Challenges and Opportunities of Import Substitution: In The Case Of Intermediate Products

A Thesis Submitted to the Department Of Management in Partial Fulfillment of the Requirement for Degree of Masters in Executive Masters of Business Administration (EMBA)

By

Melkamu Tamrie Temesgen

Addis Ababa University

College of Business and Economics

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December 2019

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Advisor: Mesifin Fikre (PhD)

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Approval Sheet

This thesis, by Melkamu Tamrie, is accepted in its present form by the board of examiners as fulfilling for Department of Executive Masters of Business Administration (EMBA): "Challenges and Opportunities of Import Substitution: In The Case Of Intermediate Products".

Advisor

Full Name	Signature	Date
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Examiners

Full Name	Signature	Date
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Dedication

I, Melkamu Tamrie, declare that this paper entitled “Challenges and Opportunities of Import Substitution: In The Case Of Intermediate Products” is the outcome of my own effort and study and that all source of materials used for the study have been duly acknowledged. I have produced it independently except for the guidance and suggestion of my advisor.

Melkamu Tamrie

Signature _____ Date _____

List of Abbreviations and Acronyms

ADLI: Agricultural Development Led Industrialization

CSA: Central Statistics Authority

DBE Development Bank of Ethiopia

EPRDF Ethiopian Peoples' Revolutionary Democratic Front

FDI: Foreign direct investment

GDP: Gross Domestic Product

GTP: Growth and Transformation Plan

ICT: Information and Communication Technology

IDS: Industrial Development Strategy

IS: Import Substitution

ISI: Import Substitution Industrialization

LPI: Logistics Performance Index

TVET:Technical and Vocational Education and Training

WTO: World Trade Organization

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I would also like to dedicate this study to my father, Ato Tamrie Temesgen, and my mother, Emahoy Alemitu Mengiste, who passed away six years and three months ego respectively for their stimulating advice and guidance throughout my life.

Above all, I would like to thank the Almighty God for his blessing sin the day I born.

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Abstract

The general objective of this study is to assess the opportunities and challenges of import substitution in Ethiopia. More specifically, the study has tried to achieve the following specific objectives: to review the different policies, rules and regulations that are undertaken to stimulate import, to appraise the implementation of import substitution and its effectiveness, to describe the economic benefit of import substitution to the economy and to determine the role of manufacturing sector in relation to facilitating import substitution. Descriptive research design was used because it helps to answer the research question and assess, identify, and describe the problem at hand. The study also adopted mixed research approach which includes qualitative and quantitative research approaches to obtain the desired results of the study. The target population of the study is exporters, manufacturers, and government (public) workers. Therefore, the student researcher used interview using non-probability sampling approach, specifically convenient sampling technique by using those customers available in a certain time and place. Convenience sampling is used because it is a type of sampling where the first available primary data source would be used for this research without additional requirements. The study has found that bureaucratic red tape, the difficulty to get well trained labor, technological inferiority, shortage an frequent interruption of electric power supply are found to be the major challenges of import substitution industrialization. On the other hand, efficient road network, the developments of industrial parks, the presence of efficient and low cost telecommunication network, and the presence of various economic incentives are found to be the major opportunities of import substitution industrialization in Ethiopia.

Key words: *Import substitution, import substitution industrialization, Intermediate*

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Before studying the challenges and opportunities of import substitution, let us see the basic background concepts related to the topic under investigation. Regarding Import Substitution (IS), it is generally refers to a policy that eliminates the importation of the commodity and allows for the production in the domestic market. The objective of this policy is to bring about structural changes in the economy. The structural change is brought about by creating gaps in the process of eliminating imports and thus making investment possible in the non-traditional sectors (Clark, 1990).

In order to understand the import substitution policy of Ethiopia, it is necessary to understand the historical background of industrialization. The country has followed different economic policies based on the type of government in the power. For instance, during the imperial regime (up to 1974) including Emperor Haile Selassie, between 1958 -1973 three successive development plans were implemented to boost the development of industrialization and attract forging investors in the country. However, by the end of the industrial regime the overall, created very few employment and mainly owned by foreign nationals. (World Bank, 1985). During the Dergueregime, there was no specific industrial policy until mid-1980s, the Ten Year Perspective Plan devised for the year 1984/85 – 1993/94. The current regime has implemented various sub-sector strategies and by the successive development plans such as Sustainable Development and Poverty Reduction Program (SDPRP) 2002/03-2004/05, the Plan of Action for Sustainable Development and Eradication of Poverty (PASDEP) 2005/06-2009/10, and the first Growth and Transformation Plan (GTP I) 2010/11-2014/15 and the second Growth and Transformation Plan (GTP II) 2015/16 – 2019/20. The first development plan gave great emphasis to smallholder agriculture, while in the second and third ones the policy scope was broadened to encompass urban and the industrial sector development. The main emphasis of the IDS is to actively support the export-oriented and labor-intensive sectors. Various policy instruments were introduced to support and guide industrial development.

Historically, import substitution is a recent phenomenon. Import Substitution Industrialization (ISI) had its origins in the nineteen century. It was essential that domestic circuits be built in the economy and this could be achieved by protecting the domestic economy from the world economy. ISI had distinct origins in the different countries where it had been adopted. In some Latin American countries ISI was externally enforced. The interruption of shipping and the decline of non-military production in Europe and the US during World War II created severe shortages of manufactured goods in Latin America. This raised the relative prices of such goods and increased the profitability of IS industries. Textiles, food products and various light consumer goods industries were the principal areas of ISI (Torero, 1989). The situation that emerged, thus undermined the traditional acceptance of division of labor.

This study has attempted to investigate the challenges and opportunities of import substitution in Ethiopia through objective collection of both primary and secondary data from official sources such as Ministry of Trade, ERCA.

1.2. Statement of the Problem

In many developing countries, import substitution and export promotion are often encouraged through protective measures such as tariffs, quotas and export subsidies. The protection is even more complete when the immediate product and the intermediate input used in producing the product are isolated from foreign competition, and, if the domestic markets are competitive, the domestic resource costs (and prices) of the protected products may remain substantially below the price of imports (in domestic currency) (Prescott, 1983).

However, these policies are now seen to be more appropriate for large developing countries than small developing countries, for numerous reasons and it is felt that in these later countries, domestic industrialization polices may not encourage a competitive market structure. In a small policies may not encourage a competitive market structure and in a small country with limited market scales economies of scale may occur only to single firm industry.

At the beginning of the import substitution process, it is the consumer goods that are sealed off from foreign imports. The reason for choosing consumer goods sector is that the cost

disadvantage is comparatively less in this sector as compared to either capital goods or intermediate goods. Moreover, consumer goods are considered inessential for development and an increase in their cost will not affect other production units as would the capital goods and intermediate goods. The demand for consumer goods is assured, due to the growing population, whereas the demand for capital goods and intermediate goods would take place only as the development process is set in motion (Montijory, 1982).

Recently, Ethiopia has followed different policies and strategies directed at stimulation export trade in an effort to reduce trade deficit and to increase import substitution. The implementation of import substitution so far is not as effective as it supposed to be, as far as the knowledge of the researcher, due to many challenges. These challenges are mostly as the result of socio-economic situation of the country, social economic background of the country and the nature and structure of enterprises operation in the country. There are also positive outcomes achieved through import substitution industrialization. Therefore, this study has tried to investigate the major opportunities and challenges of import substitution in Ethiopia using both primary and secondary data.

1.3. Objective of the Study

1.3.1. General Objective

The general objective of this study is to assess the opportunities and challenges of import substitution in Ethiopia.

1.3.2. Specific Objectives

In order to achieve the general objective of the study, the researcher has tried to achieve the following specific objectives:

- To review the different policies, rules and regulations that are undertaken to stimulate import substitution in the country.
- To appraise the implementation of import substitution and its effectiveness.
- To describe the economic benefit of import substitution to the economy.
- To determine the role of manufacturing sector in relation to facilitating import substitution.

- ❖ To suggest important recommendations based on the research findings which can be used to facilitate the import substitution efforts of the country.

1.3.3. Research Questions

After the end this study, the researcher answered the following research questions using the research methodology selected. These questions are;

1. What are the different policies, rules and regulations that are undertaken to stimulate import substitution in the country?
2. To what extent the implementation of import substitution and its effectiveness?
3. What are the major economic merits of import substitution for the economy of the country?
4. What are the role of manufacturing sector in relation to facilitating import substitution?
5. What should be done in order to facilitate the import substitution efforts of the country?

