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The Role of Government policy package in boosting Export - A Comparative Study of Ethiopia, South Korea and Vietnam

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Abstract-*Ethiopia mostly exports agricultural products such as coffee, Gold, leather products, and oilseeds and imports higher valued capital goods .The country runs a severe balance of trade deficit, because the return from exports is far less than the expense needed for the imports. This export and import unbalance leads the nation to the instable export and weak macroeconomic management due the depletion of foreign currency, eventually the nation is forced to look for additional finance to cost of its imports. Lack of own financial source has led the country to the development of a significantly sized external debt.. this paper tried to answer the main problems that why Ethiopia's export is too weak in the past decades, to see how korea and Vietnam has become successful in boosting export, how is the link between private sector and government regarding financial credit, how much FDI is important in export growth as well as what can be done to improve the nation's export performance. In this paper Herfindahl index, trend analysis and SWOT analysis models has been used for three country case. After analyzing this paper there is finding that revealed the Ethiopian economy remains highly dependent upon coffee production; during 1995 to 2010, coffee accounted for an average of about 44 percent of the country's total value of exports, both FDI inflow and the role of private sector in the export sector economy is too low compare to South Korea and Vietnam. To solve those problems found in this paper , Ethiopia should promote export through encouraging FDI, by setting multi incentive and introducing EPZ, badly encouraging domestic private sector by supporting through financial instruments.*

Key words: *Export concentration, Role of private sector, Export promotion, market seeking FDI and Economic growth.*

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1 INTRODUCTION

1.1 Background of the Study

The Ethiopian economy remains highly dependent upon agriculture mainly coffee production with 25 percent of the population deriving its livelihood from this agricultural product. Coffee accounted for an average of about 44 percent of the country's total value of exports during 1995 to 2010. Gold, leather products, and oilseeds constitute some of the country's other important exports. The current government has embarked on a cautious program of economic reform including privatization of state enterprises and rationalization of government regulation. While the process is still going on, so far the reforms have attracted only meager foreign investment.

Ethiopia‘s export is tiny fraction of the GDP due to dominancy of less diversified and less productive agricultural products. Also the yield of agriculture is highly plagued by various factors which include periodic drought, underdeveloped water resources and poor, infrastructure & expensive transport for supply of goods to market. Eventhough Ethiopian Agricultural sector is not modernized, yet it is the source of country’s most promising resources. More over potential exists for self-sufficiency in food security and for export development in livestock, cut flowers, grains, oil seeds, sugar, vegetables and fruits and large mineral resources which are hardly exploited yet. Being dependent on a few and vulnerable agricultural products for its foreign exchange earnings and spending much on oil import, Ethiopia is suffering a severe lack of foreign exchange while simultaneously battling high inflation. The economy is highly subsistent and therefore struggles to meet the budget requirements for drought relief in addition to realizing growth.

In general, Ethiopia has many problems which hurt its export expansion and economic growth. The most important problems in the country related to this research are discussed below. Low levels of productivity and living which resulted in low income lead to low investment in education and health as well as plant and equipment manufacture and in overall infrastructure development. This in turn led to low productivity and economic stagnation. Problems intertwined one with another could be listed as follows. These include dependence of export on primary and traditional sector products and their low volume of supply, land lockedness of the country; under developed financial and other markets, low levels of private sector’s role in sectors with exportable and value added products in the economy, low saving or capital formation share of GDP, low level of financial service facility for the private sector, low administrative and financial support, low inflow of FDI in the country and a few engaged in service and non-exportable industry. All these lists of issues are supposed to be a good research problem; however this paper does not address the entire set of problem listed here due to time and resource limitation. However, the overarching of the problems mentioned above are investigated and discussed in details using different models.

1.2 purposes of research and question

Since 1992 the government of Ethiopia has introduced a variety of reforms aimed at improving macroeconomic stability, accelerating economic growth, and reducing poverty. Tariffs have been cut, quota constraints relaxed, licensing procedures simplified, foreign exchange controls eased, compulsory grain delivery and forced membership to cooperatives discontinued. Privatizations have been introduced where private banks officially authorized, interest rate control deactivated, and an inter-bank money and foreign exchange market introduced.

The nation has also introduced foreign direct investment policy in some sectors though still there are some restricted sectors. The current regime is working towards changing economy from its command nature to market based. Despite these facts mentioned, still Ethiopia's export sector is too weak eventhough there is annual increase in absolute terms in the past 5 years. Potentially it would have been by far better than its current position. Ethiopia's total exports were higher than that of Vietnam in the 1981 but now have become just a tiny fraction: $2 billion in Ethiopia versus $65 billion in Vietnam in 2010.

1.3 Objectives of the research

The main objectives of the research is to determine the main issues that are hampering Ethiopia's export sector, in both policy aspects and productivity issues determined by volume effects

To analyze the main reason for Ethiopia to lag in export performance compared to countries with almost poor condition in the past, i.e. Ethiopia was much better exporters of merchandizing products than South Korea in 1960 and also larger exporter than Vietnam in 1981.

To compare the relevant policy issues which have been used by Vietnam and Korea in respective of Ethiopia, and finally to forward policy issues and strategies that will improve the country's export based on lessons of the comparison.

1.4 Methodology

In this research various methods are used to analyses the export determinants of three country cases basically through comparative analysis using Herfindahl index, trend analysis and SWOT analysis. In addition to these tools the paper includes reviews about the role of government in promoting export in three country cases. Due to the different government and country situation different implementation mechanisms has been used but policies are somehow similar. Finally data for this paper has been entirely taken from international data base like

IMF, WB development indicator, government websites related to the export and investment, UNCOMTRAD, UNICTAD, and various publications.

1.5 Organization of the research

This paper is organized as follows ; chapter two addressed , back ground of export performance in three country chapter three addressed about literature review regarding the variables used in this analysis; chapter four addressed comparative analysis and discussion of results, chapter five deals with conclusion and policy implication for the country’s export growth and how to address export promotion.

