Most of the recent research on the competitiveness of Ethiopian manufacturing has reached the same conclusion without asking the right question, argue Dan Ciuriak, former deputy chief economist at Canada's Department of Foreign Affairs and International Trade, Derk Bienen, managing partner of BKP Development, a Munich-based research firm, and Mamo Mihretu, former principal attorney of the Ethiopian World Trade Organisation (WTO) Accession Project.

Unlocking Competiveness Puzzle Obliges More Competition

Can Ethiopian industry compete without tariff protection? Study after study has reached the conclusion that, no, Ethiopian industry cannot compete. Accordingly, the Ethiopian government has stuck to its policy of maintaining a wall of protection against imports. As the calendar marches on into 2012, the story remains the same: another study, another conference, yet the same conclusion that Ethiopia cannot compete.

Although Ethiopia helped establish the Common Market for Eastern & Southern Africa (COMESA) in 1993, on the basis of the latest assessment, the Government may decide once again to postpone joining the free trade area launched in 2000.

This is not to challenge the established evidence that Ethiopian industry is not competitive. However, this is the wrong question to focus on. The right question is whether there is any evidence that tariff protection is working. The evidence in mind is thousands of Ethiopian firms engaged in import-replacing manufacturing because that, after all, is what tariff protection is supposed to generate.

Let us step back for a moment and survey the landscape. The entire Ethiopian economy has about 2,200 medium and large-sized industrial establishments and an additional 43,000 or so micro establishments, more than half of which are grain mills. The role of the private sector remains largely limited to several exceptional sectors such as leather, textile, and cut flowers, which have been given priority status. Otherwise the private sector's role is marginal at best, particularly in manufacturing.

These numbers are extremely low. To put them in perspective, consider that the average Japanese automaker's production system alone (leaving aside the rest of the economy) comprises of 170 first-tier, 4,700 second-tier, and 31,600 third-tier subcontractors.

Industrial production is complicated, with a vast number of moving parts. Simply put, Ethiopia needs vastly more business establishments. It needs a vastly greater variety of businesses. It needs a veritable ecosystem of firms interacting in each other's supply chains. Tariff protection is not producing this.

Missing Middle

By far, the more important impediments to the development of Ethiopian industry are the internal barriers to competition that have prevented the emergence of a thriving small and medium-sized enterprise industrial sector. This is Ethiopia's problem of the missing middle.

How is it possible to get there from here? First basic answer: business start-ups.

How difficult can this be? According to the World Bank's Doing Business benchmarks, it takes one day, one procedure, and costs nothing to register a business in the leading countries (New Zealand, Canada, and Denmark, respectively), while in 82 economies there are no minimum paid-in capital requirements. In Ethiopia, it takes nine days, five procedures and costs 12.8pc of per capita income to register, plus a requirement for paid-in minimum capital that is more than three times per capita income. Moreover, "stiffened licensing regulations," among other things, "weigh on the short and medium-term growth outlook," the most recent joint staff report of the World Bank and IMF on Ethiopia noted.

Stiffened licensing regulations? The government's goal of ensuring compliance with tax obligations in its recent licensing reform is understood and agreed with, but are there not other reform solutions and implementing mechanisms to achieve these goals? How about simple integration of commercial and tax registration?

After all, both use the same tax identification number (TIN). There are many things in a developing economy for which government engagement is desperately needed. But, making it more difficult to start a productive enterprise is not one of them. This is an area where Ethiopia could go from 99th in the world to first simply by spurring private initiative: one day, one procedure, no fee, and no paid-in minimum capital to register a business that can then at least try to get small business financing. How difficult can that be?

Unbanked Enterprises

There are massive gaps in the availability of basic financial services for small businesses in Ethiopia, notwithstanding the various facilities that have been put in place, shows study after study, survey after survey. For the overall Ethiopian economy, credit supply is roughly three billion dollars short of credit demand, a recent study concluded. The problems in this area in terms of lacking financial infrastructure are legion, so there is no simple "fix," such as simply dropping requirements for paid-in capital and waiving fees, as could be done to facilitate business start-ups. Nonetheless, it is useful to think about this sum in terms of numbers and businesses and the sizes of loans.

