The African Continental Free Trade Area (AfCFTA): Opportunities and challenges for the Ethiopian private sector

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1 Introduction

1.1 Background

With the growing hype of globalization, amid the associated costs and commitments, trade integration (via free trade agreements) are often considered to offer a given member country the opportunity to expand trade, better technological transfers, free movement of labor and potentially higher value-added jobs, and better economic growth and by then sustainable development (UNCTAD, 2017). In line with this, Ethiopia has been negotiating to be a member of a number of free trade areas over the last couple of decades and has been a signatory, for example, to these trade agreements: the Common Market for Eastern and Southern Africa (COMESA), African, Caribbean, and Pacific Group States (ACP)-European Union (EU) Economic Partnership Agreement, Bilateral Investment Treaties (BITs), and Everything but Arms (EBA). Ethiopia has also been in accession process to be a member the World Trade Organization (WTO); this process started in 2003 when Ethiopia submitted its membership application to the WTO.

Although the country is not in bilateral trade negotiation with USA, it is eligible for a preferential access to the US market through the African Growth and Opportunity Act (AGOA) with the latest agreement giving Ethiopia access up until 2025. In its latest act, Ethiopia has already ratified the Continental Free Trade Agreements (CFTA) in 2019. It is expected that CFTA will soon be operational as the agreement will only need to be ratified by half of the total signatories by their respective national parliaments. If implemented, the CFTA will be one of the largest free trade areas in the world. However, the impact of joining CFTA on the Ethiopian economy in general and on the private sectors in particular is not clear. This report tries to fill this gap. The structure of the report is organized as follows. After a brief introduction, the second section describes the macroeconomic context of the Ethiopian economy. Section 3 presents the trade reforms while Section 4 discusses results and findings. Section 5 reviews challenges to export competitiveness. Finally, Section 6 presents conclusions and recommendations.

1.2 Objective of the study

The main objectives of this study are to assess the likely impacts of the continental free trade area (CFTA) on the Ethiopian economy in general and the private sector in particular.

The specific objectives of the study include:

- Review previous studies on the likely effects of free trade arrangements on the Ethiopian economy, with a focus on the private sector;
- Discuss the possible implication (challenges and opportunities) of the AfCFTA in line with the existing situation of the Ethiopian private sector;
- Propose a possible category of rules of origin for the upcoming negotiation on AfCFTA's rules of origin that ensure the benefits of the country's private sector in general and growth of emerging manufacturing industries in particular;
- Identify issues that needs to be considered by private sector in order to be full beneficial from the AfCFTA
- Point out essential reforms and measures that need to be taken by the government that enable the private sector capable of properly beneficial from AfCFTA.;
- Forward, on the basis of empirical evidence and global experiences, recommendations and strategic directions to maximize the benefits of CFTA.

1.3 Data Sources

In terms of data, the study uses both primary and secondary sources of information. Primary data have been collected from stakeholder consultations through key stakeholder consultations and focus group discussions (FGD). The secondary data was collected from different sources which *inter alia* include Ethiopia Customs and Revenue Authority, Ministry of Trade and Industry, National Bank of Ethiopia, Ministry of Finance, National Planning and Development Commission, and Central Statistical Agency (CSA).

2. An overview of the Ethiopian Economy

2.1Ethiopia's growth context

Ethiopia has experienced solid growth, especially since the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) plan period (Table 1). Ethiopian GDP measured at current market price stood at 1.7 trillion birr in 2016/17. With an estimate of 93.4 million people in 2016/17, Ethiopia's per capita GDP was estimated at 19,329 birr, which is equivalent to 862 USD at the official exchange rate (EEA, 2018)[1]. The economy has been grown double digit over the last decade and is continuing to grow even during the recent political setbacks and uncertainty and El Niño in 2015/16 where real GDP in Ethiopia grew by 10.9 percent, slightly lower than the GTP-II target of 11.1 percent growth in 2016/17. The contribution of agriculture, industry and service sectors to the overall growth rate (10.9 percent) was 2.5, 4.4, and 4.0 percentage points, respectively, in the total value-added observed in 2016/17. The construction sector alone accounted for 3.4 percentage points (31.2 percent) of the real growth in GDP during the same fiscal year.[2]

Growth in the value-added of the agriculture sector increased from 2.3 percent in 2015/16 to 6.7 percent in 2016/17due mainly to recoveries in the crop subsector. The value added in the industry sector grew at a rate of 18.7 percent, lower than the 20.6 percent growth rate that had been recorded in the preceding fiscal year (2015/16).The slow industry growth is partly due to the weak performance of the mining and quarrying sub sector. The construction sector accounted for 77 percent of the industrial sector's contribution to GDP over the same period. The contribution of the manufacturing sector to overall growth has remained low.

Value added in the service sector grew by 10.3 in 2016/17 and contributed to nearly 36.7 percent of the overall GDP growth during the period. Service sector growth is

1Average exchange rate in 2016/17, $1= Br. 22.1

[2]The new data series showed a significant change in the structure of the economy. Particularly, the static share of industry sector in the GDP was revised from 16.7 percent to 24.4 percent in 2015/16. The revision mainly changed the share of the construction sub sector from 9.5 percent to 16.7 percent in the same year thus increasing both the static and dynamic contributions of the industry sector to the GDP.

mainly dominated by expansion in communication and transport services, hotel and restaurant businesses, as well as wholesale and retail trading.

Table 1: Growth Rates

Plan Period	Agriculture	Industry	Service	Real GDP
1991/92-2015/16	5.2	10.8	9.3	7.3
Pre-SDPRP: 1992/93-1999/00	2.4	6.3	7.5	4.28
SDPRP: 2000/01-2004/05	5.6	7.9	5.9	5.87
PASDEP: 2005/06-2009/10	8.3	10.1	14.1	10.86
GTP-I: 2010/11-2014/15	6.6	19.6	10.9	10.08
2015/16	2.3	20.6	8.7	8.0
2016/17	6.7	18.7	10.3	10.9

Sources: EEA (2018)

Agricultural sector has historically been the engine of the Ethiopian economy, but it has recently given way to the service sector. The sectoral structure of GDP indicates that agriculture, industry and services have contributed36.1, 25.6and 39.3 percent to GDPin 2016/17, respectively. The agricultural sector's share of GDP shrank by more than 25 percent between 2005 and 2016, while the service sector's share grew by 27 percent. However, the service sector's share started falling sharply in 2016/17, giving way to the rise of the manufacturing sector. The construction industry, particularly roads, railways, dams and residential and business buildings, was the main driver of growth in the industrial sector, contributing more than half of the sector's growth.

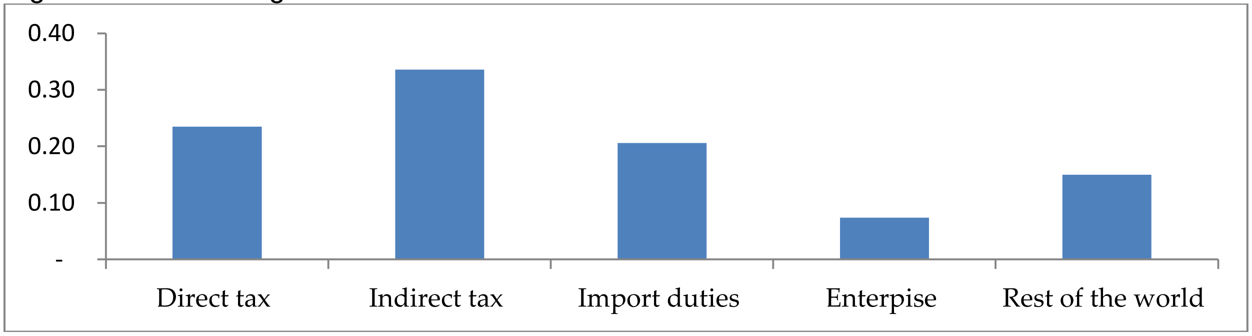
Overall, although the industrial sector has shown improvements due to expansion in the construction sector, value added in the manufacturing sector was not growing fast enough to compensate for its low base. The need for structural change calls for the overtaking of the manufacturing sub-sector and other key service sectors (e.g. finance and information technology) in leading the growth momentum. The limited institutional capacity in term of project management, and limited technological capability that causes the delay of mega industrial projects in the country is believed to partly cause the sluggish structural change in the country (EEA, 2018).

2.2 Revenue structure

While the government gets its revenue from various sources, tax revenue constitutes the largest share. The share of tax revenue in total government revenue was 65.4 percent in 2009/10. This increased to 68.9 percent in 2010/11 and 74.1 percent in 2011/12. Likewise the share of tax revenue in total domestic revenue increased from 80.4 percent in 2009/10 to 85.3 percent in 2010/11 and to 83.4 percent in 2011/12. The ratio of tax revenue-to-GDP rose from 8.6 percent in 2008/09 to 12.7 percent in 2014/15, though it has declined since then to 11.1 percent in 2017/18(IMF, 2018). This figure is lower than the SSA average of 17 percent of GDP. During 2011/12, total government expenditure has increased to birr 124.4 billion from 93.8 billion in 2010/11 of which 41 percent is spent on recurrent expenses while the remaining 59 percent is spent on capital expenditures. Ethiopia relies heavily on trade taxes, while direct and indirect taxes have underperformed. Direct and indirect tax revenue was 56 percent of total revenue in Ethiopia in 2016/17, below the 64 percent average for low income countries (LICs). Trade tax revenue, at 26 percent of total, is substantially above LICs (IMF, 2018).

Membership of CFTA makes the government of Ethiopia to lose revenues from import duties. The extent of the loss depends on the share of import duties from the total revenue of the government as well as the share of imports from African countries. From the 2015 social accounting matrix (SAM) of Ethiopia, it has been indicated that indirect tax accounted for 34% of government revenue. Direct tax and import duty account for 23% and 21% of the total income of the government, respectively. This shows that if Ethiopia joins CFTA, government revenue from customs duty will decline from goods imported from African countries.

