THE STATE OF COMPETITION AND THE COMPETITION REGIME OF ETHIOPIA: POTENTIAL GAPS AND ENFORCEMENT CHALLENGES

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Acronyms

AAGTA	Addis Ababa Grain Trade Association
AISCO	Agricultural Inputs Supply Corporation
AISE	Agricultural Inputs Supply Enterprise
AMC	Agricultural marketing Corporation
CBE	Commercial Bank of Ethiopia
CSA	Central Statistical Agency
DFID	Department for International Development
DSA	Development Studies Associates
ECEA	Ethiopian Coffee Exporters Association
ECX	Ethiopian Commodity Exchange
EEA/EEPRI	Ethiopian Economic Association/Ethiopian Economic Policy Research Institute
EFFORT	Endowment Fund For The Rehabilitation of Tigray
EGTE	Ethiopian Grain Trading Enterprise
ETFRUIT	Ethiopian Fruits and Vegetables Market
EPRDF	Ethiopian Peoples Revolutionary Democracy Front
FCA	Federal Cooperatives Agency

IDA	International Development Association
ILO	International Labour Organization
IMF	International Monetary Fund
LMSMEI	Large and Medium Scale Manufacturing and Electricity Industry
MARD	Ministry of Agriculture and Rural Development
MFA	Ministry of Foreign Affairs
MT	Ministry of Trade
MTI	Ministry of Trade and Industry
MWITE	Merchandise Wholesale and Import Trade Enterprise
MWUD	Ministry of Work and Urban Development
NBE	National Bank of Ethiopia
OECD	Organization for Economic Co-operation and Development
RSC	Rural Service Cooperatives
SNNP	Southern Nations, Nationalities and People
SSA	Sub-Saharan Africa
UCA	Urban Consumer Association
UNCTAD	United Nations Conference on Trade And Development
WFP	World Food Programme
WTO	World Trade Organization

Chapter 1

INTRODUCTION

1.1 The Rationale

The potential benefits of market competition, at least in industrialized economies, for creating the incentives and dynamics driving efficiency, innovation and productivity growth is well established. Policy and regulatory measures which enhance competition bring "productivity gains, consumer welfare gains, and long-run economic growth".[World Bank, 2009, p48] In economies where markets are yet not developed, whether competition brings in practice such gains is, however, controversial, though there is a general consensus that it is still beneficial in broad brush terms.

Ethiopia today has set out on a long journey towards establishing a full-ledged market economy. On the one hand it aspires to establish a competitive market economy, while on the other it pursues a state-led economic management system to develop productive forces during the interim. However, successfully marrying these two approaches in practice is quite challenging. Private actors complain of being marginalized; the government is often uncomfortable with certain practices, which lead to rising prices and acute shortages in some markets.

The purpose of this research is to investigate how state- and market-led economic managements interface in practice and to suggest ways where these two approaches reinforce towards developing market forces (the private sector) in the longer term.

To this end, the research discusses/addresses the state of competition in some selected markets, i.e., the roles of the state and private actors, and the policy framework under which these markets operate, the relevance and effectiveness of the regulatory provision (the competition law) governing the markets, and the challenge of enforcing the law in practice.

1.2 Research Methodology

1.2.1 Selection of sectors and markets

Four key sectors of the economy, namely agriculture, industry, infrastructure and finance are selected. In a low income economy such as Ethiopia, poverty reduction and growth is primarily and essentially addressed through the transformation of agriculture, provision of reliable infrastructure, access to financial/banking services, and expansion of basic manufacturing industries. The choice of these sectors is, therefore, not accidental.

Taking different criteria into account, such as socio-economic importance, in terms of consumption, export and GDP growth, unique ownership structure of enterprises, the nature of competition, etc., a number of markets, including coffee, cereals, fertilizer, edible oil, sugar, cement, hides and skins, and banking has been selected. However, other key markets, not addressed in this research, need to be included to provide a complete picture of the competition environment in the economy.

1.2.2 Data and information Sources

Both primary and secondary sources were used to solicit the required information. A survey was conducted in eight major cities of the country. After a careful selection of enterprises/firms in each relevant market, respondents were issued a structured questionnaire to complete or interviewed. Interviews were administered where the required information could be accessed within a brief period of time or where respondents preferred so, particularly in the case of farmers. In the case of coffee and cereals, group discussion with farmers and cooperatives leaders has also been conducted. In goods markets, a number of market participants are involved along the supply chain: starting from an input supplier, to a producer, suppliers, and consumers.[1] Thus all participants had to be addressed to access complete information. Secondary sources, such as published and unpublished materials, media reports, websites, etc., were also used as vital sources of information.

1.2.3 Selection of survey locations

[1] Consumers were represented by Urban Consumers Associations.

The survey was conducted in eight major towns of the country, namely Adama, Addis Ababa, Bahir Dar, Dire Dawa, Gonder, Hawassa, Jima, and Mekele. Survey locations are selected based on business and population significance. Such cities also have political importance, as most of them are capitals of administrative regions, hence representatives of the latter. They are also industrial centres, accounting for over 90 percent of the industrial establishments in the country.

1.2.4 Analytical framework

The analytical approach closely follows the operational guide for assessing the nature of competition in developing countries drawn by DFID UK with some variation to fit the specific political economy condition of the country. [DFID, 2008] Also, OECD material on competition assessment has been used as a reference. [OECD, undated] First, the contextual framework provides a setting for the theoretical dimension of competition that may be desired in the political economy environment of Ethiopia, and the rules of the game – the competition law (Figure 1). This gives an indication of the kind and extent of competition that may exist in the economy.

Second, for each market, its salient features, involving its economic importance, policy environment, market players and ownership structure, marketing structure, etc are discussed. Then the effects on the extent of competition, i.e., entry & exit, market concentration, anti-competitive practices, etc., are explained. Then the impact of competition on prices, profitability, innovation, export, competitiveness, etc., is addressed. Finally recommendations towards developing market forces are provided.

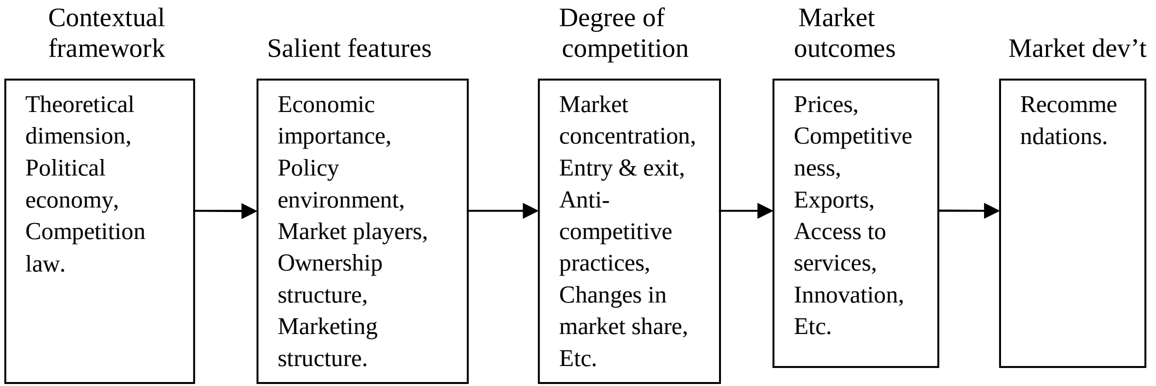

Figure 1. Analytical framework

Source: Adapted from Karen Ellis & Rohit Singh (2010), p.2, Figure 1

1.2.5 Validation seminar

As part of the methodology to assess the state of competition, a one day validation seminar was also held in each surveyed town, which introduced the preliminary findings of the research to all survey participants. The seminar not only served as a capacity building programme, but also facilitated a forum to access feedback from participants for further polishing the findings of the study.

1.3 Structure of the Report

Chapter 2 contextualizes competition in the current political economy environment of the country; followed by the assessment of the state of competition in selected markets in Chapter 3. Chapter 4 reviews the new competition law and discusses the practical challenges of enforcing the law. Chapter 5 concludes with a summary of findings and recommendations.

Chapter 2

CONTEXTUALIZING COMPETITION IN THE ETHIOPIAN POLITICAL ECONOMY ENVIRONMENT

2.1 The Developmental Dimension of Competition and Competition Policy

2.1.1 The Merits of Competition

The process of rivalry between business enterprises for customers (i.e., for market share) is a fundamental characteristic of a flexible, dynamic market economy. Competition puts firms under pressure to devise more efficient methods of production, supply more variety, introduce better marketing techniques, and improve quality of products. This often results in lower prices, wider choice, and better quality goods for consumers. [Khemani, S. 2007] Higher demand for goods and services at lower prices and of higher quality spurs competing businesses to reduce costs, increase productivity, make investments, and adopt new technologies and organizational methods to innovate in processes and products. This tends to enhance economic efficiency and improve consumer welfare. The greater the competition that firms face, the greater is the incentive and motivation to gain cost and quality advantage. There is positive relationship between competition and efficiency and between competition and the rate of productivity growth.[2] [DFID, 2008] "Efficient allocation and utilization of resources also lead to increased competitiveness resulting in substantial growth and development." [UNCTAD, undated, p2] Competitive domestic markets (essentially of industrialized and semi-industrialized economies) generally tend to have higher levels and rates of growth in per capita income. These economies also have lower rates of poverty (World Bank, 2003). Based on data from the World Bank and World Economic Forum (global competitiveness report), Khemani, argues that:

> Higher levels and rates of growth in per capita gross domestic product (GDP) are associated in countries that have high intensity of competition in local markets. The IDA countries tend to have low levels of competition intensity in local markets, and low levels of per capita GDP. Higher intensity of competition in local markets is associated with greater effectiveness of competition law-policy. Again, IDA countries have low effectiveness in the application of competition law-policy. [Khemani S. 2007, p3]

Standard mainstream economic theory also holds that competitive forces work best and deliver the expected outcomes when there exist a market that is not overridden by distortions, such as price distortion, quality deterioration, etc. The merits of market competition depends on the market environment in which businesses operate, including the legal and regulatory framework,

[2] Though there is positive correlation between these variables, it does not imply that competition is a major determinant of efficiency and growth.

barriers to entry and exit, and prevailing conditions in markets for labour, land, finance, infrastructure services, and other productive inputs. Moreover, even where a conducive environment exists, competition may not be necessarily assured. Pro-competition economic reforms, such as liberalization, privatization, deregulation, etc., are insufficient. These measures do not address the restrictive business practices and rent seeking behaviour of vested interest groups, incumbent large monopolistic firms, and other stakeholders of the private sector. Such private actors may capture or dampen the benefits of reforms, resulting in loss of welfare for final consumers and loss of economic opportunities for competitors. [Khemani, S. 2007].

Moreover, certain government regulations may not be pro-competition, or may even interfere with competition objectives. Primarily, governments often intervene in markets to promote desirable socio-economic goals – including regulating the behaviour of business. There can be good economic reasons for such intervention, such as preventing market failures arising from the presence of externalities, overseeing common public resources and public goods, limiting market power, and reducing inefficiencies from insufficient or asymmetric information, ensuring safety of consumers, ensuring availability of basic essential goods at affordable prices, minimizing accidents, promoting industrial policy, supporting small scale and micro enterprises, etc. In addition to economic regulation, governments regulate the behaviour of businesses to promote valuable goals in the areas of health and environmental quality. [OECD 2011] However, while governments motive to intervene may be justifiable, the challenge of identifying the best feasible form and extent of intervention and selection of instruments to achieve such goals may result in market distortion, thereby retarding competition.

Thus, the competitive environment needs to be maintained, protected, and promoted by a well-designed and effectively enforced competition policy and law. Competition policy typically includes measures that enhance competition in local and national markets (such as liberalized trade policy, relaxed foreign investment and ownership requirements, and economic deregulation, transparent public procurement policy, etc), and competition law designed to help prevent anticompetitive business practices by firms and unnecessary market intervention by government. The latter also includes institutional aspects to enforce the law and promote competition. [Khemani, S. and M. Dutz, 1996].

Though enactment of competition law does not necessarily result in higher competition, having it in place and effective implementation signals to firms and markets that certain business behaviours and commercial practices are illegal. It confers rights and obligations on transacting parties and provides for due process to resolve disputes and obtain relief from anticompetitive practices. As such, competition law basically aims at reducing or eliminating impediments to competition that unnecessarily arise from public policy interventions as well as private sector restrictive business practices. It also promotes better public and private sector market governance through promoting greater compliance with the law and adoption of sound business ethics. It also fosters broader and shared economic development by reducing barriers to entry and competition, increased accountability and transparency in government-business relationships, and limiting opportunities for rent seeking and corruption. As such it provides for a system of checks and balances so that businesses are free to pursue legitimate commercial interests, consumers including other business firms are not exploited, and both government and business adopt good market governance principles. An effective competition policy includes a set of instruments that buttress a healthy investment climate, thereby contributing to investment, productivity, and broad-based economic development. [Khemani, S. 2007] Without effective competition law, firms are more likely to resort to anti-competitive business practices to wield considerable market power and earn excess profits. [Evenett, s. et al. 2006]

2.1.2 Competition policy and the development need of low income countries

The merits and benefits of fostering open and competitive markets have been recognized in many countries, though the nature and extent of competition prevailing within and across countries at different stages of economic development widely varies. For instance, using data from

Global Competitiveness perception survey report, Khemani graphically shows and concludes that:

> … the least-developed (based on IDA ranking) countries, which tend to have low levels of per capita GDP, also have low intensity of competition. … these countries also tend to have less-effective competition (antitrust) law-policy, which probably explains why local markets are dominated by few large firms. These economies also rank lower in terms of the business competitiveness index, which is positively associated with effectiveness of competition (antitrust) low-policy. Finally, [...] the intensity of competition in local markets and effectiveness of competition (antitrust) low-policy tend to be positively correlated. [Khemani, S. 2007, p.17].

Moreover, there is no consensus, even theoretically, on the nature and extent of competition that has to prevail across countries (and within a country) at different stages of development. While mainstream economic theory posits a monotonic positive relationship between competition and development, suggesting the greater the intensity of competition, the better the economic performance,[3] empirical studies and modern economic analysis seriously qualify that conclusion.[4] Specifically, while there is now wide consensus that developing countries (low income countries too) need to have competition and competition policy, there is strong argument that the nature and intensity of competition has

[3] See for instance, World Bank (1991); Khemani, S. (2007); Jones, A. and B. Surfin (2001); Evenett, S. et al. (2006); ICN (2002); OECD (1997).

[4] See Telser (1987); Laffont (1998); Amsden and Singh (1994); Singh, A. (2002); Mehta, P. and S. Chakravarthy (2001).

to be development supportive. In relation to this, Laffont, for instance, contends that:

> Competition is an unambiguously good thing in the first-best world of economists. That world assumes large numbers of participants in all markets, no public goods, no externalities, no information asymmetries, no natural monopolies, complete markets, fully rational economic agents, a benevolent court system to enforce contracts, and a benevolent government providing lump sum transfers to achieve any desirable redistribution. Because developing countries *(particularly low income countries)* are so far from this ideal world it is not always the case that competition should be encouraged in these countries."[5] ([Laffont, J. 1998, p.237] Quoted in Singh, A. 2002, p.15).

Thus, the gap between the assumptions of perfect competition and the realities on the ground in most developing countries, particularly low income countries, is often considerable. In these countries the conditions for perfect competition are far from being met and the benefits of enhancing economic efficiency do not necessarily always translate into improved consumer welfare. Therefore, the relationship between enhanced competition and development consequently becomes less tangible. [UNCTAD, undated].

Based on the theory of the second-best, "… if any one of the assumptions required for the validity of the fundamental theorems of welfare economics cannot be met, restricted rather than unrestricted competition may be a superior strategy." [Sing, A. 1999, p.11].

[5] Italics in brackets added.

Also, the weak institutional capacity of low income countries may not guarantee intensive competition. A strong state is required to administer a comprehensive and intensive competition policy, such as that observed in industrialized economies today. [Laffont, 1999] Moreover, these countries have a lot of sectoral variations: some are moderately developed, while the rest are quite backward and least competent. [Mehta, S. and Chakravarthy, S. 2001]. Such constraints make application of a universal (nation-wide) competition and competition policy less justifiable.

A central issue in adopting a competition regime/policy is the objective for which it is undertaken. The essential focus of competition policy in advanced countries is the promotion of allocative efficiency and reduced prices for consumers (WTO, 1997). Sing argues that from the stand point of economic development, this perspective is too narrow and static. In order to raise the standard of living of the people, a central objective, hence the prime focus, of developing countries must necessarily be the promotion of long term growth of productivity. The pursuit of this objective requires high rates of investment, which in a low income country necessities conscious support and encouragement of enterprises’ propensity to invest. However, if, as a result of competition, profits become too low, even temporarily, private sector’s motivation to invest could be dampen. This suggests that unfettered competition may not be appropriate for a developing economy, particularly for low income economy. Broadly, this implies that unrestricted competition policy may not allow state authorities to have at their disposal adequate space/discretion in relation to other development policies, in particular industrial policies or strategic trade policies. [Singh, A. 2002].

There are also other arguments labelled against unrestricted competition policy. Not only that it gives too much weight to efficiency relative to other societal goals, such as environment protection, income distribution, etc., its effective contribution to efficiency is also relatively small. [UNCTAD, undated] It is also noted that competition evolves overtime, responding to the needs of society and socio-economic progress. Realizing fair competition in an economy, therefore, requires not only progress in industrial development, but also raising the consciousness of the public at large, including the business community, the public sector, consumers, civil society groups and academia. [Singh, A. 2002; Mheta, S. et al. 2011].