Background

2.1 Export Performance And Promotion Policies in Ethiopia

Like other African countries, Ethiopia has faced deep rooted structural problems, weak policy frameworks and institutions, protection at domestic level and abroad for a long time. For instance, in 1983 the Provisional Government of Socialist Ethiopia noted that the basic constraints for Ethiopian exports include the low volume of exportable products, the limited degree of diversification of exports mainly due to unprocessed primary products, frequent economic crisis which substantially reduce the demand for and prices of primary products, artificial trade barriers by trading partners etc. (cf. Abay and Zewdu 1999). Moreover, after the downfall of the Derg regime, the Transitional Government of Ethiopia stated that “it is essential to increase and diversify exports” (1991: 33, as cited in Abay and Zewdu 1999).

Owing to this policy shift some improvements in export performance have been registered. Trade statistics show that export earnings have increased during the post reform period. According to the Ministry of Trade and Industry (MOTI), the real value of export earnings increased from ETB 5 billion during the first six year period of the Derg regime (1973-1978) to ETB 39.7 billion in the last six years of the EPRDF regime (2000/1-2006/7) (Abay and Zewdu, 1999). Regarding the composition of exports, until the 1990s the Ethiopian export sector could be characterized as a ‘three-commodity sector’ consisting of coffee, hides and skins, and oilseeds and pulses. Between 1966 and 1996, on average 59% of the country’s export earnings came solely from coffee (Abay and Zewdu, 1999). According to MOTI data, although coffee is still the dominant export item, since 2001/02 its contribution to total export earnings has declined to 36.3% in 2007 and it became 30 % by 2010. On the other hand, the share of non-coffee agricultural exports and major manufacturing export commodities (leather and leather products; textile; and agro processing products) has increased remarkably. However, Ethiopia’s share in total world exports is still very low, amounting to 0.01% in 2006 (WTO, 2007). In this regard, Alemayehu (1999) and Abay and Zewdu (1999) argue that Ethiopia's external trade has major problems both on the supply side – due to its dependency on few primary products characterized by large fluctuations in volume; and a very high degree of concentration of exports on few commodities. On the demand side – a low income elasticity for the type of commodities that Ethiopia exports, declining prices for its exports, and limited destinations for Ethiopian exports. Both supply and demand side problems are typical African problems: For example, more than 50% of African countries' export earnings are derived from only three principal commodities such as coffee, tropical beverages and cocoa (Alemayehu, 2006).

2.2 Export performance and promotion measures of south korea

South Korea has shown rapid economic growth since the 1960s. The government has provided various incentives to promote exports, expecting export-led economic growth. Export values increased from US$87 million in 1963 to US$17.5 billion in 1980, and then to US$363.5 billion in 2009. Export expansion has been believed to be possible by aggressive export promotion (EP) policies, in particular in the early stage of economic development. The Korean government provided tax and financial incentives in addition to incentives such as establishment of organizations to promote exports. Thus, the experience of economic growth of Korea has been regarded as an example of pursuing the export-led economic growth strategy. By the early 1960s, the Korean government had pursued import substitution policy. In 1964, the government announced pursuing export promotion policies with the slogan "Export Number One", i.e. export promotion is the most important policy. The government began to increase the amount of export subsidy, placing emphasis on exports of the products of the labor intensive Light Industries (LI), in particular textile and garment industry where the Korean economy had a comparative advantage. The government introduced 50 percent reduction of profit tax relating to exports and export finance schemes at low interest rate in 1964. Exchange rate devaluation introduced continually. Under the export-import link system, the government granted the exporters the right to use foreign exchange necessary for imports, which was intended to promote exports under the situation of extreme foreign exchange shortage. The government developed land sites for industrial complexes and provided them cheaply to the firms entering those businesses. Together with various tax and financial measures to promote exports, the government established the institutions to support EP. During the 1970s, the main drive of the industrial policy of Korea shifted from the LI to developing the high value-added. The government chose iron and steel, non-ferrous metal, shipbuilding, electronics and chemical industries as the most important HCI. The share of the HCI in all industries increased from 23 percent in 1960 to 39 percent in 1970, and then to 54 percent in 1980.

Export promotion instruments in South Korea

The EP measures of Korea have comprised tax incentives, financial incentives, establishment of free trade zones and the supporting organizations. The government provided huge amount of subsidy to promote export-related industries. The export subsidy ratio of Korea during the aggressive EP period, i.e. the mid-1960s to the early 1980s. Among export measures the followings are strongly used in the Korea's development period. **Tax incentives**: In December 1961, the Tax Exemption and Reduction Control Law began to provide export firms with tax deduction measures, again the Tax Exemption and Reduction Control Law amended in 1975 granted investment tax credits and accelerated depreciation to designated key industries. **Policy loan**: The government control of interest rates provided the strategic industries preferential access at subsidized interest rates. As a result of the HCI drive in the 1970s, the HCI sector not only had better access to capital, but also faced significantly lower average borrowing costs. The export industries enjoyed preferential access to capital.

Export financing: Export finances have been provided to exporters in various stages of export-related activities since 1961. The export finance system is one of the currently used export promotion measure in Korea. The Korea EXIM Bank has lent to the export firms. Export finance covers mainly capital goods, such as industrial plant, machinery, and ships. As of 2009, lending of up to 100 percent of contract value is available provided that the minimum foreign exchange earnings ratio is not less than 25 percent.

Export insurance: The export insurance scheme (Fund) was introduced into Korea in 1969 under the Export Insurance Act to help exporters increase their exports by protecting them against losses.

Free trade zone: FTZs are exclusive areas outside the national customs boundary, exempt from customs requirements, upon request from regional governments. Activities in the FTZs are subject to streamlined import procedures and exemption from import tariffs, and receive tax relief, e.g. value-added tax and reduced corporate tax. Foreign cargo may enter and leave freely from the FTZs. Since Korean goods entering the FTZs are treated as exports, they are entitled to duty drawback.