Figure1: Sources of government income



Source: Based on 2015/16 SAM

2.3 Ethiopia's trade performance and structure

2.3.1 Africa-wide perspective on exports and imports

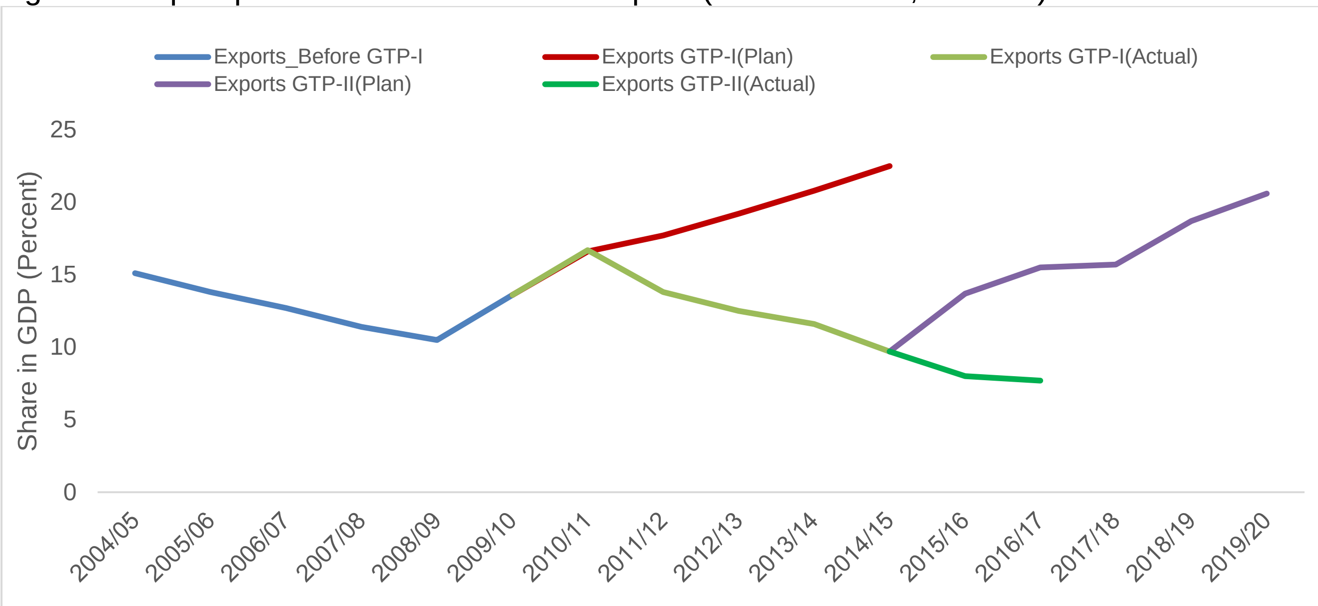
Africa accounts for more than 80% of its trade with non-African countries and its share in global trade remains less than 3% of the value of world's trade in goods (AU, 2018). Between 2010 and 2016, Africa's annual exports and imports were fairly stable (at around 500 billion of USD), its imports slightly exceeding exports. The ratio of goods exports to goods imports seems erratic. For instance, in 2010, Africa was a net exporter (with the ratio of exports over imports reached 103%), whereas it became a net importer in 2016 (with the ratio of exports over imports reached 74%).

There are few African countries that dominate trade within Africa. The exports of 15 of the 54 countries constituted 82 percent of Africa's total exports between 2010/11 and 2016/17. The top exporting nations to the rest of Africa in 2016/17 include South Africa (34.4 percent), Nigeria (7.2 percent), Côte d'Ivoire (5.4 percent), Egypt (5.1 percent) and Ghana (3.7 percent).

2.3.2 Ethiopia's export performance

During the second Growth and Transformation Plan (GTP-II) period, the country targets to a 29 percent annual increment in foreign trade and secure US$14 billion by the end of the plan period (2019/20). However, the export performance has been extremely disappointing, as reflected by the wide discrepancy between the planned target and actual performance.

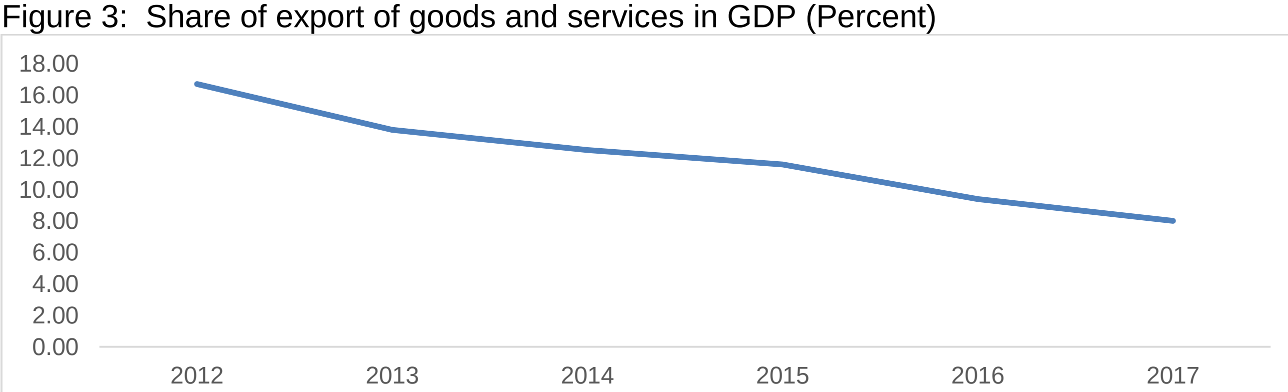
Figure 2: Export performance: Actual versus plan (Share in GDP, Percent)



Source: Ayalew*et al*. (2019)

Export of goods and services as a share of GDP declined from 16.7 percent in 2010/11 to 8 percent in 2017 (Figure 3). This might be mainly due to the export sector's dependence on agricultural commodities such as coffee, oilseeds, pulses and cereals, flower, fruits and vegetables, and declining prices in the international market for these commodities, particularly of coffee (NPC, 2016).

Figure 3: Share of export of goods and services in GDP (Percent)

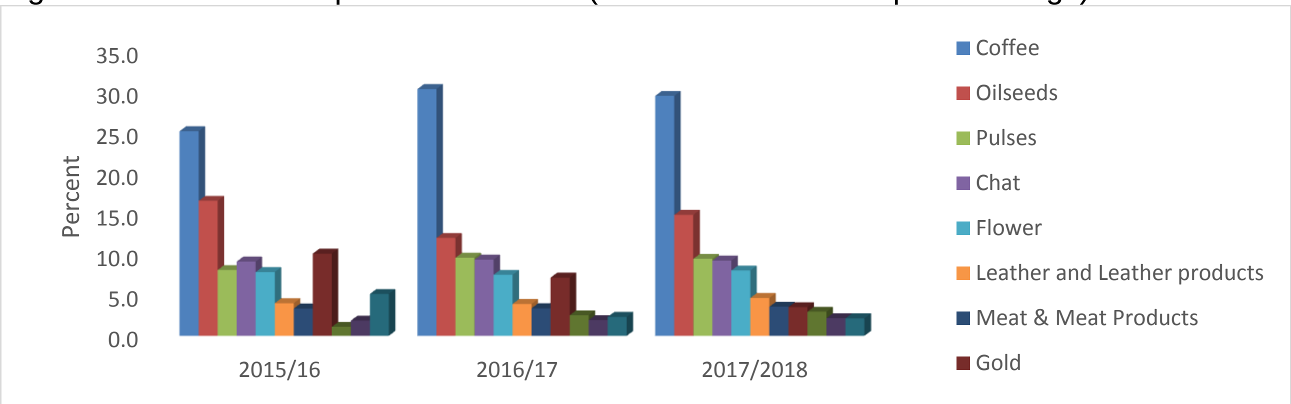


Source: Own computation from NBE data

Ethiopia's exports are composed of low-value primary commodities. The value of export has decreased from US$ 2,867.7 million in 2015/16 to US$ 2,839.8 million in 2017/18, a

1.0% decline compared to 2015/16. The main export items by value included coffee (USD 839million), oil seeds (USD 423.5 million), pulses (USD 269 million), khat (USD 263.2 million), flowers (USD 228.2million), and leather & leather products (USD 132.4 million) account for 76% of total export earnings in 2017/18 (NBE, 2018). Note that the major export items of the economy are still dominated by agricultural goods and with very little change on the export structure of the economy. In terms of share from total export earnings, the major exports were coffee (29.5%), oil seeds (14.9%), pulses (9.5%), chat (9.3%), cut flower (8.0%), and leather and leather products (4.5%).

Figure4: Structure of export commodities (Percent from total export earnings)

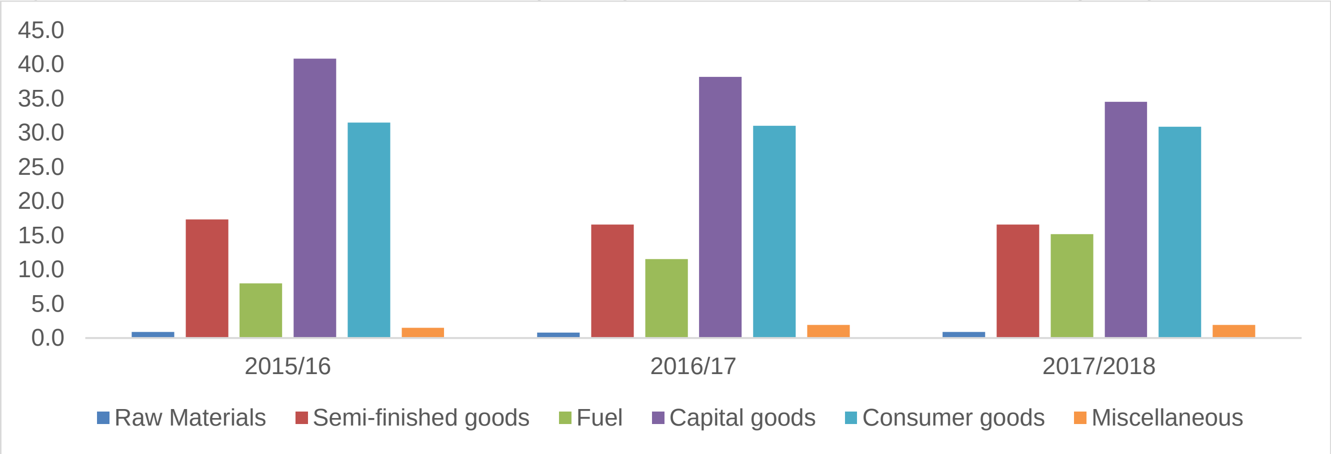


Source: Based on NBE data

2.3.3 Imports of Ethiopia

Total import bill has decreased from US$16.7 billion in 2015/16 to US$15.2 billion in 2017/18, 8.8 percentage drops in 2017/18 compared to the previous year. The share of total import in GDP went down to 19.6% compared to 23.1% in 2016/17(NBE, 2018). Ethiopia imports capital, consumer goods and semi-finished goods which constituted 82% of total imports in 2017/18. The share of imported capital goods in the total value of imports has decreased from 40.1% in 2015/16 to 34.5% in 2017/18. The decline in the import share of capital goods could be linked to slowdown in investment activities due to protests and political instability in the country that began in 2015/16. The most significant change of the import structure is manifested by the continual increase of imports of fuel which has increased from 8% of total imports to 15% (NBE, 2018).

