is an important reason why Champro, Cintas and Superior Uniform, which specialize in workwear and sportswear production with polyester-cotton blends, are sourcing from Ethiopia, including locally owned firms.

The first phase of industrial policy also included encouraging foreign direct investment; however, it was rather small-scale in the early and mid-2000s, involving a few individual entrepreneurs in textile production, largely from India and Pakistan. As of 2016, there was one Indian (Mahavir Textile) and two Pakistani textile firms (Al Mehdi and Al-Asr) left, with the latter two expanding into apparel production in recent years. These firms largely produced for the domestic market; the government tried to push them to export, but with limited success (Staritz et al. 2016).

A second, more substantial, wave of foreign direct investment occurred beginning in 2008/09 from Turkish investors producing textiles, with some investment in apparel production in response to the government's focus on exports and the higher export competitiveness of apparel compared to textile. Incentives from the Turkish government played a key role, which encouraged Turkish firms that were experiencing rising wages in Turkey and looking for a site for production to move to Ethiopia as well as Turkish subsidiaries in Egypt to relocate to Ethiopia given the political instability in Egypt (Staritz et al. 2016).[12] At this time, the Development Bank of Ethiopia extended the 70/30 investment loan offer to foreign investors. Close diplomatic relations between Turkey and Ethiopia also played a key role, with the Ethiopian ambassador, who is now Prime Minister of Ethiopia, active in country marketing and business negotiations.

Ayka Addis is the largest of the integrated Turkish firms, employing around 7,000 workers. It accounted for the majority of apparel exports in mid-2016, which went to the European market, especially Germany. The company still has an apparel factory in Turkey that does cutting and sewing of complex and fashion products, but spinning, knitting, dyeing, printing and basic apparel manufacturing is done in Ethiopia using domestic and imported cotton due to limited local availability. The arrival of Ayka Addis in 2007, as the first large-scale integrated producer successfully exporting to Western markets, increased the visibility of Ethiopia as a location for foreign direct investment in apparel (Staritz et al. 2016).

By 2016, there were six Turkish integrated textile mills, two apparel factories, and one accessories producer of narrow fabric. The biggest projects include Ayka Addis, SayginDima, Etur, Selendawa, and Else. The Turkish firms aimed for exports, but many now also produce fabric for the domestic market. These Turkish textile firms source cotton locally, but getting access to cotton was more challenging than they expected. Some of them invested in ginneries in order to secure higher quality cotton fibers.[13]

[12] Turkish textile firms have locations generally in three tiers: Isanbul, eastern part of Turkey which is cheaper than Istanbul but still quite well developed and close by, and low cost locations for the lower value apparel production. The latter used to be Egypt and Syria, but the productivity of labor and political instability made these countries difficult, and Ethiopia became an alternative (Staritz et al. 2016).
[13] Report on the Ethiopian textile and apparel industry, 2014, accessed from the Ethiopian Textile and Garment Manufacturers' Association, Addis Ababa, June 2016.

There were problems recently and several of these Turkish firms were closing in December 2016. Several sources within the apparel sector commented that SayginDima, Else, and Selendawa had gone bankrupt and the Development Bank of Ethiopia was taking them over. Another source within the government indicated that Else and Ayka Addis had stopped paying back their investment loans, and that Else was producing only for the domestic market. The Bank decided that these firms must export and do it through the Bank so that exports could be deducted from their debt, and forced them to do so for a year. Complications around these issues appear to have led to the defaulting on the loan and the Development Bank of Ethiopia taking over the firms.[14] Hence, Else, SayginDima, and Selendawa are closing down, but Ayka Addis is staying.

The government encouraged all firms in the textile and apparel sector to export. Firms had to submit their export plans on an annual basis, show commitment that they were striving to export, and meet certain export targets to which government incentives were coupled, such as access to finance from the Development Bank of Ethiopia on better terms than offered by commercial banks. Foreign firms were only allowed to sell up to 20% of their production in the domestic market. However, these rules were not always enforced, or uniformly enforced. The government put more pressure on foreign firms than local ones to export, and even with foreign firms, exporting seems to have been enforced only when other issues were at stake, such as financial obligations. This was probably because the government had limited mechanisms with which to enforce exporting, short of shutting down the firms, which was not in the government's interests, as these firms contributed to increasing the dynamism of the apparel manufacturing sector. As a result, the government modified its policies to encourage apparel exports, which we refer to as the second phase of industrial policy.

Trying to solve constraints on apparel exports: industrial policy phase 2

The textile and apparel sector remained a priority in the government's first Growth and Transformation Plan 2010/11-2014/15. The initial targeting of the sector and encouragement of local investment had been undertaken without a full understanding of the apparel global value chain and what was required to enter and remain competitive. The government thought that locally available textile could be used for apparel export production, but most of the inputs into apparel production for export had to be imported for two reasons. First, many buyers nominate the textile mills that their apparel suppliers have to use in order to ensure conformity of products among their diverse suppliers, regardless of whether the supplier CMT or full package is (responsible for sourcing inputs). Second, the existing textile mills in Ethiopia did not produce the kinds

[14] SayginDima was a joint venture with the government, but the government was not happy with its performance and pulled out in 2014; the Turkish owners struggled to find the financing to buy out the government shares, and then part of the factory was burned down during the political instability in October 2016.

of fabric or the level of quality required for knit or woven apparel demanded by buyers, and the Turkish textile firms, which did produce export quality fabrics, generally did not sell their fabric to other firms. Furthermore, there were no local accessory supplier firms. This situation is typical in countries new to the apparel global value chain, where local firms enter first by just doing the assembly stage, and foreign investors come to assemble apparel in low cost countries. Many local investors were not aware that this is how the apparel global value chain operated, and thus that they would have to start with CMT and use imported inputs, nor was the government aware. In this buyer driven value chain, buyers dictate prices and other requirements, and apparel firms do not get orders unless they accept these buyer demands.

As a result, the government created the Ethiopian Textile Industry Development Institute (TIDI) under the Ministry of Industry in 2010, a specialized agency for the sector that could provide support to local apparel and textile firms. TIDI was involved in finding a practical system for apparel export firms to be able to import the inputs without paying duties, which existed to protect the domestic market from cheaper imports of both fabric and apparel. In September 2012, the government passed the Export Trade Duty Incentive Schemes Act which created several schemes that exporting firms can use to avoid paying duties on imports that form components of manufactured exports. They include a duty drawback scheme, a voucher scheme, a bonded warehouse factory, a bonded export factory, and bonded warehouse for inputs. The duty drawback scheme involves more capital being tied up, as the firm has to pay import duties and then claim them back once it has exported, so most firms do not use this system. Instead they use the voucher scheme, in which firms do not pay import duties, but at the end of the year they reconcile inputs and outputs through a complex system involving an input-output coefficient for every product. TIDI has a technical committee that calculates these coefficients. Firms then submit to the Customs authority its export documents at the end of the year, and the Customs' voucher section compares. If the firm shows a higher level of wastage than the coefficient, the firm has to pay duty and taxes, and a penalty because it is assumed the 'missing' materials were sold on the domestic market. The system is complex, but deters importing inputs duty free and then selling on the domestic market. The bonded export factory is meant to control foreign direct investments. This means that a factory is recognized as a customs territory: the Customs authority checks and registers inputs going in and out. With the bonded warehouse factory, only the warehouse is bonded.