1.4. Significance of the Study

Under taking this kind of study is very vital for different beneficiaries. The beneficiary of this study can be useful to the economy, to apply the outcome of the study to its effectiveness in implementing import substitution policies so as to create jobs for growing population of the country, saves foreign exchange, and narrowing trade deficit. Most of all this study is also useful to the student to practice the theoretical since in a practical manner.

It can also serves as a reference for the one who are undertaking the same topic or related fields. This study is also significant to others who want to understand and know about social marketing.

1.5. Delimitation of the Study

Conceptually, the study is delimited to studying the challenges and opportunities of import substitution in the country. In terms of time frame, the study is delimited in the past five years (2012 – 2017).

1.6. Organization of the Study

The thesis is organized in to five chapters which are sub-divided into small sections. The first chapter deals with an overall introduction and provides an overview of the entire study. The second chapter presents the theoretical backgrounds and empirical literatures.

The third chapter presents the study design and methods used in the study. This chapter encompasses discussion on type and source of data, sampling design, data collection instruments and procedure and data analysis methods. The fourth chapter gives brief summary of the data and analysis i.e., it deals with the descriptive analysis. Finally, the last chapter (fifth chapter) attempts to compare the result of this study with the previous research results, and concludes the result and forward relevant recommendations based on the findings.

CHAPTER TWO

RELATED LITERATURE REVIEW

1.6.1. Introduction

This chapter presents the theoretical and empirical literatures regarding the import substitution policy of Ethiopia and the role of manufacturing for the performance of import substitution and other related literatures. An emphasis on domestic economic activities that produce substitutes for imports has been a popular economic development strategy. Import substitution was established in many in less developed countries of the capitalist world to domestically produce those products for which foreign exchange was previously spent, and so to create employment opportunities for growing population. This chapter presents the definition of concepts, theoretical and empirical literature reviews.

1.6.2. Definition of the concept

Deferent scholars define import substitution differently. Chenery (1990) says it is domestic production of identical goods to replace foreign source of supply. He also defines import substitution with reference to the change in the proportion of imports to total supply (import plus total domestic population) and says substitution takes place if domestic production rises faster than imports.

Clark (1990) explains that import substitution is a strategy to create indigenous industrial base for domestic production of goods. It is a development process whereby less developed countries begin with domestic production of consumer goods and then move to produce intermediate and capital goods. However, such a sequence is extremely difficult to achieve in practice and majority of less developed countries have tended to get stuck at stage of production of consumer goods.

2.1. Ethiopian Industrial Policy

Industrial policy is a contested issue, especially for low-income countries. On one hand, it is widely accepted that these countries need proactive policies to master the transition from low-productivity resourced-based societies with large informal sectors to more productive, knowledge-based and formalized patterns of productive organization. On the other hand,

deliberate interventions aimed to channel resources into preferential activities may well end up reducing allocative efficiency and creating perverse incentives for investors and bureaucrats alike. This is especially true for low-income countries, where political checks and balances tend to be weak (Gebreyesus, 2008).

The Ethiopian government has demonstrated impressive dedication and ability to create the preconditions for a market-based and socially inclusive industrial transformation. It is strongly committed to investing in technological learning in order to build new competitive advantages. This becomes evident in ambitious programs to strengthen the Technical and Vocational Education System and to set up new universities as well as supporting institutions for specific sectors, e.g. for textile, leather and horticultural products. The government has defined priorities for diversification and industrial development. Agricultural demand-led industrialization and export promotion play a key role in its strategy. From 2004 onwards, the Ethiopian economy has grown at 11% annually. This growth, however, has mainly been due to favorable agro-climatic conditions, high coffee prices, considerable inflows of aid and remittances, and a boom in construction; it does not reflect increased competitiveness, and it has not yet prompted significant changes in the economic structure. The share of manufacturing in GDP stagnates at 5%, and still virtually all exports are unprocessed or at best semi-processed (USAID, 2007).

2.2. Import Substitution Industrialization (ISI) in Ethiopia

The recent policy of Ethiopian government focuses on import substitution and export led industrialization. Given the limited size of local markets and the need to generate foreign exchange, there is a clear focus on export industries. Export-led industrialization is also one of the lessons the government has learnt from the successful development of Taiwan and Korea. Again, the main emphasis is on high-value agriculture (horticulture) and agro-processing industries (leather products). Export industries benefit from favorable land lease rates, soft loans, tax incentives, subsidies for participation in trade fairs and international missions, and other services. Differential interest rates are offered for different products, e.g. horticulture projects qualify for soft loans, whereas the production of pulses for export does not. Following an “East Asian” approach, export targets are agreed upon for individual firms.

The case studies in Chapter 3 document political support for two exporting industries. So far export promotion has had limited success. Between 2003/04 and 2007/08, the total exports of three priority sectors (leather, textiles, agro-processing) increased from US$ 72 to 168 million. Exports thus remain marginal. What is more, the export share of these three priority sectors actually decreased from 12 to 11%. The policy bias in favor of exports has repeatedly been questioned. Critics argue that efficient import substitutions may have the same positive effects on the foreign exchange account; and, even more importantly, entry barriers may be much lower, as local entrepreneurs do not have to cope with international standards, economies of scale, and high transport costs involved in the export business. Then again, encouraging firms to export may have a number of advantages, especially in terms of technological learning (MoTI, 2009).

When it comes to modern industrial policy, governments formulate industrial policies in a participatory process that enables them to elicit information from private stakeholders in order to address specific market failures. This requires both close interaction with these stakeholders ('embeddedness') and independence in decision-making ('autonomy'), in order to avoid serving the interests of particular lobbyists (Evans, 1995).

Temporary incentives may be provided if they are necessary to trigger private sector responses that may generate positive externalities; but they should be phased out when there is evidence that the private sector does not respond as expected, or when market development takes off and generates sufficient response. In order to take these decisions, close monitoring and evaluation of policy performance is needed, and stakeholders should be invited to provide their feedback. Hence good industrial policies build on an evidence-based, participatory and transparent institutional learning process. Moreover, policymakers should make use of private service providers whenever possible, providing incentives if necessary, and encourage competition among service providers, rather than implementing each and every service through government channels.

Industrial policymaking in Ethiopia has advanced substantially over the last few years. Especially the institutional reforms of the Civil Service Reform Program are shiftingthe industrial policy system in the right direction. Some agencies under public ministries have

already been restructured in a way that makes them more flexible and responsive to the needs of the private sector. The Ethiopian Horticulture Development Agency, for example, was formerly a department of the Ministry of Agriculture and Rural Development, which made it difficult for the agency to react quickly and flexibly to the demands of the private sector. Now it has gained flexibility as an autonomous agency that reports directly to the president and is free to hire its staff independently.

As shown above, business membership organizations are weak, represent only a certain faction of the business community and lack political independence. Moreover, there are few other open spaces for interaction with non-state actors. There are no independent policy think tanks that are asked to bring in their expertise when strategies and programs are drafted. Moreover, the adoption of the Charities and Societies Proclamation in 2009 is expected to reduce the democratic space for civil society to participate in the policy dialogue. In sum, the government is only partly able to elicit information from the business sector and other social groups about the constraints that exist and the opportunities available. Industrial policies in Ethiopia are not yet evaluated systematically and independently. No rigorous evaluations of core institutions and programs are available. Although there are some reporting requirements, reports provide information on activities, rather than impacts, and are usually prepared by the implementing agencies themselves, rather than third parties. Monitoring and evaluation is increasingly built into some programs (e.g. the TVET system), but the government has not yet taken steps towards fully independent third party evaluations or open stakeholder processes. E.g. it was reluctant to accept a social monitoring component in the donor-financed Protection of Basic Services program (MoTI, 2009).

2.3. Challenges for ISI in Ethiopia

2.3.1. Socio-Economic Situation

With fast growing population, Ethiopia is the second most populous country in Africa, with a rapidly growing young population. It is one of the world's least developed countries, ranking in place 180 out of 187 on the Human Development Index. Ethiopia's GNI per capita is as low as US$ 280 (2008). In 2007, 39% of the population were estimated to live below the poverty line of US$ 1.25 a day (PPP) a considerable improvement compared to the 61% reported in 1995. Lack of basic education is a big problem, but, again, the government is

undertaking strong efforts to improve this situation. The percentage of the relevant age group that has completed primary education increased rapidly, from 22% in 2000 to 46% in 2007 (USAID, 2009).