Export promotion agency: In Korea, Korea International Trade Association (KITA) and Korea Trade Promotion Corporation (KOTRA) have worked as the institutions helping firms overcoming the export barriers such as the motivational, informational, and operational/resource barriers.

2.3 Export performances and trade reform in Vietnam

Doi Moi innovation (1986-1996)

Doi Moi was the beginning of great changes in the Vietnamese economy, during a time when the country still was a part of the communist world. It included institutional and structural changes and a development towards market economy. In the long run, the reforms had mainly two broad economic effects; Vietnam became outwardly oriented instead of focusing on import substitution and changed from a centrally planned system into a market economy. The reform meant that state-owned enterprises could make own price decisions instead of using prices fixed by the state. Furthermore, companies became free to decide over inputs used. These two reforms were combined with a hardening of the soft budget constraints and an increasing pressure for efficient use of the available resources. As a consequence, the general level of competition in the economy increased. Naturally, so did efficiency. Moreover, the view on private enterprises started to alter in a liberal direction. Profits generated were no longer confiscated and the owners got power to decide over fundamentals such as labor and salary (Hakkala & Nilsson, 1997:20-22).

Doi Moi also had great impact on trade policy. Before 1989 the system of trading rights were characterized by state monopoly (Thanh 2005:77). Now the state started to abandon the monopoly of trade and change import substitution towards export oriented policies. The policy of export subsidies was launched. Export quotas were replaced by tariffs and the number of goods concerned was decreased. Export zones were introduced. Between 1989 and 1991, Exchange rate reforms were carried through. Among other things this meant that one single exchange rate replaced many different rates, which made trade costs easier to calculate (Hakkala & Nilsson, 1997:28-29). These changes combined made it easier for companies to export.10 years after it was launched, Vietnam experienced extraordinary GDP growth rates, on average almost 10 percent per year. Despite this, inflation had been successfully reduced. Further effects of the reforms were large increases of exports and foreign direct investments (FDI), and sharp reduction of poverty (Thanh 2005:75). Nevertheless, liberalization and export-promoting reforms continued, in 1998, the system of foreign trade based on licenses was abandoned. Since then, trade with foreign countries has in general become easier which has resulted in a large increase in the number of companies engaged in this activity. Recent reforms include export credits and zero export duty.

FDI and export expansion in Vietnam

A stabilized economy, abundant cheap labour and rich natural resources, together with an improved legal environment, have transformed Vietnam into a popular destination for multinational enterprises (MNEs) in Indochina. Foreign invested enterprises (FIEs) have made a significant contribution to export expansion in Vietnam from the early 1990s. Their share in total merchandise exports (non-oil) from the country increased persistently from 4% in 1991 to 8.8%

in 1995 and 33.8% in 2000. By 2000, over a half of non-oil manufacturing exports of Vietnam originated in FIEs, up from an average share of 19% during 1991-95. During the early years of market-oriented reforms in Vietnam, much of FDI investment in manufacturing was in production for the domestic market. During 1988- 90, less than 20% of total approved projects had export-output ratios of over 50%. From 1997, there has been a clear upward trend in the share of export oriented projects in annual FDI approvals. By 2000, over 70% of approved FIEs had Export-output ratios of 50% or more (Thanh, 2005).

In the changing world environment there are no standard and unique instruments that could lead to increase export, however every country can use different strategies and tools that can help to boost its export sector. As described above each of the three countries have used different export promotion instruments, for instance korea has used aggressive export promotion by applying export financing, and administrative support establishing, whereas Vietnam has applied by starting economic reform and abandoning state monopoly in the trade sector, through time introducing FTZ, as well as promoting FDI that did not appear in Korea during 1960s. Ethiopia has also tried to use export promotion in 2000s and trade reform in the year 1990s after collapse of military regime, more over currently the nation is applying aggressive promotion on FDI, never the less the export performance of Ethiopia is not much satisfactory in comparisons with korea and Vietnam. Please see the following figure showing the share of export in the entire GDP.

3. LITERATURE REVIEW

3.1 The role of Government Policy in promoting export

International trade has played a crucial role in the historical development of the third world. In the second half of the 20th century, the tremendous economic performance of the "four tigers"- South Korea, Taiwan, Hong Kong and Singapore has been largely attributed to the performance of the external sector where the export sector was given a greater emphasis. Strong political commitment towards export promotion and the application of appropriate policies together with efficient institutional mechanisms helped these countries to attain a higher growth rate of exports and hence of the overall economy.

Over the past two decades, developing countries have progressively increased their share in global trade from just less than one quarter to about one third. Asia and particularly China account for most of the change, which has been facilitated by diversification of exports. While developing Asia's share in total world exports increased from 11.7% in 1985 to 21.5% in 2005, Africa's share decreased from 4.3% to 2.9% over the same period (Bacchetta, 2007). Deep rooted structural problems, weak policy frameworks and institutions, protection at home and abroad (IMF and World Bank, 2001), and the structure of African exports, which is characterized by dependence on primary commodities (Alemayehu, 2006; Biggs, 2007; UNCTAD, 2008) are considered as the reasons for Africa's poor export performance.

3.2 Export incentives as export promotion instruments

Returns from trade sector depend up on accelerating growth of exports. According to the orthodox classical economists as well as the modern liberal economists the trade is equivalent to engine of economic growth. Export promotion strategy is often in accordance with the principles of comparative advantage, when a country specializes in a product, which it can produce competitively. The goods become available to the community of the world at cheaper prices. In outer layer, putting more emphasis on the promotion of exports would permit the optimal allocation of country's resources.