The government also devised policies to influence resource allocation to priority sectors and exporting, some of which are positive incentives and some of which are negative ones. For example, if one of the local firms that received the DBE investment loan stops exporting, the interest rate on the loan it has to pay back will go up to 12%. On the other hand, if the local firm increases the percentage of production that it is exporting, the interest rate on its loan will be lowered. For example, if a firm exports 60%, it gets a 2-

3% deduction, and if it exports 80%, it will get a 4% deduction. Local and foreign firms seeking to expand their existing factories can also access special expansion investment loans from the Development Bank of Ethiopia in a 60-40 scheme, where the bank provides 60% of the cost of the expansion project.

Through strongly controlled access to foreign exchange, the government can also favor exporting firms. In the textile and apparel sector, the government uses this to reward exporting firms and punish those firms only serving the domestic market. Many new local apparel firms emerged in the late 2000s and early 2010s, but only produced for the domestic market (see Table 4 below). The government used its control over access to foreign exchange to encourage them to engage in production for export, which has had some impact. Several of the local firms exporting in 2016 produced for the domestic market first and had only recently started exporting, and one of the reasons they gave for starting to export was access to foreign exchange with which they also buy imports for their domestic market production.

Furthermore, in collaboration with donor agencies, the TIDI offered free benchmarking studies, salary contribution when hiring foreign experts, contributions towards the cost of training, and support in export marketing through sharing the cost of participating in major trade shows abroad and sending prospective buyers to local firms. Sixteen local apparel firms took part in the benchmarking study aimed at improving productivity, through which firms created an action plan and TIDI provided a matching grant system to help finance foreign supervisory and managerial personnel to help local firms increase their productivity.

The government also put considerable effort into expanding universities to build local knowledge of the textile and apparel sector. The sector is dependent on graduates from Bahir Dar University for technical expertise in textile production, as this university has a long history in providing education for the textile sector. However, education in apparel engineering and export merchandising, critical for the apparel export sector, was only recently added to the curriculum of Bahir Dar University and about five other universities. Another challenge is that graduates lack practical knowledge and experience. They now do internships within firms during their degree programs, and often end up being employed there after graduation.

Given that the country's economy is still largely agrarian and that the apparel export sector is relatively new, unskilled workers employed by apparel firms lack experience in a factory setting in general and in apparel factories in particular. Therefore, firms must spend time and resources internally in training labor in basic skills. Nevertheless, labor productivity is still low by international standards, making labor in Ethiopia relatively expensive in terms of productivity even though labor costs are very low. The government has created vocational schools that specialize in apparel, in order to produce operators and factory workers for the sector. TIDI is training people that become the teachers in these vocational schools. TIDI also offers training services to local firms, which can send workers to TIDI for training in rooms with state of the art equipment.

More recently, and very important to allow upgrading from CMT to full package, the government sought to solve problems that local firms faced in having enough working capital to finance the import of inputs for orders from buyers requiring full package services. The Development Bank of Ethiopia created a pre-shipment financing scheme in which firms showing orders from buyers in the form of a letter to credit can have access to a revolving fund in hard currency with which to buy inputs. The few local firms engaged in, or switching to, full package orders have just started using this scheme. These specific financial incentives are supplemented by general export promotion schemes such as the establishment of a foreign exchange retention scheme and an export credit guarantee scheme to avoid problems of working capital, and the government reduced the costs for opening letters of credit.

Lastly, the government sought to attract more foreign apparel firms by directly initiating marketing visits to leading apparel buying and producing countries, including in Asian locations where transnational producers have their head offices (Staritz et al. 2016). It also sought to attract foreign investors through the construction of industrial parks that address infrastructural challenges by providing land and factory shells as well as electricity, water, and communication services. The idea was piloted with the Bole Lemi industrial park, just outside of Addis Ababa, and the Eastern Industrial Zone developed by Chinese investors.[15] The Eastern Industrial Zone was developed in Dukem, outside Addis, by a private Chinese group with Chinese government support in 2007, and is easy to reach on a new highway road also built by Chinese contractors, which bypasses the old, heavy traffic road running from Addis to Dukem. Although the Zone concentrates on Chinese investments, there is one foreign-owned apparel accessories firm (labels and printing) in the Zone that is not Chinese. There are four Chinese-owned apparel firms operating in the Zone.

The Bole Lemi industrial park, on the other hand, focuses on the textile and apparel sector, but also includes some leather-related manufacturers. It took five to six years to build the park that opened in 2015/16. It contains 20 relatively large prefabricated factory sheds that were built before securing investors. Factory rental rates were very low, and the government provided an effluent water treatment plant for the park. There are seven foreign-owned apparel firms in Bole Lemi: four from India (Jay, Arvind, Ashton, Vests), one from Korea (Shinz), one from China (C and H Garment), and one from Taiwan (New Wide Garment). Bole Lemi turned out to be oversubscribed, leading

[15] For background information on Chinese special economic zones in Africa, see Brautigam and Xiaoyang (2011).

to an expansion of the park (Bole Lemi Phase 2) that is supposed to be completed in 2017.

The foreign firms in Bole Lemi noted that their main motivations for investing in Ethiopia were the low labor, electricity and water costs; security and political stability; duty free market access to the US and EU; and government incentives for foreign direct investment, both from the Ethiopian government and from their home countries. These foreign firms generally have globally dispersed plants, focus on exporting and follow the typical production set up of transnational producers manufacturing low value added, large run products in Ethiopia on a CMT basis with head offices and often also textile mills abroad pursuing the higher value added activities. However, several of the foreign apparel firms in Bole Lemi Industrial Park have plans to also produce more complex products and aim to build backward linkages into textiles. This backward integration diverges from the typical production structure of transnational producers, and thus they have the potential to be more embedded and diverge from governance structures and firm setups typical for transnational producers (Staritz et al. 2016).

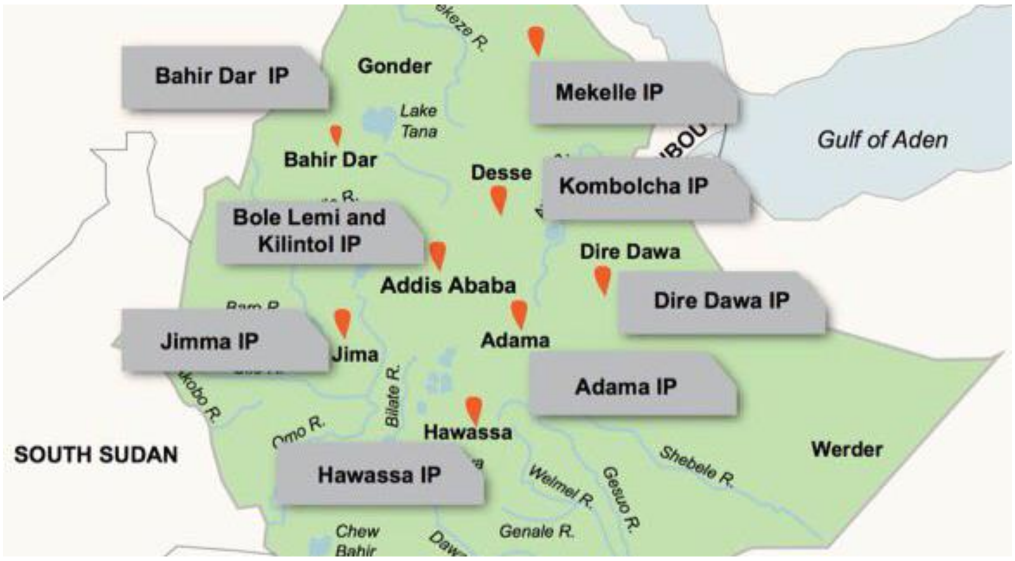
Upscaling the apparel industrial park model: industrial policy phase 3

During the 2000s, the textile and apparel sector grew significantly as a result of government incentives and support to promote the sector even though the targets included in the successive Development Plans were not reached, often by large margins. The government had higher ambitions for the sector as a driver of industrialization as well as bringing in foreign exchange earnings through exports and creating employment and incomes. The Prime Minister’s Office spearheaded a new investment strategy that aimed to increase manufacturing as a percentage of GDP, drive growth, and create 80,000 new jobs. It hinged on attracting new foreign direct investment, but not just any kind of foreign investor. The aim was to attract lead firms in the apparel global value chain and to build sector specific industrial parks for them that focused on reducing delivery time and the costs of production. These parks also aimed to link local firms better with foreign investors and buyers, and to develop vertical integration within the country from fiber to apparel.