Ethiopia is still largely agrarian. 85% of the workforce is engaged in the rural economy, mostly in agriculture. Agriculture accounts for 43% of GDP (down from 50% in 2000). Agriculture is dominated by smallholders, the majority cultivating less than 0.5 ha and producing mostly basic staples for the subsistence of their households. Farmers do not have property rights on the land they cultivate. While abolishing private land ownership was a measure to overcome the legacy of a highly polarizing feudal system, it also constrains investments in agricultural productivity. Despite some geographical disadvantages – dependence on irregular rainfalls, increasing soil erosion, aridity in some regions and pervasive tropical diseases in others – many regions of Ethiopia do have substantial agricultural potential, with different climate zones and relatively good availability of water. Agricultural productivity, however, is stagnating, and food security is a major concern. Several million people are once again dependent on food aid. Manufacturing has stagnated at about 5% of GDP over the last 20 years. The decreasing share of agriculture has been compensated for by a similar increase in services. Manufacturing industry is largely limited to simple agro-processing activities (sugar, grain milling, edible oil production, leather tanning) and production of basic consumer goods (beer, footwear, textiles and garment). Industries that might help accumulate technological capabilities and create dynamic inter-industry linkages – such as chemical, electrical and electronics, metal-processing and other engineering industries – are almost non-existent. Likewise, production of agricultural inputs is insignificant. Overall, the technological level of firms is very low, even by regional standards; e.g. only 4% of firms use technology licensed from foreign companies, and likewise only 4% have ISO certification (compared to 12% in both cases in Sub-Saharan Africa) (World Bank, 2007a).

The main export products are agricultural. Coffee, oilseeds, *chat*, pulses, flowers, skins, meat and meat products account for about 80% of all exports, with coffee by far the most important item. Some high-value horticultural products have recently been picking up. Manufacturing exports were as low as US$ 105 million in 2007, accounting for less than

10% of total exports. Basically all manufacturing exports are agriculture-based (clothing, canned and frozen meat, semi-processed hides, footwear, beverages, and oilcakes). On the import side, Ethiopia imports most capital goods and manufactured consumer goods, and the country is heavily dependent on fuel imports. In recent years, imports grew much faster than exports. Currently, exports finance less than 22% of imports (European Union 2009). Ethiopia therefore has a huge and rapidly growing current account deficit. When Eritrea ratified its independence in 1993, Ethiopia became a land-locked country. Although the port of Djibouti is not far off, and shipment through Djibouti is quite reliable, transport to the port is a significant cost factor. Adding to this is the administrative cost of trading across borders. In this regard, Ethiopia ranks particularly low (152 out of 181 countries) on the Doing Business Index (World Bank / IFC 2008). Since the end of the civil war and establishment of the current government in 1991, Ethiopia has shown steady progress. The economy recovered slowly during the 1990s. After a drought-related recession in 2002/03, economic growth took off, with an average of 11% during the subsequent five years. Per capita GDP increased from US$ 107 in 2003 to US$ 201 in 2007 (World Bank 2009). This growth has been fueled by inflows of official development aid, including soft loans from China and India, by remittances from the diaspora, and by foreign direct investment (FDI). Furthermore, Ethiopia has recently benefited from a series of good harvests. As a result of development aid and other inflows, public investment – primarily in roads, dams, education, and health – has grown much faster than private investment. This has spurred employment growth, but also provoked a foreign exchange crisis. Overvaluation of the birr has recently driven up inflation. It also undermines incentives for industrialization, because it benefits imports of simple consumer goods and increases the price of exports. Inflation is now expected to come down, but the current account deficit remains a major concern. In 2009 foreign exchange reserves were down to five weeks of imports (European Union, 2009), causing the government to ration foreign exchange, mainly for private investors, and to force coffee exporters to put their stocks on the market. Such interventions are likely to have a negative effect on future private investments.

2.3.2. Enterprise Structure

The vast majority of Ethiopia's firms are micro and small. According to the 2003 survey of the Central Statistics Authority, 1.3 million persons were engaged in the micro enterprise manufacturing sector, 94.2% of whom were own-account workers. Only 98,000 persons were employed in "small" (larger than micro) manufacturing enterprises. The micro and small firms sector of the economy is mainly a sector of self-employment. 55% of the micro enterprises in manufacturing activities produced food and beverages, 23% textiles and garments. 85% of the businesses in the small scale manufacturing sector are grain mills. Employment in informal micro enterprises is growing much faster than employment in the formal sector. Between 1999 and 2005, informal employment (defined as employment in firms with fewer than 5 employees) increased by 144% compared to only 16% in formal employment. By 2005, 71% of urban employment was in the informal sector (World Bank, 2009). In the last several years, the country has created central committees and teams more or less randomly to deal with the expanding policy scope. Starting with the monthly Export Steering Committee, which has so far worked well, the government has added two committees on infrastructure and a working team on import substitution policy. For the enhancement of the TVET system under the MSE strategy and the new task of kaizen institutionalization, inter-ministerial coordination is expected to take place in the Board of Directors established individually for these policies. Admittedly, these are ad hoc creation of coordination mechanisms whose complexity will accumulate as policy scope further expands. Policy support will be focused on industries that are labor intensive, have broad linkages with the rest of the economy, use agricultural products as inputs, are export-oriented and import substituting, and contribute to rapid technological transfer.

In 1950s and 1960s, most of the developing countries followed the IS (import substitution) policy for their economic growth. Since the mid-1970s, in most developing countries, there has been considerable shift towards EP (export promotion strategy). This approach postulates that export expansion leads to better resource allocation, creating economies of scale and production efficiency through technological development, capital formation, employment creation and hence economic growth. The export-led growth has been the focus of Ethiopian economic policy since 1992.

The foreign exchange earnings from exports allow the import of high quality intermediate inputs, mainly capital goods, for domestic production and exports, thus expanding the economy's production possibilities (Krugman and Obstfeld, 2006).

Thus formalized medium- and large-sized firms absorb only a very small share of the annual increase in the Ethiopian workforce, and the majority of new entrants to the labor market are forced to engage in own-account work. The Federal Micro and Small Enterprise Development Agency and international development agencies confirm that micro and small firms rarely ever grow into a medium-sized segment, reflecting a lack of entrepreneurial and managerial capability. When micro entrepreneurs are successful, they often prefer to diversify into new activities rather than to develop and expand their respective core activity. It is not clear to what extent this is a strategy to remain below the radar of public authorities. Labor productivity is extremely low, even by the standards of Sub-Saharan Africa (ibid.). As a result, medium-sized and large firms are barely developed. In 2002 Ethiopia had only 49 manufacturing enterprises with more than 500 workers, plus 225 small and medium sized manufacturing firms which employed between 51 and 500 persons (Ethiopian Economic Association, 2005).

2.4. Ethiopia's Recent Economic Performance

Ethiopia has achieved a remarkable and sustained economic growth over the past decade. The major sectors, including agriculture, industry, and services, have also shown unprecedented growth over the same period. The main drivers of this impressive economic growth have been the service sector and agriculture, in that order. The annual average of the service and agriculture sectors' contribution to GDP growth over the period 2005–06 to 2014–15 was respectively about 51.5 and 32.5 per cent. In contrast, the industrial sector contribution to GDP growth remained small at only 16.3 per cent (National Bank of Ethiopia, 2016).