Figure 5: Strcuture of merchandise imports (Percent of total merchandise imports)



Source: Based on NBE database

2.3.4 Direction of Ethiopia's trade

Major destinations for Ethiopia's exports in 2016/2017 were: Asia 37% (of which China accounted for 20%), Europe 32.4% and Africa 21.5%. In 2016/2017, Ethiopia's export to the US represented 8% of total exports, registering a 1% increase from the previous year. Ethiopia primarily exports coffee, leather, and leather products to the United States.

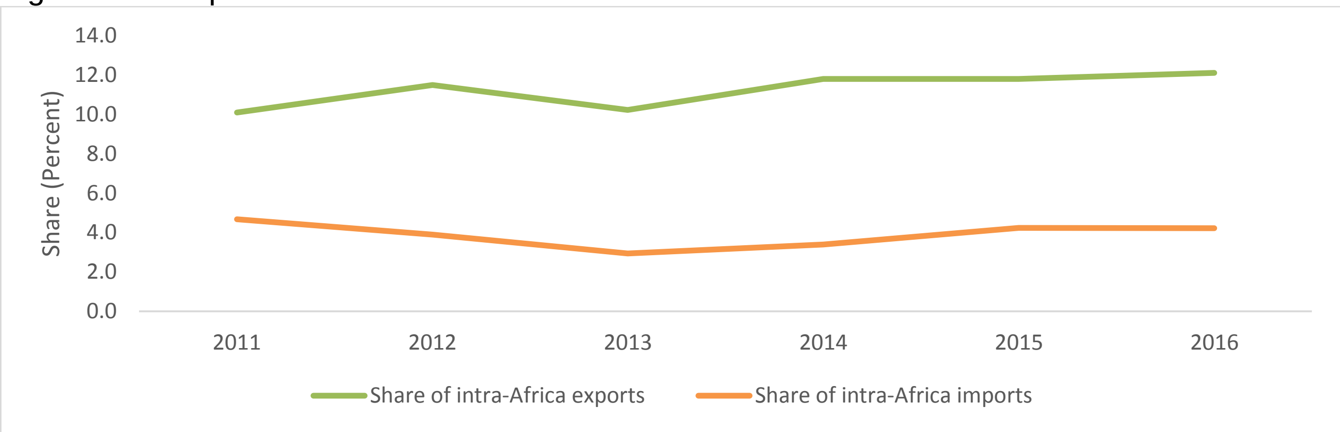
The vast majority of Ethiopia's imports come from Asia (63%) followed by Europe (25%), Africa (4%) and the United States (8%). Imports from China accounted for 50.7%, followed by India (11.8%), USA (8%) Kuwait (7.4%), Japan (6.9 percent), and Saudi Arabia (4.7 percent) are the major sources of Ethiopia's imports.

The discrepancy between export and import indicates that huge trade balance of US$ 12.4 billion in 2017/18. The current account also remains in deficit due to massive imports and sluggish performance of the export sector.

Ethiopia's trade with Africa has also changed over time. Ethiopia exports to Africa increased from US$ 180 million in 2011 to US$ 184.7 million in 2015 and US$ 180 million in 2016. Ethiopia's top 10 export destinations account 98% Ethiopia's intra-Africa exports; with the main export destinations include Somalia, Djibouti and Kenya.

Similarly, the country's imports increased from US$427.8 million in 2011 to US$686.8 million in 2016.The ratio of exports to imports declined from 42% to 26%, indicating a deteriorating trade balance. In relative terms, however, the share of Ethiopia's export to Africa in total exports increased from 10.1% to 12.1%, while that of imports declined from 4.7% to 4.2%, indicating that Ethiopia sees African countries as a potential market destination to its exports (Figure 6). Ethiopia's top 10 import sources account for 99% of Ethiopia's intra-Africa imports. Amongst the top import sources include, Morocco, South Africa and Egypt.

Figure 6: Ethiopia's trade with Africa



Source: African Union (2018), African Trade Statistics: Year Book 2017

3 Trade policy reforms

Before 1991, the maximum tariff rate was as high as 230%. This rate was reduced to 80% in the first round of tariff adjustments made in 1993. In the second round, the maximum tariff rate was further decreased to 60%. In the fourth round, the maximum tariff rate reached 50% and the average tariff rate decreased to 21.5%, which was half of the average tariff rate prevailed before the first round of adjustment. The average tariff rate was further reduced to 19.5% in the fifth round and 17.5% in the sixth round in 2003 when the country applied to be a member of the WTO (Table 2:).

Currently, there are six tariff bands on imported commodities to Ethiopia: 0%, 5%, 10%, 20%, 30% and 35%. These tax rates are levied on two groups of goods. The first group consists of imported items which are used for productive purpose, re-export and for public use while the second category consists of goods consumed by final consumers. The latter category mainly comprises items such as consumer or finished goods imported for personal use or for non-productive purpose. The highest tariff rates are usually applied on these goods. The guiding principle in setting tariff rates in Ethiopia is that the more the imported item is to be used solely for personal use, the higher the rate of import tariffs and other taxes.

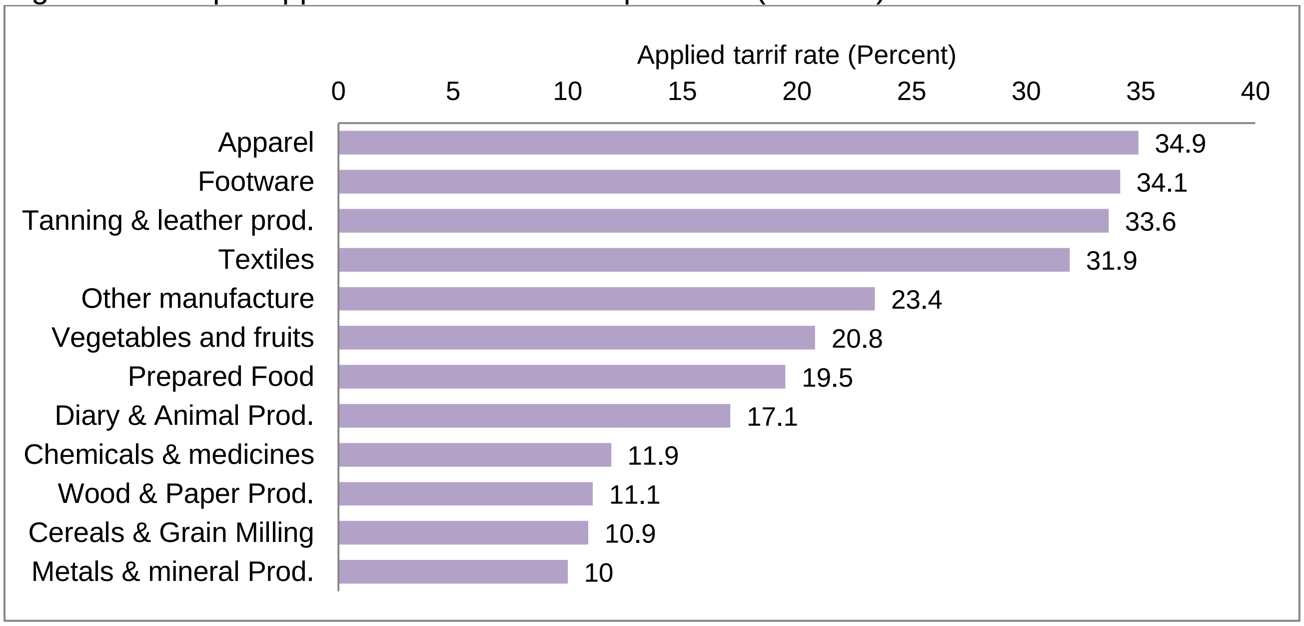
Table 2: Tariff reforms in Ethiopia

	Year	Maximum tariff (%)	Average tariff (%)
Before reform	1993	230	41.6
1st round	1993	80	
2nd round	1996	60	
3rd round	1997	60	
4th round	1998	50	21.5
5th round	1998	40	19.5
6th round	2003	35	17.5

Source: MoFED

In Ethiopia, raw materials and intermediate inputs face zero tariff rates in most cases. Semi-finished goods are imported for further processing. Mostly the import duty rates of these goods are either 10% or 20%. Interestingly, the tariff rate is not only high but also the import tariff structure does not seem to be aligned well with the industrial development strategy of the country. In particular, some export-oriented industries (such as textile, apparel, and leather), which are supposed to have lower tariff rates due to their high export affinity, have higher tariff rates and, thus, the most protected, while all the import substituting sectors such as chemical, metal have lower tariff protection (Figure 7).

Figure 7: Ethiopia applied tariff rate on final products (Percent)



Source: Ayalew *et al*. (2019)

Despite implementing successive tariff reforms since the early 1990s, Ethiopia is still characterized by high average import tariff rates compared to Sub-Saharan African average and Least Developed Countries (LDCs) (Figure 9). Like LDCs, Ethiopia levies higher tariff rate on consumer goods than other commodities.