Thus, in light of these conditions, i.e., lack of sound theoretical relevance, lack of institutional capacity, central development objective, the evolvement of competition overtime, etc., what is required by low income countries may not be a comprehensive and intensive competition but 'optimal degree of competition'. This implies that only fewer and simpler competition rules capable of being enforced and which would entail sufficient rivalry to reduce inefficiencies and promote investment and development is what these low income countries require, not so much competition and competition policy that would deter the propensity to invest and least manageable. It should be underlined that as there is no blue print for competition policy, what may be 'optimal' for one economy, may not be so for another. This is determined by the specificities of the economy at issue.

2.1.3 Recent experiences with competition and competition policy

Proponents of the theoretical setting against unrestricted competition and competition policy for developing countries argue that not all countries, including today's advanced industrial economies, adopted open market competition during their earlier periods of industrialization. There are successful industrialized countries in adopting and operating limited and managed competition consistent with their development needs. Among the East Asians, Japan, Korea, and, recently, China are often quoted as forerunners in such exercise. Over a couple of decades – in the 1950s and '60s, Japan achieved historically unprecedented industrial growth (Sing, A. 1998). The key factors for its success are very high rates of saving and investment. To maintain private sector's high propensity to invest and high rate of profitability, its industrial policy, driven by a package of incentives, had been accorded top priority vis a vis the competition policy. [Lall, S. 1996] To this effect, restrictions were frequently imposed on product market competition. [Singh, A. 1999] Amsden and Singh noted that;

> It (The Ministry of International Trade and Industry) encouraged a variety of cartel arrangements in a wide range of industries -- (including export and import cartels, technology cartels, cartels to combat depression or excessive competition, rationalization cartels, etc. […] Similarly, believing that large scale enterprises were required for promotion of technical change and for Japanese firms to compete effectively with their western counterparts, MITI encouraged mergers between leading firms in key sectors." [Amsden and Singh, 1994, p.944][6].

It also sequenced investment by firms and intervened in the exit and entry decision of firms, all of which contributed to the high investment concentration ration observed in the Japanese economy. [Singh, A. 2002]. At the same time, Japan implemented an industrial policy that encouraged contest-based competition between oligopolistic firms where the rewards were access to cheap credit and foreign exchange as well as, where necessary, protection from international competition. These rewards were contingent on relative performance either in export markets, technological development, or new product development. This resulted in intensive rivalry between firms. [Porter, M. 1990].

[6] Quoted in Sing, A. 1999.

Korea too, had a strong industrial policy which dominated competition policy. The government was instrumental in the creation of giant conglomerates – the *chaebol* – which went on to capture world markets. While enforcement of competition has been lax, these conglomerates compete with each other for government support in return for meeting specified performance targets, such as exports, new product development, technological change, etc. [Lall, S. 1996] In the market place, the *chaebol* competed for market share, as it determines their subsequent investment allocations in particular industry. Until recently, The Korean government has purposefully coordinated industrial investment by competing *chaebol* so as to prevent overcapacity and too much competition. [Chang, 1994]
Thus both Japan and Korea shared similar policy framework that maximize long-term growth of productivity (dynamic efficiency) through an institutional structure that combined both cooperation and competition between firms.

China followed strict central planning until recently and emerged a 'global economic power' without even little open market competition in the domestic economy. Behind high trade barriers, the Chinese created large firms, so called 'national champions' in select strategic areas such as electricity generation, coal mining, automobiles, iron and steel, and the like. It is only since the late 1970s, that china began to introduce limited domestic competition following its economic reconstruction programme. Since the mid 1990s, China adopted a policy of moderating competition in certain sectors (particularly when the viability of state enterprises (SEs) underwent erosion with problems relating to unemployment, labour unrest, and social welfare surfacing), and promotion of vigorous, but fair, completion in others. Where goods were in short supply, the industrial policy supported firms producing such goods and where goods were in excess supply, the policy restricted overproduction by firms. [Mehta, S. and S. Chakravarthy, 2001].

In fact even the "European competition law also makes provision for industrial policy under strict guidelines as well as provision for other objectives such as fairness, equality of income distribution, and other social goals (e.g. reducing regional disparities and unemployment)". [Singh, A. 2002, p.16].

The policies adopted, and empirical successes recorded, underline the broad dimension of competition in addressing the developmental need of countries. Essentially, the development experiences of these Asian economies lends to a modern economic theory which suggests that dynamic efficiency is best promoted by a combination of cooperation and competition between firms rather than by intensive or unrestricted competition. [Graham and Richardson 1997] This in turn requires close-cooperation between government and business. It also implies the need for coherence between industrial (and other policies) and competition policy.

In light of such experiences, therefore, it is not surprising that different schools of economic thought emerge with divergent approaches to the relevance and the content of competition policy. What can be inferred from this section, however, is that while low income economies too essentially need competition and competition policy to help promote their socio-economic goals, there is no blue print for the content of the latter. These economies, including Ethiopia, while exploiting the advantage of taking lessons from successful experiences of countries with competition polices, they need to come up with their own version of competition policy based on the specific socio-economic condition of their respective economies, and evolve accordingly.

2.2 The Political Economy Environment and Implications for Competition

2.2.1 Political instability and regime change

As of the mid 20th century, Ethiopia has gone through divergent economic development paradigms: from a mixed economy during the Imperial era (pre 1974), to state controlled central planning of the socialist regime (1975-1991), and a hybrid of state-controlled and market-oriented economic structure of the current regime (as of 1992).

The Imperial era (1930-1974) was characterized by the landed aristocracy (including the church) and the vast majority of peasants (most of them tenants) constituting the major socio-economic agents of the time. Agriculture was the most dominant activity contributing the bulk of the national income. This makes land, which was also privately owned, the most critical resource and instrument to acquire, not only wealth, but also political power.

The imperial regime followed a market based economic policy, particularly as of 1960. To this effect, a series of three five-year development plans, focusing mainly on private sector growth, were designed and implemented. [Mulatu Wubneh 1991] At the centre of the private sector development strategy was the provision of incentives to attract foreign investment, including tax relief, import-export privileges, financial support, etc. A number of foreign banks and insurance companies, such as Banco di Roma and Banco di Napoli, and a private domestic bank, Addis Ababa Bank, were operating along with state owned banks. Protected behind high tariff, non-bank foreign investment in manufacturing began to take shape during this period. Specialized government institutions to oversee specific activities, such as an independent decision making investment committee, a National Economic Council to design strategies for enhancing agro-industrial productivity and improve living standards, and coordinate the state's development plan were established.

Thus market based competition in the country was, for the first time, initiated during this period. The imperial regime was also characterized by relative political and economic stability, which came to a halt in 1974 by a military coup.

Following the takeover of power by the military junta, all land and modern economic establishments, including banks and insurance companies, medium and large scale manufacturing industries, large wholesale distribution companies, commercial farms, urban rented houses, private schools, etc., were nationalized. In the mid 1970s, the formation of a socialist economic regime took shape. Central planning, nevertheless, became the sole approach to guide the economic development of the country. The vast traditional agricultural sector was brought under direct control of the state via villagization, forced peasant association and cooperativization; the modern private sector was largely marginalized through nationalization of modern economic establishments. Nationalized enterprises were reconstituted as state owned enterprises (SOEs). Such measures effectively arrested the nascent private sector and market competition, initiated earlier during the Imperial era.

As of 1992, with the coming to power of the pro-ethnic identity group, EPRDF, through armed struggle, reform programmes mainly in two areas, namely decentralization and liberalization, were introduced. The reform measures brought new features to the political economy platform of the country.

The economic liberalization programme initially mirrored the structural adjustment programme (SAP), driven and supported by the Britton Woods institutions. Key policy reforms include deregulating the product and labour markets and decontrolling prices, dismantling peasant associations and cooperatives (though some have been efficient and profitable)[7], reducing tariffs and eliminating export taxes and subsidies, privatizing a number of state owned enterprises (though not relatively larger ones), relaxing the investment code and in general opening up the economy for foreign investment (with some important exceptions), and introducing a land-lease system (but still keeping intact public ownership and control). Important market oriented reforms have also

[7] Agricultural service cooperatives are now reintroduced in the spirit of EPRDF.

been introduced in the financial sector, including allowing the private sector to invest in financial intermediation (though not foreign banks and insurance companies), devaluating the overvalued domestic currency and gradual depreciation, introduction of the foreign exchange auction and interbank markets (though still not privatized), allowing interest rates to be determined by market forces (with the exception of the minimum deposit rate), and introducing treasury bill auctions. Also, as part of the liberalization scheme, perhaps, primarily meant to meet WTO's requirement for accession, a trade practices law (competition law) was first enacted at the turn of the century.

However, the legacy of the defunct socialist regime has not gone altogether. The EPRDF government still maintains a high degree of centralization and control of a large proportion of available resources. [Kibre M. Belete 2015; Teshome T. & K. M. Belete 2007].

Moving from a centralized to a market-based economic management involves significant costs. Despite the criticism that the restructuring is incomplete and the pace of the transition is very slow (notably, land is still public owned and is suspected to be used as an instrument of political leverage; privatization is still ongoing, even two decades later; foreign investment is kept at bay in some key (strategic) sectors, etc), economic reforms, already undertaken, have positive implications for competition. At least theoretically, re-instating the private sector into the modern economy and deregulating some markets, re-introduces some element of competition in the domestic markets. Also, the incentive driven export promotion policy encourages domestic suppliers to compete in the international markets. In general, the economic reform measures have opened up a window of opportunity for market-based competition in the economy, at least compared to its predecessor – the militarized socialist regime, though the introduction of new features may bring along new constraints to market competition.

2.2.2 New features of the political economy

2.2.2.1 Political ideology

The ruling ethno-linguistic affiliated group had deep rooted socialist[8] orientation before it embarked on power.

> The ruling EPRDF party and its approach to politics are ideologically rooted in Marxism-Leninism, its military history, its rural origins, and its experience of mass mobilization in opposition to the previous *Dergue* regime. While much of its Marxist rhetoric dissipated after 1991, the central leadership of the party […] continues to see itself as the vanguard for the economic and social transformation of Ethiopia. [Vaughan, S. and M. Gebremichel, 2011, p31]

The administrative structure of the country was redrawn as a federation of nine regional states, based on major ethno-linguistic formation with the guarantee to secede

[8] Referred to as ‘garrison socialism’

when and if the majority feels like doing so.[9] Two of the major cities in the country were also designated as ‘federal cities’. Constitutional reform introduced a system of multi-party elections (though, in practice, this turned up to be a myth).[10] A number of ethnic affiliated parties has been established since then but with little success to either influence policy or ascend to power.

The ruling party’s ‘revolutionary democracy’ and its implications for economic freedom, is not one of a liberal version. Vaughan describes it as follows:

> The ruling party’s rhetoric stresses that the rise of an entrepreneurial middle class is important not only in boosting the economy, but in securing an eventual transition to competitive ‘liberal’ democracy. EPRDF’s position is that economic development will not be sustainable and in the interests of the majority without ‘genuine,’ i.e. revolutionary, democracy led by the vanguard party. The corollary is that liberal democracy will not be either sustainable, inclusive, or in the interests of the poor majority unless and until such a system can be supported and protected by an educated middle class (one that is not only strong but broadly based and representative) capable of protecting its economic interests and assets and motivated to do so. According to the party, this class

[9] It is widely said that the Italian invaders in the 1930s attempted to divide the administrative structure of Ethiopia along ethnic lines so as to create internal disunity. This must have been a time-bomb which never defused for so long, but only waited for the right time to explode.

[10] “Multiparty politics is unarguably constrained […], the Prime Minister himself describing it in August 2010 as a dominant party system.” [Ibid, p9]

> does not yet exist in 'pre-capitalist Ethiopia', so that the unregulated introduction of competitive politics would be open to abuse and exploitation of the impoverished mass by wealthy elites. Thus (in its view) revolutionary democracy, under the leadership of the vanguard party and developmental state is the only 'genuinely democratic' option. [Ibid, p32].

Throughout the period in power, the ruling party had uneasy relationship with the urban population in particular. After the 2005 election, the political tension between the ruling party and competing 'opposition groups' has been overstretched nearly to breaking point. "Whilst ruling party ideology and policy changed in 2002 (from explicit prioritizing of the rural sector), it remains the case that the private sector is not always seen as the natural ally of 'revolutionary democracy', at least under current circumstances." [Ibid, p27].

Hence, at least for now, political rights are not unconstrained. The political ideology that sought to streamline the population on ethnic ground does not seem to encourage nationwide market competition over the couple of decades it has been practiced.[11]

[11] Vaughn quoted Alemayehu: "Ethnic federalism' per se as an economic risk factor […] is likely to limit labor and capital mobility across the ethnic enclaves, and ensue [sic] investor's insecurity when an entrepreneur invests away from his/her ethnic home region Alemayehu Geda, 2005, p26". [Ibid, p20] In fact, an outstanding evidence of this was the implicit investment policy of one of the regional states (SNNP), which use to prohibit investors from other ethnic groups to run business on his/her own, unless jointly with someone whose ethnic background is believed to be

2.2.2.2 Development paradigm

The economic development strategy of the government in power is not strictly based on market forces, but rather on a 'state managed' economic model, a version of a 'developmental state' approach, based on broad brush experiences of other countries to lean on, but with no specific and clear cut economic model to pursue.

> We in Ethiopia have embarked on a reform programme that is based, not on the neo-liberal paradigm, but on an alternative paradigm of the establishment of a developmental state. […] The key task is to transform our political economy from one of pervasive rent-seeking to one that is conducive to value-creation in the context of establishing an effective and democratic developmental state. [Meles Zenawi, 2006]

Thus, while partially opening up the economy and reinstating the private sector, at the same time the government endorsed a centrally guided development strategy. The ruling party's official statement envisages a managed economic transition from pre-capitalism to a 'sustainable' and 'inclusive' form of capitalism led by a 'developmental state'." [Vaughn, S. and M. Gebremichel, 2011, p9] The EPRDF government, therefore, seems to be convinced of the need for a developmental state and a

from the same region, while allowing foreign investors without such constraint.

single ruling party in directing the development of the country, in line with Asian industrialization approach.[12]

EPRDF's belief does not stop at distrusting the market's ability to efficiently allocate resources. Given the fragmented and incomplete market structure, and nascent private sector which has been marginalized from active market based business activities for nearly two decades, the distrust may have some justification. But, EPRDF also distrusts the private sector itself, at times for reasons having less economic justifications, claiming that it is generally engaged in 'rent seeking' activities, a term often used in a political context rather than business to discredit the opposition and those having alternative ideas to that of the party in power.

For the state to play its developmental leadership, a number of key and strategic sectors have been retained under its ownership and control, including land, telecom, electric power, water, nationalized urban houses/buildings, distribution of fertilizer, large production enterprises such as in cement, sugar, textiles, leather, etc. Moreover, it also maintains ownership and control of the largest and most dominant commercial bank and insurance company. The state not only provides broad based investment incentives, it also makes selective intervention as part of its industrial strategy. The developmental state also regulates foreign

[12] Vast literature on the industrialization strategy of East Asian economies exist including Lall, S. (1998), Stien, H. (2006), Amsden, Alice (1989).

investment, keeping it at bay in some key sectors including finance, telecom, power, import, export, etc. As part of its regional development strategy, it makes large transfer of the national revenue to relatively less developed ethno-linguistically configured states.[13] Thus, the role of the 'developmental state' is far reaching in its control of and intervention in the economy.[14] In fact in January 2011, the government reconsidered its earlier liberalization measure, by re-fixing prices of a basket of food stuffs.

The aim of the government, therefore, seems primarily, not necessarily to create an enabling environment for private sector growth, and certainly not to create a level playing field for market competition, but to have a firm and widely entrenched grip of the economy so as to shape it in line with its political economy model. Vaughan describes it as follows:

> The Ethiopian government's centrally directed state-led approach is partly modelled on the developmental states of East Asia and elsewhere, where the state has played a crucial role in

[13] Alemayehu noted, "Although these reforms countered the regulatory syndrome characteristic of the Derg, the EPRDF regime can be viewed as displaying the "redistributive" syndrome, with power, policymaking, and resources controlled by, and in the direct interest of the TPLF, which originated from the North of the country." [Alemayehu Geda 2006, p3] TPLF refers to the Tigray Peoples Liberation Front.

[14] As a result, "… despite privatization, the volume and value of the public enterprise sector is thought to have grown since 1991." [Vaughan, S. and M. Gebremichel, 2011, p32]

> stimulating and sustaining growth and markets have been managed rather than fully liberalized. The state envisaged in the official pronouncements of the current Ethiopian leadership is conceived very much along the lines of the 'social transformation state' advocated by Mushtaq Khan in contrast with the much less interventionist 'service delivery state' of the liberal consensus (Khan, 2004). The Ethiopian state is assertive both in shaping and regulating the business and investment climates, and also as a participant entrepreneur. [Vaughn, S. and M. Gebremichel, 2011, p31]

Being perceived by the party in power as 'naturally rent-seeking', hence unproductive, if not closely and directly controlled (as a corollary, if left to operate in a free market environment), the private sector is still kept with limited economic role and remains relatively dwarf, while economic growth is currently, and to a great extent, driven by government spending on infrastructure and service delivery, often within the large SOE sector and endowment enterprises.[15] As a result, "public-private sector relations have often been fractious, and the government's response to market problems has tended to be abruptly punitive rather than engaging, applying sticks rather than offering carrots." [Ibid, p11] Thus, as it stands today, with a centrally directed state-led economic development strategy on the one hand, and a rather limited enabling market environment for private sector

[15] In light of the high inflationary pressure in the country on the one hand, and very low interest rate on the other, and also due to the expectation of continuing land scarcity in the future, private investment largely prefers to hedge on to what the sector considers less risky, i.e., building construction, through bank loans.

development, on the other, promoting a competitive domestic market may take longer time to develop, than what it might take with less constrained space for private sector role in the economy.