Some more clarification regarding the EP strategy is as follows. Firstly, the definition of EP strategy relates to average incentives (Krueger (1997a). The EP strategy can coexist with IS strategies in some sectors as has been the case in many successful East Asian countries. Secondly, the EP strategy does not imply the absence of government intervention. Thirdly, the EP strategy relates, to trade incentives, therefore, the countries that follow this strategy are not necessarily out ward oriented in their foreign investment policy. Trade orientation is also defined in terms of effective exchange rate for exports, relative to that of effective exchange rates for imports. These effective exchange rates measure the incentives to exports and to substitute for exports respectively. The IS strategy is the one where effective exchange rate for export is less than effective exchange rate for imports and so called biased towards import. An out ward oriented trade strategy is recognized to have a number of advantages. Firstly ,this Strategy brings incentives for domestic resource allocation closer to international opportunity costs and hence, promote the efficient use of resources. Secondly , EO is better policy because it involves incentives rather than controls. The rationing of import license , credit , and foreign exchanges has invariably generated premiums and , inturn rent seeking under the IS strategy.

Thirdly, it gives industries the opportunity to enlarge their markets and achieve greater economies of scale. Fourthly an out ward oriented strategy forces industries to compete in the international market and achieve greater export efficiency(Balassa(1981). Fifthly , there is increasing evidence that adoption of new technology has been faster in out ward oriented than inward oriented trade in developing countries. Exporting firms often benefits from a considerable transfer of technology from abroad , including advice on production engineering and aid in product design and marketing. Sixth, out ward oriented regime provides self correcting mechanisms to allign the macroeconomic variables that affect growth. Finally , it is well known that, out ward oriented economies have achieved spectacular growth in saving rate. A shift from in ward to out ward orientation should generate additional real income , partly by reducing the misallocation of resources and partly by raising income through multiplier efffects as rising exports bring spare capacity in to use. The export incentives include export credits, tax rebate scheme, premium from the “support & Price stabilization fund”, duty free imports of intermediates and raw materials, and exemption from the value added tax, foreign exchange allocations, exemption from the corporate income tax and other subsidies and improving domestic policy for foreign firm attraction to the economy. All the above mentioned success story of Asian country and over all theory and rational behind the government’s export promotion intervention, export growth, and overall economic growth are assessed in extensive and logical flow. Based on the reviews made in this section, this paper discussed the models selected for the analysis part of the research in the following sections.

3.3 Export diversification and export growth

The degree of export diversification can be considered as a function of both the number of commodities in a country’s export mix, and distribution of their individual shares. When using the measures of export earning focusing on a wider variety of exports will lead to increased stability or growth in export earnings. Consensus now seems have been built around the belief that export diversification leads to economic growth. In a seminal paper, Imbs and Wacziarg (2003) showed that the relationship between export diversification and economic development (measured by per capita GDP) is broadly positive for countries with per capita incomes of $10,000 (2000 US dollars). Countries with incomes higher than $10,000 tend to specialize in goods. This is evident from the export structures in upper middle income countries such as Korea, Hong Kong and the OECD countries. In a significant departure from the conventional view of export diversification and economic growth, Hausmann and Rodrik (2003), and Hausmann, Hwang and Rodrik (2006) have contended that, in addition to physical and human capital, natural resources and institutional quality, market failures also play an important role in affecting export diversification. Asserting that “what you export matters,” HHR have demonstrated how the income level of a country’s exports is a good predictor of economic growth. They conclude that in the presence of market failures, there is a role for governments to spur export diversification.

3.4 FDI and Export growth

Insufficient domestic capital investment and outdated technologies greatly impede the economic growth of developing countries. FDI is often emphasized as a shortcut to solve the problems in development policies. FDI is another important factor affecting the export supply capacity of a country. There is consensus among development economists that FDI inflows are likely to play an important role in explaining growth of recipient countries (De Mello, 1997, 1999; Buckley et al., 2002; Akinlo, 2004; Seetanah and Khadaroo, 2007). By increasing capital stock, FDI can contribute to a more efficient use of existing resources and absorb unemployed resources and thus increase a country's output and productivity (De Gregorio, 1992; Seetanah and Khadaroo, 2007).

The new trade theory emerging in the early 1980s basically classifies FDI into horizontal and vertical ones. In the case of vertical FDI, MNEs decompose the production process into stages according to factor intensity and locate production activities in different areas so as to exploit differences in factor cost, therefore minimizing production costs. Through production fragmentations, MNEs vertically integrate product designs, production and marketing across different countries. Disintegration of production leads to more trade as intermediate inputs cross borders several times during the manufacturing process. Rising outsourcing activities by MNEs are a direct consequence of production fragmentations, which allow firms to optimally allocate their manufacturing processes along their production value chains (Feenstra, 1998). On the other hand, horizontal FDI means MNEs are locating production close to final markets. The production process is duplicated, and demand in foreign markets is served by local production. Unambiguously, horizontal FDI tends to reduce trade volume while vertical FDI stimulates trade. Markusen (1984) analyzed the case in which an MNE optimized its operation with horizontal FDI. Brainard (1997) empirically showed that trade barriers, high transportation cost and the similarity between home and foreign markets are factors driving MNEs to expand overseas horizontally. Markusen and Maskus (1999) modeled the choice of the MNE's affiliates for local market versus exports as a function of country characteristics, such as market size, size differences and relative variations of endowments. In particular, utilizing developing countries as an export platform has emerged as another motivation for MNEs' FDI.

A widely debated aspect of the trade-FDI nexus developing countries concerns the role export processing zones (EPZs). According to the 'new view', the early studies, given their narrow focus on the direct economic impacts (or national profitability), have ignored important catalytic effects of EPZs on potential domestic exporters, operating through exposure to marketing know-how and technology, direct demonstration effects and linking, and bringing international buyers to the country. In many countries EPZs failed to generate these externalities and to provide a conducive setting for an export takeoff, not because of any intrinsic limitation of the zones but because they were used as a supplement to a highly regulated domestic economy. Moreover, the 'footloose industry argument' against EPZs (i.e., that they possessed shallow linkages with the rest of the economy and would quickly migrate in response to rising domestic costs) ignored the inevitable time lags involved in the process of linkage formation with the domestic economy by new entrants to EPZs. There is convincing evidence that EPZ firms tend to increase their local purchases and shift over to more sophisticated production process as their operations in the host country mature, provided the local business environment is conducive to such behavior (Athukorala and Menon 1996, Lim and Pang 1991).

