



Where are the Dynamics of Export Diversification in Ethiopia?

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Abstract

With the export promotion strategy, Ethiopia has tried to increase export earnings by exporting more in terms of volume and number of commodities. It has also formulated different strategies and undertaken various policy changes. Among such changes is the commitment to trade integration as revealed in existing trade negotiations. The export basket is dominated by coffee, but its share is shrinking because there are a few other new export items entering the exports basket, such as cut flowers, textile products and some processed goods. While Gravity Model is widely used to identify the determinants of trade, it is wise to employ product-destination descriptive matrix to analyze export diversification and identify the

relevant factors that practically influence Ethiopia's export performance. Based on the analysis for Ethiopia, the top 20 export commodities are contributing more than 80% of export earnings, but the performance of the new export items such as textile and textile articles is promising. Among the fastest growing exports, most of them are value added products such as vehicle parts, and the respective export earnings have grown by multiple times in 2013 compared to the value in 2004. At HS 6-digit level, among 316 New Products to Old Destinations (NPOD), 84 are from textile and textile articles and, though the values per each export are low, there are also 74 new exports in vehicles, aircraft, vessels and associated transport equipment. The major destinations of these dynamic products are the EU, North America, China, Middle East, Africa, and India. Thus, the major factors that play a pivotal role in the export performance and diversification in Ethiopia are institutional and structural changes, trade facilitation and export priority, infrastructure improvements, foreign firm participation, trade promotion and preferential market access, stretched objectives and declining bilateral trade costs.

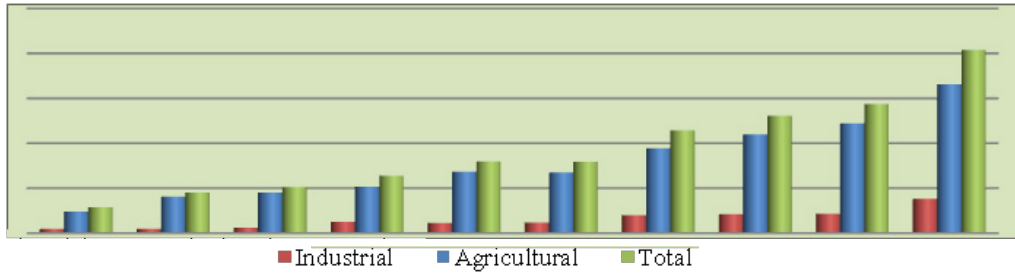
Keywords: *Export, Diversification, Ethiopia, Product, Destination.*

Background

Industrial development and trade policy of Ethiopia has given emphasis to labour-intensive agricultural development-led industrialization¹ and export diversification. Though its integration to the world economy is weak, its commitment is revealed through existing trade negotiations. Currently, Ethiopia is an observer in the World Trade Organization (WTO) and is undertaking regional and bilateral negotiations with different trading blocs (Ministry of Trade, 2011/12). Relative to the past, with such motives and objectives to increase exports, Ethiopia has carried out various trade facilitation activities and this has increased the quality and quantity of exports to the world market, which has motivated investment in value addition. Accordingly, the value of exports of agricultural commodities and industrial products has shown an increasing trend, as indicated in Figure 1, but the growth of agricultural exports is by far more than the industrial products in the ten-year period from 2004-2013.

In the history of Ethiopia's exports, coffee is the leading contributor to export earnings, but its share is declining due to new commodities entering the exports bundle, such as cut flowers and some processed products. As stated by Abay and Zewdu (1999) as cited in Tekaligne (2009), from 1966 to 1996, the share of export earnings of coffee was 59.0%, on average, and declined to 36.3% in 2007 while the non-coffee agriculture and industrial sector share of export earnings increased to 63.7% (Tekaligne, 2009). However, exports are still dominated by agricultural commodities, which is mostly confronted by price fluctuations in the international market.

1 Ethiopian government portal: www.ethiopia.gov.et

Figure 1: Trends of agricultural and industrial exports

Source: World Integrated Trade Solutions and author's computation

Ethiopia has dramatically diversified the number of export products/commodities from 52 in 2005 to 148 in 2013. UNCTAD (2014) stated the diversification index (modified Finger-Kreinin measure of similarity in trade) as whether the structure of exports by product of a given country or group of countries differ from that of the world, taking 1995 as a base year. An index value closer to 1 indicates a bigger difference from the world average (improvement). Thus, compared to 2005, Ethiopia's diversification index is showing improvement in 2013 and in comparison, to Land Locked Developing Country (LLDC), Least Developed Country (LDC) and East African countries' average (value closer to 0 means 'traditional' export). Besides, the concentration index, normalized version (Herfindahl-Hirschmann index) as per UNCTAD (2014) is a measure of the degree of market concentration. An index value that is close to 1 indicates a very concentrated market and a value of 1 implies only one product is in the export basket, while values closer to 0 reflect a more equal distribution of market shares among exporters and a value of zero means high diversification. Therefore, the concentration index of Ethiopia has slightly reduced in 2013 from 2005 value and thus it is better compared to LLDC and LDC average, Rwanda and Somalia. This could imply that Ethiopia has done better in diversifying exports.