The central idea was to have new companies located within industrial parks, in order to reduce the initial capital requirements and time that it takes for individual firms to start operations. Firms do not have to acquire land, contractors, utility services, and financing, as all of this is provided in the parks, reducing the start up time. The parks also provide government services related to customs clearance, visa, and immigration services, and all required licenses; residential quarters for expatriate workers near the park; and business centers. Additional incentives for local and foreign investors in the industrial parks are access to financing, 10-15 years of income tax exemption, and duty-free import of capital goods. Within the parks, the Development Bank of Ethiopia offers long term loans, but with a shorter grace period. Foreign firms can access a loan for 50% of the investment costs, while local investors can access a loan for 85% of the investment costs and also benefit from additional support with training workers and hiring expatriate technical staff for a period of five years. This assistance to local firms is supposed to be tied to performance targets, and the government will also offer help with marketing arrangements. Providing the facilities, assistance with financing investment and training is supposed to make it easier for local investors and to incentivize learning.

The flagship textile and apparel industrial park is Hawassa industrial park, which is also an eco-industrial park addressing environmental and sustainability issues. The motivation is to avoid repeating the environmental mistakes of previous apparel producing countries, as well as to use the ‘eco label’ as a marketing tool in order to gain a competitive advantage. The Hawassa industrial park is designed with state of the art technology that uses 100% renewable energy and has zero discharge of treated water. Other industrial parks are currently under construction, with the Mekelle and Kombolcha industrial parks specializing in textile, garments, and leather products, while the industrial parks in Dire Dawa and Adama are multi-sector (Figure 1). All facilities in the parks are built to international building, fire and electrical standards.

Figure 1 Map of New Industrial Parks in Ethiopia



Source: Industrial Parks Development Corporation, September 2016.

The government aims to use the industrial parks to boost employment significantly and placed them around the country in order to distribute employment opportunities. The focus on large foreign investors was strategic because they could meet multiple aims of the government at the same time: boost exports quickly, create a large number of jobs, and bring in knowledge and buyers to the country. Thus, they are part of a political agenda to increase the legitimacy of the government through economic development. The Industrial Parks Development Corporation, under the direct guidance of the Prime Minister's Office, manages the parks. There are regular domestic flights (Ethiopian Airlines) to the cities where the industrial parks are located, and some of the airports are to be upgraded to receive international flights.

The government describes this third phase of industrial policy as a change in strategy from reactive to proactive, in the sense that it began actively seeking certain kinds of investors rather than reacting to investors that approached it. In this regard, the government tried to attract lead firms (buyers) in the apparel global value chain to be anchors for each of the industrial parks focused on apparel exports, along with some of their transnational producers, textile mills and accessory suppliers, and to accommodate their needs in the design of the park. The anchor for the Hawassa park is the US company PVH, which owns the Tommy Hilfiger and Calvin Klein brands. The Hawassa park has 52 sheds, which are occupied by 16 foreign firms and three local firms. The foreign firms include large transnational producers such as Hirdaramani Garment (Sri Lanka), Indochine International (China), Wuxi Jinmao Textile (China), Busana Apparel (Indonesia), Sarasavi Exports (Sri Lanka), Epic Group (Hong Kong), and Raymond Silver Spark Apparel (India), among others. They include 10 apparel firms, two fabric mills, and accessories producers. Built in just nine months, the Hawassa park was inaugurated in mid-2016. Only a few firms started operations by the end of 2016, with the rest expected to start in 2017. For example, Epic Group shipped its first export orders in May 2017. The Hawassa park alone is expected to generate 60,000 jobs and $1 billion in exports by the end of 2017.

The Mekelle industrial apparel park is under construction. The government sees H&M as the anchor for this park; however, H&M is not as involved in the park as PVH is with Hawassa, but rather is encouraging its existing suppliers to invest in Mekelle. H&M has been in Ethiopia since 2012, and initially planned to source from local firms, but there were few local firms at the time that could meet their standards, so H&M began sourcing from foreign firms as well, including those recently set up in the Bole Lemi industrial park. Some of H&M's suppliers have already set up operations in Mekelle, not waiting for the park to be finished. These include the Dubai firm Velocity Apparelz, which constructed a large vertically integrated denim manufacturing firm, and DBL, one of the largest Bangladeshi apparel firms. These firms should start operations in 2017, and together they aim to employ 14,000 workers.

News reports and interviews with the key advisor in the Prime Minister's Office indicate that the anchor of the Adama apparel industrial park is Chinese conglomerate Jiangsu Sunshine Group. There is no news yet of investors in the Kombolcha industrial apparel park, which is under construction, but a small industrial area has merged on the outskirts of the town near the railway station (under construction) that includes a few textile and apparel firms, including a new locally owned firm and a denim jeans factory owned by Kanoria, an Indian firm that set up a denim textile factory in Bishoftu (not far from the Chinese Eastern Industrial Zone).

Local investors were invited to submit a proposal for the Hawassa, Mekelle, and Kombolcha apparel parks, where sheds have been reserved for local firms. For example, in the Hawassa park, 8 out of the 52 sheds were reserved for local firms. According to the Prime Minister's Office, the government received 23 proposals for the Hawassa park and held a meeting with these interested local investors in mid-2016. It is not clear how many local investors continued with the process, but only three local investors will have sheds in the Hawassa park. One of them is an existing apparel export firm that has had problems remaining in exporting and currently does not export, and the other two investors are new to the sector.[16] In interviews with local firms, we asked the owners if they had applied for a shed in the new industrial parks. Most of them had not. They indicated that they planned to expand in their existing location rather than relocate. Some complained about the high rental cost of the shed, but others indicated that the price was reasonable. A few firms mentioned that they would apply for a shed in the Kombolcha or Mekelle parks, which are closer to the Djibouti port.

The key advisor in the Prime Minister's Office and officials at TIDI stated that an objective of the current industrial policy in the sector is for local firms to learn from foreign firms in the industrial parks. A key linkage could be foreign firms subcontracting orders to local firms, which requires that local firms reach the quality standards and efficiency levels of the foreign firm, often with its active assistance in designing production and management processes. But it remains to be seen how many local firms will be located in the parks, and how the linkages between local and foreign firms will develop.