Figure 8: Ethiopia's simple average duty rate compared with other countries (%)

Source: Ayalew *et al*. (2019)

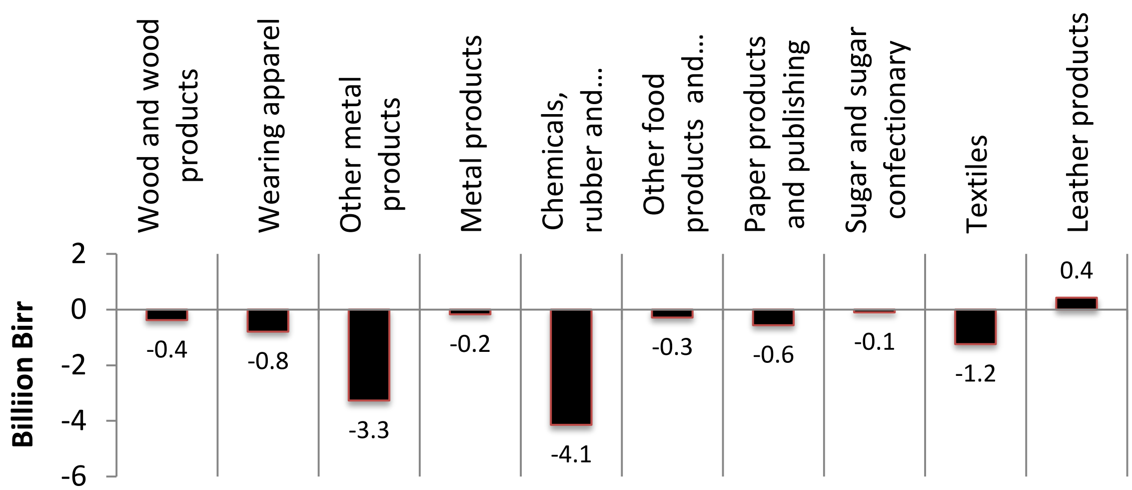
4 Results and key Findings

This section has two main components. The first sub-section summarizes key results from empirical literatures. The second sub-section presents key insights from focus group discussions and key informant interviews.

4.1 Summary of empircal evidence on the impact of tariff removal

In Ethiopia, nearly 26.6% of the total goods of the priority industries are imported but these industries contribute only 3.9% of the export earnings. From all priority industries, it is only the leather industry which exports more than it imports. In addition, the net import shares of chemical and metal sectors are higher when compared to other priority industries. This may be due to the fact that these industries are capital and skilled labor intensive when compared to other sectors. In food, sugar, wood and other sectors, the import and export are almost balanced. Figure 9 shows net trade balance of priority industries.

Figure 9: Trade balance among priority manufacturing industries



Previous Studies in Ethiopia indicate that trade liberalization in the form of a decline in import tariff rate leads to an increase in exports of domestic manufacturing industries such as textile, leather, food, and beverage products (Table 3). However, the magnitude of change in exports is much lower than that of imports. On the other hand, the results suggest that imports of agricultural commodities decline, while agricultural exports increase. Complete trade liberalization increases production of crop sector. In contrast, output from agro-processing declines, as competition becomes stiff and labor migrates to other sectors. This is particularly true for agro-processing industries, as they are forced to lay-off workers due to lack of market/reduced demand for products. The result further reveals that the overall output in the economy will also decline.

In summary, the studies indicated that complete removal of tariff on goods and services negatively affects the industrial and service sectors of the country. But, the results further showed that if we adopt strategic intervention (if we liberalize some sectors while protecting priority industrial sectors), Ethiopia can benefit more from trade liberalization and, hopefully, this is also going to work for CFTA. Hence, the government shall identify strategic sectors which will be adversely affected by the few trade arrangement and require some support in the short run.

Table 3: Empircal findings on the likely effects of trade liberaliztion

Research	Method	Scenario	Results
Seid (2012)	Dynamic CGE	Complete removal of tariff on goods and service	The production of manufacturing and service sector decrease while the production of agricultural good increase
Sindu et al (2016)	Static CGE	Complete removal of tariff on goods and service	The production of manufacturing and service sector decrease while the production of agricultural good increase
Solomon (2015)	Static CGE	Complete removal of tariff on all commodities	The production of manufacturing good except leather sector decreases while the production of agricultural good increase
		Complete removal of tariff on all commodities except priority industrial commodities	In this scenario, the production of manufacturing and service sector increases while the production of agricultural good increase
Mussie et al (2015)	Dynamic CGE	Complete removal of tariff on all goods except priority industries	The production of manufacturing and service sector decreases while the production of agricultural good increase
Hammouda et al(2015)		Ethiopia opening its market to EU and COMESA Removing export tariffs to COMESA countries	Import of goods and service increases. Vegetable products and the sugars and sugar confectionery sector are going to gain more. Sectors like coffee, tea mate and spices and raw hides and skins and leather will also register a significant rise in their exports but These Ethiopian exports gains (USD 10.7 million) are lower than the new imports originating from COMESA countries (USD 27 million).

4.2 Discussion with the FGD Participants

Participants of the focus group discussion came from Ethiopian textile and garment manufacturers Association, Ethiopian leather Industries Association, Livestock Traders Association and Sugar and Sweets Producers.

4.2.1 Key insights from FGDs

The participants have explained that joining CFTA has both opportunities and threats. According to them, opportunities of joining CFTA include skill and technology transfer, enhancing regional supply chain, wider market and employment creation. However, participants indicated that there can be significant threats of joining the CFTA if adequate safeguard measures are not in place. The main challenges include risks of dumpling, incidences of high prevalence of illegal trade among member countries, stiff competition that threatens infant industries[3], diversion of commodities from non-CFTA member countries, etc. In addition to these, the participants explained that there are many internal weakness of Ethiopia that hinders the private sector not to benefit from the CFTA. These internal weaknesses mainly emanate from lengthy bureaucracy, regulatory and widespread corruption, inadequate capacity of handling rules of origin, lack of strategic raw materials, weak domestic production base, poor logistic services, unsound investment policy which doesn't favor domestic investors, frequent power interruption and unreliability of power, lack of access to credit (e.g. for both working capital and investment) and foreign exchange.

The participants of the FGD have further explained that speedy decision of joining CFTA will cause a huge loss for Ethiopia. They mentioned that there should be a detailed assessment of sectors in terms of their competitiveness and constraints. It has been mentioned that not all sectors or commodities will be competitive. They mentioned that there are a lot issues that should be corrected before Ethiopia joins CFTA. The Participants have indicated the following corrective actions to be considered by the government:

[3] The core of the argument of protecting infant industries is that these infant industries often do not have the economies of scale that their competitors from other countries mainly from developed countries may have, and thus need to be protected until they attain similar economies of scale.

- The government should conduct a diagnostic assessment to identify which sectors or commodities are competitive/or uncompetitive and which ones need support;
- Capacitate and modernize the rules of origin administration;
- Policies should be designed to give privilege and incentives to local manufacturers rather than FDI companies;
- The government should work to solve administrative and bureaucratic bottlenecks;
- The experience of East African Community markets of Uganda, Kenya, Burundi, Tanzania, south Sudan, etc. should be considered as lessons;
- Improve the tax policy of Ethiopia;
- Improving the financial and credit support;
- Revise the existing investment policy; and
- Combating corruption

4.2.2 Sector level analysis

The empirical literature has shown that it is only the leather sector which has the potential to benefit from AfCFTA. Hence, sector-specific focus group discussions have been held to examine the potential competitiveness coupled with identifying the associated hurdles in each sector. The sectors have been clustered into three main groups. The first group contains participants coming from textile, garment and leather and the second group has been composed of participants coming from livestock and related activities while the participants of the last group contains produces of sugar and sweet. The key results of the FGD comply with the results of the empirical literature review. The discussants have revealed that except the leather and textile sectors, all other sectors would be threatened if Ethiopia joins AfCFTA without proper preparation. Indeed each sector has its own perspective and concern about the likely actions that should be taken before joining CFTA. The results of the discussions are summarized below.

Textile garment and leather

The result of the discussion from textile, garment and leather industries have shown that The CFTA will enable Ethiopia to access African markets which will fill the gap that is being created with Europe and America. This is because African markets are less stringent compared to markets in Europe and America. Comparatively, the CFTA will benefit the Ethiopian producers since they have comparative cost advantage. Ethiopian leathers are highly demanded globally. The participants have explained that the only threats from joining CFTA is that of illegal trade and contraband (synthetic of equal quality with leather). If these illicit trades are not fully controlled, they can vanish these sectors. So, they indicated that the government should give prime attention to legal, financial, administrative, and other policy supports to support the sector.

Livestock

The participants have explained that Ethiopia can tap its massive potential from livestock sector. But, they claimed that the commercial livestock sector is very backward even by African standards. Hence, joining CFTA at this time might cause a huge loss on the sector. Hence the participants have notified that though the agreement can bring technology, access to raw materials, employment opportunity and others, the net outcome of joining CFTA at this time can damage the livestock sector and hence should not be implemented without making all the necessary preparations. According to the participants the government should solve the basic problems of the sector which are mainly associated to provision of land, access to finance, and technological supports.

Sugar and Sweets

The discussants have shown that due to its small size and less emphasizes given by the government, the Ethiopian sweets and sugar producers are so feeble that they cannot withstand the stiff competition coming from CFTA. The discussants have further revealed that the sector doesn’t get any kind of assistance from the government. Consequently, the sector will vanish when it confronts any strong foreign competitors. The discussant revealed that the current policy of government towards sugars and sweets is discouraging such that possible actions should be considered to support the sector. The participants have indicated that the current tax policy of government towards glucose encourages illegal trade and hence corrective actions should be taken before joining CFTA which will possibly exacerbate the problem. In addition to this, the government should consider the sector as one of the most promising sector.

4.3 Results of Key informant interview

In order to examine the possible impacts of CFTA on Ethiopian private sector, discussion with experts who have extensive years of experience on international trade from the Ministry of Finance and Ministry of Trade and Industry have been made. The key informants have more or less the same views on the likely impact of joining CFTA on the private sector of Ethiopia. The results of the discussion have been synthesized and summarized into three categories. The first part presents the possible benefits of CFTA, while the second part portrays the challenges of joining CFTA, especially on Ethiopia's private sector. Finally, the last part of the discussion contains the possible mitigation actions that ought to be taken by the government and the private sector to maximize the benefits of joining CFTA.

Potential benefits of joining CFTA

The key informants have shown that the following are the possible benefits of joining CFTA.