An international benchmark for a government-sponsored programme of financing aimed at the support of small and micro enterprise (SME) formation is provided by the Canada Small Business Financing Programme (CSBFP), a programme designed to fill a gap in terms of credit availability for higher-risk SMEs, particularly businesses at the start-up phase. The programme celebrated its 50th year of operations last year. In the past decade, this programme provided loans of 11 billion dollars in Canadian funds to over 90,000 SMEs, for an average loan size of about 120,000 dollars.

Imagine the operation of such a programme in Ethiopia suitably scaled for the local context-call this the Ethiopian "Give Enterprise a Chance Bank." What would be the look and feel of an Ethiopian economy that had the benefit of such a Bank in operation for a decade, that is, an economy with 90,000 additional businesses competing?

Of course, it cannot be said exactly, but it would be an economy much more vibrant and competitive domestically and internationally than what the Ethiopian economy is today. The number of firms would be triple the number competing today. It would be an economy much better able to take on competition in the COMESA region and support high and rising living standards in Ethiopia.

Would such a programme entail high risk? Of course it would. Ethiopia lacks almost all the necessary financial infrastructure for a tight control on risk. Would it be worth it? In Ethiopia's context, where there is almost no private sector, even the failed loans might be worthwhile as the lessons learned in failure are applied in subsequent enterprises and the assets generated even in failed enterprises change hands for another go.

Ironic Isolation

Worrying about tariffs is perhaps the least of the issues with which the government of Ethiopia should be preoccupied. The institutions and infrastructure for trade make exporting and importing very difficult. In 2012, Ethiopia slipped to 157th in the World Bank's Doing Business Report on the ease of trading across borders. Many of the constraints and issues in trade logistics identified in the recently held Public Private Consultative Forum involving the government of Ethiopia and the Ethiopian Chamber of Commerce & Sectoral Associations (ECCSA) validate this finding. From the standpoint of a multinational firm thinking about possibly relocating labour-intensive assembly operations from, say, China where labour costs are rising, Ethiopia might as well be on the other side of the moon.

The financial and time costs of getting goods in and out of Ethiopia for supply chain processing are prohibitive. With those prohibitive costs, Ethiopia's best chances for gaining access to the knowledge spillovers that could fuel the imitative and spin-off business start-ups characteristic of vibrant industrial districts simply evaporate.

Ethiopia is stitching together the logistical framework for efficient connections to the global economy. For example, a railway line between Addis Abeba and Lamu Port, Kenya will be part of the larger programme of developing a rail corridor and oil pipeline from Juba, South Sudan, to Lamu, it has been recently announced. This will be a welcome addition to Ethiopia's links to the global economy.

However, the shorter trade corridor to Djibouti continues to depend on inefficient truck transport along a congested route. Djibouti sits directly on the supply route between Asia and Europe. A heavy-duty, high-speed rail link to Djibouti, with a high quality customs cooperation agreement with Djibouti to streamline the movement of goods in transit, would help reduce the current congestion problems and directly serve the interests of Ethiopia's manufacturing sector's participation in global supply chains.

Protectionist Puzzle

Like all developing economies, Ethiopia faces a "chicken and egg" problem in bootstrapping into existence an industrial economy from the raw material of an agricultural subsistence economy. Potential entrepreneurs face an inadequate base of effective domestic demand for most sophisticated industrial products and major gaps in the supply of industrial inputs required to produce sophisticated industrial products.

In the face of these missing markets, trade becomes an essential enabling factor for industrial development. By linking into global supply chains, Ethiopian industrial enterprises would not be dependent upon domestic demand. Moreover, access to imported inputs would allow them to develop in their own area of comparative advantage without waiting for the development of indigenous supply chains.

In the larger scheme of things, joining the COMESA free trade area would be only a modest step in filling the above roles for Ethiopian industry. Moreover, it would not expose Ethiopian industry to unmanageable competition.

The limited extent of trade that Ethiopia has with its immediate neighbours, who would be the main sources of intensified competition from tariff elimination, is primarily explained not by tariff protection but by the "thickness" of Ethiopia's borders due to inadequate transportation and border facilitation.

The bottom line is that a competitive economy requires competitors, not protection from competition. The key to unlocking Ethiopia's competiveness puzzle is not tariff protection but the removal of domestic constraints on entry for new businesses.

By Derk Bienen, A managing partner of BKP Development, a Munich-based research firm, and Mamo Mihretu, former principal attorney of the Ethiopian World Trade Organisation (WTO) Accession Project..

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