



Industrial parks as engines for economic growth in Ethiopia

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Key messages

- Industrial parks can increase production, employment and household income while reducing poverty.
- Attracting foreign direct investment while constructing and renting new parks is essential for ensuring the success of this policy.
- If it is unsuccessful, poverty will be exacerbated.

Industrialization vs agriculture: the quest for economic growth in Ethiopia

Since the mid-1950s, Ethiopia's government has introduced various policies to promote industrialization on a trial and error basis. The economy suffered a negative growth rate for nearly 20 years between the 1970s and 1990s.

The current government has been implementing the Growth and Transformation Plan (GTP), now in its second phase, since 2010. The GTP aims to increase industrialization. It promotes the industrial sector, notably by constructing industrial parks for labour-intensive sectors.

Industrial parks prioritized to promote productivity

Funded by foreign direct investment (FDI), industrial parks cluster industries and aim to increase overall productivity and employment. Under the current plan, USD 650 million, on average, will be borrowed from foreign sources each year to construct industrial parks. The Ethiopian government plans to increase the number of industrial parks to 15 by 2020 under the second Growth and Transformation Plan (GTP II). Five parks are currently operational with another six under construction.

However, the government has found attracting FDI for the GTP more difficult than expected. Despite reallocating resources to the industrial sector, the impact of this policy on growth, poverty and income inequality remains unknown. Understanding these impacts will provide direction regarding the efficiency of reallocating resources to this sector.

The analysis

A team of local researchers sought to investigate the extent to which the construction of industrial parks affects the country's economic growth, poverty levels, and income inequality. In particular, they compared the impacts under different financing options for the program, as proposed in the Growth and Transformation Plan (GTP).

To finance the construction of industrial parks under the GTP, the government proposes to:

1. Borrow USD 650 million in FDI per year for ten years, OR
2. Increase tax on non-priority industrial goods by 5% every year for ten years

The team simulated these two scenarios. To do so, they used the PEP dynamic Computable General Equilibrium model on the 2010 Social Accounting Matrix for Ethiopia, updated to include information related to industrial parks.



Key findings

Industrial parks are found to have a positive effect on:

- Employment
- Production
- Income
- Income equality
- Poverty reduction

The majority of Ethiopia's industrial parks are for the priority industries of textile (60%) and clothing (27%) production. These sectors are labour-intensive and generate more foreign exchange and employment opportunities for the country's semi-skilled labour force.

By attracting foreign direct investment (FDI), industrial parks are found to have a positive effect on the growth of Ethiopia's economy. By injecting resources into the economy, production and exports can increase, leading to growth.

As the majority of household income comes from production, **increased production in priority industries also boosts household income.**

Poorer households were found to benefit more than non-poor households, slightly reducing income inequality. Poverty is also very slightly reduced.

Increased production, however, is only found to happen for the businesses inside the parks. Production by businesses in priority industries that are based outside the parks is found to decrease. The difference in production levels is attributed to government resource allocation and policies that favour in-park businesses, creating short-term "crowding out" effects on firms outside the parks.

Furthermore, **the positive effects will only be felt if all industrial park shades are rented.** If they are not, the parks cannot attract FDI and the government must increase taxes (as in simulation 2).

Increasing tax on non-priority industrial goods by 5% every year was found to increase poverty as goods and services become more expensive while household incomes stay the same.



Conclusions and policy messages

If run well, with all industrial park shades rented, the funding industrial park development with FDI loans is beneficial to Ethiopia's economy.

To ensure the success of this policy, the government must attract foreign direct investment by developing special schemes and export-promoting strategies. These could include duty free imports and bank loans for investors constructing and renting new parks. **If the policy is unsuccessful, poverty will be exacerbated.**

Introducing incentives for both foreign and local businesses could foster an environment of cooperative competition.

Additionally, steps should be taken to ease the crowding out effects on businesses in priority industries that are outside the parks. For example, by creating a scheme to encourage knowledge flows from priority industry businesses inside the parks to those outside.