Cost and delivery time are crucial for firms to be competitive in the apparel global value chain. Time and cost to import and export are high in Ethiopia compared to competitor countries in Asia. For example, time to export in Ethiopia was 44 days, compared to 28.3 days in Bangladesh, 21 days in China and 17.1 days in India; and cost to export was $2380 in Ethiopia, compared to $1281 in Bangladesh, $823 in China and $1332 in India.[17] To reduce transport costs and the long time of importing and exporting that firms in Ethiopia face, the industrial parks are to be connected to the Djibouti port by an

[16] We were unable to get a list of the local firms from the Industrial Parks Development Corporation in November 2016, which stated it did not yet have the list. The information presented here comes from interviews with locally owned firms.

[17] Report on the Ethiopian textile and apparel industry, 2014, p.30, accessed from the Ethiopian Textile and Garment Manufacturers Association, Addis Ababa, June 2016.

electric-driven railway system. The railway line from Djibouti to Addis Ababa was commissioned in mid-2016, but was not yet operational in December 2016. The Awash to Mekelle line is under construction and halfway completed, and the Modjo to Hawassa line is expected to be completed in 2018.

Throughout these three phases of industrial policy in the textile and apparel sector, the goal has always been to generate foreign exchange and employment as well as spur industrialization, but the focus and instruments of industrial policies changed over time. In the beginning, industrial policy focused on local firms as well as local value added and linkages from cotton to textile and apparel. Later the focus shifted to foreign direct investment as a means to increase exports and employment quickly, and industrial parks catered to the needs of global buyers and transnational producers. The importance of locally owned firms learning from foreign firms and the creation of local linkages between cotton, textile, and apparel are still mentioned by the government. However, it remains to be seen to what extent local firms are supported in the new industrial parks, and whether linkages between foreign and local firms develop without any explicit government directives or support.

Overview of the Ethiopian Apparel Export Sector

By 2016, the textile and apparel sector included four spinning mills, 15 weaving/knitting mills, 16 vertically integrated textile and apparel firms, and 49 solely apparel firms, making a total of 84 firms overall and 65 firms involved in apparel production.[18] Table 2 provides an overview of all of the firms in the textile and apparel sector as of June 2016, including ownership and type of production. These figures include only one of the firms in the Hawassa industrial apparel park, which was already operating in 2016. Ownership is quite diversified in the Ethiopian textile and apparel sector, made up of different types of locally owned firms (see below) and a variety of foreign owned firms.

A total of 36 foreign owned firms operated in the textile and apparel sector, including 11 textile mills, eight integrated textile and apparel firms, and 17 apparel firms. These foreign firms were mostly exporting, although several also produced for the domestic market and a few produced only for the domestic market. China is the largest investor in terms of number of firms, accounting for 12 firms (which are however small compared to other foreign firms), followed by Turkey (eight firms), India (six firms), Korea (three firms), Pakistan (two firms) and Israel, Italy, Japan, Sri Lanka, and Taiwan with one firm each. These shares will change markedly in the near future when the new industrial parks are fully operational. Employment-wise, the latest industrial survey on medium and large enterprises employing at least 10 persons estimates that textile and apparel

[18] Eight handwoven (or cultural clothing) firms are not included in the list.

account for roughly 56,000 persons employed in 2013/14.[19] This figure is similar to data obtained from TIDI, which suggests that the textile and apparel sector had around 55,000 direct employees in 2016.[20]

Table 2 Overview of Firms in the Textile and Apparel Sector, June 2016

Ownership	Total	Textile (spinning & weaving/knitting)	Integrated (textile & apparel)	Apparel
Ethiopia	***48***	***8***	***8***	***32***
Foreign	***36***	***11***	***8***	***17***
China	12	7	1	4
Turkey	8	1	5	2
India	6	1	1	4
Korea	3			3
Pakistan	2	1	1	-
Israel*	1			1
Italy	1			1
Japan*	1	1		
Sri Lanka	1	-	-	1
Taiwan	1	-	-	1
Total	84	19	16	49

Source: Based on data from Ethiopian Textile Sector Profile, TIDI, January 2016. The data was confirmed by fieldwork information from firms and sector institutions. This data was compared to an excel sheet on textile and apparel firms directly accessed from TIDI. There were minimal discrepancies, but the excel sheet showed 50 Ethiopian-owned apparel firms, compared to 23 in the Sector Profile and confirmed in fieldwork. As the existence of these additional Ethiopian-owned firms could not be confirmed, we did not include them in Table 2.

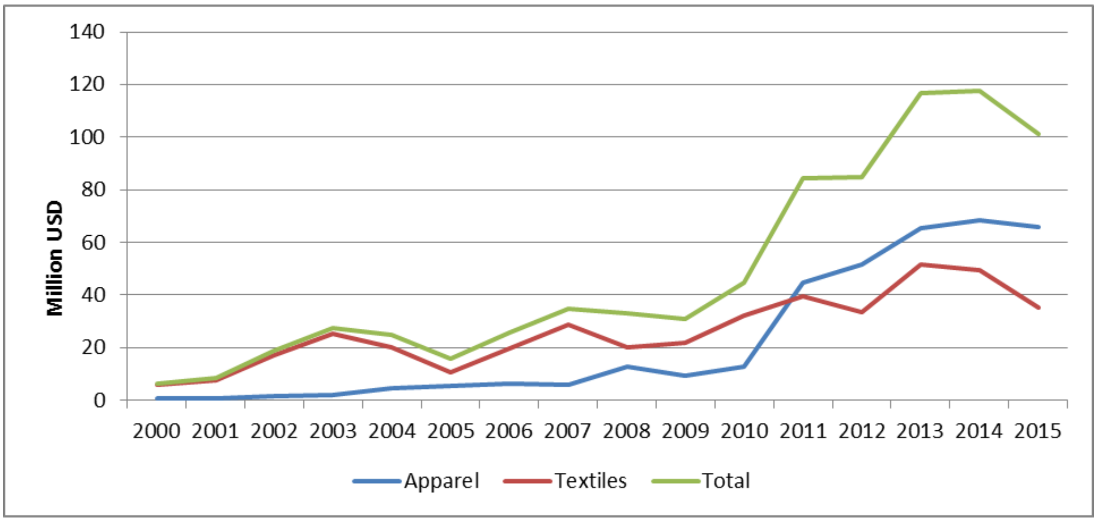
***Note:** The Israel and Japan firms are joint ventures with an Ethiopian partner but the foreign partner seems to be dominant in business decisions.

With regard to exports, according to UN Comtrade data for 2015, apparel exports were modest and remained largely flat at around US$1 million until the mid-2000s, and then climbed to around $12 million by 2010. Since then, they continued to rise substantially and accounted for around US$68 million in 2014. In 2015, they declined slightly (-4%), reaching US$66 million in 2015. The overwhelming majority is accounted for by knitted apparel (HS61), valued at US$57 million or 86% of total apparel exports in 2015. There is no complete data available yet for 2016 from UN Comtrade, as not all importing countries have reported, but even the incomplete data shows already a large increase in apparel exports. Textile exports accounted for US$49 million in 2014 and also declined by -28% reaching US$35 million in 2015, including US$14 million in

[19] Central Statistical Agency, Report on Large and Medium Scale Manufacturing and Electricity Industries Survey, Statistical Bulletin, August 2015, Addis Ababa.
[20] Ethiopian Textile Sector Profile 2016, TIDI, January 2016.

cotton yarn, US$13 million in made up textiles, and US$5 million in knit fabric. Hence, in 2015, textile and apparel exports together accounted for US$101 million, down from the peak of US$117 million in 2014 (Figure 2). Data from the Ethiopian Revenue and Customs Authority (accessed through TIDI) show similar developments, with total apparel exports reaching US$72 million in 2014/15 and textile exports US$26 million (including 4.6 million cultural clothing), accounting together for US$98 million. After years of high growth rates, there was also a decline of -12% between 2013/14 and 2014/15. Differences are accounted for by two factors: difference in reporting periods, and different reporting measures being used (imports reported in partner country versus exports reported by Ethiopia).

