Policy brief

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Firms in Ethiopia's industrial parks

COVID-19 impacts, challenges, and government response

In brief

- The COVID-19 pandemic poses an unprecedented challenge for Ethiopia's ambitious industrialisation agenda focused on export-oriented light manufacturing.
- To quantify the impacts of COVID-19 on firms in Ethiopia's export processing zones, the World Bank Group in cooperation with the Government of Ethiopia administered a phone survey of firms.
- Survey data suggest the pandemic has severely impacted firms' ability to produce and sell their output. The availability and affordability of foreign inputs and the availability of labour are widely reported as constraints to production.
- During the survey period, firms reported that they expected orders to decrease by an average of 20 percent and employment by 17 percent in the next six months, compared to the same period last year.
- The findings illustrate the need for sustained support to help firms and workers in this strategic industry.

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Overview of the research

The COVID-19 pandemic poses an unprecedented challenge for the Ethiopian economy and the country's ambitious industrialisation agenda focused on export-oriented light manufacturing. As part of this agenda, the Government of Ethiopia has invested massively in enabling infrastructure and set up a series of special economic zones – industrial parks – to encourage foreign direct investment (FDI) into the manufacturing sector to promote exports and job creation. Before the pandemic, 14 industrial parks across the country provided employment for about 88,000 workers. While the government's strategy has focused on export-oriented manufacturing, several firms, concentrated in privately-owned Eastern Industrial Park, are focused on manufacturing goods for the domestic market. Because of the different natures of these firms, they are likely impacted differently by the shocks to the global markets.

"As global demand for key industrial park exports such as garments and textiles fell to unprecedented lows, factories in Ethiopia's industrial parks were hit with order cancellations."

In line with the broader impacts of COVID-19 on industries and value chains around the world, production in Ethiopia's industrial parks has been heavily affected. As global demand for key industrial park exports such as garments and textiles fell to unprecedented lows (Figure 1, panel a), factories in Ethiopia's industrial parks were hit with order cancellations. At the same time, confirmed cases of COVID-19 were slowly rising in Ethiopia (Figure 1, panel b). While some firms have been able to repurpose their production towards personal protective equipment (PPE), many had to put their labour force on temporary paid or unpaid leave.

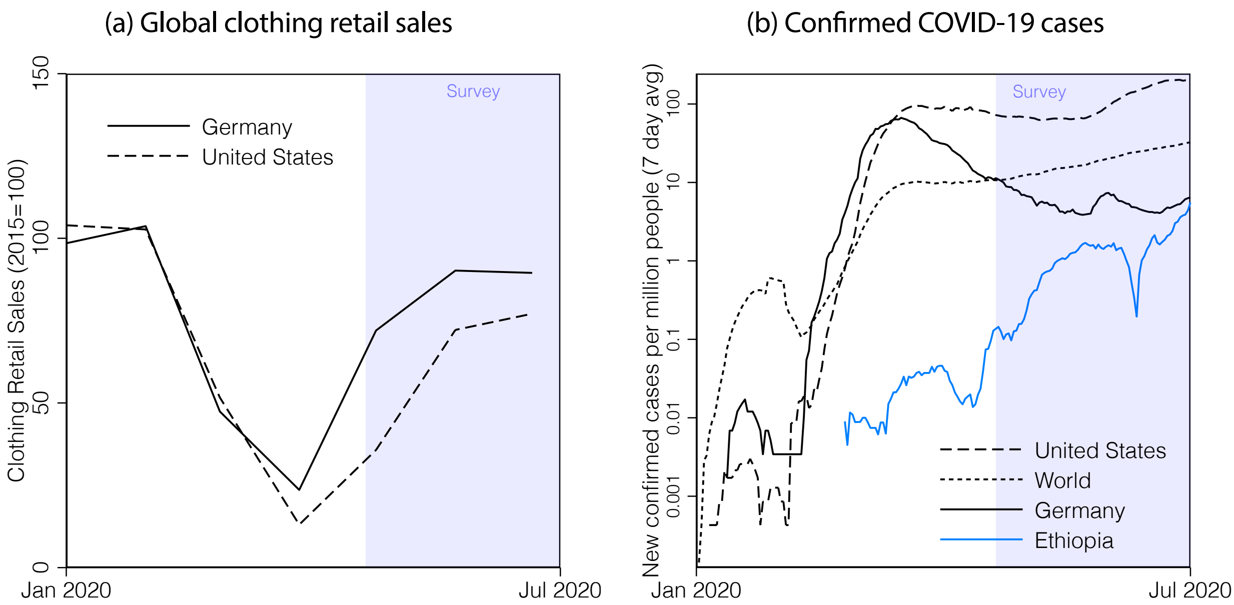
The World Bank Group in collaboration with the Government of Ethiopia has fielded a phone survey of industrial park firms to answer the following questions:

1. How have industrial park firms been affected by the COVID-19 crisis?
2. What kind of firms have been more or less affected by the crisis?
3. What are the main constraints preventing firms from maintaining planned output levels?
4. How has the Government of Ethiopia supported industrial park firms?
5. What does the near future hold for these firms?

The survey carried out was designed as a census of all operational industrial park firms and reached about 70 percent of eligible firms. Interviews were conducted over the phone by professional enumerators. Most respondents were HR managers or firm executives. The survey reached firms in 11 out of 14 parks. In Hawassa Industrial Park and Bole Lemi Industrial Park, both cornerstones of the government's industrialisation agenda, 91 and 90 percent of firms were surveyed, respectively. At the time of the survey, most firms were fully operational.

This brief summarises a more detailed analysis of the survey data in Mengistu et al. (2020).

Figure 1: COVID-19 and the global garment industry



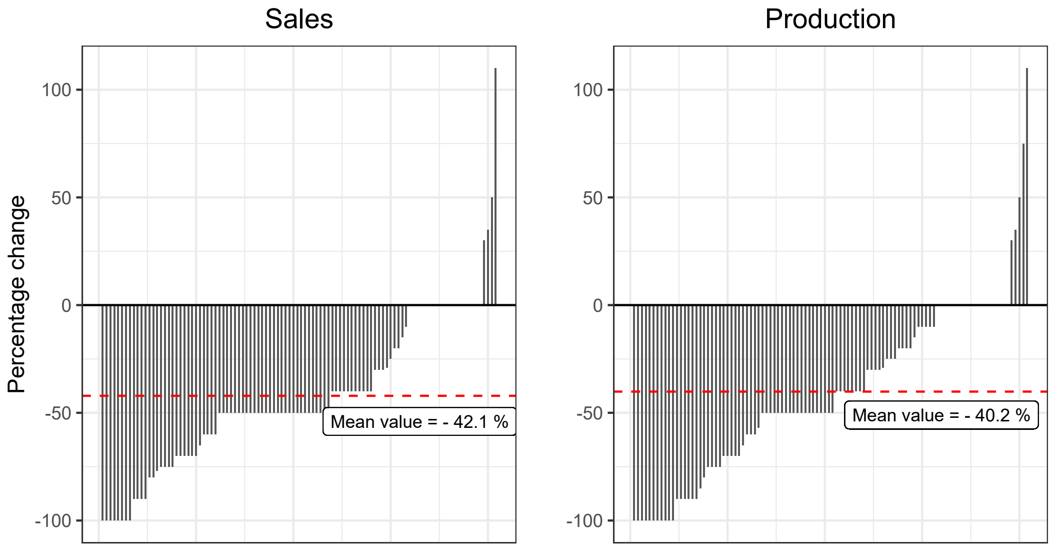
Notes: Survey dates shaded in purple.