- Creation of integrated common market;
- Free movement of goods and services with lower barriers so that there will be greater market opportunity for local products;
- Bigger market attracts investment for Ethiopia;
- CFTA urges quality improvement to compete continentally;
- Less market regulations and quality standard requirements compared to markets in advanced economies;
- The large population base of the country can serve as a comparative advantage for the country;
- Political and diplomatic benefits as a leading member of OAU and AU;

- The existence of comparative advantage in some sector like power(electricity) export, strong construction sector which can compete continentally, leather and textile export; and
- Competition will encourage and strengthen local industries.

Challenges of joining CFTA for the Ethiopian privates sector

The key informants have further revealed the potential threats of joining CFTA. They indicated the following issues as potential threats.

- The current fragile peace and security problems of the country would hinder trade;
- Poor infrastructure and connectivity;
- Limited capacity of managing rules of origin;
- Weak capacity to control dumping;
- Weak institutions and cumbersome bureaucracy of the country and low enforcement of laws;
- Existence of weak and uncoordinated private sector;
- Lack of prior experience of managing other sub regional free trade areas;
- Poor post production product development such as packaging and branding, etc;
- Lack of detailed assessment of sector wise strengths and weaknesses of the country's private sector before approving the agreement; and
- Challenges to the infant industries, in terms of competition;

Mitigation actions

The key informants also suggested that corrective measures need to be taken at different levels.

The role of the government:

- Strong and efficient institutions and bureaucracy;
- Ensure peace and security;
- Control contraband and illicit trade;

- Investment in improving the technical production capacity and inspection such as rules of origin, verification, etc.;
- Carryout sector specific analysis to identify strong and weak sectors or commodities;
- Provide continuous training and awareness creation on CFTA and on the exclusion list and sensitivity lists of the agreement;
- Incentivizing the comparatively competitive sectors of the country; and
- Provision of the most important infrastructure for competitiveness.

Private sector

The private sectors should be well informed of the competitiveness of international market, such as in areas of production, pricing, international trade laws, market, culture of the destination countries, etc.

- Improve the internal management and finance issues of the company;
- Improve investment in technology, promote innovation and value addition;
- Provide on job training such that they could maintain their competiveness, etc.

5. Challenges to competitiveness

The discussion so far has shown that Ethiopian private sector is not strong enough to compete with other African countries if Ethiopia rushes to join ACFTA. This section discusses the potential challenges of competitiveness of the Ethiopian private sector from different dimensions.

5.1 Tariff and non-tariff barriers

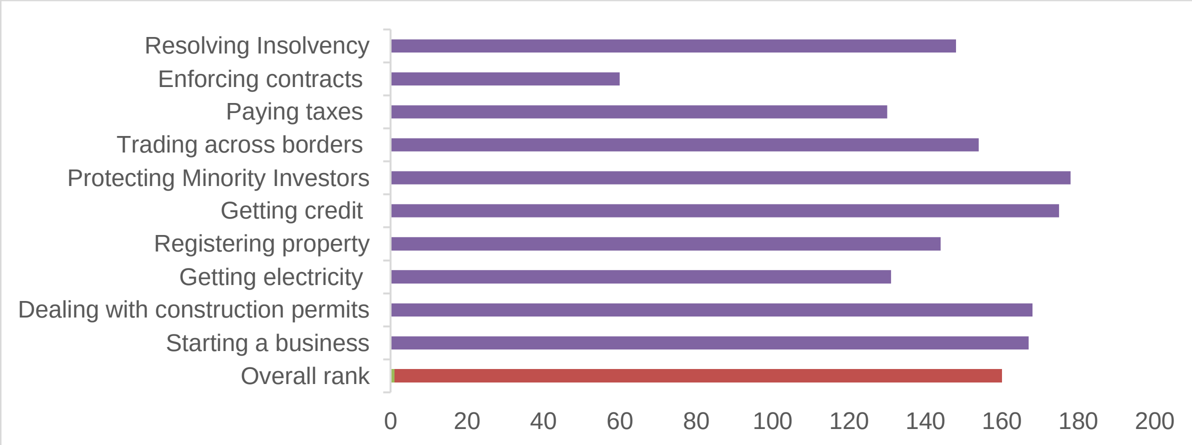
Ethiopian businesses (particularly in the manufacturing) have become increasingly interested in the domestic market but less willing to enter into the export market. In 2015, the share of firms with positive level of export was only 7 percent (Gebreyesus and Demile, 2017). Studies indicate that the value added (and profitability) in domestic market is up to 2-3 times higher than exporting, leading to diversion of exportable commodities to the domestic market, i.e. firms have higher incentive to sell their products in domestic market instead of exporting (Gebreyesus and Kebede, 2017).

There are different mechanisms to assess the relative attractiveness of domestic market and export markets such as using the nominal rate of protection (simple rate), Effective Rate of Protection (ERP) (captures the distortion produced due to tariff on both the input prices and the final output prices), and anti-export bias (often unintentional) that basically measures the relative value added obtainable in the domestic market versus in exporting (Gebreyesus and Kebede, 2017).

The cost of doing business in Ethiopia is one of the highest and Ethiopia ranks at 159 out of 190 countries measured by ease of doing business in 2019 (World Bank, 2019) and time to clear exports in Ethiopian remains one of the highest in the region.[4] Due to these constraints, Ethiopia has not yet fully benefited from its export potential and available market access opportunities.

[4]World Bank (2019), *Doing Business 2019: Training for Reform– Ethiopia (English)*. Doing Business 2019. Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/807951541094964582/Doing-Business-2019-Training-for-Reform-Ethiopia

Figure 10: Ethiopia's rank in Ease of Doing Business



Source: World Bank (2019)

Ethiopia's required time and cost in trading across borders is very high compared to the average of Sub-Saharan African countries (Table 4). In 2019, Ethiopia's rank in trading across borders was 154 out of 190 countries.

Table 4: Cost of trading across borders, 2019

Indicators of non-tariff barriers	Ethiopia	Sub-Saharan Africa
Time to export: Documentary compliance (hours)	76	72.8
Time to import: Documentary compliance (hours)	194	97.7
Cost to export: Documentary compliance (USD)	175	168.8
Cost to import: Documentary compliance (USD)	750	283.5

Source: World Bank (2019)

5.2 Trade policies and regulatory environment

The development strategies and plans such as the Growth and Transformation Plan (GTP) comprise the activities of trade, but trade policies are lightly integrated into the national development strategies. The country lacks a comprehensive trade policy and integration strategy to guide the trade sector including exports. Although trade related interventions have given more weight to the export sector, little attention has been given to import substitution.

The country has been engaging in different trade negotiations such as WTO, COMESA-FTA, EPA, etc., but there is no a consolidated trade negotiation strategy for the country. Currently, different trade negotiations are being handled by different institutions and these negotiations are not coordinated to the required level. A forward looking trade policy framework is crucial in building the capacity of the government to formulate, negotiate and implement trade policies and to be proactive rather than being reactive in trade negotiations. It also contributes to strengthen the capacity of the country to participate effectively in, and benefit from bilateral, regional and international trade.

5.3 Supply side issues

The challenges facing exporters from Ethiopia largely emanate from supply and production-side limitations and poor trade logistics. Addressing the supply side of the export sector will ease many of the problems of the export sector. Key supply side factors that constrain the export sector include the following.

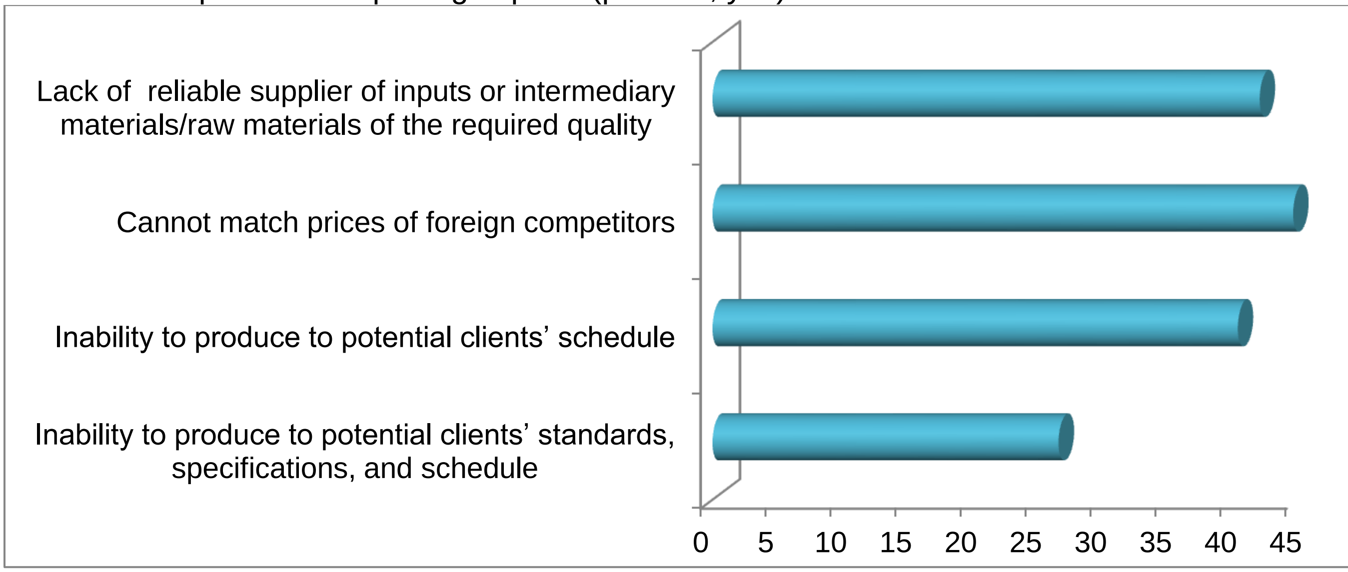
- Inadequate production and low productivity,
- Low quality of domestic production,
- Unreliable domestic input supply,
- High cost of inputs,
- Inadequate supply of improved seeds,
- Lack of agro-ecology-based fertilizer supply,
- Inadequate attention to research and development,
- Traditional farming practices with high post-harvest loss,
- Limited finance support to the agricultural sector,
- Inadequate attention to commercial agriculture,
- Limited feed supply for the livestock sector, etc.[5]

In addition, internal factors that inhibit the export sector which are related to capacity of exporters, shortage of organized input suppliers, price competitiveness, unable to meet deadlines, and quality as constraining factors for the export sector (Ferede and Fantahun, 2014). In this regard, 45% of respondents said that they are unable to match

[5] There are also other factors that adversely affect export supply such as political instability, drought, etc.

prices of other competitor countries. Lack of reliable suppliers of inputs and intermediary materials are reported by 42% of survey respondents (Figure 14). Inability to produce and export as per potential clients schedule has also been reported as another constraint by 40% of the respondents.