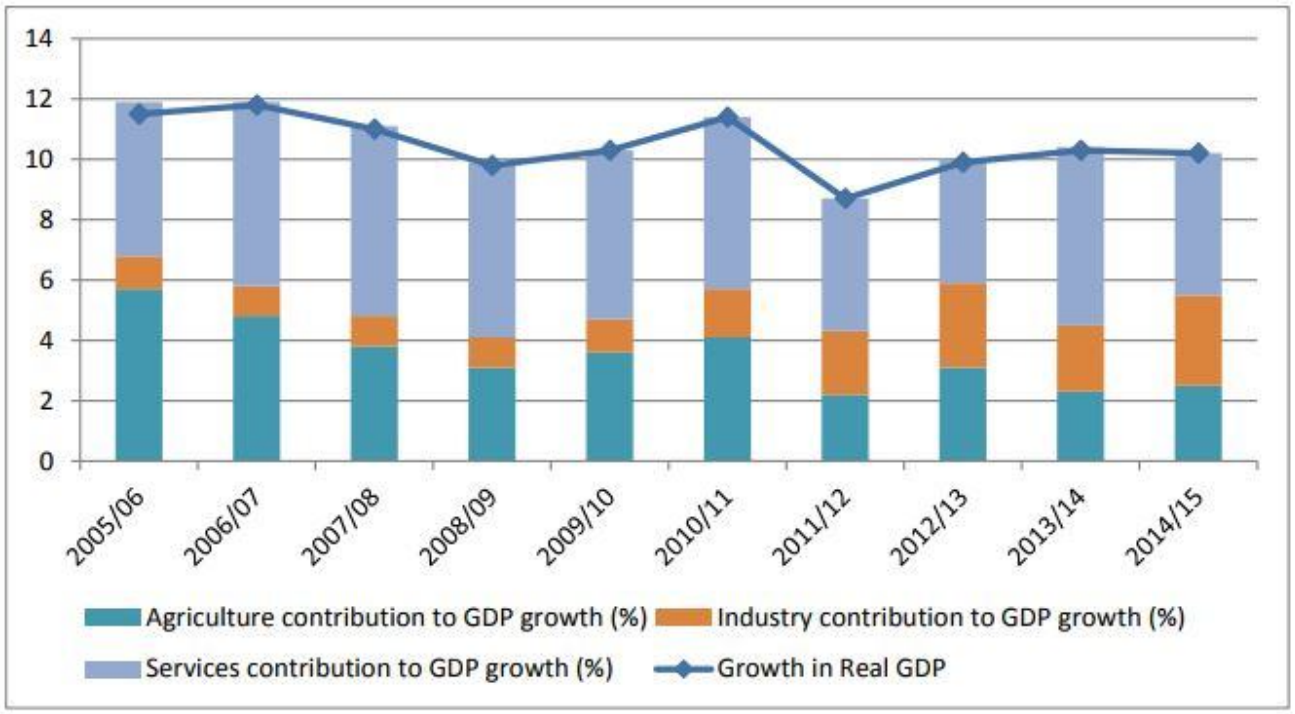

Figure 1: contribution of the different sectors to Ethiopia's real GDP growth, source NBE, 2016

Despite such rapid economic growth, the pace of structural transformation has been slow. Ethiopia's structure of output has shown a shift from agriculture to services. In 2014–15, the respective shares of the services and agriculture sectors to GDP was 46.6 per cent and 38.8 per cent. However, Ethiopia's industrial sector—which includes construction, manufacturing, mining, and utilities subsectors—remained underdeveloped and contributed only about 15 per cent of GDP. The contribution of the manufacturing subsector to GDP was only 5 per cent, which is very low even in comparison to the sub-Saharan Africa average.

2.5. Import substitution as an Approach to Industrialization

In many developing countries the policy of import substitution has occurred either as a normal process resulting from economic growth or as a deliberate policy to encourage industrialization with considerable government intervention. Historical studies show that at the early stage of development a country's import requirements will grow faster that its export as a result of economic development. Therefore, due to structural imbalances between

import demands and supply of foreign exchange, a natural incentive to avoid balance of payment difficulties encourage substituting domestic for imports. Increased taxation of international trade, especially at the low level of development, and taxing consumer goods conform to a development policy to mobilize resource for investment in an attempt to substitute domestic production for imports.

Chenery (1990) in his research concluded that industrial growth has three causes, substitution of domestic production for imports, growth in the final use of industrial products, growth in intermediate demand stemming for the above. He emphasized the effects of market size which is increased by either a rise in income level or population. When there are economies of scale in production, an increase in market size lowers cost of production and permits substitution of domestic products for imports. An increased in the size also affects output indirectly by increasing intermediate demand for other industries which experience import substitution.

Hirschan (2004) describes four different origins for industrial growth. Besides ware which can bring a strong impulse to industrialization, he emphasizes; import substitution in response to growth of domestic market (brought about by rising exports), import substitution as a (forced) result of balance of payment crises brought on by increased spending for development.

Deliberate intervention of the government to import substitution, may be induced by the numerous advantages that appear attractive at the beginning. Import substitution is initially attractive because it meets a demand that is already known and can be measured by existing imports. It offers the possibility of beginning with the easiest, final stage processes until more experience is gained with modern industrial technology. Local production of consumer goods provides visible evidence of self-reliance and can save foreign exchange (if it involves substantial contributions from domestic inputs including labor and capital, as well as raw materials), an additional attraction is that import substitution can be implemented through policies that protect domestic production and can be seen as a more toward economic independency and political stability.

2.6. Theoretical arguments for and against Import Substitution

The main objective of import substitution as a strategy for development are creation of employment opportunity for growing population, a rise in standard of living and improvement of the balance of payment situation. Economic independency, political stability, accelerated the rate of economic growth, minimize inequality in income distribution, increases in public saving and investment are other objectives of import substitution (Hirchan, 2004).

Since the Second World War, foreign exchange earnings of many less developed countries have been greatly reduced because for their part, rich countries import unprocessed raw material and food stuffs from poor countries which are subject to low income elasticity of demand and price. By contrast, when the income of poor countries rises at higher rates. This will change the terms of trade against less developed countries and lead almost automatically to a problem in their balance of payments. But, import substitution strategy will reduce the demand for imported manufactured goods and is a tactic to reduce foreign exchange needs of less developed countries by developing industries to produce substitutes for imports (Montijory, 1982).

Import substitution is often encouraged through protection measures such as tariffs and quotas to encourage industrial expansion, serving to attract local investment and stimulate domestic employment. The protection is even more complete where both the immediate product and the intermediate inputs used in producing the commodity are isolated from foreign competition. If the domestic market is competitive the domestic resource cost (and price) of protected products may remain substantially below the price of import (in domestic currency).But in small countries with limited markets, economies of scale often occurs only to a single firm and this does not encourage a competitive structure. Cost escalation may occur where single firm industries dominate the domestic economy and intermediate goods produced by monopolies are sold to single firms producing final goods. So the excessive prices of suppliers are reflected in the cost curves of the producers of final goods and services. Therefore, import substitution may be increasingly difficult to pursue under the conditions of domestic cost escalation (Prescott, 1983).

Contrary to expectation import substitution industrialization has often increased the economy's dependence on imported goods. Import substitution depends on at least in the beginning on import of capital goods and inputs in the form of semi-finished materials. This can cause a substantial drain on foreign exchange. On the other hand, failure to secure enough foreign exchange from exports leads to difficulties to import materials and parts for domestic production, and there will be recurring cries of underutilization of capacity and work stoppage. Therefore, a large number of people who leave their land to work in the manufacturing sectors remain unemployed (Hirschan, 2004).

The growth of luxury and semi luxury industries is one of the common features of import substitution which meets the demand of a small high income group and those consumers who previously could afford to by imported goods, and thus gives importance to what is unimportant. So the increased income that could generate saving is spent on non-essential commodities and this slows down the rate of economic growth.

Social problems also increases as a result of import substitution industrialization. When a country imports a large numbers of finished goods, inability of most domestic consumers to pay for them makes these goods unavailable to them and thereby lowers their standard of living. But as Mountijory(1982) argues, when these goods are produced domestically from imported materials and parts, inability to import such materials and parts will disturb the economy by reducing domestic income through work stoppage and cause severe output fluctuations in times of foreign exchange crises. It leaves the economy with a few large and relatively high cost industries.

2.7. Other countries Experience on IS

2.7.1. Indian Experience of IS

India adopted the strategy of ISI in the fifties. The chief objective was to build a self-reliant economy. From the Second Five Year Plan, there was a determined thrust towards substitution of basic and capital goods industries. The ISI strategy was based on the model of growth as propounded by Mahalonobis. The lopsided growth which was a legacy of the colonial period was sought to be set right by adopting ISI. Deficiencies which were

pronounced in the production of capital goods and basic intermediates were to be rectified by the import of machinery and critical intermediates. This was based on the reasoning that lack of industries producing investment goods could restrain high rates of investment and growth.

The Mahalonobis model stressed the significance of basic industries for growth; and long term patterns of growth were to be achieved by utilization of the products of these industries. Designing of time paths alone was not considered sufficient, but devising measures for achieving rates of saving and consumption patterns corresponding to these time paths, was also considered as an integral part of the strategy. The State was to play an active role in building a self-reliant economy, discriminating structure of protection was evolved to acquire foreign technology and for policies towards foreign investment. Import protection was to apply to new industries to give 'breathing space'. The infant-industry argument for protection was put forth.