2.2.2.3 Business and Politics

Another new feature of the pro ethnic identity group in power is its central role in business. Currently four 'endowment' conglomerates, established by the respective ethnic based parties representing the four relatively larger regions, operate along side with the private sector proper. These include, Tiret for Amhara, Tumsa (former Dinsho) for Oromia, Wendo for Southern nations and EFFORT for Tigray, of which the latter is the oldest and the largest. [Ibid]

Some of these endowments are said to be initially established with resources donated on behalf of the various fronts of the incoming ruling party. Initial resources were partly accumulated through confiscation of assets during the civil war.[16] These endowments are managed by the respective political parties, and a number of senior politicians of the ruling parties are still closely involved in their corporate policy-making.

[16] But the largest proportion of the resources are amassed through borrowing from commercial banks, particularly from the state owned Commercial Bank of Ethiopia, after EPRDF took power, though it is very difficult to substantiate this, as information on banks credit is withheld from the public on the ground of 'customer confidentiality'.

The endowment-owned companies are uniquely placed to access resources (inputs, finance, land, information, etc) and to exploit strong synergies not only between the various businesses within the respective endowments, but also between the endowments and agencies controlled by the ruling party in power including federal and regional government bodies, SOEs, regional development entities, mass associations, co-operatives, major media outlets, etc. Thus, "... the endowment-owned companies, including EFFORT, form only one set of actors in a much wider centralized and ideologically driven strategy of managed economic development pursued by the ruling party." [Ibid, p13]

Right at the outset, however, these endowment conglomerates encountered controversies, not only because of their evident ruling party associations and because of what was considered to be their 'ethnic' profile, each dedicated to the interests of a particular federated state, but also because of the sources of their resources, and inevitable favouritism they receive from the ruling party in power (hence conflict of interest). And all happen in spite of the fact that the country's constitution does not allow political parties to engage in business activities.

In the past, there have been instances of aggressive competition, not between enterprises within the endowment conglomerates or between SOEs and endowment conglomerates, but between these business empires and private sector proper. There is a wide spread assumption among the general public that endowment enterprises are given precedence in winning bids for purchase of government goods and services, including donors funded projects. Most of the private businessmen and members of the international community think that endowment-owned companies and ethnic affiliated individuals, and SOEs, receive privileged access to credit, land, information and government contracts as a result of political connections. World Bank's study on the investment climate in 2006 noted that

> Endowment- and state-owned firms confront an investment climate that is substantially different from that faced by private enterprises, which may partially explain the fact that they appear to have greater access to policymakers, government as a market, and the state-owned part of the financial sector. […] Ethiopia has approved a competition law to regulate anti-competitive practices, but this regime was not used to address the significant questions of competition with state and endowment firms. [World Bank 2009: p58]

Irrespective of the claim of the ruling party that the private sector is key to the 'transition to capitalism' and entrepreneurs should lead the process (i.e., private sector led economic growth), it is endowment owned conglomerates and SOEs, both directly controlled by and in the interest of the party in power, and few favoured private conglomerates that are playing the leading role. As it stands now, the leading role of the private sector is very much in the remote future, if at all it does while EPRDF is still in power.

Chapter 3

THE STATE OF COMPETITION IN SELECTED MARKETS

3.1 The Coffee Market

3.1.1 Economic significance

Ethiopia, the largest producer and exporter of coffee in Africa, is also one of the ten world largest producers and exporters. For decades, coffee has been the largest export commodity of the country. In 2012/13, the shares of coffee export in GDP and total export were about 1.6 and 24.2 percent respectively. In the same year, a total of 198,737 metric tons of coffee was exported, which accounts for about 50 percent of total production. In addition, apart from the relatively large export earning, the process of coffee production through export generates employment for millions of people engaged as producers, farm labourers in commercial plantations, and daily workers in washing station The bulk of coffee, about 81.4 percent, was produced by small-holders, while private commercial plantations accounted for the balance (Table 1). Members of service cooperatives, though they have gradually increased their share, still produce a much smaller proportion (about 6.4 percent) of total coffee production. It is now two decades since the effort to organize cooperatives and their unions has begun, but the progress is limited as only 7.8 percent of coffee producers have joined the associations to date. Also, as smallholders don’t apply chemical fertilizer on their farms, productivity remains too low, about 0.79 tons/ha, which is less than half of major producers in Brazil, though organic coffee attracts a premium price in international market. [Sutton, J. & Nebil Kellow 2010]

Table 1. Production share by type of farms 2013/14

Farm type	Production	
	Tons	Share - %
Smallholder farmers	392,006	81.4
Cooperatives members	30,576	6.4
Non-cooperative farmers	361,430	75.0
Private commercial farmers	89,739	18.6
Total	481,745	100

Source: CSA (2014a,b); FCA-MARD (2015)[17]

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[17] Interview with the Federal Cooperatives Agency (FCA) in May 2015

Also, as smallholders don't apply chemical fertilizer on their farms, productivity remains too low, about 0.79 tons/ha, which is less than half of major producers in Brazil, though organic coffee attracts a premium price at the international market. [Sutton, J. & Nebil Kellow 2010].

3.1.2 Market definition

For this study, a market is defined as a product, or group of products (goods/services) most buyers regard as substitutable in a given geographical location. Coffee in the international market involves a heterogeneous variety, including Arabica and Robusta. But these varieties are substitutable. Moreover, though different coffee areas produce coffee of different flavours, only Arabica coffee is produced in the country. As such, it is a homogenous product.

3.1.3 Key players in the supply chain

There are a number of distinct institutional and individual players in coffee marketing, including

- small holder farmers which supply coffee to primary (up-stream) markets,
- service cooperatives who collect coffee largely from member farmers and supply it to their union for direct export,
- suppliers (private traders) who collect coffee from farmers and supply it to the ECX auction market,

- private commercial farmers, who produce and export directly,
- private coffee exporters who buy from the ECX auction market and export,
- EGTE, which buys coffee at the auction market and export,
- traders who buy non-exportable low quality coffee from the ECX and supply it to the local market for consumption.

3.1.4 Policy intervention

For the last three decades or so, coffee has been Ethiopia’s flagship product in the international market, and is considered of strategic national interest. As such, the marketing channel, stretching from up-stream (primary) markets through export, is regulated. This is primarily meant to control the movement of coffee in the domestic market, so as to channel it, as far as possible, to the export market. Accordingly,

- Distinct licenses are issued for specific activities in coffee business. Suppliers, exporters, and domestic retailers, each group has different licenses and one cannot engage in more than one activity.
- A supplier operates only in a given coffee growing zone, as per the license
- It is illegal to sell exportable standard coffee in the local market

- Export trade in raw coffee is exclusively reserved only for domestic investors
- Except for producers (small holders and commercial farmers), all others have to supply coffee to the ECX
- Storing exportable coffee of more than 500 tons, without having a shipment contract with an importer, is prohibited.
- Cooperatives are not obliged to pay any tax to the government, associated with coffee trade.

3.1.5 The marketing structure

Figure 2 depicts the structure of the formal marketing chain. The regulation allows coffee producers to export their own produce directly, outside the ECX auction market. Commercial farmers and cooperatives fall under this category. The origins, hence the respective quality of coffee supplied by these producers, are easily traceable. Moreover, coffee grown by small holders is organic, hence able to fetch premium price at the international market. On the other hand, coffee collected by suppliers, organic or not, and irrespective of location, has to be supplied direct to the ECX auction market.

The ECX was established by the government in 2008 as a platform for trading agricultural commodities, including coffee, sesame, etc. Over 80 percent of coffee for export passes through the ECX auction market.

Coffee at the ECX, is first standardized, graded, and branded. In principle all exporters, including those with waivers from the auction market, have to obtain quality certification from the ECX. Then exportable standard coffee is traded in the auction market, based on an ‘open cry out’ bidding system. Low quality (non-exportable) coffee is sold to local traders (retailers) for domestic consumption.

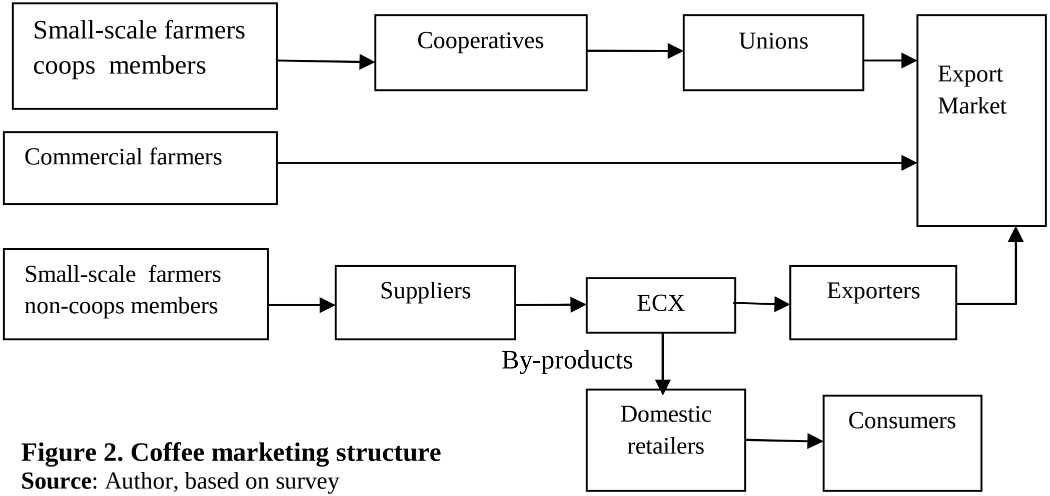

Figure 2. Coffee marketing structure
Source: Author, based on survey

3.1.6 Export structure

There are just over 200 licensed private exporters, together accounting for the bulk of total export. As shown in Figure 3, out of the total 191 thousand tons of coffee exported in 2013/14, private exporters accounted for 90.3 percent.

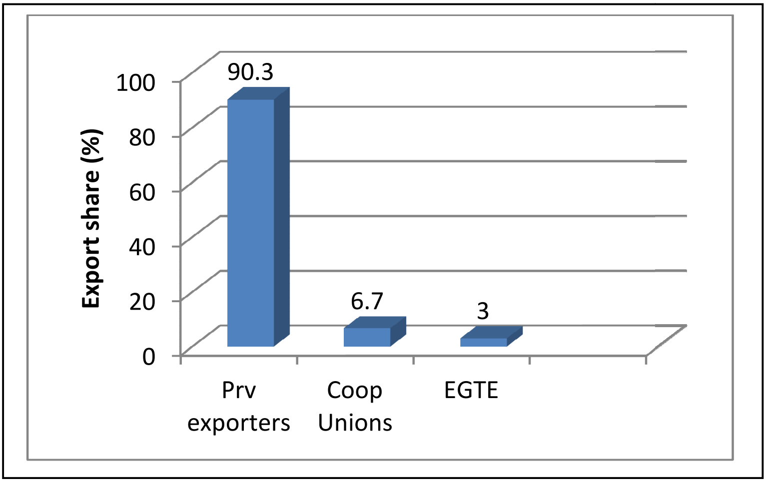

Figure 3. Share of coffee exporters – 2013/14
Source: FCA-MARD (2015); ECEA (2014)

Institutional exporters such as cooperatives and EGTE exported the remaining 6.7 and 3 percent respectively. The latter joined the trade in 2009, exporting coffee seized from the stock of 6 exporters whose licenses have been revoked by the government, after being accused of hoarding. [Zavetta, R. & S. Feyissa, 2009] Despite comprehensive support by the government, the export capacity of cooperatives is still small, though growing gradually.

3.1.7 Competition issues

3.1.7.1 Market entry

There is no regulatory barrier to entry either in production or in any of the specific activities in coffee trade for domestic investors, except for foreign investors in export trade of raw coffee. [MFA 2005] However, the licensing system of coffee is restrictive even for domestic traders, hence a barrier to entry.

3.1.7.2 Market fragmentation

As shown in Figure 2, producers have the right to export, hence the opportunity to form vertical integration. Suppliers on the other hand cannot deal with export, except supplying to the ECX market. Similarly, exporters cannot engage in any other activities of coffee trade. Licenses to non-producers do not allow to engage in multiple trade activities. More often, dealing with one activity, leads to knowledge of the related activities having backward or forward linkages. Moreover, entry in export trade in particular, requires time and experience. It is very likely that those actors dealing with any one of the activities of coffee trade have better opportunity to understand and become successful than fresh entrant. As such, restricting entry in more than one activity limits the degree of competition.

Spatial restriction of trade also limits the extent of competition. A supplier is allowed to collect coffee only from a single zone within a given administrative region. Hence there is an internal boundary for trade beyond which one cannot expand business. Moreover, even the type of coffee a supplier has to deal with (wet cherries, sun dried, etc) is defined by the license. Perhaps this is primarily meant to strengthen the traceability of coffee. However, if traceability is beneficial to suppliers too in the form of premium price, then there is no ground to expect that suppliers would not capitalize on this benefit by supplying coffee parcels by origin or flavour, as required by importers. Again such a mechanism of control may weaken the competition environment, as it creates a geographical fragmentation of the market.

A related issue is the modality by which Unions have been organized to run business. These institutions are organized in tune with the political-administrative structure of the country, i.e., based on ethno-linguistic configuration. A union can only collect coffee from own cooperatives within a single administrative region, hence doing business based on politically carved market. This can hardly encourage competition country wide.

3.1.7.3 Concentration

Based on their exporting capacity, there are about 20 large exporters, each capable of exporting annually USD 10 to 41millions, another 16 exporting USD 5 to 10 millions, and about 60 mid size exporters, with a capacity to export USD 1 to 5 millions[18]. Regarding institutional exporters, there are about 7 cooperatives unions engaged in coffee export, of which 3 are large enterprises each exporting annually over USD 10 millions.

For 2013/14, the largest exporter has a concentration ratio (CR1) of only 6.8 percent of the total volume of export, while the second and third largest exporters, each has a 5 percent export capacity (Table 2). Thus the largest two exporters have a total share of 12 percent (CR2); the largest three, 17 percent (CR3); and the largest four, about 20 percent (CR4). As such, there is no strong concentration in coffee export trade that could affect the state of competition in the domestic market.

Table 2. Concentration in coffee export trade

No	Scale of operation	Concentration Ratio (CR)
1	Largest exporter - CR1	0.068
2	Largest two exporters - CR2	0.12
3	Largest 3 exporters - CR3	0.17
4	Largest 4 exporters - CR4	0.20

Source: ECEA (2014)

[18] This however, varies depending on the international price of coffee.

3.1.7.4 The presence of SOEs, endowments, and cooperatives

Until recently, the state had owned coffee plantations, and it used to export directly. As of last year, however, all plantations have been privatized. Currently, the state owned enterprise, EGTE, is engaged in coffee export buying on auction at the ECX market. As noted earlier, EGTE has been dragged into the business as a gap filler, i.e., to export coffee seized by the government from private exporters' warehouses, who were accused of hoarding. [Zavetta, A. and S. Feyissa 2009] EGTE is one of the major exporters, handling about 3 percent of the total export, though this varies from year to year, depending on its volume of trade.

Endowments, such as Guna and Wondo are also engaged in export buying at the ECX auction market. However, their scale of operation is not large, nor is there any sign of bias by the government or any other party towards these enterprises that might affect the market.

As explained earlier, cooperatives operate in the primary markets, but not at the ECX market. As such, except in primary markets, they have no direct impact on other domestic markets. Unions collect coffee from member cooperatives and export directly, outside the ECX market. As such, their operation has little competition impact on downstream domestic markets.

3.1.7.5 Carving the market and creating a residual domestic market

As hinted earlier, the regulation regarding coffee export standard trade restricts sale of coffee for local consumption outside the ECX market. Only low quality non-exportable coffee finds its way for local consumption. This in effect makes the domestic market a residual market, not part of the international market. The domestic market price of the rejected, poor-quality coffee is at least as high as the international price of high grade quality coffee. At times, it is even higher than the international price. This situation is the result of a regulatory measure which created artificial supply constraint in the domestic market. Obviously this restricts the state of competition in the domestic market. Moreover, it creates a disincentive to improve the quality of coffee, as poor quality coffee sold in the domestic market can fetch high price.

Whether regulating the market, as it stands now, would lead to higher volume of export than otherwise, cannot be easily determined, as the parallel market (quality coffee smuggled to neighbouring countries, and also sold for local consumption) is quite significant. All respondents to the survey believe that there is illegal trade. In a market where trade restriction is imposed, particularly with internationally traded products, emergence of a parallel market is almost inevitable, irrespective of the motives of the restriction. Contraband trade in coffee in

Ethiopia is an open secret; perhaps not only because of the restrictions, but also because of the porous border of the country. There are allegations that even non-coffee producing neighbouring countries also export coffee, smuggled out of Ethiopia. Coffee exporters and local traders surveyed for this project estimated the extent of the contraband trade between 10 and 15 percent of production, equivalent to 20-30 percent of export. In 2013/14, household consumption of coffee is estimated at 47 percent of production. [CSA 2014c] Given the total production and export for the same year, coffee unaccounted for totals about 50,676 metric tons, which is equivalent to 10.5 percent of production, or 26.6 percent of export (Table 3).

Table 3. The extent of the illegal market 2013/14

Item	Quantity (MT)	Share in total prodn - %
Coffee, production	481,745	100
Coffee, exported (total)	190,873	39.6
Coffee, not exported	290,873	60.4
Coffee, household consumption 2013/14*	226,420	47.0
Coffee for other household purposes	13,777	2.86
Coffee unaccounted for	50,676	10.5
Coffee, contraband trade**		10-15

Sources: CSA (2014a,c); ECX (2015)[19]
*Author calculation based on CSA's crop utilization survey
** Survey result

[19] Interview with ECX experts, May 2015.