Figure 11: Other problems impeding exports (percent, yes)



Source: Ferede and Fantahun (2015)

The above supply side factors are weaknesses that are common to many low-income countries which are still relevant to the Ethiopian context. For example, one of the major supply-side constraint in Ethiopia is the weak domestic value chains, particularly from agriculture to manufacturing as demonstrated by the difficulties that export-oriented enterprises are currently facing in securing good quality inputs and raw materials locally, even in sectors where Ethiopia has the comparative advantage such as the manufacture of leather products, textile & apparel production, agro-processing, etc.

5.4 Demand side factors

Ethiopia already enjoy virtually free access to the markets of most developed countries such as Africa Growth Opportunity Act (AGOA) for the US market, Everything But Arms for the European market, and other preferential market access. But these opportunities are not permanent and are subject to change depending on country's level of development. In view of these, Ethiopia should give attention to the ongoing trade negotiations, particularly trade negotiations such as accession to WTO.

Among the demand side factors that affect Ethiopia's exports include:

- Low world price of export commodities,
- Price volatility,
- Limited market access, etc.

5.5 Support institutions and coordination issues

Policy inconsistency and implementation weakness/ unpredictability of the trade and macroeconomic policy strongly affect the external trade performance. Institutional quality export bureaucracy, logistics, bank credit facility, lengthy marketing channel, absence of or very weak default management is also the main factor for the Ethiopian trade performance.

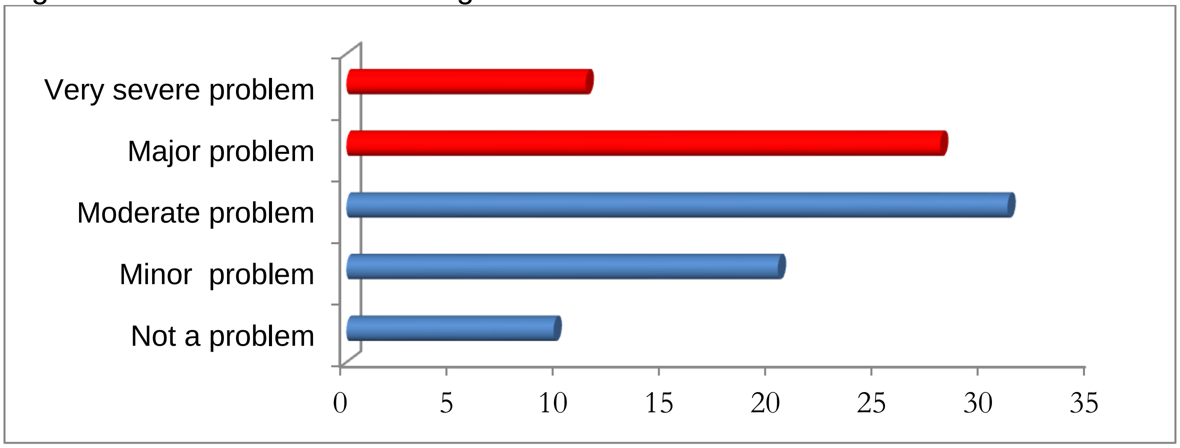
An inter-agency mechanism with focal points from different stakeholder offices, ministries and agencies would help facilitate trade by coordinating and harmonizing regulatory reforms in addition to leading consultations and informational outreach campaigns. But one of the main problems of the Ethiopian export sector is the institutional integrity, unclear mandates given for different organizations involved on the export sector. Another major governance related problem is the lack of monitoring and coordination among different government agencies in administering the export incentives leading to continuous abuse of the incentives by the private sector (exporters) and underutilization for some exporters because of information gap and lengthy bureaucracy.

Another institutional problem is capacity and motivation problem of the civil service in general and export bureaucracy in particular. These include lack of adequate and skilled staff of the institutions administrating export incentives, lack of a specialized institution for the export sector, lack of motivation and high labour turnover in the civil service[6] and limited use of information communication and technology (ICT), i.e. manual based clearance (reconciliation) process.

[6] A study by Abebe et al (2017) indicate that the majority of the available staffs want to leave with short time period (85% would quit in 4 years), about 44% consider the public employment the worst possible employment, and 52% suggest low pay as the main cause for the high turnover.

A study by Ferede and Fantahun (2014)[7] indicated that more than two-third of respondents reported that customs and trade regulations as moderate to severe constraint to their business effectiveness (Figure 12).

Figure12: Customs and trade regulations

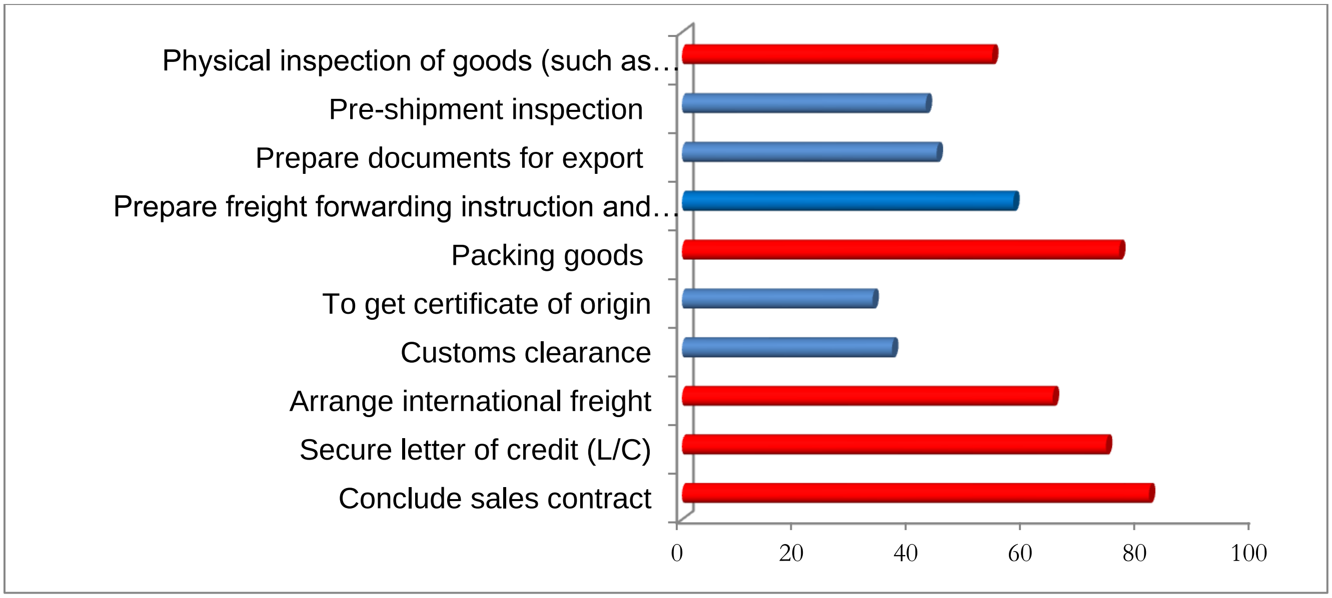


Source: Ferede and Fantahun (2014)

Sample firms were asked to list major causes of customs and trade problems. For the majority of the exporters (82%) reported that concluding sales contract (weak negotiation power) is the most cumbersome activity, followed by packing goods (76%) (Figure 13). Securing letter of credit (74%) and arranging international freight (65%) have also been constraints to export firms. Preparing freight forwarding instruction and other documents, physical inspection of goods (e.g. technical or sanitary or phyto-sanitary, pre-shipment inspection and custom clearance) are additional barriers in the export business.

Figure13: Factors causing customs and trade related problems

[7]Ferede, T. and Fantahun, B. (2014), Ethiopia's Export Status: Challenges and opportunities for export competitiveness and diversification, a research report prepared for the National Planning Commission, Ethiopia.



Source: Ferede and Fantahun (2015)

Stakeholders also raised a number of institutional barriers that constrain the competitiveness of the export sector. These include the following:

- Lack of coordination among service providers,
- Inefficient bureaucracy,
- Inadequate use of modern technology (e.g. ICT),
- Lack of laboratory for testing and other services,
- Weak and inefficient logistics,
- Poor monitoring mechanism,
- Lack of enforcement capacity,
- Weak public-private partnership,
- Lack of access to finance, especially limited access to working capital and investment,
- Weak and inadequate incentive mechanism, etc.

There are several institutions (e.g. Ministry of Trade and Industry, Ministry of Mines and Energy, Chamber of Commerce, the National Export Council, etc.) directly or indirectly involved to support the trade sector and they are given the mandate and the role to play in promoting trade, especially the export sector. A study by EIFTRI-AEMFI (2013) indicates that not only there is absence of effective coordination mechanisms among the different institutions, but also there is overlap of activities among the various institutions that are engaged in the export support. The National Export Coordinating Committee (NECC), National Economic and Business Diplomacy Coordination Committee (NEBDCC), and National Productive Sector Competitiveness Support Council (NPSCSC) are the three most important institutional setups, which aim at supporting the export trade in the country. For instance, the Ministry of Foreign Affairs, which leads the National Economic and Business Diplomacy Coordination Committee (NEBDCC), was not initially a member of the National Export Coordinating Committee (NECC)[8]. Similarly, until recently, members of the NECC were not members of the NEBDCC. It is not clear how the three institutions are coordinated to bring the desired impact on exports. The NECC and the NPSCSC seem to have profound overlapping activities since both are in charge of enhancing the competitiveness of the export sector through addressing bottlenecks related to infrastructure, tax, customs, logistic and finance to create conducive policy environment for the private sector to operate.[9]

There have been instances whereby divergence in terms of coffee grades has been observed by the ECX which grades coffee on arrival and the Coffee Liquoring Unit of MoA which ultimately decides on export status of coffee regardless of the grades given by the former. A similar problem has been observed in the case of crops and spices and horticultural products: exporters need to pass through the plant health regulation of the MoA and visual inspection of the Ministry of Trade, which entail transaction costs for exporters. This clearly shows lack of communication and coordination between the different regulatory institutions. As a consequence, there is no institutional mechanism to ensure the consistency of trade and related policy reforms.