Empirical researches suggested that in India, IS accounted for 33 per cent of industrial output growth in the First Plan and a major share came from capital goods and intermediates. In the Second Plan, IS accounted for 13 per cent of the output growth and this was contributed by paper, newsprint, petroleum products and electrical machinery. In the Third Plan, IS was 25 per cent of output growth and capital goods accounted for a major share. For the whole period 1950-51 to 1965-66 IS accounted for 23 per cent of output growth and capital goods accounted for half of it.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Research Approach and Design

As mentioned earlier, the general objective of the study was to assess the challenges and opportunities of import substitution in Ethiopia. In order to achieve this objective the student researcher used descriptive design because it helps to answer the research question and assess, identify, and describe the problem at hand. The study also adopted both qualitative and quantitative research approaches to obtain the desired results of the study.

3.2. Population and Sampling Technique

The target population of the study is exporters, manufacturers, and government (public) workers. Therefore, the student researcher used interview using non-probability sampling approach, specifically convenient sampling technique by using those customers available in a certain time and place.Additionally, convenience sampling is used because it is a type of sampling where the first available primary data source would be used for this research without additional requirements. In other words, this sampling method involves getting participants wherever you can find them and typically wherever is convenient.

3.3. Types of Data collected

Both primary and secondary data were used. The primary data werecollected from selected exporters, manufacturers, and public servants. Theseprimary data were collected through questionnaire.

Additionally, apart from the primary data, the secondary data were gathered from reports of CentralStatistical Agency (CSA), National Bank of Ethiopia, and from other books, internet, and previous researches.

3.4. Data Analysis Method

The researcher used both qualitative and quantitative data analysis techniques. The responses were collected from interviewwhich were analyzed by both quantitative approach,

tabulation of the results shows the number of responses to each question and percentage of respondents who gives each possible response to the questions, and the other questions were analyzed through interview are narrated qualitatively.

3.5. Validity and Reliability

Before the analysis of the primary data that was collected through semi structured interviews, analysis of the variables' reliability and validity of the constructs were done and verified. To ensure reliability of this research, the interview designed to measure the concepts in the theoretical model in a consistent manner. This implied that the research study could be conducted by other researchers to arrive at the same findings. The validity of the research is concerned with the measurement of the data collection process implemented regarding the quality of the study. It outlined the evaluation of the quality of both the primary and secondary data used in the research. To ensure the validity of this study, each question in the interview were designed to represent the concepts that are used in the study.

3.6. Ethical Considerations

All the research participants included in this study were appropriately informed about the purpose of the research and their willingness and assent will secured before the commencement of distributing questionnaire and asking interview questions. Concerning the right to privacy of the respondents, the study maintained the secrecy of the identity of each participant.

Chapter four

Results and discussion

In this section, primary data gathered from the respondents through structured semi structured interview is analyze and discussed.

4.1. Demographic Characteristics

Regarding the demographic characteristics of respondents, the following table summarize it in terms of sex, age, marital status, and educational level.

Table 4.1. Demographic Characteristics

Characteristics		**Frequency**	**Percentage**	**Cumulative percentage (%)**
Sex	Male	66	92.96%	92.96%
	Female	5	7.042%	100%
Age	18 – 30 years	8	11.27%	11.27%
	30-50 years	50	70.42%	81.69%
	above 50 years	13	18.31%	100%
Marital status	Single	23	32.39%	32.39%
	Married	48	67.61%	100%
	Divorced	-	-	-
	Widowed	-	-	-
Educational level	1-8 grades complete	-	-	-
	9- 10 grades complete	2	2.817%	2.817%
	Certificate	5	7.042%	9.859%
	Diploma	22	30.99%	40.849%
	Degree and above	42	59.15%	100%
Total		**71**	**100%**	**100%**

Regarding the sex of respondents, the majority of interviewees 66(92.96%) were males while the rest 5(7.042%) were females. Concerning the age of respondent, the majority of them 50(81.69%) were in the age range 30-50 years followed by above 50 years old.

Concerning the marital status of the respondents, 48(67.61%) were married and the remaining 23(32.39%) were leading single life. Concerning the education level of the interviewees, the majority of them 42(59.15%) were degree holders and above followed by diploma and certificate,22(30.99%) and 5(7.042%) respectively.

4.2. Policies, rules and regulations

The following section summarizes the major policies, rules and regulations in the country which directed at creating a strong manufacturing sector which enable import reduction and export promotion. For instance, since 2010, the country has devised and implemented the first Growth and Transformation Plan (GTP I) (2010/11-2014/15) and the second Growth and Transformation Plan (GTP II) (2015/16 – 2019/20). Based on GTP I, the industry sector has received utmost emphasis by way of encouraging export based and import substituting industries. Vertical and horizontal linkages between agriculture and industrial sector were planned to be promoted. The Government's program focused on strengthening the small-scale manufacturing enterprises, as they are the foundation for the establishment and intensification of medium and large scale industries besides creating employment opportunities and accelerating urbanization, it was planned to play supportive role for the development of the agricultural sector. The government also encourages medium and large scale industry expansion.

GTP II has also given to advance the import substitution industrialization effort in different sectors. For example, remarkable achievement has been registered in import substitution in the chemical sub-sector and particularly in the cement industry largely undertaken by the private sector during the planning period. Due to the booming construction industry, the demand for cement was so high that the country was forced to import a significant amount of cement from abroad. Import substitution in the metal and engineering industry was undertaken both by the private sector and public enterprises with encouraging results both in terms of substituting imported goods and building technological and industrial

capabilities.Generally, the GTP II also has given massive emphasis for the development of the manufacturing sector in an effort to facilitate import substitution industrialization in the country. The manufacturing industry or industrialization and structural transformation is critical for sustaining the gains so far and realizing the long-term vision of the country.

As a step forward to attract potential investors and pave the way for private investors, the government issued a liberalized investment code (Proclamation No. 37/1996), and later made a series of amendments (Proclamation No. 116/1998, 280/2002, and 375/ 2003) to make the environment more conducive for both foreign and domestic investors. Following the issuance of these liberalized investment codes, focal points both at national and regional level for promoting, coordinating and facilitating investment in the country were established. The Ethiopian Investment Agency (EIA) and regional investment bureaus are entrusted to facilitate the investment process.

The EIA, the focal point at national level, provides one-stop investment services such as the provision of all necessary information required by investors, approval of investment applications and issuance of investment permits, trade registration and operating licenses for private investors, granting of work permits to expatriate employees, approval and registration of technology transfer agreements between local companies and foreign technology suppliers, and facilitating the acquisition of land as well as utilities by private investors in accordance with the relevant federal and regional government laws and regulations.

Within the framework of the investment code, the government granted various incentives to both domestic and foreign investors who are engaged in investment areas eligible for incentives. The objective of the investment incentives is to encourage private investment and promote the inflow of foreign capital and technology into Ethiopia. Special incentive sectors and sub-sectors include agricultural development and agro-processing, agricultural production, manufacturing of equipment and machinery, spare parts, components and supplies, vehicle bodies, other products and assembly plants, and publishing of printed goods, large-scale road and building construction and other related works. Rural transportation facilities including the purchase of spraying machinery, trucks fitted with refrigeration facilities, or other equipment for support services are also eligible for special

incentive facilities. The investment incentive packages as described in the Council of Ministers Regulation No. 84/2003 include the following:

***Exemption from payment of customs duties*:** One hundred percent exemption from the payment of import customs duties and other taxes levied on imports is granted to all investment capital goods, such as plant and machinery, equipment etc. Also exempted are spare parts worth up to 15% of the value of the imported investment capital goods, provided that the goods are not produced and not available locally in comparable quantity, quality and price.

***Exemptions from payment of export customs duties*:** Ethiopian products and services destined for export are exempted from the payment of any export tax and other taxes levied on exports.

Income tax holiday: Any income derived from an approved new manufacturing and agro-industry investment or investment made in agriculture shall be exempted from the payment of income tax for a specified period. Profit tax holiday of up to five years is granted for investors based on industry type (new or expansion/ upgrading), level of export-orientation. An additional one year profit tax exemption is given if the investment is made in the under-developed regions like Gambela, BenshangulGumuz, Afar and Somali regional states.