3.5 Domestic infrastructure

One of the major factors affecting export supply capacity is the domestic infrastructure such as transport, communication and power (energy). It is likely to play an important role especially at the early stages of export sector development (UNCTAD, 2005). Most African countries are characterized by poor transport infrastructure, with insufficient communication and energy which are major impediment to trade, competitiveness and sustainable development (UNCTAD, 2005; Mbekeani, 2007; Bacchetta, 2007).This isolates countries inhibiting their participation in global production networks (Limão and Venables, 2000). Due to poor internal transport infrastructure African transport costs are high making their exports expensive and uncompetitive (Radelet and Sachs, 1998; Matthee, Grater and Krugell, 2007), and reducing foreign earnings from exports (UNCTAD, 2003; Matthee, Grater and Krugell, 2007). The analysis of African trade flow shows that their relative volume is low due to poor infrastructure (Limão and Venables, 2001). Therefore, improvements in transportation services and other infrastructure can lead to improvements in export performance (Fugazza, 2004; Clarke, 2005; Francois and Manchin, 2006; Edwards and Odendaal, 2008).

It has been shown that infrastructure affects trade via altering transport costs (Limão and Venables, 2001; Edwards and Odendaal, 2008). In this context, Edwards and Odendaal (2008) argue that infrastructure directly affects transport costs by determining the type of transport used (for example, the type and quality of roads determines the maximum size of trucks) and delivery time for the goods. Bougheas, Demetriades and Morgenroth (1999) have analyzed the effects of infrastructure on trade through its influence on transport costs and found a positive relationship between the quality of infrastructure and the volume of trade. Fugazza (2004) also finds that the internal transport infrastructure has a significant and positive impact in raising exports.

4. COMPARATIVE ANALYSIS AND RESULTS

4.1 Introduction

In this chapter the main problems of the research are analyzed in line with existing theory. Many variables were listed as determinants of export that could affect Ethiopia's export performance. Comparison was done between Ethiopia and the two countries, Vietnam and Republic of South Korea. The analysis was based on extended time interval to harmonize the prevailing situation of three countries' export status, including the period where Ethiopia used to be the larger exporter than those 2 countries. It is attempted to see relevant facts about factors which helped Korea and Vietnam in the past. These include various policy mechanisms in export sector in 1960s to 1980s in Korea and since 1980s to present in Vietnam. The reason for differentiating the time scope for case of Korea in contrast to Ethiopia and Vietnam is that the current case for Korea is highly advanced through the use of high tech exports since mid-1980s. South Korea and Vietnam cases are seen in this paper just for policy lesson and to get idea about why Ethiopia is lagging behind, where it used to be larger exporter than both, i.e., compared to Korea in 1960s and Vietnam in 1981.

4.2 Export diversification

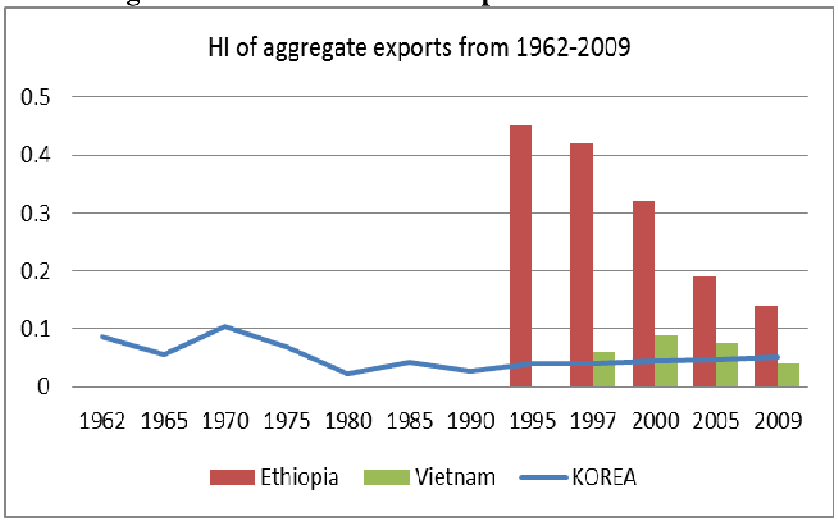
This paper uses the Herfindahl Index (HI) as the measure of export diversification. The HI lies between 0 and 1. Lower values of the index represent more diversification. The Herfindahl index simply computes the sum of squared shares of the variable in question, in this case export shares, or where **si** is the share of total exports attributed to the country's exports. According to (Haussmann, Hwang and Rodrik (2006), the HI indicates that there are two factors that can lead to a lower HI: an increase in the number of products or a more even distribution of the shares of the products. Economies with highly diversified export baskets are likely to have Herfindahl indices below 0.05, followed by a slightly less diversified range of 0.05-0.1. Between 0.1 and 0.4 is another range of much more specialized export baskets. And above 0.4 is highly specialized; this paper use COMTRADE (export) data. All the export data are at the SITC- 3 digit level.

Mathematically the HI is represented as:

$$\text{HERFINDHL INDEX} = \sum_{i=1}^{n} (Si)2\}$$

In this paper, three countries' exports have been measured using the model. RoK from 1962 to 2009. Vietnam and Ethiopian case have been only from 1995 to 2009 due to data limitation. While measuring these indices exports of all products on SITC-3 base were used. As seen in table 5 and figure 6, Ethiopian export sector share at present is in good progress. This could easily be seen the HI that significantly improved from approximately 0.45 in 1995 to 0.14 in 2009. But the bottom line is that the level of reduction of HI and export increment is not that much proportional. This finding helped to understand significant diversification effort is made but the way it was made is horizontal focusing on primary commodity expansion. Still the first three leading exportable products dominate to date. Moreover, the reduction of Ethiopia's HI from 1995 to 2009 is still attributed to the top three products which means the diversification effect is not significant when it is seen on the basis of all export sectors so far. Conversely, the level of diversification in South Korea since 1962 was high except 1970 which was relatively more specialized because of dominance of three products such as veneers, plywood boards and other wood, worked, nes, clothing except fur clothing and manufactured articles, nes having share of 11%, 25.5% &12.5% respectively of total exports in the mentioned year. Since 1975 Korea's export have been the most diversified and having HI index share of less than 0.05. Vietnam is considered as developing country and more of traditional products exporter. However, its export was interestingly among the slightly less diversified which is almost less than 0.1, even in 2009 its HI was 0.04.