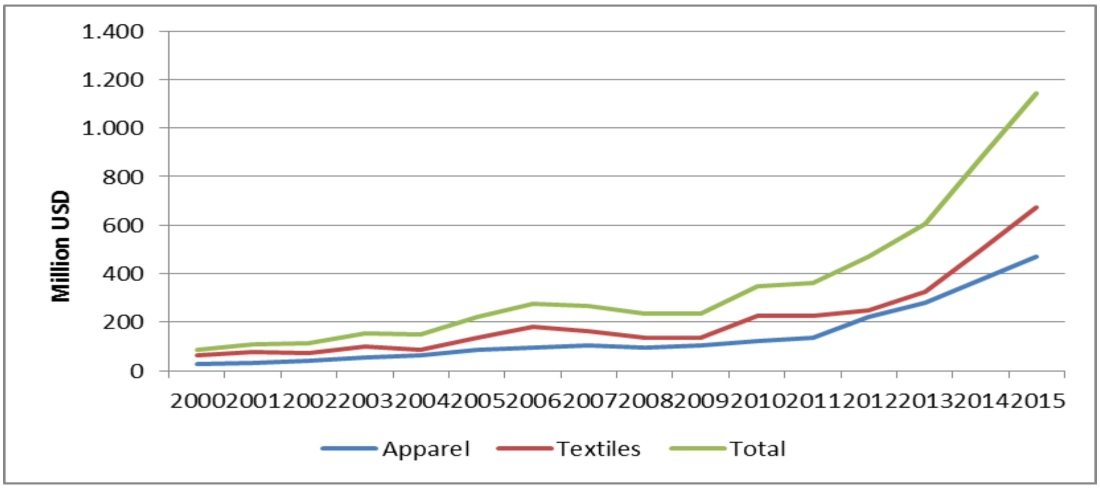
Figure 2 Ethiopia's Apparel and Textile Exports, 2000-2015



Source: UN COMTRADE (2017).

The domestic market remains important, not only for local firms but also for foreign firms, even though the government aims at pushing particularly the latter group solely into exporting. This attractiveness is related to a 96.6 million population with an increasing share of consumers, but also to protection of the domestic market. The importance of the domestic market is also demonstrated by high apparel imports, particularly from China, accounting for US$469 million in 2015, which increased on average 31% annually over the past five years (Figure 3). Textile imports are also important and have increased over the past five years, with an annual increase of 25%, accounting for US$675 million in 2015 (Figure 3). Textile inputs are used for the domestic market but also for apparel exports, with many firms using imported yarn and fabric. According to data from the Ethiopian Revenue and Customs Authority, the trade balance is negative in all segments, including yarn, fabric, apparel, and cultural clothing, accounting in total for -517% (in terms of exports) in 2014/15. This increased from around -350% in the previous years. The negative trade balance is largest in fabric (1332% in 2014/15), followed by yarn (-519%) and then apparel and cultural clothing (-419%).[21]

Figure 3 Ethiopia's Apparel and Textile Imports, 2000-2015



Source: UN COMTRADE (2017).

Export markets are very concentrated. Regarding apparel, the major end markets for Ethiopian exports are the EU-15, which accounted for 63% of total exports in 2015. The bulk of these exports go to Germany (49%) and Austria (7%). The EU-15 share decreased, however, from almost 73% in 2014. The US market accounted only for 28% in 2015, which increased from 18% in 2014 (Table 3). There is no complete data available for 2016 from UN Comtrade, as not all importing countries have reported yet. But the US has reported imports, which show a drastic increase from US$18.5 million in 2015 to US$34 million in 2016. Hence, the US end market share will increase again in 2016. Other important albeit smaller end markets in 2015 included the UK, Poland and Switzerland. Textile exports go primarily to Turkey, which accounted for 51% of textile exports in 2015 and has increased since the mid-2000s. In contrast, the share of the EU-15, which historically accounted for more than 90% of textile exports, has decreased to around a third. The lion share of textiles going to Turkey and China are made up of cotton yarn and, in Turkey's case, also of knitted fabric, while made-up textiles dominate exports to the EU-15. Regional exports play a very limited role, which is related to Ethiopia's restrictive regional trade policy.

[21] There are some discrepancies in UN Comtrade data and TIDI data but the trends are similar.

Table 3: Top 5 end markets of apparel and textile exports

	‘00	‘04	‘07	‘10	‘13	‘14	‘15	‘00	‘04	‘07	‘10	‘13	‘14	‘15
Apparel														
World	***1***	***5***	***6***	***12***	***66***	***68***	***66***							
EU-15	*0*	*1*	*1*	*5*	*48*	*49*	*42*	*83,2*	*17,3*	*12,6*	*41,3*	*72,5*	*72,8*	*63,3*
Germany	0	0	0	3	39	40	32	0,2	7,3	0,7	27,7	59,5	59,3	49,0
United States	0	4	5	7	10	12	19	1,1	78,9	84,0	54,5	15,8	17,7	28,0
Austria	0	0	0	0	6	6	5	0,8	0,4	0,1	2,9	8,6	8,7	7,1
United Kingdom	-	0	0	0	1	2	2	0,0	0,3	0,5	0,1	2,2	3,5	2,8
Italy	0	0	0	1	1	0	2	28,8	2,2	3,5	8,9	0,8	0,5	2,4
Textile														
World	***2***	***9***	***14***	***23***	***45***	***49***	***35***							
Turkey	0	4	7	18	22	25	18	1,3	21,5	23,8	55,3	43,2	51,2	51,4
EU-15	*5*	*8*	*12*	*8*	*12*	*17*	*11*	*82,3*	*41,4*	*43,3*	*25,3*	*23,9*	*35,2*	*32,3*
Italy	1	2	3	3	7	5	5	17,2	8,8	10,5	9,0	12,7	9,5	13,8
Germany	0	2	3	3	4	11	4	1,8	8,0	11,7	7,9	7,1	22,5	12,3
China	0	1	0	2	13	5	3	0,0	2,7	1,5	7,1	25,8	9,8	8,8
Norway	0	0	0	0	-	0	1	0,0	0,0	0,2	0,0	0,0	0,2	2,8

Source: UN COMTRADE 2016; apparel represents HS92 61+62; textile represents HS92 50-60+63; exports represent partners' imports.

The Ethiopian textile and apparel industry mainly produces cotton-based products such as cotton yarn, cotton fabrics, bed sheets and blankets, and cotton-based apparel. Focusing on the apparel segment, exports are concentrated in basic relatively low unit value knit, cotton-based items and show a high degree of concentration. Cotton t-shirts accounted for around 35% of total apparel exports in 2014, followed by cotton women’s trousers (18%) and cotton shirts (6%). There was no woven product category among the top-10 products in 2014. Export product concentration is relatively high compared to Asian and also other Sub-Saharan African countries. In 2014, the top five products accounted for almost 70% of total apparel exports. Unit values were relatively low, with a median price of the top five products of US$8.8 per piece (Table 4). With regard to the two key end markets, product concentration is high in both markets, with the top 10 products accounting for 92% in the EU-15 and for 88% in the US. All of the top 10 products for the EU-market in 2014 were knit items, while there were four woven items among the US top 10.