In fact when coffee prices fall sharply in the international market, the extent of the illegal trade widens and intensifies. This indicates that a significant quantity of coffee finds its way out of the country, simply because of the regulatory environment which created artificial barrier in the domestic market.

3.1.7.6 Carving the market – the operation of cooperatives and lack of competition

Cooperatives are established by law, which also defines their operation. Accordingly, a member is obliged to supply coffee to one's own cooperative only. Correspondingly, cooperatives are allowed to buy coffee only from their members, though in practice this is not always the case. Cooperatives also buy from non-members. In the primary market, where farmers sell their coffee, cooperatives buy at market price, closely cross-checking what traders pay, and with some *a priori* information about current international coffee price. Thus, there is some degree of competition in the primary coffee market. However, at the next stage of the supply chain, cooperatives hand over their coffee to their union at a price determined by the latter, said to be at international price. Cooperatives cannot sell coffee to other markets, unless their union agreed so. As such, there is no (market) competition element at this stage. This resulted in a highly skewed income flow; this study found that unions, not only in coffee, but also in grain trade, have established large business empires, amassing huge wealth, while cooperatives and their members have changed little.

3.1.7.7 Hoarding

Hoarding is relatively a widely practiced anti-competitive measure among business actors in coffee and other markets, where scarcity prevails either as a result of supply shortage or regulatory constraint. The 2009 incident of hoarding and the government's strong reaction, as noted earlier, is a case in point. As a result, the government has regulated the quantity of coffee that can be stored by an exporter without signing a shipment contract with an importer. Accordingly, exporters cannot stock in their own warehouses more than 500 tons of coffee without such contract. But cooperatives and the ECX are not required to abide by this regulation. 75 percent of the exporters, who responded to the survey, also think that hoarding is still practiced by exporters. However, this practice should not be over-exaggerated. Coffee is said to be a sensitive product whose test/flavour changes with time. The longer the storage period, the greater the loss of the test/flavour, and the lower the price. At times, when price falls steeply, exporters may withhold shipment for sometime based on a calculated risk; but cannot hold it for long threatening their profit. Thus the length of time they can store is limited and calculated. If the regulation cannot give room for undertaking calculated risks, then it might as well end up to be counterproductive as coffee may be diverted to the informal channel.

3.1.7.8 Concerted practices

The bulk of exported coffee passes through the ECX auction market. It is a new endeavour of the government to create an organized, transparent and efficient marketing system for agricultural products including coffee. It surely has the potential to revolutionize the mechanism of transactions by preventing a number of fraudulent practices prevalent along the marketing chain of the long drawn traditional approaches. However, as a young institution, it is not yet immune to certain anti-competitive practices prevailing within the system. The auction operates on a single floor where market actors, both buyers and sellers, exchange their deals in an 'open cry out' bidding system. These actors are members of the ECX (or their official agents) who are said to have invested on membership seats either as a seller or buyer or both. There are about 329 members and thousands of clients. But, members know each other quite well.

A number of allegations of concerted actions are levelled against these operators. A member who would like to sell can make agreements with other buyers to help bid-up the price during the auction, even though they don't buy. Also, an exporter, having at the same time a license to import other goods, may export coffee not just for its profit, but for the foreign currency it fetches to facilitate the more profitable import business, even if exporting may not be profitable. To this end there may be a concerted action among agent buyers in favour of a given exporter in particular, or to keep prices within a limited ceiling, in general. At times, winning a bid at any price, even at a price higher than international price, may be necessary, for the sake of accessing foreign currency. 50 percent of the exporters, who responded to the survey, believe that concerted bidding is practiced from time to time, and 75 percent confirm that ECX coffee prices never correlate with international prices. Discussions with ECX experts, also agree that such concerted actions do prevail.

3.1.8 Recommendations

Traceability of the origin of coffee does help identifying the quality of coffee along with other means including cupping and technical grading measures. But the control system instituted to help achieve this such as restricting traders to a single trade activity, single location, specific coffee type/character (sun-dried and wet cherries), etc., can hardly help improve traceability satisfactorily. If traceability is to the advantage of suppliers too, they would uphold it even without any regulatory control. The control system installed only discourages specialization and operation with scale. It prevents vertical integration, denying the opportunity to minimize cost of operation.

Similarly, the two track trading system which gave wavers to cooperatives from the auction market is of little use. In fact coffee from a single location/area is given different status because of the type of supplier – one fetching a premium price, while the other sells at normal price. It is more beneficial to strengthen the identification mechanism and subject all suppliers to go through a system of competition, so that further improvement in quality could be gained.

Another policy concern is related to taxation. Private suppliers pay all taxes associated with trade and license fees, while cooperatives, trading side by side with private traders in the same market, are exempted from all sort of taxes payable to the government. While supporting cooperatives may be commendable, it would be preferable to do so in a non-discriminatory approach, which does not deny other traders a level playing field to compete in the same trade. One such approach would be to strengthen their association, technically and financially; another is to let them have the power and freedom to decide on their produce.

The need to channel coffee to the export market is understandable, given the critical importance of foreign currency. Also, the effort to cut short middlemen, to avoid multiple agency problems, is commendable. However, the current marketing structure has neither benefited farmers nor prevented the leakage (contraband trade). Hence, it might be worth introducing some degree of liberalization to motivate both producers and suppliers to increase the quantity and quality of coffee supply. 50 percent of the respondents (suppliers, exporters, domestic retailers) think that liberalizing the market structure, will improve the competition environment and could lead to increased supply of quality coffee both to the international and domestic market.

The income/wealth gap between the unions and cooperatives is alarming. As hinted above in this section, large concentration of assets, both physical and financial, takes place at unions level (though not all), while some cooperatives even don’t have appropriate and adequate warehouses. In an interview with cooperative leaders in Jima zone, some insisted to establish a system, such as ‘commission’ with which unions have to operate. An interview with experts at FCA reveals that policy makers are well aware of this fact and are practicing a new mechanism where unions could operate with a certain ‘commission’ rather than a separate decision making entity. Whatever is the system is to be installed, it has to give the leadership and decision making authority to cooperatives, not otherwise.

The concerted action of market players at the ECX, is capable to down grade the performance of this market institution. In an interview with the researcher of this project, experts at the ECX explained that the institution is to introduce ‘online bidding’ to overcome such malpractices.

3.2. Cereals Market

3.2.1 Salient features

Cereals (wheat, maize, teff, etc.) are the main agricultural products and the staple food of the country. Smallholders produce the bulk of cereals, primarily for own consumption. A smaller proportion of smallholders are members of farmers' service cooperatives. Commercial farmers produce a marginal proportion (3.9 percent) of total production (Figure 4).

For 2013/14 crop year, total production of cereals was about 24.41 million metric tons,[20] of which 96.1 percent was produced by smallholders, while commercial farmers accounted for the balance [CSA, 2014a]. Of the total smallholders, about 15 percent are members of farmers service cooperatives, organized to facilitate marketing of the products of members and supply of farm inputs.[21] As cooperative members have, on average, equal plot size and productivity level as non-members, their production share would, nevertheless, be proportional to their relative size.

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[20] This includes production of both Meher (main) and Belg seasons, with the former being about 22.46 million metric tons and the latter about 8 percent of total yearly production

[21] Total number of cooperatives members engaged in grain production is around 225,000 [MARD]. This accounts for about 15 percent of total holders in grain production [CSAb]

The sheer size of subsistence farmers, however, cannot guarantee food security. The country has to import cereals every year to fill the deficit gap. For instance, for the three years period inclusive: 2011/12-2013/14, about 952 thousand tons of wheat has been imported, 58 percent of which was food assistance, and the remaining commercial import[22]. Ethiopia still remains one of the largest recipients of food aid in Africa, with around 27 percent of the global food aid given to SSA.[23]

3.2.2 Market definition

Cereals involve heterogeneous products that are not easily substitutable. Moreover, each crop type involves different varieties for different purposes. In this study, the focus is on wheat, maize and teff. These three crops together, account for nearly 70 percent of cereals production, as well as consumption. Teff and wheat are the most marketed products of all cereals; the former, in particular, is a typical cash crop. The three crops have the same structure of marketing channels and, in most cases, their prices move in the same direction, though not necessarily at equal rate. Thus for this study, these crops are treated as a unified product.

[22] Revenue and Customs Authority
[23] Source: http//gain.usda.gov/

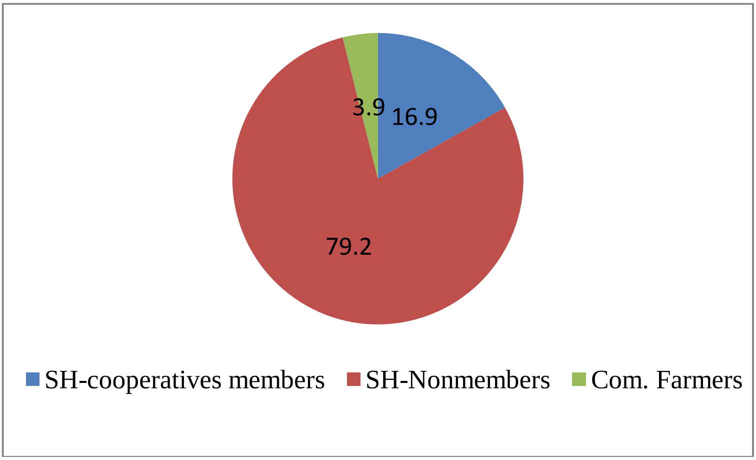

Figure 4. Production share for cereals (percent) 2013/14
Source: Autor, based on CSA (2014a,b); FCA-MARD (2015)

3.2.3 Market players

Similar to coffee, commercial farmers and smallholders (cooperatives members and non-members) feed the primary (farm-gate) market. This market is cleared by a number of market actors, including small traders, EGTE, service cooperatives, and households (or final consumers). Though actual figures are scanty, some studies suggest that about one-third of total production is marketed. [Zavetta, R. and S. Feyissa, 2009] The bulk of the marketable surplus (80 percent) is cleared by wholesale traders (Figure 5). Farmers' service cooperatives handle about 9 percent[24], while EGTE deals with a much smaller proportion, about 2-3 percent.[25] Households (rural population engaged in non-farm activities, deficit farm households, small urban dwellers, etc), having direct access to farm-gate markets account for about 8 percent of marketed surplus.[26]

3.2.4 Policy context

Similar to coffee market, foreign investment in retail trade and brokerage, wholesale trade – hence, export (if not own local production) and import trade are not allowed.

Land cannot be sold for its own but only for the structure on it. There is no secondary market for land. It is only available in the primary market through lease hold from the government. The latter supplies land irregularly and in limited plots, not to satisfy demand but to meet part of the government's development plan. This is so despite the fact that, for long, the country has not been and still is not self-sufficient in food supply.

[24] Interview with experts in Amhara regional state, Bureau of Agriculture, noted that the share of cooperatives in grain market is less than 10 percent.

[25] Interview with EGTE experts

[26] Estimated based on a consumption level of 1.6qtls per capita per year of rural non-farm population and small urban dwellers with direct contact to farmers.

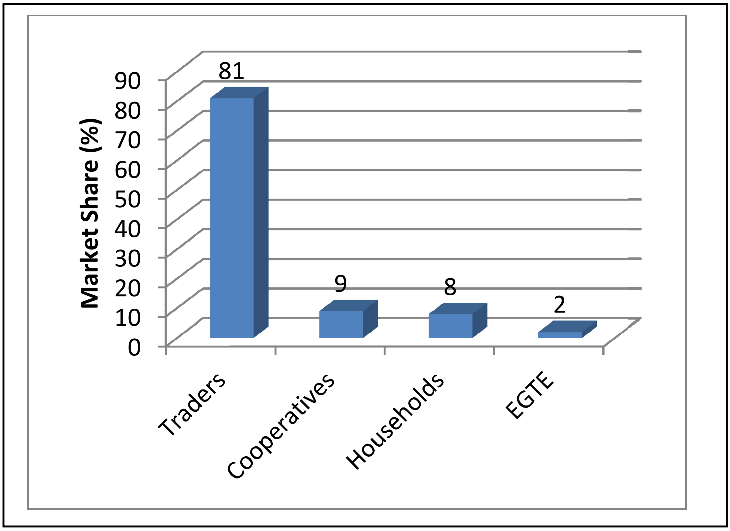

Figure 5: Share of market actors at primary (farm-gate) markets (2013/14)

Data Source: CSA (2014a,b,c); FCA-MARD (2015); EGTE (2014)

Export of cereals has been banned since February 2008, following the sharp rise in grain prices and looming food crisis in the country. This leaves the domestic cereal market less integrated with the international market. On the other hand, import of wheat is the monopoly of the state owned enterprise EGTE. Though there is no regulatory barrier, the private sector (unlike EGTE), has no access to foreign exchange for this purpose.

3.2.5 Marketing structure

The previous central planning regime regulated markets and controlled prices. As cooperativization was a must, all farmers were organized under producers' cooperatives. Cooperatives were forced to hand over a significant proportion (up to 50 percent) of their marketed surplus to the then state owned grain marketing enterprise (AMC) at fixed and much lower than open market prices. Thus, state farms and smallholders were feeding the primary markets, while AMC, traders, and households were clearing these markets, largely at controlled prices.

Major changes introduced under the current regime include decontrolling prices and partially deregulating the market. Producers' cooperatives were replaced by service cooperatives, largely on voluntary basis, and this has brought some change to the market structure. Figure 6 portrays the marketing chain of cereals.[27]

Similar to coffee, members of farmers' service cooperatives are obliged to supply their produce to their cooperatives, and the latter, in turn, to their unions.[28] The

[27] The marketing structure depicts the flow from farmers to final consumers for most of the grain marketed. But a smaller proportion of marketed cereals also flows through different channels, making it difficult to trace out a clear pattern of the marketing chain.

[28] At times a union may not be interested to buy, in which case cooperatives will sell it in the open market.

latter then channels grain to flour mills, government institutions (universities, hospitals, etc), urban consumer associations, and WFP. Most of these organizations get the supply upon the government's influence. Any leftover, is sold on auction to wholesalers or other organizations.

Non-cooperativized smallholders sell their produce to collectors (small traders) in primary (farm-gate) markets, largely in nearby rural or small urban towns, at the going market prices. Brokers network traders operating in different locations, mainly between surplus and deficit urban areas. Then wholesalers sell it to retailers and small grain mills, where final urban consumers have direct access. This, nevertheless, portrays a typical marketing chain of an open market economy.

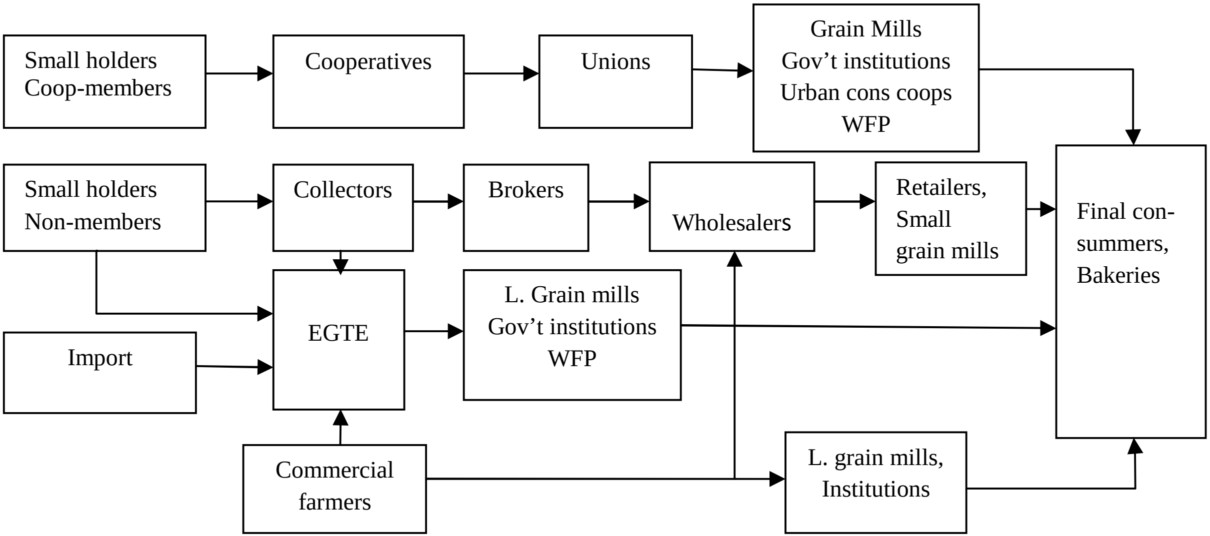

Figure 6. Marketing structure of cereals
Source: Author based on survey

Price stabilization is one of the multiple tasks of EGTE. It procures grain in open markets from surplus regions and from international market, and distributes to institutions and large grain mills, at centrally predetermined prices, as directed by the government.

Commercial farmers, as explained earlier, has currently minor share, but operate in the open market.[29] They supply to wholesalers, large grain mills, and institutions. Commercial farmers use to export, small quantity of white maize, mainly through the ECX market, before it was banned in 2008.

3.2.6 Issues of competition

3.2.6.1 Market entry

There is no direct regulatory barrier, both for domestic and foreign investors in cereal production. However, the monopoly hold of the state on land and its limited supply is a serious barrier to agricultural production in general. Apart from small holder farmers, having usufruct rights, the only way to secure land is through lease hold from the government, and only when the government likes to do so, defining the size and the location. Thus entry in cereal production is highly constrained by regulatory barrier to access land. In habitable areas of the country, land is acutely scarce. For cereals, for instance, there are about 13.4 million holders of 9.8 million hectares of land

[29] Their share is likely to remain so small as long as the current policy on land (state ownership) is unchanged.