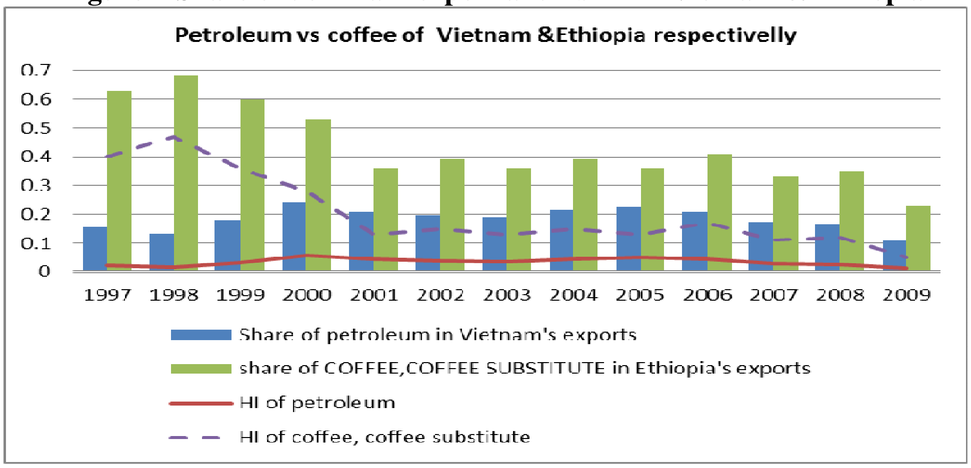
Figure: 6 HI indices of total export from 1962-2009



Source: UNCOMTRADE SITC -3

Ethiopia's export is dominated by coffee exports among all exports. The dominance of coffee export may not be bad, but when we observe the HI indices of Ethiopia's export at product level and aggregate level coffee is the determining factors. This implies that coffee is not only leading the share of the Ethiopia's export but also concentrates all the country's export. However, the bottom line is that the value of the export of coffee in Ethiopia never reach 1 billion USD compared to that of Vietnams export having only 3 percent of total export share accounting approximately 1.billion USD. But in contrast Ethiopia's coffee share toll about 23 percent out of total export share with a value of USD 370 million (see figure 7 and 8). Figure 8 explains the dominance of petroleum in Vietnam's total export and its diversification progress through time by show casing how petroleum's share affected its diversification aspects. It also explains that of Ethiopian coffee export share and the progress of its diversification. Through comparison of both countries case we understand that though petroleum is still the leading export in Vietnam, its impact on diversification is offset by other export items. However in Ethiopia as coffee export increases, the diversification value decreases leading to increased specialization just because of weakly competitive supply of other product items weakness in proportion to volume of coffee export.

Figure 7-Share of dominant export and its HI in Vietnam & Ethiopia



Source: UNCOMTRADE SITC-3

No matter how the single product leads overall export, diversification depends on the comparative value of the dominant export item and the number of other export baskets and their value. In the figure Vietnamese's export is still lead by petroleum however it has no negative impact or volatility on the overall diversification level, conversely the Ethiopia's coffee export has significant negative impacts on the overall diversification levels of export.

.Table 7-Vietnamese top export basket in (%) during 1997 -2009

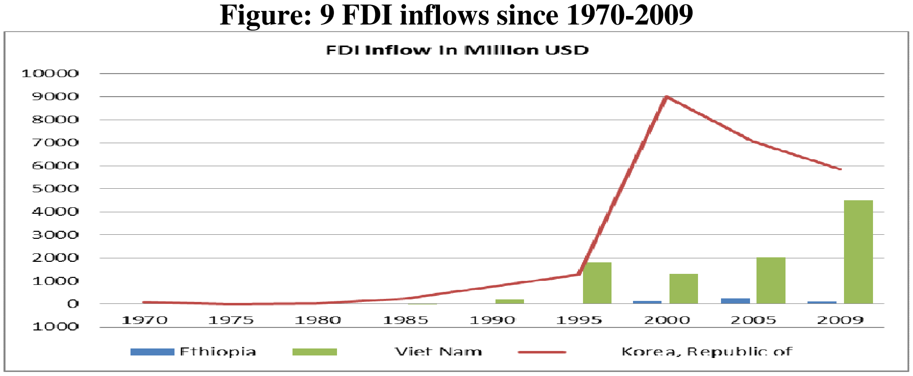
Export items	1997	2000	2005	2009
PETROLEUM OILS, CRUDE	15.5	24.2	22.7	10.8
FOOT WEAR	10.5	10.2	9.5	7.3
others	74	65.6	67.8	81.9
Total	100	100	100	100

Korea's export was diversified at its early stage of the development beginning from 1962 with its HI indices of less than 0.1 except for the year 1970 a maximum value of 0.104. This was due to the high share of garments except those for fur and manufacturing articles, net in export basket. Apart from this the nation's export basket has been highly diversified and always been less than 0.05 since 1980s. In the case of Vietnam also the export basket was too diversified and almost less than 0.1 HI indices. It was even less than 0.05 since late 2005, though petroleum is the leading export commodity of the country. Ethiopia's export basket is still under the range of 0.1 and 0.4 a value ranging from much more specialized to highly specialized export basket. The HI indices were 0.45 in the year 1995 but in the year 2009 it became 0.14, encouraging but still requires much more improvement. This would be revealed looking at mix of commodity on figures 7 and 8, which take the share from Coffee. When Korea started its economic development specially the change in trade policy from inward to out ward industrialization in 1962, the country had almost good status in terms of trained manpower and supported by government policy that gave first priority to '"Growth number one". Lack of natural resources could have influenced the nation to be concentrated in specific exportable products like Ethiopia had coffee as primary products. But the nation's good leadership with a catching up effects of North Korea in 1960s and Japan later on complemented by Government commitment to finance export sector in general and the private sector in particular and the active role of private sector helped to great extent. However, the same scenario was observed in Vietnam like having relatively good level of educated man power Vietnam also had plenty of primary resources like coffee and petroleum