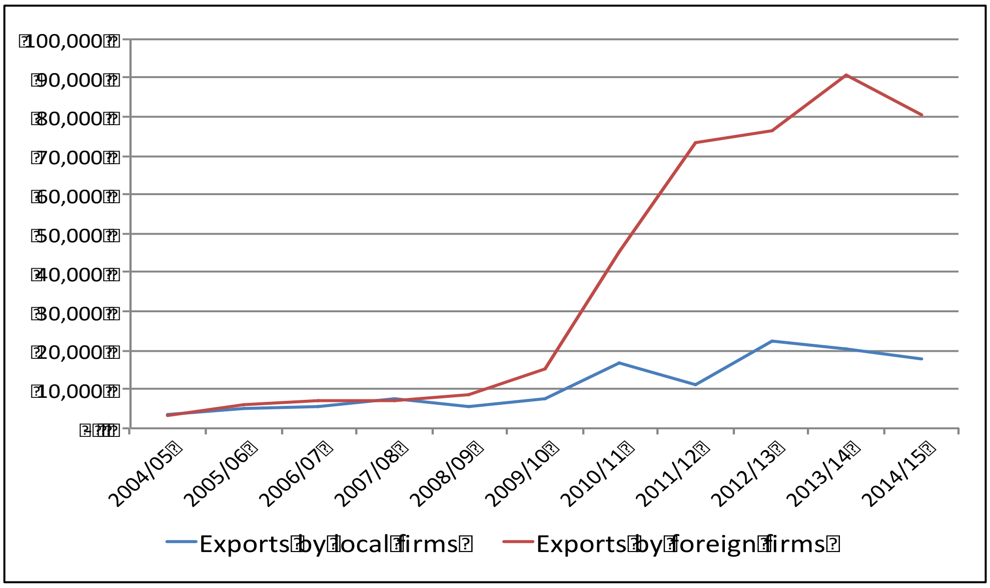
Table 4: Top-10 apparel export products (2014)

HS code	Product	Value (US$ ths.)	Share (%)	Unit Value (US$/pc)
610910	T-shirts (N/A, cotton)	23,733	35%	4.3
610462	Trousers (W&G, cotton)	12,563	18%	5.6
610510	Shirts (M&B, cotton)	4,413	6%	8.8
611430	Garments (N/A, MMF)	3,924	6%	14.0 (US$/kg)
611030	Jerseys (N/A, MMF)	2,703	4%	10.5
Average		**47,336**	**69%**	8.6
Median				8.8
620343	Trousers (M&B, synthetic)	2,240	3%	12.5
610469	Trousers (W&G, other textiles)	2,227	3%	7.9
610463	Trousers (W&G, synthetic)	2,127	3%	7.7
610444	Dresses (N/A, artificial)	1,729	3%	13.7
610990	T-shirts (N/A, other textiles)	1,673	2%	5.1
Average		**57,332**	**84%**	9.0
Median				7.9
Total		**68,408**	**100%**	

Source: UN COMTRADE 2016.

In 2015, textile and apparel exports were characterised by a high concentration of a few large firms. According to ETGAMA, only 30 to 35 firms export, with 30 further firms having the potential to export. One foreign-owned integrated firm accounted for more than 50% of exports; five to six large firms accounted for the next 20% of exports; and the other 20% came from the rest of the exporting firms. This composition will change in the next years given the large foreign direct investments in the industrial parks. According to firm-level TIDI export data, the share of foreign firms in exporting increased continuously, accounting for 82% of total textile and apparel exports in 2014/15. As Figure 4 shows, the share of local firms declined from around 50% in 2004/05 to 2007/08, to only 18% in 2014/15.

Figure 4 Textile and Apparel Exports by Local and Foreign Firms



Source: Ethiopian Textile Sector Profile 2016, TIDI, January 2016.

Mapping the locally owned firms

Out of a total of 84 firms in the apparel and textile sector in January 2016, 48 were Ethiopian-owned firms, consisting of eight integrated textile firms, eight integrated textile and apparel firms, and 32 apparel firms. Table 5 lists all of these firms and indicates the year they were established, their ownership type and whether they were exporting in 2016 and had previously exported. These 48 local firms include a range of ownership types: nine previously state-owned firms of which only two are still state-owned[22]; one firm that belongs to the Endowment Fund for the Rehabilitation of Tigray (EFFORT), which is linked to the TPLF and thus considered a party-owned firm; one firm that is part of Al-Amoudi's MIDROC group; and the remainder are owned by individuals or groups of local investors, including four Ethiopian diaspora-owned firms where the owners do not have official citizenship.[23]

[22] The other four previously state-owned firms were privatised to foreign investors or are joint ventures with a dominant foreign partner.
[23] This group includes Ethiopians who have lived abroad for a long time and returned to Ethiopia in the 1990s or 2000s. They kept the citizenship of the country in which they were living, and only acquired a yellow card that gives them all the rights of Ethiopian citizens except the right to vote.

Table 5 Ethiopian-owned Textile and Apparel Firms, 2016

Name	**Activity**	**Ownership**	**Year established**	**Exporting in 2016**	**Previously exported**
Adama	Spinning	Private	2008	Export (yarn)	
Alemgena	Spinning	Private	2013	No	
Crown Weaving	Weaving/knitting	Private	2008	No	
DH Geda Blanket Factory	Weaving/knitting (blankets)	Private	2002	No	
Debre Berhan Blanket factory	Weaving/knitting (blankets)	SOE, Privatized		No	
Firke Factory	Weaving/knitting (socks)	Private	2009	No	
KK	Weaving/knitting (blankets)	Private	1992	No	
Tehute Knitting and Garment	Weaving/knitting	Private	2011	No	
Bahir Dar	Integrated textile	SOE	1961	Export	
Kombolcha	Integrated textile	SOE	1986	Export	
Yirgalem	Integrated textile & garment	SOE, Privatized	1969, 2010	Export	
Dire Dawa	Integrated textile	SOE, Privatized	1947, 2007	Export (yarn)	
Awassa	Integrated textile	SOE, Privatized	1989, --	Export (yarn/fabric)	
ArbaMinch	Integrated textile	SOE, Privatized	1991, --	Export (yarn/fabric)	
Akaki Garment	Garment	SOE, Privatized	1971, 2004	No	
Gulele Garment	Garment	SOE, Privatized	1983, 2005	No	Yes
Addis Garment	Garment	SOE, Privatized (foreign), Resold (local owner)	1965 2006 2016	No	Yes
Almeda Textile	Integrated textile & garment	EFFORT	1994	Export	
Edget	Garment	Private	1996	No	
EMD	Garment	Private	1996	No	
Ambassador	Garment	Private	1997	No	
Adugna Kebelay	Garment	Private	2000	No	
MAA Garments	Integrated textile & garment	MIDROC Group	2004	Export	
GMM	Garment	Private	2004	Export	
Knit to Finish	Garment	Private, diaspora	2004	Export	
Yonis	Garment	Private, diaspora	2004	Export	
Eltex	Garment	Private	2004	Export	
Novastar	Garment	Private, diaspora	2005	Export	
GG SuperGarments	Garment	Private	2005	No	Yes
Vitcon	Garment	Private	2005	No	Yes
Yabets	Garment	Private	2005	No	

Haile Garments	Garment	Private	2006	No	Yes
Asbm	Garment	Private	2006	No	
Feleke	Garment	Private	2006	Export	
Concept	Garment	Private, diaspora	2006	Export	
Oasis	Garment	Private	2007	No	Yes
Wossi	Garment	Private	2007	No	Yes
Mantel	Garment	Private	2007	No	
Abem	Garment	Private	2008	No	
Toto	Garment	Private	2008	No	
Desta	Garment	Private	2009	Export	
Berhanu Tsehay	Garment	Private	2010	No	
Getachew, Ayinalem and Yeshareg	Garment	Private	2011	No	
Big M	Garment	Private	2011	No	
Lucy Garment	Garment	Private	2011	Export	
Hay	Garment	Private	2012	No	Yes
EDE	Garment	Private	2013	No	
Rainbow	Garment	Private	2013	No	

Source: Compiled by the authors based on data from TIDI and interviews.