(CSA 2014b). Thus, a small holder has, on average, 0.7ha of land for cereal production. Thus even securing rental land for a short term is highly limited.

With respect to trade, however, foreign investors face strong regulatory barriers. Retail trade and brokerage, as well as wholesale trade (unless locally produced own product) are restricted to foreign investors. [MFA 2005] Domestic investors are not restricted in cereals trade. In fact, most traders are small scale operators, as it requires small capital to kick off such business.

Other barriers facing private operators are related to external trade. Commercial import of cereals is currently monopolized by EGTE. There is no regulation banning entry of the private sector in import trade of cereals, however, in practice import is subjected to foreign exchange rationing, to which private importers have no access. But the choice of the parastatal as the sole importing agent is a matter of policy preference, not of competitiveness. Similar to its operation in the domestic market, EGTE imports wheat at international prices, but distributes it to grain mills, institutions, etc, as directed by the government, at subsidized prices, which in turn, sell at government fixed prices to bakeries, other institutions, etc.

Another regulatory measure is the export ban on cereals, which is still active. The 2007/08 food crisis in the country, which led to sharp rises in agricultural products, forced the government to launch urban food rationing and at the same time to impose, among other measures, a ban on export of cereals (largely maize/corn), even though export quantity was too small to make any difference on domestic prices. For instance, in 2008/09 the share of export in total wheat and maize production was only 1.5 percent.[30] [NBE (2014b)] Thus, the domestic cereal market is not only least integrated with the international market, but is also not unified internally, leaving the domestic market distorted and partly less competitive.

3.2.6.2 Concentration

With millions of small holders producing the bulk of cereals, there is no production concentration. Only commercial farmers, have the capacity to hold relatively large stocks, 5000 tons minimum, which is also a prerequisite to participate in a supply tender to large institutional buyers, such as industrial millers, universities, military establishments, WFP, etc.

In trade, there are over 2,500 licensed traders plus a large number of brokers dealing with cereals [Zavetta, A. and S. Feyissa 2009]. Also, according to the FCA, there are about 2.3 million cooperatives, and about 300 unions. In an interview, the leaders of the Addis Ababa Grain Traders Association explained that there is no dominant single or even small group of cereal traders.[31]

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[30] See http//gain.usda.gov/

[31] However, an early study hinted that 4 traders account for less than 33 percent of the wholesale trade. [Zavetta, A. and S. Feyissa,

However, despite the fact that there is no regulatory barrier to hold large stocks in legally registered warehouses, traders argue that they cannot do so because of the implicit pressure by the government not to hold stocks. A discussion with traders in the surveyed areas, including with AAGTA leaders confirms this same thing. Currently, even in the capital, Addis, with millions of inhabitants, there are no traders with a capacity to hold significant stock and stabilize the market. Consumers in the capital largely purchase from millers, located in every Kebele (county). Millers are directly supplied by regional traders in surplus regions. The large open warehouses, where many medium size traders retail together side-by-side, largely supply to hotels and institutions. In other urban towns consumers purchase cereals largely from open market retailers who are in turn supplied by medium size wholesalers with a capacity to store up to 2000 quintals. Thus, there are no large traders with a capacity to collect tens or hundreds of thousands of quintals from small holder producers and hold stock to stabilize markets. Currently, therefore, there is no significant concentration in cereal trade that could adversely threaten competition in general, as use to be in the early period.

2009] To figure out this, however, it requires a survey of surplus regions/areas across the country, what the shares of large traders could be.

3.2.6.3 The presence of SOEs and cooperatives

In primary (farm-gate) markets, both cooperatives and traders, including EGTE, operate side by side. Thus apparently, upstream markets operate competitively. Traders, however, complain about the absence of a level playing field to compete fairly with cooperatives, even in these markets. For one thing, cooperatives are supposed to buy only from their members, but in practice they also buy form non-members; for another, they are exempted from paying trade related taxes and other obligations to the government which traders are required to pay.

Similar to cooperatives in coffee trade, in cereal too, cooperatives have to forward all that procured at primary markets to their unions, at prices determined by the latter, of course factoring in the cost of operation of the former. Moreover, prices that the unions receive by marketing these products to different institutions, except to wholesalers in the open market, are determined by the unions with close control by regional government officials, though informally and implicitly. Often unions make purchase deals with their member cooperatives ahead of harvest, but they do reject the deals (on various grounds, such as quality) at the time of delivery, if they reckon that it would not bring much profit. Thus, this aspect of the marketing chain is closely controlled and less transparent, hence can hardly be regarded as a competitive market. Note also, that cooperativization, though officially argued as a means to benefit farmers, which indeed is also the case, is the brain child of the previous socialist regime which, critics argue, had been used as an effective mechanism to distribute agricultural inputs in a centrally controlled market, and as a political leverage to control farmers.

As noted earlier, the state owned trade enterprise, EGTE, operates under strict government directives. It procures cereals in open markets, factoring in both market prices and its stabilization objective. But it rations to institutions, grain mills, etc., in line with the government plan, at centrally determined and largely subsidized prices. As such the action of EGTE is not in tune, at least partially, with market competition, though its small scale operation may not give rise to significant market distortion. At times, however, EGTE's open market operation, particularly, contract procurement, has raised open complaints by farmers. EGTE makes purchase deals with farmers' cooperatives much earlier before harvest, to be delivered at fixed prices on maturity. As such deal pre-fix future prices, it carries both potential losses and gains to cooperatives – a loss in case of price rise, and a gain in case of price fall. EGTE also faces similar risk, though profitability is not its prime objective. However, there were cases where farmers complained of such deal when significant price rises occur by the time of delivery. In fact what EGTE is doing is not different from what unions are doing regularly to their members (the cooperatives) as noted in the previous paragraph, though the action of the latter has not been so eyebrow raising, because of 'the dividend factor', a token amount transferred to cooperatives as 'dividend on profits'.

3.2.6.4 Hoarding

In an agricultural based subsistence economy, and where food self-sufficiency is still a critical problem, such as Ethiopia, too many factors influence price volatility. In such cases, stock holding becomes a central instrument to stabilize prices and smooth out traders loss. Of course, such a situation can as well be exploited, to make more than normal profits. But for traders to influence prices, either there has to be a significant concentration ratio, or there should exist a limited number of large traders to make a concerted move simultaneously to influence prices. As explained above, there is little concentration in cereal trade. There are hundreds of traders and a large number of brokers across the country, which make concerted action quite challenging. However, from time to time, when grain prices rise sharply, the government accuses traders' of illegal move – hoarding, to satisfy their selfish interest of making unwarranted personal gains. For instance, in 2007/08, when food prices rose sharply to unprecedented level, the government pressed charges against some traders accused of hoarding. However, 'the available evidence regarding the alleged abuses has been inconclusive, as reflected also in the verdicts issued by the TPC (some defendants were acquitted and others received relatively mild fines).' [Zavetta, R. & S. Feyissa 2009, p56) Also following the

2008 price hike, the government has taken stern administrative measures including, among others, "…closing of illegal shops and stores without prior warning. Accordingly many traders were arrested for not respecting the directive (*Ethiopian Herald* 2008). But, the strategy seems to be not effective, as shortages of staple grains were observed in the market following these measures." [Admassie, A. 2013] However, there is no doubt that there will always be the tendency by some traders to withhold stocks when price trends are on the decline, and deplete stocks when price trends are on the rise, as this is expected to be a rational survival measure in trade.

3.2.6.5 Explicit and implicit price control

The lack of policy stability has been one of the defining features of the cereal market. While the government lets market forces arbitrate when the economic cycle is favourable or normal, it overrides this and imposes administrative control on markets in other times. Following the 2007/08 food crisis and sharp increase in food prices, the government imposed price control measures, fixing the maximum selling prices of grain. [Admassie, A. 2013]

As discussed above in this section, a significant proportion of marketed surplus (80 percent) is destined to the open market, where a large number of producers and traders/suppliers interact. Apparently, this aspect of the marketing chain seems to function in line with open market principles, and relatively well. However, there is still strong complaint by traders on the modality of market control in practice. Interviewed traders noted that officials from trade bureaus frequently harass traders threatening them for increasing prices and asking about the cost of goods bought, as well as their profit margins. In fact interviews with trade bureaus experts too, confirm that they do investigate on why prices have increased, and what the costs of the traders were. According to the competition law, proc 813/2013, bureaus have the mandate to investigate whether grain (or other goods) has been hoarded, as defined by the proclamation, but not why a trader has increased or decreased prices. Interviewed traders underlined that for bureau officials hoarding means maintaining large unsold stock, even in officially registered warehouses, as the latter argue that large stock cannot be maintained for other objectives other than increasing prices. Bureau officials have the administrative right to go in person, open any suspected store without any warrant, question traders, and take measures. Hence to avoid such accusation, traders noted, they prefer to operate with small stock.

What the government would like to see is a stabilized market with well behaved traders making regulated margin of profits, so as not to tax consumers heavily. But in a country where food insecurity has always been a threat, the free play of demand and supply may not guarantee this. Traders, on the other hand, argue that relatively low price for consumers and normal profit for traders can be maintained with large scale operation (economies of scale) hence large stock holding. But as the government does not seem comfortable with this, it prefers to maintain the role of a watch dog of the market, in its own way. The strategy seems to keep traders under mental siege – make them feel that the government is around if they tend to increase prices, thus controlling the market/prices implicitly. Some interviewee explained the strategy of the government as ‘a scare crow’; ‘when food prices rise, the government goes out on the media blaming traders, irrespective of the underlying reasons; and traders, expecting the worst to come, sell whatever stock they have, small or large, thereby lowering prices immediately. But it has always been the case that prices would rise again immediately after stocks deplete. Price stability relates largely to capacity and incentives to store, as well as to engage in trade. Public interventions and reforms aimed at promoting price stability and improving grain markets have been implemented in Ethiopia with limited success. (Byerlee, D. et al. 2007, p27).

The cereal market is infested with illegal traders – unlicensed small scale traders and brokers. Such operators don’t have permanent addresses or locations – office or warehouse. Their power base is the trust they have developed with customers over a long period of time and efficient communication – now using mobiles. All interviewed traders believe that such traders have the power to limit the flow of grain, thereby influencing prices, though largely for a short term. Such practices retard competition. Even though trade bureau officials pretend to know such illegal traders, they have little capacity to control them, at least not until now.

3.2.7 Recommendations

The mechanism to control prices implicitly, i.e., the scarecrow approach, is ineffective in the long run, as prices increase as soon as stocks deplete. Moreover, it leads to corruption. Setting ceiling prices, as in the past, has in practice also proved less effective. Influencing the supply through open market operation could be a less market distortive and effective way of stabilizing prices. This might be done by increasing the volume of operation of EGTE. In fact EGTE has a long experience and adequate infrastructure to handle the task.

The exclusionary policy with respect to import is typical of the socialist Deurg. Granting a monopoly to parastatal is of little use as long as it operates with heavy subsidy. It might be possible to deliver a better service/performance with little or no subsidy to private operators. A better and inclusive approach would be to allow both public and private importers to operate simultaneously side by side. This creates competition among all operators which inevitably leads to improving delivery and reducing the cost of operation. It also gives the government the opportunity to check the undesired behaviour of private operators, if any, through market forces.

The illegal domestic trade, may evolve to cross boarder contraband trade, and has to be controlled. To this end harassment of legally operating traders has to cease. Effort to license illegal traders while at the same time intensifying the legal means to bring them to justice, could be an effective way to minimize the extent of illegal trade.

The operation of cooperatives might have benefited an insignificant proportion of urban consumers and institutions receiving subsidized grain, but not farmers as initially expected. The most beneficiaries are the unions, i.e., whoever is controlling them, where some have established large business empires. Though the volume of operation of cooperatives and unions is still limited, the system introduces distortion to the market. The current attempt to change the mode of operation of unions (a 'commission' rather than a predetermined profit margin), may reduce to some extent their arbitrary share, though not significantly, but will not minimize the distortionary effect of the system. Perhaps, a lasting solution could be to support cooperatives at the grass-root level to increase productivity, to strengthen their association – technically and financially, and most of all, to decide on themselves on how to organize and lead their association and what to do with their produce and with the proceeds.

A long lasting market oriented solution could be to establish a marketing system, where producers, suppliers and retailers/consumers could exchange grain in a transparent and market based pricing system. The sort of marketing institution currently underway for coffee and other cash crops, i.e., the ECX market, which was primarily meant for grain but happen to divert heavily to coffee, might provide a platform for a better and lasting solution for grain trading too.

3.3 The Fertilizer Market

3.3.1 Economic importance

Being one of the poorest countries in the world, where smallholder subsistence agriculture accounts for about 40 percent of GDP, 85 percent of employment, and 90 percent of the poor; as well as where the prevalence of shortage of land in the densely populated high land areas is acute, the importance of fertilizer for intensifying agricultural production can hardly be exaggerated. Given a traditional technique of production on pieces of rain-fed and fragmented farm plots (0.2ha per capita), and marginal labour productivity close to zero, the application of fertilizer, along with improved seeds, to raise productivity significantly is, perhaps, the only choice available, at least, in the shorter term. [World Bank, 2005; Byerlee, D. et al. 2007]

Since the first move to introduce fertilizer in the 1960s, fertilizer consumption in the country grew very slowly until the turn of this century. As shown in Table 4, the quantity of fertilizer consumption is too small, though growing appreciably. As of early 2000, however, consumption somehow improved as a result of aggressive extension service by the government, currently rising over 700 thousand tons, recording a consistent yearly average growth rate of over 6 percent.

Table 4. Evolution of fertilizer consumption

Year	Quantity (metric	Average Annual growth (%)

	tons)	Period	Growth rate
1986	34,000		
1991	145,000	1986-1991	65.3
1995	250,000	1991-1995	18.1
2000	262,712	1996-2000	1.0
2005	424,521	2000-2005	12.3
2010	553,885	2005-2010	6.1
2014	730,486	2010-2014	6.4

Source: AISE (2015)[32]; Rashid, et al. 2013, p3.

Irrespective of the effort for more fertilizer application, however, only limited progress has been recorded to date. For instance, only 30 – 40 percent of smallholder farmers use fertilizer. Of the total crop land under cereals, only 49 percent is fertilized at a rate of 37–40 percent of the recommended fertilization rate. [Rashid, et al, 2013] Thus the potential for intensifying agriculture through fertilizer application is yet to be realized.

3.3.2 Market definition

Only two types of fertilizer: urea and di-ammonium phosphate (DAP) are imported. But both have the same marketing channel, and they have been applied, for long, at a fixed proportion on all farms and in different areas of the country. Every year, prices across the country are the same, with marginal differences for transportation cost from the port to a given location. The difference in the

[32] Data released by the Agricultural Inputs Supply Enterprise AISE), April 2015 and Interview with experts at AISE

cost of transportation, however, does not suggest the existence of separate markets. Thus in this study, the fertilizer market is considered as a single market.

3.3.3 Policy intervention

In tune with the socialist economic management policy, fertilizer import and distribution under the former central planning regime (1974-1991) had been monopolized by the state. Fertilizer was subsidized by the state, and special credit programmes were put in place to encourage fertilizer use. The Agricultural Inputs Supply Corporation (AISCO), established in 1984, was the sole importer and distributor of fertilizer to cooperatives and state farms. The private sector had been permanently excluded from participating in fertilizer marketing. This policy remained intact until 1991.

In practice, the current government has no long standing policy for fertilizer supply. In fact policy instability is the defining feature of the regime in this market. In line with its ‘developmental state’ approach, liberalization and/or pervasive intervention remain outstanding, not only in fertilizer, but in all other markets too. Accordingly, by 1993, the National Fertilizer Policy, which supported fertilizer market development, has been issued and the National Fertilizer Sector Project, with financial support from the World Bank and other donors, was launched. This project supported fully liberalized pricing, the abolition of subsidies, the central role of private actors, and the regulation of fertilizer standards [Byerlee, D. et al. 2007]. With a new name and restructuring, AISE took over the new role in fertilizer supply. However, by 2002, the private sector was pushed out of the market and as of 2009 the parastatal, AISE, has been the only importer and distributor of fertilizer, bringing the market back to square, where it started a couple of decades before.

3.3.4 The rationing system

Since the early 1990s, as a result of changes in government and policy regimes, the marketing chain of fertilizer went through various structures: from a 'state monopoly' to a 'liberal state-private competitive market' and back to a 'state monopoly' and control. During the central planning regime, fertilizer used to be imported by AISCO and distributed to Farmers Service Cooperatives, an off-shoot of the Producers' Cooperatives, which in turn sold it to farmers (Figure 7).

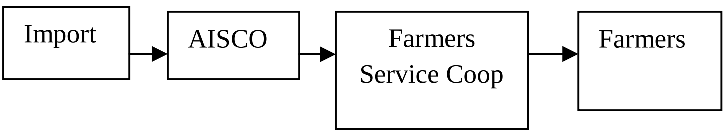

Figure 7. Fertilizer marketing chain (1975-1991)
Source: Author, based on survey

Fertilizer marketing was an all out government affair as service cooperatives were not only organized forcefully by the government, but had no other choice to access fertilizer, except through AISCO.

Since 1992, the marketing structure, as well as market players, has been changing frequently. The policy move which allowed the private sector to be involved in fertilizer marketing, led to the emergence of a competitive market, though for a brief period – 1993 to 2001 (Figure 8).