4.3 FDI and export growth

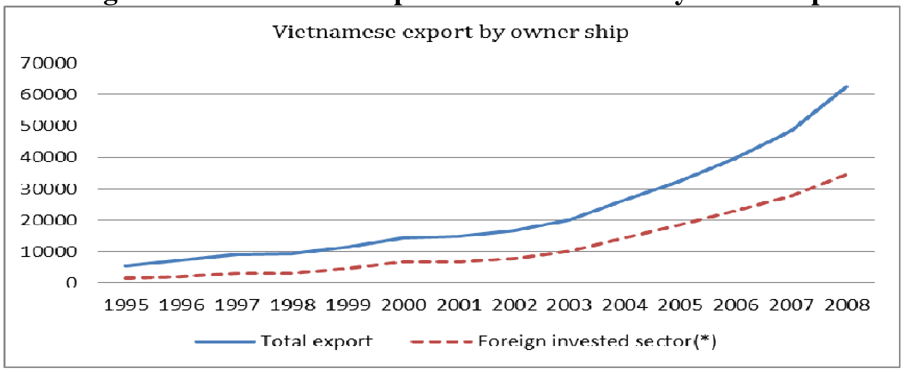
As seen in the literature review section FDI has both positive and negative effects on export growth, but both having same effects on economic growth. However, this paper's main objective is how to capitalize on or increase export growth eventually. Under this scenario, the FDI inflow was analyzed in all the three country cases and its impacts on export growth are shown. Eventhough FDI inflow prevails in three country cases, its impact on export expansion is not similar and the amounts of inflow are also difference from time to time. Figure 8 shows FDI inflow in million USD to each of these countries during 1970 to 2009.In addition, the share of export generated from FDI is also considered as determining factor for the comparative analysis between Ethiopia and Vietnam as presented on figure 10.

Figure: 9 FDI inflows since 1970-2009



Source: UNCTAD data base

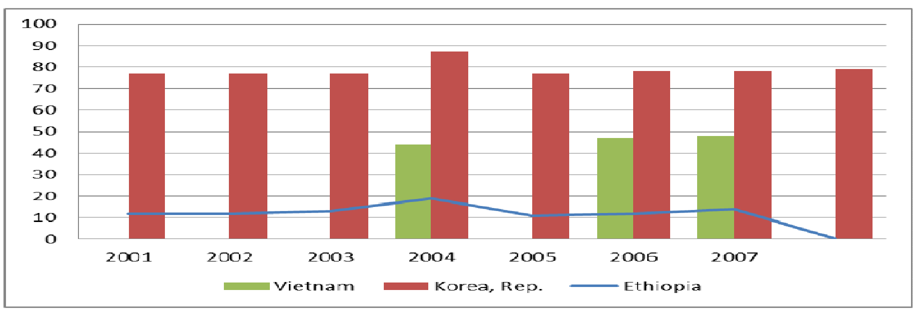
Figure 10: Vietnamese export from 1995-2008 by ownership



Source: UNCTAD data base.

In the growing and interdependent world, the role of FDI is crucial for a country's economic growth in general and export expansion in specific. The main issue is to determine how FDI can work for the country's export expansion as well as to know the main preconditions to attract FDI. The conventional advantages that a country has, and the motive of the incoming FDI to the country, could be the main factors that either boost the country's export or even take the advantages of domestic economy leading to decreasing export. On the basis of the above factors, the flow of FDI in Ethiopia is the least among the sub Saharan Africa and also the least compared to Korea and Vietnam. The main problem of the FDI in Ethiopia was explained as the policy in the past regimes. However these policy issues were dramatically changed and the reform has been introduced in Ethiopia since 1992 though some of the sectors are reserved for domestic firms and the government. As shown on figure 9, even after the reform the nation's FDI inflow is too small. This problem is explained by both domestic situation and the motive of firms. According to the domestic law, there are some sectors which are not permitted for the foreign firms. The trends of road quality in terms of % of paved road in the country; electric power production (KWH); telephone lines per (100) person; air transport –freight (million ton-km) of the three countries are presented in figures 15, 16, 17, &18.

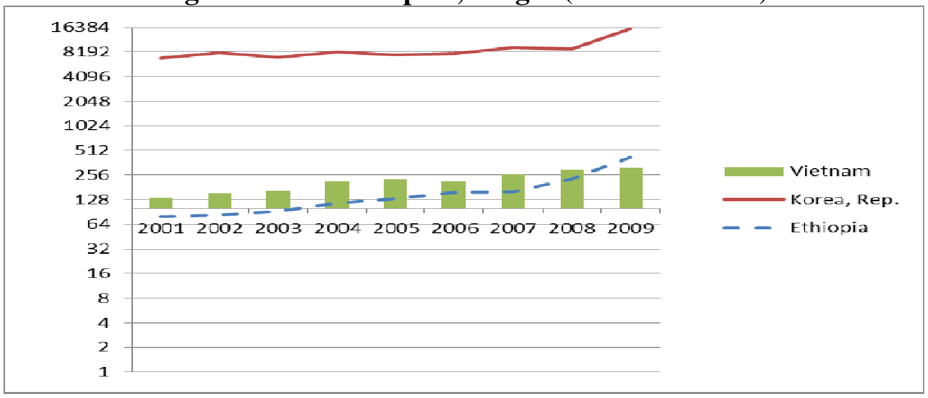
Figure 15-Roads, paved (% of total roads)



Source: World Bank development indicator.