As Table 5 shows, 18 out of the 48 firms were engaged in exporting in 2016. However, Adama, Dire Dawa, Awassa and ArbaMinch exported only yarn or yarn and fabric, and thus we have not included them in our list of local exporting firms, as we are interested only in firms exporting apparel or made-up textiles. The 14 exporting firms include firms that started out purely exporting as well as firms that started out producing for the domestic market and only later shifted into exporting. Some of the firms that started out exporting were not successful, as mentioned above, and shifted to producing entirely for the domestic market. Of the 14 exporting firms, 12 of them produced for the domestic market as well as for exports; hence only two firms were engaged only in exporting.

Most of the 13 state-owned textile and apparel firms had been privatized to local and foreign investors by the mid-2010s (see Table 1). In general, the privatized integrated textile firms had a large gap in technology and thus very low productivity or even defunct machines, and the new owners had to invest in renovations, which required time and money, before the firms could export competitively. Many of the privatized firms bought by local investors struggled with accessing investment finance, including from the Development Bank of Ethiopia. The two remaining state-owned textile firms, on the other hand, had easy access to investment finance at zero interest through the Ministry of Public Enterprise. Four out of the seven firms privatized to local investors were exporting in 2016: Yirgalem, Dire Dawa, Awassa and ArbaMinch. The new owner of Yirgalem renovated the knitting and dyeing facilities and expanded the apparel factory, and the firm has begun slowly to export basic cotton knit products using its own fabric.

Dire Dawa exported yarn to China and Italy, but otherwise focuses on sales of yarn and fabric to the domestic market. Awassa and ArbaMinch exported a small and declining share of yarn and fabric. Hence, Yirgalem is the only previously state-owned integrated textile firm bought by a local investor that has set up an export quality apparel factory and pursued exports. Two of the four firms privatized to foreign investors export apparel, with one being a joint venture where the foreign partner is dominant.

None of the previously state-owned apparel firms are exporting. The local investor in Gulele Garment tried exporting, but did not succeed and is currently producing for the domestic market. Akaki Garments has the same owner as GG Super Garments; the owner is trying to export with GG and uses Akaki to produce only for the domestic market. Addis Garments was privatized to an Italian investor, who exported between 2007 and 2013 to an Italian buyer for different end markets, but also produced for the domestic market. It switched to the domestic market entirely in 2013, before being sold in 2016 to the owner of Abem Garments, a locally owned firm that produces for the domestic market.

Two state-owned integrated textile firms remain, which according to the management of these firms, the government was not able to sell and thus adopted the strategy of making them profitable and encouraging them to export. Bahir Dar Textiles was privatized to Turkish owners in 2004, but then the government terminated the contract and reacquired it in 2006 due to problems with the investors.[24] The government invested in major renovations of Bahir Dar and Kombolcha Textile firms between 2008 and 2012. The two SOEs are both vertically integrated textile mills producing woven fabric and made-up textiles (bedsheets and towels), largely for the domestic market but with an increasing export share. Bahir Dar only started exporting made-up textiles in 2015, so its export share is lower than that of Kombolcha, which began exporting made-up textiles in 2010.

Almeda Textile is part of EFFORT, the Endowment Fund for the Rehabilitation of Tigray. The CEO of EFFORT is Azeb Mesfin, the wife of the former Prime Minister Meles Zenawi. EFFORT has firms involved in a large number of industries, such as construction, cement production, transport logistics, leather, pharmaceuticals and cotton production.[25] Almeda Textile is a vertically integrated textile and garment firm that contains both woven and knit facilities, which is not typical for textile firms as they usually specialize in woven or knit. Established in the 1990s, EFFORT decided to make Almeda large, and thus have both woven and knit textile production as well as made-up and apparel products, because it was intended to provide employment for former TPLF liberation fighters in and around the town of Adwa (Tigray region). Almeda exports, but

[24] There was a similar experience with Yirgalem, which was leased to a Turkish investor but then the government took it back, and it was later sold in 2010 to a local investor.
[25] EFFORT Investments Company Profile, 2015/16.

also produces branded t-shirts and other knit and woven products for the domestic market.

MAA Garments and Textile Factory is part of Kebire Enterprises, which also includes Tkur Abay Shoe factory, Hilltop Hotel, and Debrehirhan tannery. Kebire Enterprises is part of the MIDROC Group owned by Mohammed Hussein Al-Amoudi, but it has independent management. MAA Garments is located in Mekelle, and is a large vertically integrated textile and apparel company specialized in knit fabric. Other firm owners and observers of the industry often refer to MAA Garments as being in a similar situation as Almeda Textiles, in that the main motive behind MAA Garments is to provide employment in the Tigray region and that MAA Garments enjoys a special political status with the government.

Almeda Textile, Bahir Dar Textile, Kombolcha Textile, and MAA Garments are the largest locally owned firms in terms of the number of workers employed. They are also all vertically integrated and engage in exporting to some extent, although the two SOEs only export made-up textiles. The remaining local firms can be categorized in terms of their date of establishment and export or domestic market orientation. The first category includes local firms established in the 1990s, before industrial policy to promote exports, and which focused on the domestic market. The second category is firms established in the mid-2000s, as a direct result of industrial policy, with an initial export focus. The third category contains firms established in the 2000s and early 2010s, benefiting from domestic market protection but also attempting to export. Most of these firms are located in Addis Ababa or surrounding towns in the Oromia region. Notably, a new local firm engaged in exporting was established in Kombolcha (Amhara region) in late 2016, which is not included in Table 5. It is likely that the new apparel industrial parks will encourage local investment in those areas of the country.

Regarding the first category of apparel firms established in the 1990s, prior to the government’s proactive industrial policy, this group of firms still produces only for the domestic market. The exception may be Ambassador, which is trying to enter the regional market and set up retail shops in Uganda. Ambassador produces its own brand of men’s suits with imported fabric from China and India, and sells them (along with shirts and accessories) through 22 company-owned stores in Ethiopia and 66 agent shops. The firm is pursuing regional exports as a way to increase sales, but also, and perhaps more importantly, to increase its ability to access foreign exchange with which to import its fabrics.

The government’s first attempt at industrial policy to promote apparel exports led to the establishment of many locally owned apparel firms in the first half of the 2000s, including Knit to Finish, Novastar, Concept, GG Super Garments, Feleke, GMM, Asbem, Haile Garments, Oasis, Vitcon, Yonis, and Wossi. As can be seen from Table 5, several of these firms are no longer exporting. While some of them see their firms as only temporarily out of the export market, others have given up on the export market. One of the firms has up to now only exported to the regional market and is now trying to enter the US and EU markets.