- ***Exemption from payment of taxes on remittance:*** Any remittance made by a foreign investor from the proceeds of the sale or transfer of shares or assets upon liquidation or winding up of an enterprise is exempted from the payment of any tax.
- ***Loss carry forward:*** All investors investing in areas eligible for incentives are entitled, when their enterprises suffer losses during the tax holiday period, to carry forward such losses following the expiry of the exemption period for half of the income tax exemption period which could be from 3 to 5 years depending on the location and investment areas.
- ***Liberal depreciation rate:*** Depending upon the choice of the investor, either a straight line or an accelerated method can be employed for the calculation of depreciation allowances.

- ***Provision/allocation of land:*** According to the Urban Land Lease Holding Proclamation of 1993, the Government possibly will provide land with public tendering which is to be utilized for investment.

- ***Remittance:*** Both foreign and domestic private entities have the right to establish, acquire, own, and dispose of most forms of business enterprises with up to 100% equity ownership. Capital repatriation and remittance of dividends and interest is guaranteed to foreign investors under the Investment Proclamation. Any foreign investor has the right, in respect of an approved investment, to make the following remittances out of Ethiopia in convertible foreign currency at the prevailing rate of exchange on the date of remittance:

    - Profit and dividends accruing from an investment;
    - Principal and interest payment on external loans;
    - Payments related to technology transfer or management; agreements;
    - Proceeds from sale or liquidation of an enterprise;
    - Proceeds from the sale or transfer of shares or assets; and
    - Compensation paid to a foreign investor.

Another important factor is the development of industrial parks. Based on the Proclamation No. 886/2015, which states;

> *" … to accelerate the economic transformation and development or the country through the establishment of Industry al Parks in strategic locations to promote and attract productive domestic and foreign direct investment thereby upgrading industries and generate employment opportunity;*

According to Ethiopian Investment Commission (EIC) (2017) Ethiopia has given huge attention to boost Industrial park development. Investment area are open for the private sector (domestic and FDI). These industrial parks are located along key economic corridors, connected to ports by road and electric-powered railway lines with close proximity to high labor force pool. Enhancing economy of scale and efficiency through the development of specialized/clustered industrial parksgovernment provision of industrial park incentives targeted at increased export performance and competitiveness; Sustainability: maintaining

high environmental standards through the use of renewable energy and zero liquid discharge (ZLD) technology; - Vertical Integration: enhancing forward and backward linkages in the economy; and - Skills development and competitiveness: developing workers' skills for enterprise competitiveness.

The interview result showed that the policies, rules and regulations of the Ethiopian government are designed to support the import substitution industrialization. According to secondary sources such as Mulu (2012) unlike to many other reform policies that had to be agreed on with the international financial institutions, the industrial development strategy (IDS) was designed by the Ethiopian government and based on its broad development vision, known as Agricultural Development Led Industrialization (ADLI). In defiant to the neo-liberal advice, ADLI strategy advocates for a strong state role to guide the private sector in the development process. This has been reflected in a continuous updating of the priority sectors and policy instruments introduced to promote the selected sectors. Third, the government has shown extraordinary commitment and ownership. It exerted maximum efforts implementing the IDS through subsequent development plans and various sub-sector strategies. By providing a detailed assessment of the Ethiopian present industrial policy this study seeks to inform the ongoing industrial policy debate.

According to the majority of interviewees, industrialization is the base of import substitution. Therefore, the Ethiopian import substitution policy commonly involves attempts to restore, upgrade, and build missing production elements of the national economy, i.e., it has a predominantly vertical nature. However, without accompanying horizontal steps to promote the development of specific critical technologies and the emergence of new areas of knowledge, develop missing research competences.

4.3. The Implementation of Import Substitution Policy

4.3.1. Secondary Data Result

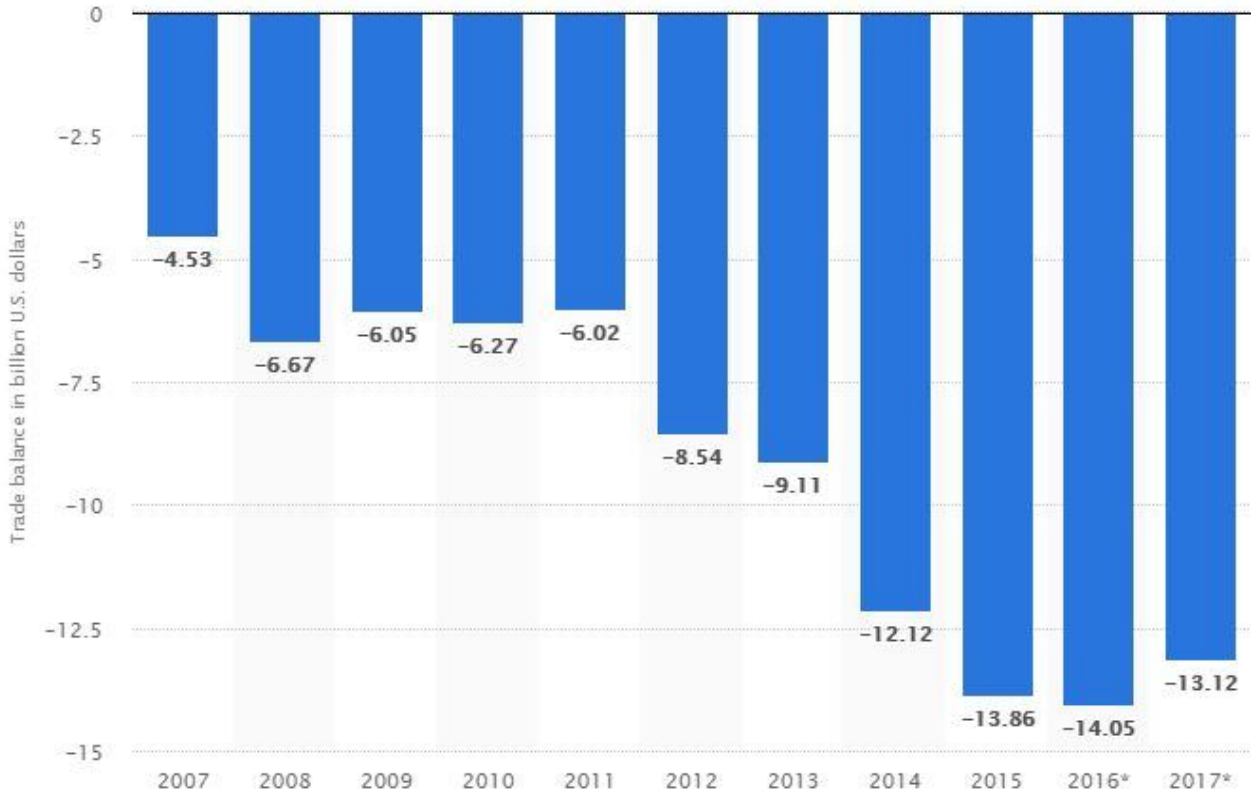

Figure 4.1. Ethiopian Trade balance from 2007 to 2017 (CSA,2018)

As shown in figure 4.1., the Ethiopian foreign trade balance has been in favor of imports than export. These broad trade gaps can be attributed by poor import substitution efforts and undeveloped export trade.

Based on the interview results, the interviewees express this condition (trade deficit) as an opportunity to be exploited by primarily the manufacturing industries through import substitution industrialization.

4.3.2. Primary data result

Similar to the above secondary data source, the interview source also showed that regarding the implementation of import substitution policy, so far the government has taken the

initiative to encourage local investors to manufacture imported products and it also has tried to attract foreign investment through its industrial parks and other similar measures

For example, regarding the establishment of industrial zones in different parts of the country has been considered as one strategic direction in the promotion of industrial development in the country. With this objective the government has taken a number of measures including furnishing the industrial estates with necessary infrastructures (e.g. roads, power, telecommunication, and water), organizing a responsible organ entrusted with the task of promoting and regulating this activity.

According to Mulu (2012), industrial zones are also perceived as one mechanism to attract foreign direct investment and the government has aggressively pursued this scheme. Recently, it allocated industrial zones to foreign investors on country cluster basis who promise to mobilize a large number of investors and engage in diversified but mainly export sectors. This scheme started to attract the interest of foreign investors; so far, exclusive industrial estates have been granted to Chinese, Indian, Turkish and Egyptian investors.

4.4. Challenges and opportunities of import substitution

4.4.1. Bureaucracy

Regarding the bureaucratic process for getting things done in different offices of the country had been criticized by the interviewees for being elongated and having redundant process and it also waste clients' time and cost by unnecessary delay.