The quality of roads in Ethiopia lags behind both Korea and Vietnam. Without standard quality road transport, export cannot be increased because; the transportation cost will be very high. This scenario is too challenging for Ethiopia since it is landlocked Vietnam compared to Ethiopia has comparative advantage of sea access to integrate with the rest of the world. In addition to road transport infrastructure air transport is very important this day since it serves to transport value added manufactured and horticulture products such as flower. Regarding this, Ethiopian Airline is among the three leading air ways in the African continent. It has contributed significant incentive for firms to engage in horticulture investment. (Please see Figure 16).

Figure 16-Air transport, freight (million ton-km)



Source: World Bank development indicator

In general, in the infrastructure sector all the indicators seen in the above figures are not that much satisfactory except the Air Transport. All the infrastructures have direct impact on export growth and this could easily be proved by the role of the efficiency of the Ethiopian airline which has given incentives for FDI and private sector to invest in horticulture like cut flower as of 2009.

4.4 Export promotion tools and export growth in Ethiopia

Ethiopia has used some of export promotion mechanisms to avert export sector problem, among those the focus of this study are listed as follows;

The Ethiopian currency Devaluated by more than 140 percent in terms of US dollar, the tariff regime was continuously revised and was reduced on a stage basis from a maximum of 230 percent to50 percent currently 35%, the import and export licensing system were simplified, a duty draw back scheme was introduced, State exporting enterprises were provided a managerial autonomy but deprived of a monopoly power, the Ethiopian Export Promotion Agency established, Exemption of capital requirement for foreign investors which export more than 75 percent of their outputs; The entire above mentioned are applied in Ethiopia since late 1990s but challenged by weaker bureaucracy and inefficiency of public sector.

Figure 19: SWOT matrix for Ethiopia current status and Government policy

	Strength Continuous reduction of coffee export share Export oriented growth strategy (with promotion policies) Growing Air transport Prior investment on infrastructure	**Weakness** Export concentration in few traditional products Low FDI Weak private sector participation in the economy Low level of credit disbursement Poor infrastructure
Opportunity FDI Market - access (AGOA, EBA)	Taking advantage of opened market opportunity (AGOA, COMESA,EBA) Encouraging private sector in export sector and support through financial instruments Increase export diversification should be in both even distribution and export baskets as well	Horizontal diversification at this level will be good option Establishing export processing and industrial zone would be good to tackle infrastructure problem Export financing and market search by government will boost export
Threats Land lockedness; Developed country policy on agricultural products; The volatility of primary product price	Increasing transport corridor Creating economic diplomacy as well as increasing export basket and standard Taking advantage of volume rather than price at the current level.	Improving infrastructure Expanding dry port and multi modal transport system In the long run focusing on heavy industrialization and highly value added products

As it is already presented on the SWOT matrix, specific factors are identified which could affect Ethiopia's export leading to instable economic growth. Among those basic factors, high concentrations of exports on few primary products, weak infrastructure & the low share of private sector in the export sector of the economy are bold. This has happened due to policy problems that facilitate access to domestic and international market which is related with geographic bottlenecks. Domestically, though the nation allowed private sector to engage in the economy, it was without sufficient facilitation of finance and consistent political support at different stages of political hierarchy. Other policy issues are restriction of sectors like telecommunication, distribution of electric power and financial service from domestic private sector and foreign firms' involvement. However both domestic and foreign firms most of the time demanded to invest their business in domestic oriented business and restricted sectors for private involvement. Because they want to minimize risks due to weak infrastructure which is explained by poor road, communication, energy facilities and low level of skilled labor that is essential for the real sector business specially manufacturing. All these cumulative effects contributed for poor growth in comparisons with the two countries used for benchmarking. The current global market situation opened access through mechanism like AGOA provided by USA, EBA provided by EU and furthermore COMESA inside the continent Africa. Maximizing the use of these opportunities could be achieved through improvement of the areas of the weakness. This could include actions like increasing multi transport corridor, providing financial support and political support for domestic private sector, linking both input and output producers in effective manner and boosting economic and social infrastructure. The government should improve its institution both in quality as well as policy arena in order to allow firms to engage in every business at least in joint venture; and improving public sector is also vital.

5. CONCLUSION AND POLICY IMPLICATION

The Ethiopian economy remains highly dependent upon coffee production, with 25 percent of the population deriving its livelihood from the coffee sector. Indeed, from 1995 to 2010, coffee accounted for an average of about 44 percent of the country's total value of exports. Gold, leather products, and oilseeds constitute some of the country's other important exports. Ethiopia mostly exports agricultural products and imports higher valued capital goods. The country runs a severe balance of trade deficit, because the return from exports is by far less than the expense needed for the imports. This forced Ethiopia to look for additional finance to cover the cost of its imports. Lack of own financial source has led the country to the development of a significantly sized external debt. In the comparative case study of Ethiopian, south Korean & Vietnamese export performance from 1960s to 2009, the following main issues are identified that hampered Ethiopia‘s export.

The main findings are that; Exports are concentrated on few traditional exports specially dominated by coffee export. Lack of competitiveness is described by the low share of private sector in the export sector economy. The country lacks good financial sector and the capital formation is insufficient. This is caused by low share of the saving in the entire GDP of the country and eventually led to the low credit access to the private sector. As few traditional export baskets are generated from government and the household sector, the share of export became tiny fraction of the GDP. FDI is supposed to be complementary for the nation's export growth; however FDI inflow in Ethiopia is a little, even though the country has reformed all the trade and FDI policy to encourage inflow of FDI. This is so because of insufficient infrastructure and financial market as well as some restricted sectors left only for state to run the business. Though there was some inflow of FDI, its contribution to the export sector is not more than 8%. Even this share is generated from cut flower which was run by domestic private sector. The country has enacted policy for FDI as well as private business, with restricting some of the sectors as state owned that private sector and foreign firms are badly demanding to invest in. Eventhough the country tried to implement the policy that encouraged free market economy, still the nation's export does not exceed 12% of the GDP. Policy implication and recommendations for the state consideration to avert all or the major problems are presented here. These policy ideas are believed to complement and feel gaps in the already existing policy initiatives.

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