From the mid-2000s, a number of local investors entered apparel production for the domestic market. Many of these local firms have continued to produce only for the domestic market, but a few of them did seek out export markets eventually and in diverse ways. For example, Lucy Garments produces its own brand of men's formal shirts and has retail stores, but entered production of different products for export in 2015 in order to increase its ability to access foreign exchange and to be able to learn from their export activities. Eltex has been involved in apparel production for the domestic market since 2004, and is vertically integrated in knit production, but during an expansion phase in 2014 decided to enter exports. Desta started in 2008 with a knitting factory, and later in 2013 entered apparel production both for the domestic market and export. Both Desta and Eltex aim to improve their fabric production through investment in new machinery in order to be able to use their own material for export products. In 2016, Hay was positioning itself to enter export markets with its own fabric, by upgrading and expanding its production facilities in order to meet export standards.

Among the local firms that produce only for the domestic market and have never exported and do not plan to do so, some of them focus on providing uniforms for businesses and the government using woven fabric produced by textile firms in Ethiopia. The others produce casual clothes, suits and formal men's shirts, and children's clothes, and sell to wholesalers who have a distribution system in the country.

Given that the domestic market is lucrative and is said to generate higher profits than exporting, most local firms still aim to also export – why is this the case? This is related to government incentives and support linked to exporting that firms aim to access, as well as priority in accessing foreign exchange for firms that export. The latter 'incentive' is more pressing for local firms that have a business strategy where they produce apparel using imported fabrics. For these firms, being low in the foreign exchange queue is a problem. In contrast, firms that produce uniforms and workwear using woven fabric sourced locally are not constrained by access to foreign exchange. The profit margin is high on these products because the local firms can use locally produced fabric, the standards are lower, and the risk is lower in terms of delivery deadlines.

But local firms also enter the export market as a means to increase their capabilities. As export products are generally more complex and have higher quality standards than products for the domestic market, firms can also learn new production techniques. The higher volumes achieved through exporting can also lead to higher productivity. Furthermore, local firms generally do CMT production for exports while they produce full package or original design manufacturing for the domestic market, and hence can learn from the designs they get from global buyers to produce new products for their domestic market business.

Almost all of the local exporting firms straddle the domestic and export market. They all report that their profit margins in exporting are low due to their low productivity (vis-à-vis international standards) combined with low prices set by buyers; most of them are just breaking even or losing money. The local exporting firms have to produce apparel for the domestic market while they are learning how to meet the cost, quality and delivery standards and investing in their physical facilities in order to meet productivity and quality as well as social and environmental standards. In sum, local firms see the value of exporting in terms of learning, but learning is a costly process and the prices set by buyers do not allow for a margin of error; therefore, firms use the domestic market as a means to subsidize the cost of learning to compete. The financing schemes from the Development Bank of Ethiopia, while important, did not sufficiently account for the costs of learning. Although DBE did allow debt on the local firms' investment loans to be rescheduled, when it became clear that the local firms were not competitive and could not repay the loans, the firms still needed a source of further capital including working capital without taking out more loans. This working capital came, at least partly, from producing for the domestic market or from other business activities in the case of owners having diversified businesses. The dangers, of course, are never moving from the comfort of the domestic market to the rigors of the export market, as well as not using the buffer of the domestic market and related profits for investments in learning and capability building. Additionally, some local firms predict that the domestic market will not remain protected indefinitely, and thus they must become internationally competitive not only for accessing export markets but also to retain their position in the domestic market.

Conclusion

The EPRDF government's pro-active industrial policy in the textile and apparel sector played an important role in the emergence and growth of apparel exports. Industrial policy targeting the sector evolved over time, with the government seeking to change strategies in response to mistakes and experiences as well as political imperatives to deliver jobs and increase exports as quickly as possible. The first phase of industrial policy focused on incentivizing local investment in apparel production for export, but both the government and the local investors underestimated what was involved in entering the apparel global value chain. Thus, the results from the local firms were modest, as it takes time for new export firms to build capabilities and become competitive. Already in the first phase, the government was encouraging foreign direct investment in the sector, but it did so in a rather ad hoc way. The government learned from this first phase of industrial policy that there were constraints in the sector that had to be addressed in order to help local firms learn and it realized how the global value chain worked, which also led it to revise its strategy of attracting foreign direct investment. It turned to specialized industrial parks as a way to address industry-wide constraints and to support new investors to start exporting quickly. It also focused on foreign investors as a way to not only increase exports rapidly, but also to bring production and marketing knowledge into the country. The current phase of industrial policy, centered on the creation of several industrial parks, aims to attract large scale foreign investments as well as to foster linkages between local and foreign firms as a means to facilitate learning and capability building among local firms. However, the exact measures taken by the government to foster these linkages remain to be seen, as such linkages will not necessarily emerge without active government involvement.

The EPRDF government has simultaneously pursued policies of export promotion and import-substitution in the textile and apparel sector. As a result, there are apparel firms producing for the domestic market, including both local and foreign firms, which buy some fabric locally. Some of these firms produce only for the domestic market, and many firms that are exporting also produce for the domestic market—especially those that are not located in the industrial parks dedicated to exports. The domestic market apparel industry includes workwear but also local brands and locally owned retail chains, especially in men's formal shirts and suits. The government's dualistic policy has helped the development of apparel exports by local firms, by allowing local firms to subsidize the cost of entering the export market with high prices garnered in the domestic market, but also might be constraining it, by reducing the incentives for local firms to undertake the hard process of developing the capabilities required to compete. On the other hand, import substitution is an important means of saving foreign exchange and creating jobs, and can create backward and forward linkages in the economy. Therefore, the challenge for industrial policy is to retain the focus on local firms given their important role in productive transformation and to ensure incentives and support for local firms to export, and through this to increase their capabilities and value added, despite the existence of a protected domestic market.

The objective of the AfriCap research project is to understand the effects of industrial policies on incentivizing local firms to invest in building capabilities in order to export, as well as other channels through which local firms can learn such as foreign direct investment spillovers and buyer-supplier relations in global value chains. The first step in this research is to understand the emergence and evolution of the sector, and thus who are the locally owned firms, when and why did they emerge, and the features of the broader textile and apparel sector in which they emerge. In the case of Ethiopian apparel exports, industrial policy has played a key role and will remain crucial, ideally in combination with incentivizing foreign direct investment linkages and spillovers and buyer-supplier relations to ensure learning and competitiveness of locally-owned firms. In contrast, in the case of Madagascar apparel exports (the second country where the apparel export sector is studied for this project), industrial policy is largely missing, except in the beginning in the form of creating the export processing zone. Therefore, in Madagascar foreign direct investment and buyer-supplier relations are potentially even more important channels for local firms to emerge and build their capabilities. The possibilities for using foreign direct investment as a basis to build linkages with, and capabilities at, local firms will depend on several factors, which include pro-active industrial policy by the government to facilitate these linkages as well as the type of foreign investors, their business strategies, and the specific global value chains in which they are integrated.

The second step in the AfriCap research is to define what technological capabilities are required to enter and become competitive in the apparel global value chain, and then to assess locally owned firms using this benchmark of required capabilities. In the Ethiopia apparel case, we conducted a survey with all of the 14 local exporting firms, which captured data across a range of indicators on different types of technological capabilities. The survey results are presented in Whitfield and Staritz (2017), which continues the discussion of the tasks involved in becoming international competitive and the processes through which the local exporting firms are building capabilities. The third step, which is still ongoing, is to assess how and why local firms build capabilities through conducting in-depth firm histories with a strategically selected sample of local exporting firms.

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