As interviewee number [5] put it:

> *"… I have been working the importing business for more than 10 years. I purchase stationary materials from Dubai, India and Malaysia for resell in Ethiopia. Most of these products do not require high-tech industries to manufacture them locally. But, my plan to produce some of these products locally has been challenged, among other factors, by complex bureaucratic processes to get land for the plant I want to build…"*

Other respondents have also agreed that such problems are prevalent and create a situation test the patience of individuals who wants to substitute imported products.

4.4.2. Well trained labor

Regarding labor, most of the interviewees have agreed that there is an abundance of unskilled or less qualified labor in the country in general. The cost of these workers is also relatively low when compared with other countries in Africa.

Most of the interviewees reported that finding well trained and qualified professionals in the technology area is a pressing problem. Despite the country's investment in higher education, the majority of the interviewees agreed that finding the right person for the job which require practical and complex skill is difficult.

Typical example for this scenario, interviewee number [7] said the following:

> *" … I have been in the electronics materials importing business for a long time. Three years ago, I and my friends established a small scale electronics accessories industry to substitute some of the imported products. However, most of the positions were unable to be filled by local employees. We were forced to hire foreign employees with high cost. Due to this escalated cost and other reasons, the industry has stopped operating and we restart importing the products…"*

4.4.3. Technology

The other factor presented for the interviewees were the issue of technology in relation to import substitution. As to the well qualified workers, the technological development of the country, as to the respondents, poses a great deal of difficulty to substitute import products. According to the interviewees, technology is a key factor in an effort to produce imported goods. In today's situation, everything no matter how simple or small piece of technology, is imported from other countries.

According to interviewee number [8]:

> *"… Technology inferiority is the most pressing challenge to produce imported materials in the country. Personally, I doubt even the reliability of the existing local technology produced in the country due to their low quality..."*

The result also showed that high tech products are more dependent on imports than low tech products. The high tech products significantly relay on imported machinery, equipment, and services.

4.4.4. Infrastructure

Regarding the basic facilities, services, installations needed for the functioning of industries which are vital in the process of import substitution, most of the interviews have expressed their views as follow. The infrastructure heading focuses on electric and power supply and road network. Telecommunications status has been discussed in a new heading.

Electric power supply: according to the responses of the interviewees, most of them have reported that sufficient and reliable electric power supply is the backbone of import substitution process. The current condition in Ethiopia showed that the power supply is severely below the required amount for medium as well as large scale industries. The result also showed that despite the country's effort in building hydroelectric dams and other renewable power generation stations, the country still suffers from shortage of electric power supply.

Kaplan (2009) also argued that electric power supply is one of the modern requirements of manufacturing industries. Connection to electrical grids is vital to the existence of these industries. Electrical grids may vary in size from country to country based on the geographic size of the country and other important factors. The power transmission network will move the power long distances including across international boundaries.

Road Network: regarding the road network, the respondents believe that currently the country's road network is relatively better and connect a lot of places in the country which enable the transportation of raw materials and finished goods easy. According to the respondents, well established road networks support the overall development of manufacturing firms in the country in general and import substitution in particular.

Therefore, the result showed that currently, there is relatively an efficient road infrastructure which will ensure a big requirement for economic and social development through linking rural roads with major towns and cities which will help the import substitution significantly.

According to World Bank (2009) poor road infrastructure and high costs of transportation are among the major constraining factors for Africa's global competitiveness and economic growth. Poor road infrastructure also inhibits the establishment of manufacturing industries which in turn cause unbalanced foreign trade in favor of importing.

Ethiopia, as a landlocked country, has long recognized the importance of improving its transportation infrastructure to reduce the cost of doing business. A ten-year road sector development program (RSDP) was implemented in two phases from 1997 to 2007. The road development plan was extended up to 2010 under a third phase. A substantial part of these projects aimed at improving the connections with neighboring countries and particularly seaports. Huge investments had also been effected by the government for the development of the power and telecommunications sectors in the PASDEP period. The recent five-year Growth and Transformation Plan (2010/11-2014/15) (GTP), carries far more ambitious targets for the power and telecommunication sectors.

According to Grant-Makokera and Rantao (2012) the Ethiopian government currently spends 10 per cent of its GDP (about US$1.3 billion annually) on infrastructure which is by far the highest on the African continent in terms of share of GDP. Despite huge and continued investment in its infrastructure Ethiopia, as a landlocked country, still remained the most difficult places in the world from which to engage in the global economy because of the absence of a competitive network of global logistics. According to the World Bank Trade Facilitation indicators, Ethiopia ranked 123rd out of 155 countries in the world overall Logistics Performance Index (LPI) in 2009. The country is also among the lowest in terms of use of information and communication technology (ICT).

4.4.5. Telecommunications

Regarding the telecommunications, including internet service, the majority of respondents have reported that despite some inconveniences, the telecommunication infrastructure is one of the significant achievements of the country which is very helpful in the process of import

substitution industrialization. The respondents believe that telecommunication infrastructures have an important role for transmitting and receiving timely market and related information across different geographical boundaries including across continents. The need for timely, efficient, and reliable means of communication has being given enough attention by the government of Ethiopia. Therefore, the presence of efficient and low cost telecommunication network is one of the many opportunities for import substitution in in Ethiopia.

Some respondents, on the contrary to the above results, said that the quality of the services of the telecommunication and power sectors in Ethiopia is even more worrying and often attributed to the absence of competition. These sectors are not yet open for private sector and the government continues as a sole investor and provider of both services.

Similarly according to World Bank (2009) telecommunication is essential to today's smooth business operations. It includes the transmission of data and information from one point to another. Telephone, faxing, e-mail, the World Wide Web – none of these essential business service would be available without fast and reliable telecommunications. Therefore, the concept of electronic commerce would be impossible. Managers in various sectors can use telecommunication technologies for better controlling mechanism and better administration.

4.4.6. Economic incentives

Based on the interview some of the economic incentives that the government provides in order to encourage import substitution industrialization include: generous credit schemes, exemption from the payment of duties on import of all investment capital goods and raw materials necessary for the production of export goods, and tax holidays on profit for five years. Credit was made available for investors in the selected sectors through the Development Bank of Ethiopia (DBE). The government also uses the opportunity that land is under government ownership to attract investors and make preferential treatment to selected sectors such as the export oriented ones.

The interview result showed that the major reasons for continued importing of goods and services namely in pharmaceuticals, computers and electronics, medical equipment and instrument from abroad are; absence of substitute products in in local market, the

insufficient quality of local products, technologies, and services compared with their foreign counterpart and their inability to comply with customers ′ technological requirements act as powerful incentives to continued need for imported products.

4.4.7. Dependent on imported raw materials

As the interview results showed that the problem related supply of raw materials for manufacturing industries. According to these results from the interview, most of the raw materials for the manufacturing of goods in Ethiopia are dependent on imported raw materials. Such raw materials are imported by foreign currency. Which in turn affect the import substitution effort.

4.4.8. Absence of proper financing institutions for long term projects

Most of the time financing mega projects either private owned of government owned in our country is granted against collateral (give priority for fixed asset). Most financing institution mostly private banks focused on short term loans which can be easily managed on collection to minimize the risk of collectability and unable to cooperate with the government to strengthen the governments import substitution policies.

4.5. Summary of results on Major Opportunities for Import Substitution

- Ethiopia being one of the most populous nations, there is a huge unsatisfied domestic demand. High rate of population growth and continued urbanization, increasing demand for food, agricultural and manufactured products;
- Supportive legal, institutional and incentive environment that stimulate investors entering into investment ventures;
- Tax exemption privileges while importing required machinery and equipment, including tax holiday advantages. Facilitative legal, institutional and incentive environment that stimulates investors to enter into the sector; and
- High potential of enhancing national economic development and foreign exchange earnings.

- Availability of adequate workforce at relatively cheaper wages (payments);

4.6. Summary of results on Major Constraints for Import Substitution

- Inadequate working capital due to limited access to bank loan/credit for manufacturers for long term and mega projects.
- Finding well trained and highly qualified workers.
- Inadequate infrastructural facilities electricity around some processing plants and factories
- Underutilized capacity of manufacturing factories resulting in higher product costs exposing them to fierce competition against imported products;
- Absence of cooperation of working together among manufacturers dominated by individual efforts denying them a chance of bulk purchase and shipping practices that can minimize their costs and enhance their income;
- Mostly operate in obsolete manufacturing equipment and machinery;
- Most raw materials and inputs are imported with long lead time which tie up working capitals causing underutilization of manufacturing capacity of factories which may again raises costs of production and prices;
- Manufacturers are constrained by short pay back periods of loans and huge bank interest rates resulting in reduced cash-flow, profitability and may entail indebtedness; and
- Institutional arrangements do not seem yet in place to undertake such tasks that require higher level of professional and logistical responsibilities.
- Most chain actors are constrained by shortage of working capital
- Lack of provision of incentive mechanisms for quality differentiation which de-motivate producers to commit for quality products;

- Attitudinal problems of investors which importing of products for resale instead of manufacturing them locally.