There are a plethora of institutions involved in supporting the trade sector, but coordination among them remains unclear and poor. Note that lack of coordination is not specific to trade issues; this seems to be an institutional weakness in the government machinery that needs to be addressed.

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[8]Except that some individual members of the NEBDCC are also the members of the NECC. Cognizant of this gap, the government has decided to link the NECC and the NEBDCC.

[9] There are some additional mandates for the NPSCSC such as promoting linkages between SMEs and LMEs, TVET, Higher and Research Institution for technology transfer and KAIZEN support.

Frequent restructuring of institutions has also remained a challenge. Although restructuring may be important for improving the efficiency and functioning of institutions, it could also create uncertainty and confusion among the staff of the institutions and other stakeholders who have to re-identify their interlocutors every now and then. It also entails discontinuity of activities and programs and loss of institutional memory. Hence, there is a need for continuing role for the government to facilitate trade mainstreaming through, for example, streamlining institutional frameworks based on its long-term vision and aspirations.

Access to finance and foreign exchange and infrastructure have remained a concern. Both the availability and access to finance for trade are really worrisome, i.e. limited availability as well as high cost of loan have remained a constraint as there is no equity financing in the country. Despite the fact the government of Ethiopia through the Development of Bank of Ethiopia (DBE) provides loans to priority sectors (e.g. manufacturing), there seems dissatisfaction with the services of DBE due to its long procedures. In addition, the loan policy of the bank does not seem support for import-substituting industries. Studies (e.g. Yusuf et al., 2013; BKP, 2013) also indicate that not only businesses lack finance for direct investment but also they face working capital constraint. In addition, discussions with stakeholder indicate that access to foreign exchange has become a chronic problem in the country.

5.6 Rules of Origin (RoO)

In the literature of international trade agreements, origin rules are one of the key elements on customs declaration among classification and valuation. Country of origin of goods indicates that the country in which the goods are produced or manufactured, according to the criteria laid down for the purposes of application of the customs tariff, tariff preference or of any other measure related to trade.[10] In particular, preferential rules of origin have become more important in the free trade agreements. In other words, Rules of Origin denote the economic as opposed to the geographical nationality

[10] If all countries were to apply Most Favoured Nation (MFN) treatment to imported products, the origin of these products would be irrelevant.

of products. Rules of origin can be preferential or non-preferential.[11] Preferential rules of origin refer to trade under trade agreements and unilateral preferential trade arrangements, such as COMESA, AGOA, and GSP. Note that preferential rules of origin are applied in the case of Free Trade Agreements and other preferential duty. The role of preferential rules of origin is to ensure that tariff preferences are granted exclusively to goods originating in the beneficiary countries, to the exclusion of others. The most obvious role of origin rules is to avoid the deflection of trade in an FTA. On the other hand, non-preferential rules of origin aim at assigning origin to all goods imported into a specific country.

Ethiopia has engaged in different trade arrangements such as COMESA, Ethiopia-Sudan free trade, GSP, Special Preferential Tariff Treatment (SPTT) with China, and duty free preferences with India, South Korea and Morocco. These trade arrangements require implementation of Rules of Origin. Accordingly, the Ethiopia Customs and Revenue Authority (ERCA) prepared rules of origin guideline (No.32/2002) which has been in effect since then.

Determining the issue of origination for primary goods (e.g. raw minerals, unprocessed vegetable products, live animals and fresh fish) seems straightforward, especially if such goods are entirely obtained in the territory of the exporting country, including its territorial waters. Similarly, goods processed in one country, with primary inputs entirely originating in any of the members of the CFTA, can be treated as originating goods, and thus be traded between the members of FTA under the preferential trade regime.

While the criteria to determine the issue of origination may be relatively simple for primary goods and their immediate derivatives, this is not the case for most industrial or manufactured products due to increased sophistication of production processes (Hoekman, 1993). For manufactured products, the issue of RoO has become more complex. Given the globalization of the production processes, most manufactured commodities incorporate inputs produced in a wide variety of countries. The issue of RoO is crucial and should be part of the agreement establishing a free trade area.

[11] See TradeMark Southern Africa, Training Module on Rules of Origin.

Manufactured products imported from CFTA members to be eligible for the preferential treatment should satisfy the requirements of RoO by undergoing a “substantial transformation”. The Kyoto Convention provides guidance whether or not a commodity that combines materials or processes from two or more countries has undergone a ‘substantial transformation’, i.e. whether or not the transformation yields a commodity a new name, a new character and a new use. There three methods of determining the RoO: change in tariff heading, value added criteria, and product-specific process.[12] Note that the type of RoO and its modality shall be jointly agreed by AfCFTA member countries. Based on the agreed RoO for AfCFTA, it is the responsibility of individual countries to develop their capabilities for effective implementation the integration process.

Box 1: COMESA Rules of Origin

According to the COMESARoO, products are eligible for tariff reduction/elimination within COMESA if they satisfy one of the following criteria (Mauritius Freeport Authority, 2003):

- They should be wholly produced (e.g. animals bred and reared on a farm); or
- The c.i.f value of the imported material content should not exceed 60 percent of the total cost of the materials used in the production of the goods; or
- The local value added in the process of production should account for at least 35 percent the ex-factory cost of the goods; or
- The process of production should lead to a changed in tariff heading of the processed goods (e.g. import of fabrics for producing garments as finished product);

[12]Many FTA agreements employ a combination of these methods. For goods “wholly obtained” which relate to mainly agricultural products and raw materials, the Egyptian-EU FTA Agreement provides a relatively a comprehensive and transparent treatment. As for industrial products that require “substantial transformation”, RoO are defined on a product- by-product basis depending on the change in tariff heading (CTH) accompanied or replaced by product specific process and/or a rather high level of value added that is needed to be achieved to confer origin of a certain product (between 40-60 percent of the value added on average). In the Canada-US FTA (CUSFTA), RoO status is determined mainly by the application of the CTH and/or a value added criteria of at least 50 percent. For some products, such as automobiles and textiles in particular, the value added requirement is higher. No ascertainable rule or principle has been employed in determining what level of change would be required for any particular product. The CUSFTA also contains RoO concerning services. The main criterion involved in determining the origin of services is the nationality of the service provider either in terms of ownership or control.

- ❖ The goods should be designated in a list by Council of Ministers to be goods of particular economic importance to the development of the member states and the local value added should not be less than 25 percent.
- ❖ Cumulative Treatment: Raw materials or semi-finished goods in any one of the member states and undergoing working or processing either in one or two or more in states shall be deemed to have originated in the member state where the final processing or manufacturing take place. Each unilateral preferential trade arrangements are non-reciprocal in nature and hence subject to its own rules of origin.

Source: Daniel *et al* (2013)

Challenges to administrating RoO: Case of Ethio-Sudan FTA

Ethiopia exports cereals, pulses, vegetables and fruits, honey, cattle, etc. to Sudan, and imports industrial products such as soft drinks, plastic products, carpets, cosmetics, detergents, etc. from Sudan. Ethiopia's exports to Sudan consist of primary and unprocessed agricultural goods while the country imports manufactured goods from Sudan. There are two sets of regimes governing trade between Ethiopia and Sudan.

- ❖ There is a border trade agreement between Ethiopia and Sudan, which provides the opportunity for Ethiopians and Sudanese living around the border with a radius of 90 kilo meters to freely transact goods with each other up to maximum of Birr 2000 per day.
- ❖ Ethiopia and Sudan also agreed to conduct free trade between them in line with the COMESA Rules of Origin procedures.

Ethiopia has two border custom posts in Metma and Gendawuha. The Gendawuha custom post checks on imports whether they originate from Sudan satisfies the COMESA Rules of Origin criteria and also check on Ethiopian exports to the Sudan to be as per the documents formally declaring their type, volume and price. The Metema checking point mainly focuses on controlling illegal border trade between Ethiopia and Sudan. It also provides information to Gendawuha custom office on the type and amount of goods formally entering into and exiting from Ethiopia.

For COMESA and Ethio-Sudan bilateral free trade agreement, COMESA Rules of Origin protocol is used to determine the originating status of products. The Chamber of

Commerce and Sectoral Associations of Ethiopia (ECCSA) is in charge of providing Certificate of Origin in the Ethiopia-Sudan free trade agreement.[13] In addition, the Ethiopian Customs Commission also provides Certificate of Origin. The Ethio-Sudan FTA implementation faces challenges, especially in administrating the Rules of Origin. A study Daniel *et al* (2013) identified the following challenges regarding the RoO between Ethiopia and Sudan FTA.[14]

Limited knowledge of the type of products produced by Sudan: It has been observed that there is a serious limitation with regard to identifying whether or not goods exported to Ethiopia are originated from the Sudan. Problems in this regard include lack of information on types of products produced in Sudan, the degree of processing to apply the value addition criteria, type and origin of inputs of the imported products, etc. These problems couldn't arise had there been a trust between certifying intuitions in both countries. The Sudanese Chamber of Commerce and its branch offices issue CO, but the Ethiopian Customs Offices do not have any information whether or not branch offices of Sudanese Chamber of Commerce have the authority to issue CO, and this creates difficulty in accepting CO issued by branch offices.

Limited capacity in commodity identification: The HS Code contains several products, and some products seem to be similar but subject to different tariff headings. Customs experts face problems of matching tariffs with commodities, and this entails subjective judgments in the valuation of imports. This requires updating commodity classifications and their tariff headings.

Weak standard and quality control: Imports from Sudan become usable once they are declared to be legal at ports. Nonetheless, standards, qualities (hygiene and

[13]The institution responsible for issuing the COMESA Certificate of Origin (CO) varies from country to country. However, in many countries, the Chamber of Commerce is responsible for issuing the Certificate. For instance, the Chamber of Commerce issues the COMESA Certificate of Origin in Mauritius, Malawi, Kenya, etc.

[14]Daniel, N., Yesuf, A., Ferede, T. and Gebeyehu, W. (2013), Mmacroeconomic policies, performance and sectoral structure: An overview, Volume 2, Ministry of Finance and Economic Cooperation.

content) and manufacturing dates are not checked in a scientific way through laboratories at port of entry.