Sources: Number of confirmed COVID-19 cases per million people are based on Our World in Data's COVID-19 dataset. Monthly clothing retail sales for the US are based on the US Census Bureau Advance Monthly Retail Trade data (Clothing and Clothing Accessory Stores). Clothing retail sales for Germany are based on German Federal Statistical Office (Destatis) GENESIS Table 45212-0005 (WZ08-4771 Retail Sale of Clothing). All retail data are in constant prices, indexed to 2015 = 100, and seasonally adjusted using X-13 ARIMA.

Impacts of COVID-19 on industrial park firms

Overall, Ethiopian industrial park firms have been significantly impacted by the COVID-19 pandemic. About 10 percent of interviewed firms reported temporarily closing due COVID-19. Over three quarters of firms have seen a decline in sales and in their production volumes. On average, sales decreased by 42 percent and production by 40 percent (Figure 2).

Figure 2: Distribution of % change in sales & production compared to planned levels

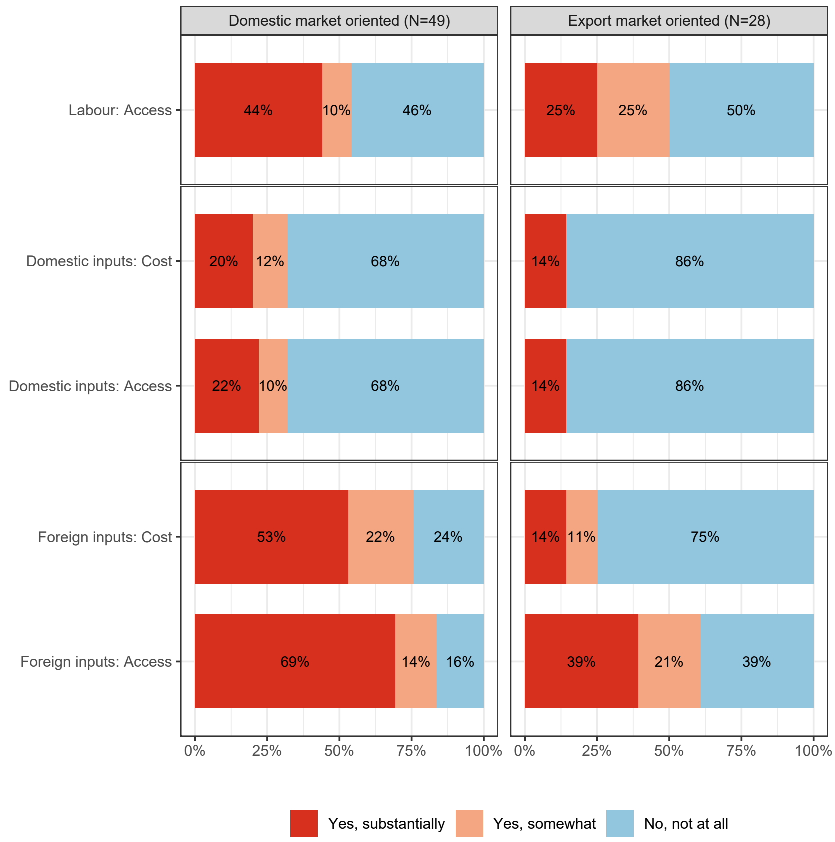


The survey findings reveal that firms oriented towards the domestic market, rather than the export market, appear to be more widely affected:

- Domestic market-oriented firms are more likely to have closed temporarily – 14 percent of these firms have done so, compared to just 6 percent of firms oriented towards the export market.
- Among domestic market-oriented firms, 86 percent experience lower sales, whilst this figure is only 67 percent for export-oriented firms.
- Closely following the sales figures, 89 percent of domestic market-oriented firms faced a decline in production, whilst only 61 percent of export-oriented firms reported a decline.