The process of fertilizer import starts with estimating the total yearly demand by the government. As shown in Table 5, this total demand was then allocated to the then importers. Importers were not allowed to import more than what was estimated by the government, as the foreign currency availed by the national bank was just for the estimated quantity. Moreover, importers were not able to choose their own suppliers; The MARD use to prepare one tender document for the total quantity to be supplied and invite international suppliers to bid. Those who won the tender had to supply to the different importers. Private or other importers were not allowed to either estimate own market demand or choose their own supplier.

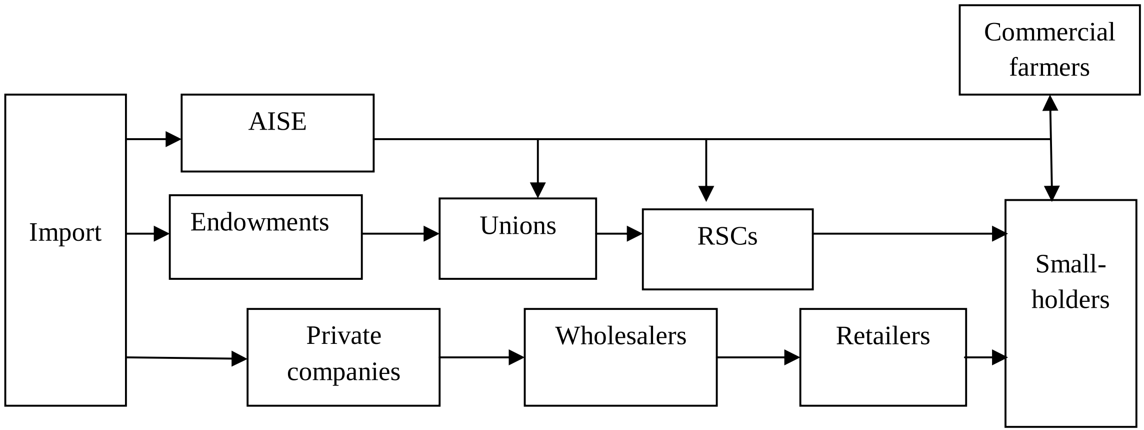

Figure 8. Fertilizer marketing structure 1993-2001
Source: Author, based on survey

Between 1993 and 1995 AISE and private companies were the only importers of fertilizer, the latter developing its share gradually. AISE started its distribution first directly to farmers, with the support of extension (development) agents, who are helping farmers at the grass root level. After RSCs were organized, distribution first shifted to RSCs, and then, as of 1996, to unions. Moreover, even today, there are many RSCs with no Unions. By the end of 1995 there were 4 private importers, 67 wholesalers and 2300 retailers. [Byerlee, D. et al. 2007]

In 1996, party affiliated holding companies[33] joined the market and began importing fertilizer. These holding companies distribute it to unions, which in turn passed it over to RSCs – the retailers. What is fishy in this connection is that the same parties who own endowments are also government officials who oversee the organization and operation of cooperatives. By 1999 the share of private companies in the market reached just over 50 percent. This marketing structure remained operational until 2001.

Despite the liberal market policy environment, all private companies liquidated their operation in 2002. Only holding companies and AISE continued operation until

[33] Holding companies, as noted earlier, also known as endowments, are established by the ruling parties formed on the basis of ethno-linguistic administrative configuration of the country, and claiming to represent the same.

2004, with AISE handling the largest quantity of the import (Figure 9).

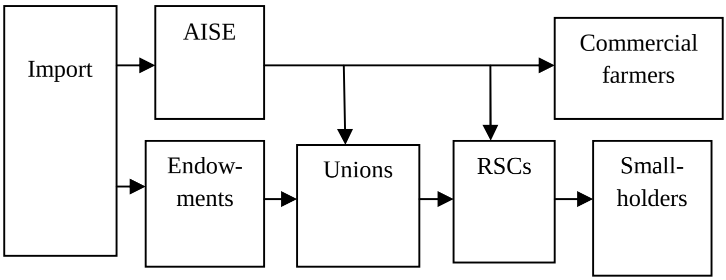

Figure 9. Fertilizer marketing structure 2002-2004
Source: Author, based on survey

A new development emerged in 2005, with the involvement of cooperatives in the import trade. Soon they became dominant importing over 65 percent of total import during 2005 to 2006 (Figure 10).

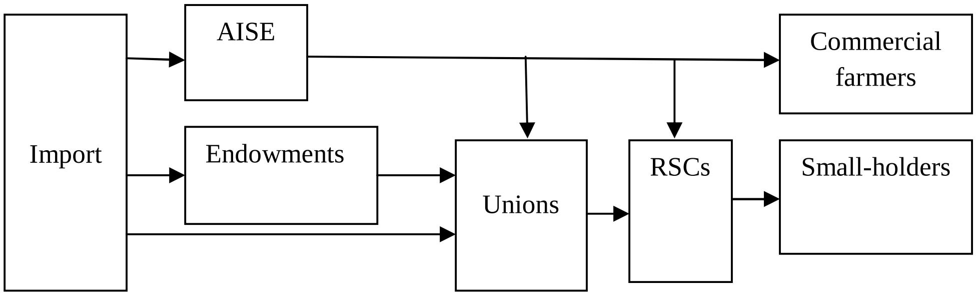

Figure 10. Fertilizer marketing structure 2005 and 2006
Source: Author, based on survey

However, with cooperatives importing their own consumption, holding companies run out of market and exited in 2007, leaving AISE and Unions to handle the import (Figure 11)

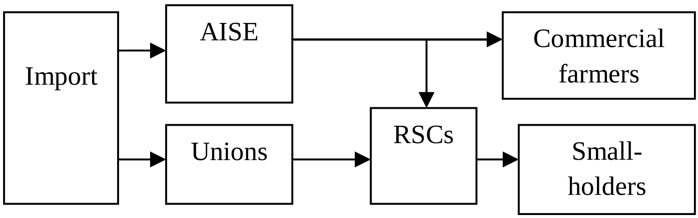

Figure 11. Fertilizer marketing structure 2007 and 2008
Source: Author, based on survey

The final turn came in 2008 when the country faced acute balance of payments deficit, food crisis and soaring inflation. "The government requested financial support from its development partners for and managed to receive $250 million from the World Bank and another fund worth 100,000 tons of fertilizer from the African Development Bank. Through some negotiations, the government and the two banks agreed to coordinate all fertilizer imports through AISE." [Rashid, et al. 2013, p3] This policy decision resulted in the withdrawal of all regional state governments sponsored unions, thereby leaving AISE as the sole importer, taking the place of its predecessor, AISCO (Figure 12). It was argued that at a time when foreign exchange constraint prevails, its allocation for agricultural purposes receives low priority and fertilizer import becomes a sacrificial goat. As such, it was decided to focus on one institute for timely and adequate supply, as well as for economies of scale that comes with bulk purchase,

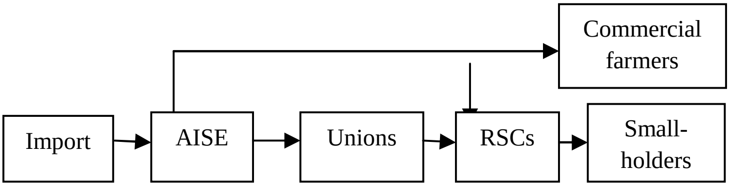

Figure 12. Fertilizer marketing structure since 2009
Source: Author, based on survey

3.3.5 Competition related issues
3.3.5.1 Market entry

The ban on private sector entry in fertilizer business has been lifted in 1992, and there has been no regulatory reversal since then, except the ban of foreign investment on import trade of fertilizer. [MFA 2005] Moreover, official subsidy has also been terminated in the same year. As such, there is no regulatory barrier restricting entry, even today. However, the regulatory provision is of little practical importance, as entry in practice is determined by the government at a given point in time. Moreover, importing fertilizer needs large foreign exchange provision. But as the foreign exchange market is not liberalized, one depends on government foreign exchange rationing to import fertilizer. Also import trade of fertilizer requires large operating capital, hence, the need for a well established and competitive financial sector to service the trade. Such limitations could as well pause challenges to entry.

3.3.5.2 Concentration

The fertilizer market is highly concentrated. As shown in Table 5, AISE has dominated the market throughout the period. Even during the period when both endowments and private companies were operating competitively (1996-2001), AISE alone imported half of the total (50.8 percent). During this time, 4 private companies and 4 endowments were also involved in import trade. However, the simple average share of each private and endowment company was less than 10 percent, though actual shares differ marginally as these companies also differ in size. Thus, entry of the private sector and endowments did not reduce market concentration significantly.

After the private sector exited in 2002, AISE consolidated its share, increasing it to an average of 64 percent, while endowments hold the balance (Table 5). As private importers exited, so did wholesalers and retailers. While private retailers held a majority share of the market in the early 1990s, the public sector and cooperatives have become almost the sole distributors of fertilizer since early 2000. [DSA 2006].

With entry of cooperatives in 2005, their import share increased immediately with considerable technical assistance from the Ministry of Agriculture. In 2005 and 2006 they imported, on average, 41 percent of total; and with the exit of endowments, their share increased to 68.5

percent in 2007 and 2008, while AISE's share still remained over 30 percent. Even then the average share of each of the 4 cooperative unions (though the actual share differs) was between 10-20 percent, still much less than that of AISE. Thus, throughout the period, concentration in fertilizer import remained high.

Table 5: Concentration in fertilizer import trade – annual average of quantity imported (%)

Year	AISE	Endowments	Private	Cooperatives	Total
1992-1995					100
1996-2001	50.8	28.1	21.1	-----	100
2002-2004	64.0	36.0	-----	-----	100
2005-2006	37.5	21.5	-----	41.0	100
2007-2008	31.5	-----	-----	68.5	100
2009-2014	100	-----	------	-----	100

Source: Author, based on Rashid 2013 and AISE 2015

3.3.5.3 The presence of AISE, endowments, and cooperatives

The government's underlying interest to closely control the fertilizer market influenced its decision on who to allow in this market. Given all the privileges extended to endowments, AISE and cooperatives in the course of the importing process, the initial liberalization, which allowed entry of the private sector, must have been an unintended decision.

An importer had to obtain a license to import, through a tendering process, in lots of 25,000 tons. Given that a single shipment of fertilizer alone requires investing millions of dollars over several months, an importer always requires substantial financing support. However, while private importers were required to deposit 100 percent of the value of the fertilizer to be imported at the time of opening a line of credit, the AISE, party-affiliated companies, and unions had privileged collateral requirements. Moreover, except the private sector all other importers had access to navigate the regulatory and administrative systems at both the federal and regional levels (Byerlee, D. et al. 2007).

Though currently, sales on credit to farmers has less importance, compared to a decade earlier, under the credit guarantee scheme funded by regional governments, fertilizer is delivered on credit at below market rates, implying an implicit subsidy element. Repayment is assured by the intervention of local governments. This however was not available to private operators. Such interventions did not contribute to the emergence of a level playing field. As a result, private companies were eventually forced to leave the trade. [Zavetta, R. & S. Feyissa 2009]

Also, it is said that some discriminatory measures were adopted by the government regarding the calculation of the sales prices of fertilizer. While the government allowed AISE to include in the calculation cost items, such as overhead cost, interest, and transportation, private operators were denied this possibility. [ibid]

3.3.5.4 Anti competitive practices

With entry of party affiliated companies, there also emerged alleged anti-competitive practices, which led to conflicts between private operators on the one hand and AISE and party affiliated companies on the other. The former complained about a number of abuses by AISE, ranging from denial to access market places to the forced closure of facilities and the threatening of clients. The matter was even investigated by some representatives of the donor community, and this led to recommendations that further "adjustments [were] in order to allow a level playing field for involvement of private wholesalers." [ibid, p59].

Moreover, farmers receiving credit for fertilizer from regional governments were not allowed to buy from private companies. [Rashid et al. 2013]

Interview by the research team of this study with an expert at the MARD dealing with fertilizer distribution argued that private companies left the market mainly because of the strong competition they encountered from party affiliated enterprises, but acknowledged the unfair pressure from one (but not from others) of the party affiliated enterprises, Ambassel, on private competitors.

3.3.5.5 Elements of Subsidy

The price margins between Ethiopian and some other African countries for fertilizer are comparable, though not so with the international prices in Asia and Latin America. [Heisey, P. and G. Norton 2006] A comparison of the price build-up of fertilizer from port to farm gate indicates that marketing margins in Ethiopia are somewhat lower than those in some East African countries. In 2012, for instance, Ethiopian price for DAP was about 85percent of Kenya, 87.7 percent of Rwanda, and 77.3 percent of Tanzania. [Rashid et al, 2013, Table 4.1, p12] In reality, however, these apparently low prices reflect elements of subsidy imbued in the process of importing, distribution and retailing. Though regulatory subsidy was lifted in the early 1990s, as noted above, there are a number of explicit and implicit state subsidies involved in the importing and distributing of fertilizer.

Extension agents were given the task of distributing/retailing agricultural inputs such as fertilizer (EEA/EEPRI 2006), though currently their role has been taken up largely by RSCs whose retailing margin is very low. Rashid explains that the margin for fertilizer retailing is too small leaving a risk of failure to cover the cost. For 2012, for instance, overhead costs and profit margin are estimated to be less than 1 percent of the value of fertilizer. “In Kenya and Tanzania agro-dealers receive 5 to 8 percent of the value of fertilizer at farm gate.” [Yen, C. and T. Chen 2010].[34]

Administrating the credit and credit guarantee scheme, involve a number of government and private entities,

[34] Quoted in Rashid, s. et al. 2012, P27.

including agricultural bureaus, unions, cooperatives, banks, etc. The scheme incurs large implicit costs. The fact that credit is facilitated at interest rate much lower than the market rate implies explicit subsidy to farmers. Early in the programme, there was also high fiscal costs and fiscal risks associated with the guaranteed loan scheme. “The write-off to loan guarantees amounted to Ethiopian birr (ETB) 84 million in 2001, but by 2005 liabilities had again accumulated to ETB 183 million (DSA 2006). Also in 2005, the Oromya Region was obliged to pay out approximately ETB 84 million to the Commercial Bank of Ethiopia to honour its guarantees for the previous three-year time period.” [Byerlee D. et al. 2007, p26] Thus, the credit and credit guarantee scheme turn out to be a significant unaccounted subsidy burdening government budget.

Beyond fiscal costs, there are also considerable but non-quantifiable implicit costs in the system, many of which are borne by the government through its administrative offices and own enterprises. Large cost is involved in central planning system of fertilizer demand estimation annually. Demand estimation begins at Kebele (county) level with the direct involvement of extension agents; this is aggregated at woreda (district) level, and further, at zonal level; then the bureau of agriculture aggregates it to come up with regional demand. Finally, the Ministry of agriculture make another exercise to find the national demand of fertilizer. Thus large civil servants are involved all the way through and every year in the estimation for fertilizer demand incurring large implicit cost. Moreover, preparation of tender documents, getting approvals, and running the bid all involve costs. Ministries and financial institutions, such as the Ministry of Agriculture, Ministry of finance and Economic Development, NBE, CBE, etc., are involved in the process.

AISE, with large number of employees, is permanently engaged in fertilizer import, distribution, and sales (to commercial farmers). Though a monopoly, AISE is said to be fairly efficient in tendering and suppliers selection. The procurement process has also been efficient in outsourcing services for shipping, port management, bagging, and loading on trucks, as compared with other East African countries. However, its transaction costs are marginally higher based on global fertilizer industry publications. [Francesconi, G.N. & R. Ruben 2008] AISE operates with a state budget. An interview with a staff member reveals that currently AISE receives a commission of Birr 1.5 per quintal, which is quite insignificant compared to the large overhead cost it incurs, implying an element of subsidy to be covered by the budget.

Neither AISE, nor cooperatives are obliged to pay any of the obligations (tariffs, taxes, or other government charges) that a private operator would have been subjected to in relation to fertilizer import, distribution or retailing. This implies substantial forgone revenue, which would have been collected if private sector was involved.

The indirect costs also include the storage costs (and earlier associated quality deterioration) incurred because closing stocks have comprised a large proportion of total consumption (as high as 50 percent for some years) [Byerlee, D. et al. 2007, p26]. In an interview with an expert at the FCA, revealed that fertilizer demand use to be estimated at 20 percent more than actual demand, though this has now proven too large and is now decided to reduce it to 10 percent. It should be noted that farmers are not willing to buy carry-over stocks as it can be easily spoiled. This excess fertilizer import had in the past led extension agents to make forced delivery to farmers beyond their demand, though such actions are no longer significant. However, there are still cases where over estimation of demand, and import, has led to inefficient fertilizer distribution. For instance, an interview with cooperatives leaders and farmers in Tigray revealed that fertilizer is distributed as a substitute for aid in cash to the needy, i.e., to those who are entitled to receive aid from the government, despite the fact that they are not willing to receive fertilizer as aid. As these people don’t need fertilizer, they take it out to the black market.

All these subsidy elements, if accounted for, explains the high cost involved in fertilizer import and distribution, to achieve its objectives. Moreover, farmers are complaining of the continuing rise of the price of fertilizer. Interviewed farmers underlined that the price of fertilizer has been increasing year after year, while prices of cereals have been decreasing. As shown in Figure 13, except for a single year, 2013/14, the price of fertilizer has been increasing since 2000, while the average price for cereals fell for a number of years during the same period.