4.7. Benefit of Import Substitutions

According to the responses of the interview, the benefit of import substitution summarized as follow,

- Employment opportunities and poverty reduction,
- Support sustainable development of agriculture,
- Full utilization of industrial capacity,
- Use of domestic raw materials and labor
- Create a strong foundation for the industrial sector to start playing a leading position in the national economy,
- Employment generation, and foreign exchange earnings and savings and local production of equipment's, machinery and spare parts

Chapter five

Conclusion and Recommendations

5.1. Conclusions

Based on the interview data collected and secondary data sources, the following conclusions are drawn.

- Lack of giving due attention by the government industry policy in producing industry raw materials in the country which can alleviate foreign currency shortage problems.
- The Ethiopian import substitution policy commonly involves attempts to restore, upgrade, and build missing production elements of the national economy. However, without accompanying horizontal steps to promote the development of specific critical technologies and the emergence of new areas of knowledge, develop missing research competences, it is hard to achieve import substitution industrialization.
- The government has taken the initiative to encourage local investors to manufacture imported products and it also has tried to attract foreign investment aggressively through its industrial parks and other similar measures.
- Bureaucratic red tape, the difficulty to get well trained labor, technological inferiority, shortage an frequent interruption of electric power supply are found to be the major challenges of import substitution industrialization.
- On the other hand, efficient road network, the developments of industrial parks, the presence of efficient and low cost telecommunication network, and the presence of various economic incentives are found to be the major opportunities of import substitution industrialization in Ethiopia.

5.2. Recommendations

Based on the result of the study, the following recommendations are forwarded.

- The government should implement a reward system or quality control to encourage better quality products, and impose heavy duties for products below standards of the country.
- To address well skilled manpower the government should consult with industries to identify the key skilled manpower required for this subsector and then by to encourage training high skilled individual through its high institutions.
- To reduce dependency on imported raw materials, private companies and other stakeholders should invest in the local raw materials supply chain, by sourcing locally for their manufacturing.
- So as to enhancing access to finance the government should alleviate the problem of shortage of finance to fund capital goods, raw material purchase and capacityenhancement tasks through using both its own financial institutions and encouraging private financial sectors.
- Since the study found that electric power interruption and insufficiency is the major infrastructural challenge for import substitution industrialization, the government should invest more on electricity power generation and should encourage private sectors to participate in electric power generation and supply.
- Regarding the bureaucratic red tape and corruptions: the government should try to resolve bureaucratic procedures required to accomplish any investment and incentives related activities and rent seeking behavior of some civil servants in major service providing public institutions to encourage import substitution industrialization.

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Appendix 1: English Version of the Interview Guide

ADDIS ABABA UNIVERSITY

School of Graduate Studies

Faculty of Business and Economics

Department of EMBA

Interview Guide

This interview guide is designed for the purpose of collecting data for conducting study on assessing challenges and opportunities of import substitution. You are politely requested to provide the required and correct data as requested because it has a great role for the attainment of the objective of the study. The information that you provide is only for academic purpose and therefore all information provided shall be treated with maximum caution and confidentiality.

Thank you for your cooperation in advance!

Part –I: Demographic profile

1. **Sex _____**
2. **Age** 18 – 30 years ☐ 30-50 years ☐ above 50 years ☐
3. **Marital status**
    1. Single ☐
    2. Married ☐
    3. Divorced ☐
    4. Widowed ☐
4. **Educational level**
    1. 1-8 grades complete ☐
    2. 9-10 grades complete ☐
    3. Certificate ☐
    4. Diploma ☐
    5. Degree and above ☐

Part -II: general questions about the organization

1. What do you think the major achievements of Import substitution rules and policies in the country so far?

   _____

   _____

   _____

   _____

2. What could be the benefit of import substitution for different stakeholders in the country?

   _____

   _____

   _____

   _____

3. In your opinion, what are the major challenges for import substitution?

   _____

   _____

   _____

4. What are the opportunities for import substitution in Ethiopia?

   _____

   _____

   _____

   _____

5. What do you think the economic benefit of import substitution?

   _____

   _____

6. In your opinion what should be done to encourage import substitution industrialization?

   _____

   _____

Appendix 2: Amharic Version of the Interview Guide

አዲስአበባዩኒቨርሲቲ

የድህረምረቃትምህርትቤት

የንግድናኢኮኖሚፋክሊቲ

የኢ.ኤም.ቢ.ኤትምህርትክፍል

የቃለመጠይቅመምሪያ

ይህ የቃለ መጠይቅ መምሪያ //የተዘጋጀው ከውጪ የሚበቡ የተለያዩ ምርቶችን በሃገር ውስጥ ለማምረት ተግዳሮቶችንና መልካም አጋጣሚዎችን ለማጥናት ታስቦ ነው፡፡ በመሆኑም እርስዎ ለዚህ ጥናት የሚሰጡት ማንኛውም መረጃ የጥናት አላማውን ለማሟላት ከፍተኛ አስተዋፅኦ ስለሚኖረው ከዚህ ቀጥለው ለሚቀርቡት ጥያቄዎች ተገቢውንና ትክክለኛውን መረጃ እንዲሰጡኝ ስል በትህትና እጠይቃለሁ፡፡ የሚሰጡትም መረጃ ለጥናቱ አላማ ብቻ የሚውልና ለሌላ ሶስተኛ ወገን የማይተላለፍ ይሆናል፡፡

ለሚያደርጉልኝ ትብብር በቅድሚያ አመሰግናለሁ፡፡

ክፍል 1፡ ግላዊመረጃ

1. ዕድሜ _____

2. እድሜ ☐

ሀ. ከ18 – 30 አመት ☐

ለ. 30 – 50 አመት ☐

ሐ. ከ50 አመትበላይ ☐

3. የጋብቻሁኔታ

ያገባ/ች ☐

ያላገባ/ች ☐

የተፋታ/ች ☐

ባለቤቱ/ቷ የሞተበት/ባት

4. የትምህርትደረጃ

1 – 8ኛ ክፍል ☐

9 – 10ኛ ክፍል ☐

ሰርቲፊኬት ☐

ዲፕሎማ ☐

ድግሪናከዚያበላይ ☐

ክፍል 2፡ ስለድርጅትዎ አጠቃላይ ጥያቄዎች

1. ከውጪ እየገቡ ያሉትን ምርቶች በሃገር ውስጥ የመተካቱን ሂደት ለማበታታት የሚወጡ ህጎችና ፖሊሲዎች እስካሁን ምንምንሚናነበራቸው ብለው ያስባሉ?

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2. እስካሁን ከውጪ እየገቡ ያሉትን ምርቶች በሃገር ውስጥ መተካት ለተለያዩ ባለድርሻ አካላት ምን ምን ጠቀሜታዎች ይኖራቸዋል?

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3. ከውጪ ወደሃገር ውስጥ የተለያዩ ምርቶችን ያስገባሉ?

የሚያስገቡ ከሆነ፣ በሀገር ውስጥ ለማምረጥጥረት አድርገው ያውቃሉ?ለምን?

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4. ከእርስዎ ግላዊ ልምድ ወይም ከሌሎች ከሚያዩት ነገሮች በመነሳት፣ ከውጪ እየገቡ ያሉትን ምርቶች በሃገር ውስጥ የመተካቱን ሂደት ምን ምን ተግዳሮቶች አሉበት?

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5. ከእርስዎ ግላዊ ልምድ ወይም ከሌሎች ከሚያዩት ነገሮች በመነሳት፣ ከውጪ እየገቡ ያሉትን ምርቶች በሃገር ውስጥ የመተካቱን ሂደት ምን ምን መልካም አጋጣሚዎች አሉት?

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6. በአጠቃላይ በሃገራችን ያለው ከውጪ እየገቡ ያሉትን ምርቶች በሃገር ውስጥ የመተካቱን ሂደት ላይ ምን አስተያት አልዎት?

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በድጋሜ ስለተባበሩኝ አመሰግናለሁ።።