Overview of trade policy environment

After ending its civil war, Ethiopia embarked on different economic policy changes starting from 1992 (UNCTAD, 2002). Among those changes, liberalization of trade policy, deregulation of prices and exchange rate, abolishing non-tariff barriers, and progressive reduction of import tariff are increasingly important in boosting the performance of exports. While formulating economic policy, trade especially through exports is a priority area and this is stressed in Ethiopia's Growth and Transformation Plan (GTP) (Ciuriak and Preville, 2010). However, its integration into the world economy remains weak as its application for accession to the World Trade Organization (WTO) before 13 years is not completed (UNDP, 2012) and it is not a member of any regional Free Trade Area (FTA) except COMESA Preferential Trade Area (PTA). According to Federal Negarit Gazet Proclamation No. 249/2001, exporters have

many incentives; no export tax except on few commodities, exemption of payment of custom duties and other taxes on imported and locally purchased raw materials for the production of goods for export; Franco valuta (no foreign currency is required from the bank) permit for imports of raw materials; and export credit guarantee and so on. Generally, Ciuriak and Preville (2010) also noted that Ethiopia is undergoing changes and availing different benefit schemes to improve Foreign Direct Investment (FDI) and its export performance. However, there are technical challenges in aligning different economic policy mixes.

The Ministry of Foreign Affairs of Ethiopia (2007), in its trade promotion manual, stated that the international trade policy of Ethiopia has three core objectives; the first is to develop and ensure export destinations for agricultural commodities. The second is to generate foreign currency to import capital goods, intermediate goods and services which are vital for economic growth and the third is to improve the competitiveness of domestic firms in the global market. The Ministry had also put in place three trade promotion strategic pillars that are important to accomplish the desired objectives. The first pillar is focused on a limited number of exportable products while the second and the third are providing any relevant support to exporters, and engaging in export promotion activities, respectively. However, the weakness of this trade promotion manual is that the second trade policy objective could not be met with the first core objective; that is, exporting agricultural commodities could not sustain and improve the terms of trade of Ethiopia where there are huge capital-intensive imports for accomplishing the country's vision to be a middle income. Thus, value addition could not be left out in any trade promotion of the country. Besides, the first strategic pillar of export promotion also focused on a limited number of commodities or products, but the other way round works better because of economies of scale advantage and importance of diversification.

Though its trading environment is vulnerable to higher logistics, trade and institutional costs, Ethiopia has made remarkable steps to streamline its policy and regulatory procedures and comply with the WTO trading principles (WTO, 2011). As a growing economy, it is required to accommodate fundamental changes in the global economy to boost competitiveness (UNCTAD, 2002). Moreover, Ethiopia has different bilateral agreements with many countries such as India; non-reciprocal market access to the European Union (EU) market under EBA; and the US market under African Growth and Opportunity Act (AGOA) and it is undergoing different multilateral trade negotiations with COMESA FTA, Tripartite FTA (TFTA) and the WTO. According to Ciuriak and Preville (2010), however, it did not utilize the existing opportunities that make its exports performance better than the existing volumes due to factors such as problems in the macroeconomic policy mix, high trade cost, lower level of private sector participation, inefficient service provision, thick borders and high tariff rates from its African partners.

International market prices for commodities and the impact

The major exports of sub-Saharan African countries such as Ethiopia are concentrated on primary agricultural commodities, which are mostly affected by price fluctuations in the international market (Deaton and Millier, 1995). Such problems induce many problems to these countries' budgets and income of households who are directly and indirectly employed by the exporting sectors. According to Deaton and Millier (1995), appropriate response mechanisms to price shocks are required to stabilize and adjust the shocks either permanently or temporarily. The important remedy for the problem, as suggested by many authors is diversification of products rather than 'sending' primary commodities.