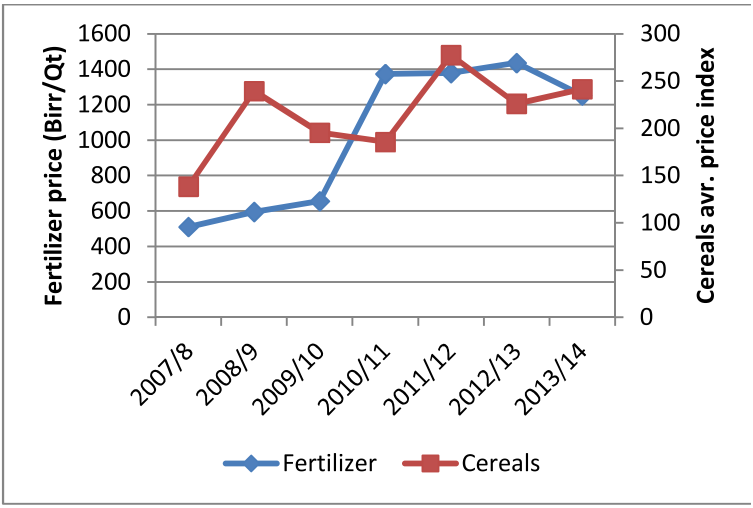

Figure 13. Comparing relative price changes of Fertilizer and cereals

Source: Author, based on AISE (2015) and CSA Statistical Abstract, various issues

In sum, it is apparent that the current system in Ethiopia is less efficient and unsustainable in the long run; and it also severely hinders the development of sound input markets and financial markets in rural areas.

3.3.6 Recommendations

Ethiopia's fertilizer market deals with high transaction costs in marketing and distribution to geographically dispersed farmers with limited financial resources and no access to credit (Harrigan 2008; Jayne et al. 2003). In addition to the relatively high fertilizer price, rainfall variability results in increased production risk and variability in fertilizer consumption. It is understandable that dispersion of settlement, lack of infrastructure, long supply timeline, liquidity problem, etc., may force the government to intervene at the initial period, bringing both public and private sectors to operate in the same market simultaneously. But, marginalizing the private sector, in the face of inefficient public operators, could not be warranted.

Marginalizing the private sector, for the sake of party affiliated enterprises, and easily controlled but dependent cooperatives and parastatals could not lead to efficient fertilizer market. Experience also suggests that marginalizing the private sector, while relying almost exclusively on the state, will not provide the intended growth stimulus to the agricultural sector. Witness the Deurg regime. The current approach reduces the quality of input services to smallholders, incurs many hidden costs to the government, and generates significant risks to both smallholders and the government. Given the large, scattered, poor agricultural population, as well as poor infrastructure, while an entirely private sector-led approach may not be a viable or desirable solution, more consideration should be given to long-term policies designed to create a level playing field for all actors and build a dynamic private sector to promote fertilizer, improved seed, credit, and market information systems.

Currently cooperatives are not operating on business models, but only on unions' guidance. According to the survey, the credit guarantee scheme is currently of little importance as most farmers are purchasing fertilizer largely on cash basis. State governments' guarantee to the parastatal CBE for the credit it provides to unions, is an administrative convenience, not a profitable market transaction for CBE. All interviewed RSCs and union leaders asserted that cooperatives cannot stand on their own without the government support, despite the fact that they have been in operation for two decades or more. The current structure may lead to collective dependency rather than entrepreneurship. What also emerged conspicuous is the business empire of some unions, but little change at the grass-root level – cooperatives and member farmers. As noted in the section on cereals, FCA experts suggested that they are trying a new approach – a 'commission' rather the current model for their service. All basically indicate the inefficiency embedded in the system.

The system's greatest weakness continues to be the lack of a private sector involvement in the distribution network that could help mediate supply and demand, offer alternatives to farmers, and provide information on the optimal use of appropriate varieties. To date, private sector growth in this area has been severely constrained. Markets are segmented by policy intervention; no competition among unions or primary service cooperatives even within a single market segment. The system is simply an administrative rationing mechanism to facilitate the import and distribution of fertilizer by the public sector. Controlling the distribution of fertilizer, may create an effective tool to control farmers, but not a sustainable market. Private actors have to be reinstated and cooperatives have to be given the power to decide on how to run their association and acquire agricultural inputs.

3.4 The Edible Oil Market

3.4.1 Salient features

The very diverse agro-ecological environment of Ethiopia enables the cultivation of a wide range of oilseeds, for which Ethiopia has a long-standing tradition. Linseed, Niger seed, soybeans, cotton seed, sesame, groundnuts, sunflower seed, castor beans, and rapeseed are important types of oilseeds grown in Ethiopia (Hailegiorgis, B. 2011). According to the Central Statistical Agency of Ethiopia, currently, over 3.7 million smallholders are engaged in oil seeds production on pieces of rain-fed and fragmented farm plots, totalling 0.816 million hectare, implying on average 0.22 ha per holder [CSA 2014b]. For decades, the labour intensive, rain-fed cultivation technique gave rise to low productivity – less than 1.5 ton per hectare, except for soybeans. Total production for the same year is 7.1 million quintals, of which, nearly half is exported. Currently oil seeds are the country's largest foreign exchange earner, exceeding coffee, accounting for about 21percent of the total export value (NBE 2014b). In spite of its high potential (increasing productivity significantly through the use of improved farm practices – inputs & technology, existence of large uncultivated and fertile land, high internal & external demand, etc) and economic importance, however, low productivity and shortages in supply have been known to beset the operations of both the edible oil industry and the requirements of oilseeds exporters.

Currently, there are about 34 medium and large scale edible oil refineries, and over 1000 small scale and micro semi-processing (less purified edible oil) plants across the country. [CSA 2012; Wijk, J. et al. 2011; ILO 2013] Medium and large scale refineries are said to have a production capacity of about 16,000 tons,[35] on average, while less refined oil processing plants have over 100,000 tons.[36] However, Capacity utilization is seriously constrained by various factors, including power shortage, obsolete equipment and technology, etc. According to the survey, all edible oil mills are operating at below 50 percent of their capacity, mainly because of raw material shortage and stiff competition from subsidized, hence cheap imported palm oil.[37] As a result, the country heavily depends on foreign sources – imported oil.[38] As shown in Table 6, currently the volume of production of medium and large scale processing industries account for only 1.4 percent of import. The volume of import nearly doubled in 2008 from that of the previous year, and continued to increase substantially every year forcing domestic manufacturing industries to reduce their capacity of production significantly. Currently, about 345 thousand tons of oil is imported; and oil mills are running at one-third of their capacity. With semi-processed edible

[35] Based on CSA, 2012.

[36] Survey result: calculated based on the interview with the 'Addis Ababa Edible Oil Processing Association' leaders.

[37] Seven medium and large scale edible oil producing firms, including the largest 4, and 27 enterprises engaged in distribution in 8 cities responded to the survey.

[38] During drought seasons, aid too accounts for a considerable proportion of consumption.

oil production assumed to be about 51,000 tons, total domestic production accounts for only 13.9 percent of consumption.[39]

3.4.2 Market definition

Some degree of product differentiation is observed in the edible oil market. Different types of oilseeds give rise to different quality of edible oil, each having its own peculiar characteristics in terms of food content and taste.

Table 6: Edible oil production and import (tons)

Year	LMSMI prod.	Import	Prd/imp ratio-%*
2004/05		20846	
2005/06	11408	36236	31.5
2006/07	6640	65717	10.1
2007/08	5787	139834	4.1
2008/09	5704	196323	2.9
2009/10	10881	222142	4.9
2010/11	6055	263989	2.3
2011/12	6520	300000	2.1
2012/13	4573	330443	1.4
2013/14	4882	344532	1.4

Source: CSA, Report on LMSMEI, various issues; MWITE (2015)[40]; NBE (2014a).

* Author calculation

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[39] Calculated based on a study by ‘Ethiopian Pulses, Oilseeds & Spices Exporters Associations’, which estimated domestic production to be about 20 percent of consumption in 2011/12. [Addis Fortune, Feb. 03, 2013, vol. 13, No.666]

[40] Data provided by Merchandize Wholesale and Import Trade Enterprise, April 2015.

Despite differentiation in their characteristics, however, they are easily substitutable. A major differentiation arises between refined and less refined oil. Obviously, refined oil is superior and can be sold at international markets. In Ethiopia, refined and less refined oil are largely substitutable, not only because less refined oil is cheaper, but also the main oil seed traditionally used for oil production, Niger seed, is said to have very low acidic content and may not need intensive refining. From geographical point of view, less refined oil is produced and sold in nearby markets because of absence of modern packing materials, reduced shelf life and poor standards, while refined oil can be transported to distant markets. Despite this, however, both types are sold in almost all markets across the country. It is only in super markets in the capital, where crude oil cannot find its way. So, for this study, crude and refined oil are taken as substitutes.

3.4.3 Policy intervention

As in many other markets, policy intervention, in the edible oil market too, is pervasive, which is the legacy of the socialist Deurg and the 'developmental state' approach. Before 2009, edible oil used to be supplied only by the private sector; the government had no role either in production, or import and distribution. All government owned edible oil factories were privatized earlier. Edible oil markets were supplied by domestic private producers, importers, wholesalers and retailers. There were about 25 Palm oil importers. As noted earlier, inflation in Ethiopia started to surge in 2006/07, later forcing the government to remove import duties on certain essential and consumption sensitive goods, including edible oil.[41] Then in early 2009, the parastatal, MWITE, started to import and distribute Palm oil. However, not only because of the general inflation, but also because of the increasing export drive of oilseeds, market prices of edible oil continued to rise (Figure 14). In early 2011, the government moved to action: initially by fixing the price of imported Palm oil, and later in May, by banning private import altogether.

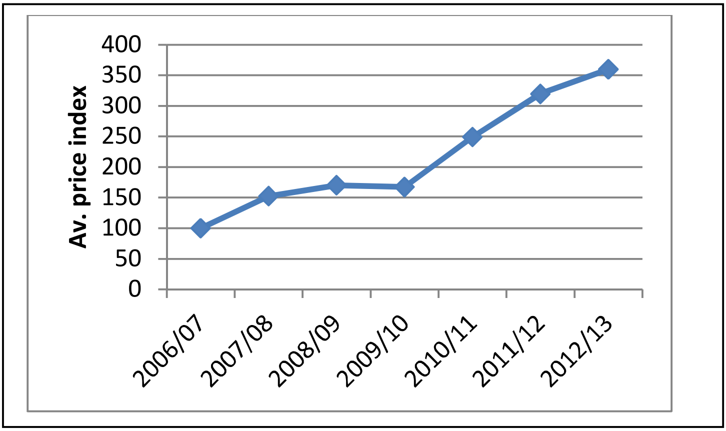

Figure 14. Edible oil open market price trend (2006/07=100)*
Source: CSA, Statistical Abstract, various issues.
* Excludes government subsidized Palm oil price

Since then, the state owned enterprise, MWITE, has been importing and distributing palm oil single handed at subsidized price to the public at large across the county.

[41] "Government Lifts Sur Tax on Edible Oil, Soap", ENA, 29 March 2008.

However, except palm oil, there is no legal restriction on importing other types of oil, though the lack of foreign currency, allocated for this specific purpose, puts a limit to the volume of import.

3.4.4 The rationing mechanism

The marketing mechanism before 2011 reflects a typical market oriented structure with importers and local industrial producers supplying the product to wholesalers, who in turn supply it to retailers where consumers have direct access (Figure 15). Different types of edible oil (palm oil, sunflower, vegetables, etc) use to be imported by the private sector. The only exception was the case of less refined edible oil, where it was, and still is, sold directly to consumers residing in nearby villages or to retailers who transport it to nearby markets. Edible oil marketing activities before 2011were an all out private sector's affair.

In early 2009, the parastatal, MWITE, began to import Palm oil along with private importers. As of May 2011, however, private import of Palm oil was banned, giving the former a monopoly power to import and distribute locally (Figure 16), while import of non-Palm oil (a relatively small proportion) continued to be imported using the same channel as before (Figure 15).

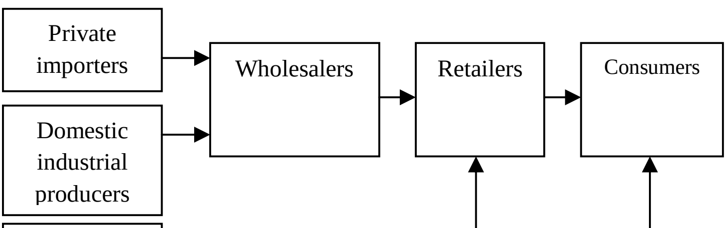

Figure 15. Marketing chain of edible oil before 2009

Source: Author, based on interviews with MWITE Officials, leaders of consumer associations, and responses of traders engaged in distribution

Figure 16 portrays the rationing mechanism of palm oil. Palm oil is imported, largely, from Malaysia and Indonesia and transported to MWITE warehouses across the county. The ministry of Trade sets selling prices and oversee the quota allocation for each region, while trade Bureaus determine the quota for zones, cities, districts, counties and households within the region.

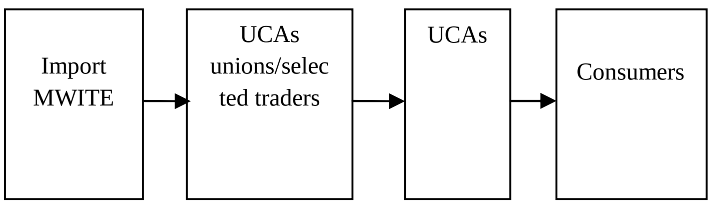

Figure 16. The rationing system of palm oil since 2009

Source: Survey result: interview with MWITE officers, leader of consumer associations and responses of traders engaged in distribution.

Depending on the specific condition of a given district, Trade Bureaus select distributors, either traders or unions of urban consumer associations, or both, which receive a fixed volume of edible oil from MWITE and distribute it to identified consumer associations, which in turn, distributes directly to consumers residing in a given village.[42] The selling price of MWITE is fixed by the Ministry of Trade, and the subsequent selling prices to consumer associations and consumers, including the margin for distribution, by Trade Bureaus. These fixed prices are, nevertheless, equal across the county, with marginal differences for transportation costs.

The paper work involved in the system of distribution and verification, starting from high ranking offices, such as the ministry of trade and MWITE, down to village level, is routine and immense, permanently involving a large number of civil servants. The marketing structure depicts the marginalization of the private sector, as a result of profound state intervention.

3.4.5 Competition issues

3.4.5.1 Market entry

The only regulatory barrier related to trade in edible oil is the restriction imposed on foreign investment. [MFA, 2005] Foreign investors are not allowed to engage in wholesale or retail activities, unless the product is from their own mill.

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[42] In the capital, Addis Ababa, another state owned enterprise, ETFRUIT, is also involved in retailing.

However, there are a number of non-regulatory barriers both in the production and distribution of edible oil. As explained above in the case of fertilizer, in the edible oil sector too, import of palm oil has been the monopoly of the state for the last 4 years.[43]

Investment capital required to establish edible oil mills varies depending upon the size, technological and operational sophistication of plants. Capital outlays for small scale mills ranges from 250 to 350 thousand US dollars, while large scale sophisticated mills costs tens of millions of dollars. [Zavetta, R. 2009] For instance, a very large scale plant to be established here in Ethiopia by the Giant Malaysian Pacific Interlink is expected to cost up to 20 million dollars. [Addis Fortune, Feb 03, 2013]. Hence, initial capital outlay for edible oil production plant would not be a serious barrier, as entry is possible with different technology and varying size. However, what is considered by producers as a barrier is the lack of raw material. All producers, who responded to the survey, confirm that access to raw material is a major barrier to entry. The only most important comparative advantage in the edible oil processing sector is the opportunity to access different types of oilseeds grown in

[43] Currently government seems to change its mind and is planning to allow private import of Palm Oil, but by handpicking few business organizations. This indicates, once again, the lack of policy instability and a problem of transparency, as traders are not openly invited to compete for imports.

the country, which, however, is highly constrained by the current incentive driven export drive. Unless an investor in edible oil processing also owns oilseeds farms to create vertical integration, oil processing would be a challenging business. But, obviously, investing on oilseeds farms too requires high initial investment capital.

There are no other strong entry barriers, policy oriented or from incumbent competitors, either in production or distribution of own product. However, entry in the distribution stream of palm oil requires satisfying the criteria set by the government. According to Bureau officials, a trader interested to distribute palm oil, has to meet the requirements involving adequate capital, warehouse, tax payment, discipline, etc. Traders, however, don't accept this and think that real requirements go beyond these explicit criteria. However, there seems to be little concern on the part of most traders, as many are not interested in the business whose return is marginal. According to the survey, for a trader, the volume of traded product (around 10 percent of the total distributed in a given city, excluding Addis Ababa), the procurement price, the selling price, and the margin for the service are all fixed.

3.4.5.2 Concentration

As shown in Table 7, concentration in the edible oil market is overwhelming. Currently the edible oil market is supplied by three sources: The parastatal (MWITE), domestic producers (including micro millers), and private importers. MWITE dominates the market with a share of about 85 percent, while domestic producers account for about 14 percent. The marginalized private import, targets niche markets, with an insignificant one percent share (Figure 17).[44]

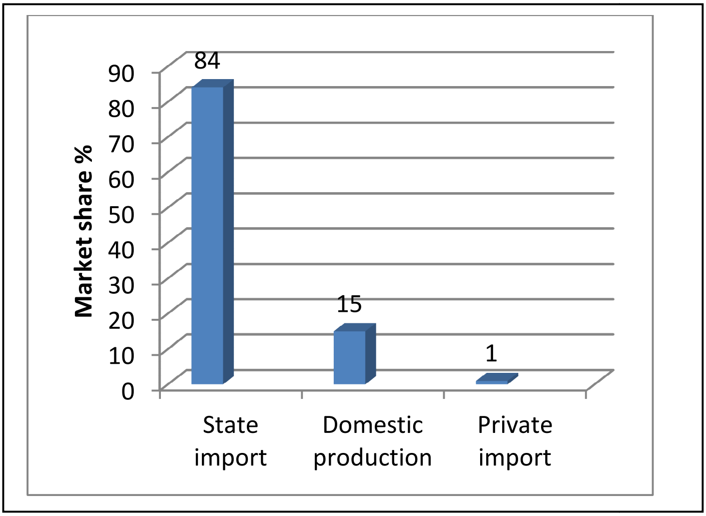

Figure 17. Concentration in edible oil market (%)
Source: Author, based on data from MWITE and CSA (2014).