The cross-sectional survey data does not allow for clear identification of the various channels through which the crisis has affected different firms. Production of firms seems to be constrained by the availability and cost of foreign inputs and the availability of local labour. Firms that saw a decrease in production were asked about the constraints to keeping production levels the same as planned. The constraints were classified as: lack of labour, lack of access to domestic or foreign intermediate inputs or raw materials, and the cost of domestic or foreign intermediate inputs or raw materials (Figure 3).

Figure 3: Constraints to keeping production volumes the same as planned



Notes: By majority revenue source. The data presented here includes only the subset of firms who indicated that their production had declined.

"Some firms reported that workers refused to come to work out of fear of contracting the virus."

In line with the impacts on sales and production, domestic-oriented firms also face more binding constraints in meeting production targets. Accessing and affording foreign inputs are reported as the most significant constraints. Importantly, all firms, whether or not they are oriented towards the domestic or export market, rely heavily on importing raw materials and intermediate inputs. The availability of labour is the second most significant constraint. During the survey period, the government did not order businesses to close, but did issue a stay-at-home recommendation. Some firms reported that workers refused to come to work out of fear of contracting the virus. Firms also reported that employees struggled to access public transportation. Finally, in industrial parks sourcing their labour more from rural areas such as Hawassa Industrial Park, a significant number of workers have temporarily or permanently returned to their rural origin communities (Meyer et al., 2020).

Government support to industrial park firms

The Government of Ethiopia reacted quickly by announcing a range of measures designed to help businesses, including those in the industrial parks. These measures served to primarily alleviate temporary liquidity constraints through the deferral of tax payments and social security contributions. The government also prohibited the firing of workers during a State of Emergency, which lasted until mid-September. However, the government has not provided financial support to help firms continue paying their workers.

"... the government has not provided financial support to help firms continue paying their workers."

At the time of the survey, 30 percent of industrial park firms received some type of support from the government. Export-oriented firms are more likely to report receiving support compared to domestic market-oriented firms. The fact that relatively few firms reported benefiting from support despite demand for it raises the question of why take-up has been muted so far. One reason could be that firms are not aware of the existing policies enacted or how to apply for them. This could especially be the case for firms that are focused on the domestic market. For the firms that are aware, some of the policies that have been announced or implemented might not be targeted towards industrial park firms (e.g. some of the tax policies are focused on firms with tax debts, which is likely to be less prevalent among industrial park firms as they are exempt from business income tax; in addition, industrial park firms can import raw materials duty free and, as a result, duty waivers on raw materials for PPE production do not impact these firms). Better understanding the issue of coverage, take-up, and effectiveness of these various types of support would be important to inform government responses to future shocks.

The path forward

When asked about their expectations for the coming six months, firms expect major reductions in their workforce and orders. Firms on average expect to lose 16.7 percent of workers and see their order volume decrease by 20.4 percent. In a pessimistic scenario, firms expect employment and order volumes to decline by almost 50 percent.

Policy recommendations

The pandemic threatens a significant setback in Ethiopia's industrialisation agenda. Firms and workers may thus require targeted and sustained support over the coming months, especially after the temporary ban on laying off workers came to an end in mid-September 2020. The structural differences between exporters and non-exporters and their respective constraints documented above illustrate the need for bespoke and differentiated support. Specific schemes may include wage subsidies and concessional loans.

- **Wage subsides:** Because Ethiopia's industrial parks are highly formalised, supporting their firms and workers should be logistically feasible. Wage subsidies are a flexible instrument to temporarily support firms and workers. They can be combined with cash transfers to workers who lose their jobs.
- **Loans:** Bangladesh provides an interesting example of a $600 million

concessional loan programme in which local banks make direct wage payments to garment sector workers in participating factories, which accrue as loans to factories (Woodruff, 2020). These bank loans are underwritten by the central bank. Similar schemes are plausible in the Ethiopian context and may be more feasible given the tight fiscal space. Addressing uncertainty for firms early on would be critical to ensure they can continue operations.

References

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