The boost in the commodity prices since 2004 to 2008 has increased the revenue of exporting countries, but concerned different countries since commodity price fluctuations easily affect their budget; that is, after the budget has risen, it is difficult to lower it when commodity prices are lower or expected to decline since it has many economic, social and political implications (Medina, 2010). Raddatz (2007) as cited in Medina (2010) argued that among external shocks, commodity price fluctuations are the most crucial sources of challenges that low-income countries are facing. UNCTAD (2015) also stressed that due to a strong appreciation of the dollar, the commodity market witnessed a decline in the prices of commodities from its peak in 2011-12 until the first half of 2015. The report stated that the investment response to the commodity price boom in the 2000s and lower oil prices had a great impact on the declining trend of commodity prices due to the fact that as oil prices decline, it reduces the cost of production and increases supply of commodities, which finally reduces prices. As noted by UNCTAD (2015), developing countries such as in Africa are victims of slowing down of commodity prices since the trade structure of these countries is concentrated on primary commodities. In this regard, the challenges to Ethiopia are not exceptional rather very intense, especially on its trade balance.

Methodology and data sources

In this research, the descriptive approach is used to answer the research questions. This approach is important in explaining the dramatic increase in Ethiopia's exports and assessing the factors influencing the existing patterns of export diversification. The important area of descriptive analysis is made on exports diversification and growth in Ethiopia, which has two parts. The first is an analysis of the exports of old products to old/traditional and new markets/destinations, while the second is an analysis of the exports of new products to old/traditional and new markets/destinations (Steenkamp et al., 2009).

Conclusion and policy recommendations

With the current economic policy objective to attain a middle-income green economy, Ethiopia has provided more emphasis to diversification of exports central to its grand projects such as building industrial parks. Due to such promising objectives, exports have been growing since the 2000s, with some new exports entering the exports market. Though the share of commodity exports did not decline, there are new processed foods, vehicle parts and new commodities joining the exports market, which has helped to reduce the concentration of exports on a few agricultural commodities. In addition to product diversification, there are also few new destinations that products of Ethiopia have been exported to in the last decade, especially to African markets.

However, only 20 commodities are contributing 88.3% of export earnings in 2005 while it is 84.8% in 2013. This implies that the rest of the exports commodities were contributing less than 16% of export earnings in the last decade. Thus, though the performance of exports is better, it is swinging on a few commodities and any price shock can pull down export earnings and devastate the national economy.

Meanwhile, after 2004, Ethiopia has exported 28 new products to 28 new destinations. Among these destinations, 19 of them are African countries, indicating that Ethiopia is increasing its exports in Africa. The number of NPOD is 316 and the values of these exports to these destinations have increased from US\$ 2.2 million in 2005 to US\$ 927.7 million in 2013. The exports of OPOD has increased extremely, and these exports are greater in value compared to NPOD, NPND and OPND due to the reason that the products in the OPOD are already in that market. The major improvement in Ethiopia's exports is observed in textile and textile articles and, among the 316 NPOD, 84 are from textile and textile articles. Thus, what change applied in Ethiopia that provokes such improvement in exports is the question at hand. Based on the analysis made, the major factors that influence Ethiopia's progress in exports are institutional and structural changes, trade facilitation and exports priority, infrastructure improvements, foreign firm participation, promotion and preferential market access, stretched objectives and declining trade costs.

Therefore, the trade policy implication for Ethiopia is that product diversification is moving slowly, but the top 20 export commodities are still taking more than 80% of the exports share, indicating the need to have aggressive product diversification, which again requires the right policy mix. In this regard, as the software is human capital that moves the policy mix, it is vital to have a pool of quality experts in revising the trade policy and the exports strategy, and to negotiate favourable trade agreements. It is also important to emphasize that no agricultural commodity priority objective alone

can boost the terms of trade of a country without value addition. In line with this, agro-processing is an area of diversification, since the current exports of live animals, vegetables and horticulture-related commodities are on the top of the exports' basket. Also, availing cold storage facilities and refrigerated containers to exports of meat and meat products, milk products and horticulture products is essential.

While promoting exports, it is vital to promote and build the awareness and capacity of domestic producers or the private sector. This is because promoting exports of the producers and building their capacities will create informed exporters. Finally, it will be the private sector that covers the cost of promoting exports in the foreign markets. Moreover, it is vital to note that exports promotion is costly; however, it will be more costly to promote while the domestic supply-side constraints are persisting. That is, trade facilitation should be the major area of concern in increasing trade volumes and competitiveness.

Finally, exports of NPND are promising and many African countries are the new destinations for Ethiopia's exports, thus these new products could be better exported by improving the efficiency and the value adding steps of production. Besides, negotiating favourable trade agreements and joining regional FTAs such as COMESA FTA is unquestionable in diversifying exports products and destinations.

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