Limited automation: The Customs Offices at ports lack modern technologies, such as cargo scanning, and activities are not IT-supported. Although the custom office at Metema is integrated with the country-wide network of using the ASICUDA software program, the operation of the custom office is not fully automated. Goods are loaded and unloaded first at Metema and then at Gendawuha for checking. Investment in automation such as in scanning machine could have solved the problem. There are also no warehouse services both in Metema and Gendawuha posts.

Staff turnover and lack of competence at Customs Offices: The Customs Offices at ports lack the necessary manpower and expertise, especially in the customs valuation, transit experts, etc. High turnover of personnel exacerbates the problem. There is lack of incentive schemes, apart from distance allowances. The Office also faces problems in handling CO documents due to lack of training as well as lack of skills in trade data management (e.g. types of goods produced by exporting countries, etc.).

Inadequate capacity in administrating CO: The Ethiopia Chamber of Commerce lacks modern facility in processing and issuing CO. The process of CO is done manually-not computerized-and forms are not available electronically and hence cannot be accessed online. The Ethiopia-Sudan FTA implementation provides a living show case how to manage and handle challenges if Ethiopia joins CFTA. This same problem will then be magnified if Ethiopia starts implementing CFTA given the current weak institutional capacity.

6. Conclusions and recommendations

6.1 Conclusions

Primary commodities export continued to dominate the Ethiopia's merchandise exports. Non-primary products (e.g. manufacturing) have a small share in total exports, and their shares have declined over time, indicating that the country has become increasingly dependent on primary exports. Not only is manufacturing lagging other Ethiopian sectors, it is also lagging in comparison to selected African countries and relative to its aspirations. The slow pace of manufacturing development in Ethiopia is also evident at the international level. Manufacturing exports not only represent a relatively low share of total merchandise exports, but also the share has shown a declining trend in recent years. Ethiopia exports very few manufactured commodities to African countries, indicating both a low manufacturing production base and a lack of competitiveness of the sector. Although some degree of export diversification has occurred, the diversification is mainly within the agricultural products, i.e. there is no diversification into the manufacturing sector. However, primary export products have tilted towards higher-value agricultural products such as oilseeds, flowers and pulses.

The main objective of this study was identifying the potential challenges and opportunities of the African Continental Free Trade Agreement (AfCFTA) for Ethiopia's private sector. As indicated in the ToR, the scope of the study was mainly based on desk review supported by focus group discussions and key informant consultations.

Ethiopia trades very little with African countries. Not only low exports to and imports from African countries but also the export structure is limited to the primary products category. Commensurate with the country's trade performance with African countries, customs duties from these countries accounted for a small share of total customs duty. In particular, customs duties from imports originating from African countries represent a very small proportion of total customs duties. This suggests that revenue loss resulting from dismantling tariff rates on goods imported from these countries will be small in the short run. In the dynamic setting, however, the government revenue could increase due to improved economic performance, increased transactions which would increase other forms of taxes such as VAT.

Despite a multitude of policies enacted and institutions involved in promoting the export sector, the performance of the export sector has shown limited progress in terms of growth and diversification across sectors. Moreover, the share of export in the economy remained low compared to other peer countries. The export sector is constrained by different factors. The supply side factors include inadequate domestic production, low quality of commodities, lack of reliable and organized domestic input suppliers, and low productivity. Demand side factors include low demand of export products, world price fluctuation, trade barriers (implicit and explicit) from trading partners, drought, frequent power outage, and political instability.

There are also policy related factors including lack of a comprehensive trade policy and strategy, inadequate and poorly monitored export incentives, lack of policy consistency, high tariff and non-tariff barriers, etc. Among the institutional factors are, lack of strong export coordinating agency, fragmented and uncoordinated interventions and support, limited use of ICT, etc. Although the government has granted a number of fiscal incentives, implementation problems beset their effectiveness. These include delays in service provision, duplication of documents, cumbersome procedures, weak coordination, lack of transparency and objectivity of determining fiscal incentives, lack of export-related information, etc. Specifically, cumbersome customs and trade regulations and corruption have been identified as critical problems constraining the export sector. Many government institutions that are involved in the export promotion activity are characterized by inadequate human resources both quantity and quality, lack of infrastructure, and limited financial support.

Particular significance is the capacity limitation at a technical level in the offices of ERCA in terms of handling Rules of Origin. Practical experience with Ethio-Sudan FTA and discussions with stakeholders revealed very serious practical problems including, (a) knowledge or information gap on the types of products originating from member countries; (b) reliability and credibility of ROO certificates issued by trading partner countries, which is again associated with the knowledge gap of specific products and also weak relationship with ROO certifying institutions of trading partner countries; (c) Inadequate capacity of (i) ERCA in checking and verifying origins of imported goods, (ii) Ethiopian Quality Standards Agency in ensuring quality of imported goods adhered to standards; and, (iii) the Ethiopia Chamber of Commerce and Sectoral Associations in processing and issuing certificate of origin, and (d) Illicit or contraband trade (both import and export).

There are also weaknesses from exporters' side such as lack of skilled and experienced managerial capacity, absence of training export related disciplines, low utilization of the state of the art information communication technologies, limited skill in research and development, and weak marketing strategy are reported as deterrent factors in enhancing the export business.

6.2 Recommendations

Recommendations can be grouped into two: headline and specific recommendations.

6.2.1 Headline recommendations

Given that joining AfCFTA entails competition, there is a need for a detailed assessment of strengths and weaknesses of the various sectors and the private sector to design safeguard measures. This underscores the need for conducting sector-wide diagnostic assessment to identify the extent of (un) competitiveness of the various dimensions of the economy and develop support interventions in the short- and medium-term.

Improve logistics to efficiently move goods and services to and from the port through state-of-art of technology in the area of cargo scanning, integrated IT-support, etc. Trade partnerships should focus on removing infrastructural constraints which are important to improve the competitiveness of the private sector.

The Ethiopian Government needs to pay at most attention to the modality of rules of origin for AfCFTA as it affects the country's participation in the trade regime. Trade negotiations should also involve identifying the type of rules of origin that would be implemented in the existing institutional setup. Subsequently, as rules of origin change over time (e.g. towards adopting strict rules of origin which require high level of institutional and organisational capacities required for implementation), efforts need to be made to identify specific gaps in implementing rules of origin to maximize the benefits of AfCFTA and minimize the risks associated with it (e.g. trade deflection).

Improve institutional coordination through interfacing the various institutions that are involved in the export sector through investment in networking so as to minimize transaction costs and enhance competitiveness. This involves online accessibility of information in all export related servicesto enhance business to business (B2B) and business to government (B2G) electronic communication.

Capacity building is very crucial for key institutions, especially Ministry of Trade and Industry, Ethiopian Customs Commission, (ECA), Ethiopian Quality Standards Agency, and Chamber of Commerce and Sectoral Associations in terms of human resources (e.g. both short-and long-term training) to improve their service delivery and promptness.

For the Ethiopia Chamber of Commerce and Sectoral Associations, apart from skill training, investment in automation is crucial to facilitate and speed up service delivery for Certificate of Origin. In addition, linking and interfacing the Ethiopian Customs Commission and the Ethiopia Chamber of Commerce and Sectoral Associations through investment networking is necessary for providing speedy services to exporters.

6.2.2 Specific recommendations

The study also provides specific recommendations on specific competiveness constraints as identified in this study. Table 5 presents specific recommendations.

Table 5: Specific recommendations

	Constraints		Recommendations
1	Anti-export bias	1.1	Revisit export promotion efforts and minimize anti-export bias effects of tariffs.
		1.2	The exchange rate management needs to be considered as a critical instrument to encourage exporters. This involves addressing overvaluation of the exchange rate by designing a compensation mechanism for exporters (e.g. by rewarding certain Birr for each earned dollar from exports) to offset the progressive overvaluation of the Birr).
2	Limited capacity in product testing facility and cargo tracking	2.1	Ensure adequate product quality testing and certification methods are in place in the country.
		2.2	Improve container tracking capability through IT-supported trade facilitation.
3	Weak coordination in customs procedures and border clearance	3.1	Reduce trade costs through improving customs procedures through streamlining procedures and coordination of border clearance processes.
4	Inadequate support in export market information	4.1	The Government shall proactively support private sector institutions including business advocacy organisations and associations to build effective information centre for export market, technology, input sources by allotting funds and technical assistance.
		4.2	Provide regular counselling supports to exporters on international businesses (e.g. after delivery payments, before shipment payments, etc.), and provide exporters update information about world market conditions (e.g. demand, supply, prices, etc.) through forecasting.
5	Limited risk mitigation	5.1	There is a need to develop intervention scheme in mitigating exporters' risks that might arise from international customers

	instruments		default and other forced measures. In the case of international price decline, price support for producers (e.g. through board, cooperatives, unions, etc.), and compensation via exchange rate instrument for exporters (e.g. use of higher the prevailing exchange rate to pay for exporters).
6	Weak private sector to comply with export quality and standards	6.1	The private sector needs to create capacities to comply with quality requirements (technology, know-how, and manpower) and institute standard and quality assurance systems at each level of production.
7	Weak enforcement capacity in trade administration	7.1	The government needs to put in place a mechanism for eliminating dumping, under-invoicing, and other unfair trade practices bolstering the capacity of inspection and other law enforcement agencies.
8	Unreliability of power supply	8.1	Power interruptions have become a binding constraint on business operations. While supply has improved in the recent past, power outages are still forcing industrial operations and businesses to cease running, leading to increased unplanned downtime to the detriment and increased loss in production and damage to machinery and equipment.
		8.2	Along with the government's determination to increase the power supply in the medium to long-term, it is important that stable power supply takes precedence over the current sudden and frequent power outage that are causing havoc on industrial and business operations.

9	Lack of a stable macroeconomic environment	9.1	A sound macroeconomic management in terms of stable inflation, exchange rate adjustment, consistency, predictability and clarity of policies, laws and regulations, flexibility in macroeconomic management are keys for improved competitiveness and long-term investment.
10	Weak institutional support for the export sector	10.1	Elevate the newly established Export Promotion Director General to an independent and full-fledged autonomous Export Development and Promotion Agency, outside the Ministry of Trade and Industry.

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