With the state being the dominant supplier at a highly subsidized price, there is literally no competition in the edible oil market. Domestic producers and private importers, whose market price is currently at least double of the state's price, though for different quality of edible oil, are targeting higher income groups and also have a gap-filler role, as demand for edible oil in general has not yet been fully satisfied.

[44] Interview with MWITE leaders.

As noted above in this section, medium and large scale edible oil manufacturing mills, altogether account for only 1.4 percent of total supply, as they are all operating at much lower capacity of their potential. If the potential production capacity of each mill is considered, there seems to be a modest concentration. Based on an earlier study, the largest of the 27 large and medium scale mills has a potential to produce 22 percent of total capacity, while the second largest has 13 percent. The third and fourth largest mills each has about 6 percent of total capacity.

Table 7. Concentration ratio in edible oil processing

No	Size of mills	Concentration Ratio (CR)
1	The largest mill – CR1	0.22
2	The largest 2 mills – CR2	0.35
3	The largest 3 mills – CR3	0.41
4	The largest 4 mills – CR4	0.47

Source: Adapted from Zavetta, R. et al. 2009, p49

Even if all mills were to operate at full capacity, this level of concentration is currently of little concern. However, this might change in the future as two relatively giant mills said to be in the pipe line, with a total yearly capacity of 450,000 tons, began to roll.[45]

[45] The two large mills are currently said to be at the stage of developing plantations for raw materials. [Addis Fortune, Feb. 03, vol. 13, No. 666, 2013; WWW.bloomberg.com/news/articles/2012-04-05]

3.4.5.3 Subsidy

The presence of the state owned enterprise MWITE, on its own, would not have created an anti-competitive environment had it not been for the large subsidy involved in imported oil.[46] MWITE does not pay any import related charges, such as tariff, Sur tax, transaction tax, etc., while private importers are obliged to pay. Domestic producers too are subjected to a number of direct and indirect taxes. Currently, such charges are calculated to be around 15 percent[47]. Moreover, similar to the case of fertilizer distribution, very large expenses related to wages of government employs (MWITE, trade Bureaus, etc) permanently engaged in the paper work related to the distribution and verification of edible oil are all born by the government, thereby burdening the budget. All these are unaccounted costs of distribution. The presence of such policy driven explicit and implicit subsidies does not create a level playing field for domestic producers to engage in fair competition in the market.

3.4.5.4 Horizontal competition

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[46] No information is available to calculate the level of subsidy. The cost, insurance and freight (CIF) price of edible oil, cost of loading and unloading, warehouse rent, cost of transportation, overhead costs, etc., all cannot be disclosed.

[47] Based on interview with the leaders of 'Addis Ababa Edible Oil Producers and Exporters Association'.

As noted above, there is no competition what so ever in the distribution of edible oil: both purchase and selling prices, the volume traded, and the rate of the service margin are all fixed. Even the customers are known a priori; hence, one cannot sell to any other customer without bearing the risk.

In production, however, there is neither strong competition, nor explicit anti-competitive practices. For over two decades the Ethiopian business environment has been largely under state control. Business tends to cooperate and share the market rather than compete. For instance, in the case of advertisement, producers don't announce their price quotation, but rather explain in vague terms, about quality. 57 percent of the respondents think that advertisements don't raise the issue of price, while only 28 percent think that they also do advertise prices. Similarly, members of the Association of Addis Ababa Edible Oil Producers and Exporters don't seem to compete against each other. For instance, 71.4 percent of the respondents hold the view that they don't compete on prices; and 85.7 percent confirm that members prefer to share the market rather than compete.

3.4.6 Recommendations

State intervention, where it is the only way to correct a market, may be justifiable, but calculating the degree of intervention, setting the timeline, etc. In the case of the edible oil market in Ethiopia, the root cause of the steep rise in prices is external to this market. There may be cases where some importers might resort to actions that might escalate the rise of prices; however, such incidents could have been addressed based on the existing competition or trade rules. Revoking the licenses of all importers, or banning them all (not some), in favour of a parastatal, is more like a command economy style, rather than a market oriented approach. About 81percent of the respondents to the survey complained about shortage of edible oil, and people are sometimes forced to buy the same Palm oil from the black market at a price as high as three times the state's rationing price.[48] In fact, the move to go back to importing, by marginalizing private actors, contradicts the earlier privatization programmes.

If indeed the state's direct involvement in import trade happens to be necessary, then it would be more effective and justifiable if it operates in the market, along with private importers, by influencing the market with its volume of operation and reasonable/fair market price. Marginalizing the private sector and rationing are the legacy of the command economy, which proved unsuccessful in creating a sustainable market economy.

Given the country's unique agro-ecological environment to grow different types of oilseeds, it has all the opportunity and comparative advantages to establish

[48] It is not easy to know for sure how such strictly controlled product find its way to the black market.

competitive edible oil industry. Despite this however, the policy environment does not seem to be in tune with the sector's comparative advantage. For instance, the country has equally greater comparative advantage in the edible oil sector as it has in the leather sector. However, while the policy deters export of hides and skins in favour of domestic tanning industries, it encourages export of oilseeds, while at the same time domestic edible oil processing industries are operating at one-third of their capacity, partly because of lack of raw material [Wijk, J. et al. 2011] All producers who responded to the survey explained that their major problem in production is lack of raw material and, of course, cheap subsidized imported oil. Thus in effect, subsidized import is burning the domestic industry. Thus, not only that both policies (for hides and skins and edible oil markets) involve less market oriented measures, though the former might be argued from long term development perspective, but are also apparently contradictory. The subsidy itself is less meaningful and unsustainable as it does not target any underprivileged group of society; in fact all consumers, except those who, for various reasons, do not like to consume palm oil of the type currently imported, are subsidized. Allowing private actors in import trade is, therefore, more meaningful and economical than subsidizing a monopoly parastatal.

3.5. The Sugar Sector

3.5.1 Salient features

Sugar is a staple product and an important consumption item even in rural villages of the country. As such, all governments who came to power have been deeply involved in the production and distribution of the product. All activities in the sugar sector today, including sugar cane plantation, processing, import, and distribution are the monopoly of the state. It is an all out vertically integrated business, run by the government single handed. Sugar production in Ethiopia was first initiated by a foreign private company – the Dutch HVA holding company – in the 1950s. Today's Wonji/Shoa and Methara Sugar factories were established by this company, but were nationalized by the Deurg in 1974 and remained so to date. In 2014, there were only three sugar factories, all owned and controlled by the state, with a combined annual capacity of 300,000 tons. As a by-product, these mills also produce 14.52 million litres of ethanol. A total of about 24,000 ha of land was covered by sugar cane plantation, of which, only 4.6 percent was held by farmers cooperatives. As shown in Figure 18, the largest mill, Methara, produces 114,000 tons (38 percent), while the next largest Fincha, accounts for 110,000 tons, (36.7 percent) (Figure 18). By all standards, these mills are not large scale.

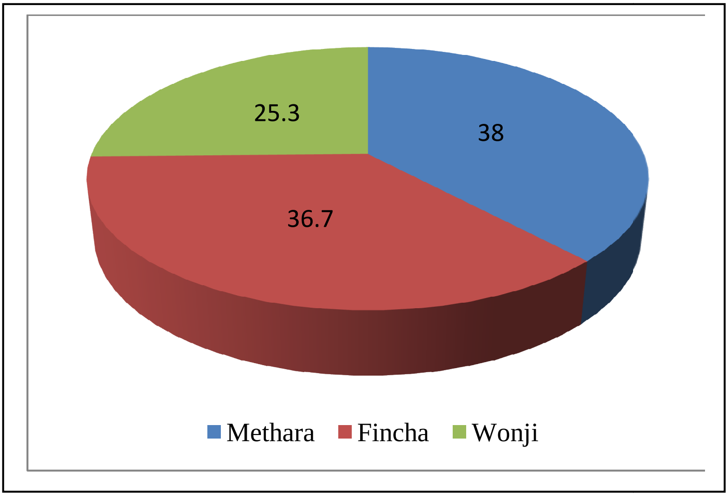

Figure 18. Production share of sugar mills (%) - 2014
Source: Author, based on survey

Per capita sugar production in Ethiopia today is only 3.4 kg per year, one of the lowest in Africa. But this is due to acute supply shortage and the ban on private import. [49] As these mills are quite obsolete, particularly Methahara and Wonji, they have to go through a rigorous overall maintenance every year, halting production; and to make up for the deficit, the government imports sugar regularly. For various reasons, import could rise up to

[49] The country used to export sugar to the UK, despite the shortage, under the EBA initiative until, but terminated when the EU project phased out in 2009.

200,000 tons per year.[50] Current demand is estimated to be double of domestic production capacity. As a result, sugar is, currently, rationed by the government at fixed prices and on quota basis.[51]

Currently, the state is engaged in expanding existing plants as well as developing a number of new vertically integrated sugar plantation and processing projects, of which, a few are at their final stage of test run.[52] The plan goes beyond meeting consumption demand – to be one of Africa's future sugar exporters.

3.5.2 Market definition

Despite the differences in the quality generated during processing, such as brown sugar and white sugar, there is no real differentiation and no segmentation along product lines. These are easily substitutable products. In Ethiopia only one type of sugar, white sugar, is produced and imported. Hence sugar is regarded as a homogenous product.

3.5.3 Policy Intervention

There is no regulatory restriction on either production or import of sugar for domestic investors. Foreign investors,

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[50] See www.indexmundi.com/agriculture/?cpuntry=et.
[51] Survey result, 2014.
[52] Six sugar projects are initiated by the government and are said to be at different stages of construction.

however, cannot engage in import, wholesale and retail trade. But as discussed above in the case of fertilizer and edible oil markets, absence of regulatory restrictions does not guarantee market entry, as the government changes the rule of the game by administrative fiat. By the same tune, private sector is not allowed to import sugar. In sugar wholesale and retail activities, consumer associations are preferred, as these institutions are easily controllable. In their absence, well behaved traders, so called ‘developmental capitalists’, are selected to handle the distribution.

3.5.4 The rationing mechanism

The rationing mechanism of edible oil and sugar are identical; the only difference being that in this case the state has a monopoly both in production and import.
The government shifted to rationing after being uncomfortable with large scale private distributors, who were banned after being accused of hoarding by the former.

As shown in Figure 19, MWITE is at the centre of the rationing mechanism. The Ministry of Trade and Ethiopian Sugar Corporation determine the quota for each region and Addis Ababa (including Dire Dawa), as well as for industries using sugar as inputs. Then Trade & Industry Bureaus set out further quotas for zones, districts, towns, counties, and households in their respective regions.

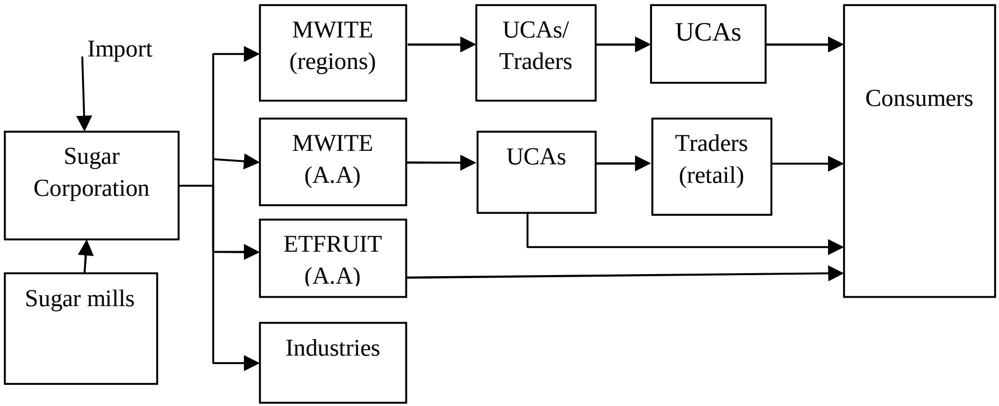

Figure 19. Sugar rationing mechanism
Source: Author, based on survey

MWITE transports sugar to its regional warehouses and distributes at a price fixed by the Ministry of Trade to urban consumer associations or traders as prescribed by the trade Bureaus. Similar to edible oil, for sugar too, the profit margin of each distributor and retailer down the chain is fixed a priori by the Bureaus. In Addis Ababa MWITE distributes to UCAs, which in turn supply to selected traders, and then to consumers. But UCAs also distribute directly to consumers. Moreover, the parastatal ETFRUIT also supplies direct to consumers, particularly, institutional consumers such as hotels, restaurants, etc. According to the survey, MWITE's procurement price, which is the factory gate price, is administratively set by the Sugar Corporation. What is not visible in the Figure is the cost burden associated with the planning and verification of the rationing, where large number of civil servants, involving the Ministry of Trade and the Corporation, the factories, MWITE, trade Bureaus and down to consumers are engaged with routine bureaucratic work.

3.5.5 Competition related issues

3.5.5.1 Market entry

As for regulatory measures, the only barrier is on foreign investment in import trade and domestic distribution. Also, as noted above, irrespective of the absence of explicit regulatory entry barrier on domestic investors, current policy in practice poses entry barrier on private sector import and domestic distribution.

Moreover, the sugar industry is heavily capital intensive, as it requires investing on green field projects and processing factories. Vertical integration, though, entails heavy cost on initial investment, avoids relying on out-growers for raw material, which otherwise could be difficult to access it easily and at reasonable prices, thereby raising the cost of production. Even the government is said to have resorted to a supplier's credit from a foreign bank to finance the new sugar mills currently under construction. Thus, the requirement for heavy investment may limit domestic private sector entry in sugar processing activity. However, capital may not be a limiting factor for foreign investors, particularly in the face favourable incentives in place.

3.5.5.2 Presence of SOEs

Though sugar processing was first initiated by private foreign investment, state monopoly prevailed for the last 4 decades. Moreover, not only that the current three factories in operation will remain under state control, but all those projects in the pipeline are also controlled by the state. About seven projects, which are expected to be operational in the near future, are all state owned, implying that the sector is to remain dominated by the state in the near future too. With the state holding a dominant share and given its current policy stance, the private sector may be reluctant to join the market; also, there is no guarantee for private participation in distribution even in the future. Thus, the prospect of establishing a competitive market in the sugar industry is doubtful.

The necessity for rationing arises due to supply deficit, which has been prevalent for long, and which inevitably introduces pressure on prices. Being a basic consumption item, and with the state holding the monopoly to import, produce and distribute, there is no other pretext for shortage, except that of the inefficiency involved in the system. This makes state monopoly less meaningful.

3.5.5.3 Price distortion

According to the survey, factory-gate prices of all processing mills, which are determined by the Corporation, are equal, despite the fact that the three factories operate at different capacity, and two of them are so obsolete and often interrupts production for various reasons. Hence it is unlikely that all have equal unit cost of production. Also the rationing price of sugar does not change from year to year, despite the rising inflation in the country which inevitably raises the cost of some inputs. Moreover, both domestic and imported sugar are rationed at the same price, despite the fact that the latter is much more refined, and involves additional cost for freight and insurance, inland transport and related costs from port to the distribution centres. Moreover, according to the survey, up to 50 percent of the sugar revenue is set aside as ‘sugar fund’, meant to be a financial source for the expansion of existing enterprises and establishment of new ones. The world price of quality (refined) white sugar in 2014 was $0.37 per kg.[53] But the rationing price of sugar in the same year was 15 birr/kg, equivalent to $0.78 per kg, nearly double of the world price. This implies that additional cost related to freight and insurance, loading/unloading, inland transport cost, warehousing cost, etc. is 100 percent of world price, which is quite high. Either the MWITE is charging a monopoly price, or it is inefficient. Thus, both imported and domestic sugar types are priced much higher, compared to world price.

3.5.5.4 Horizontal competition

In a system of rationing there is no room for competition of any form. Survey, respondents also confirmed that there is no competition in distribution or production. In fact, not only the setting of factory gate prices, but also the decision of borrowing and paying, the type of sugar to be produced, hiring and firing, etc. are all done by the Corporation. As both inputs and output prices are determined by the corporation, the case of profit or loss is not an issue; it is a matter of accounting for the record under a predetermined set of prices and volume. Irrespective of the mechanism, this is an obvious procedure in rationing.

[53] See www.worldbank.org/ commodity prices

What is of concern too is that with all forth coming sugar estates and factories being state owned, the prospect of competition in the future is also gloomy.

In sugar cane production, one of the sugar mills accesses part of its input from private out-growers. According to the survey, private plantations supply 17 percent of the input. The sugar enterprise makes an agreement with the farmers' association that is producing sugarcane every three years regarding prices and volume of supply. But for three years prices remain fixed, irrespective of general inflation and price changes of other goods. As out-growers have no other alternative market to go around, they have to agree on the terms of the sugar mill. Moreover, there is little option to disagree against a state enterprise.

3.5.6 Recommendations

Sugar is one of the basic consumption commodities, whose supply has to be given a priority. Thus if domestic production capacity cannot meet domestic demand, it needs to be satisfied through import. But the government even exports in the face of serious supply shortage. Moreover, the government never thought of privatizing the sugar mills, despite the fact that SOEs are less efficient than private operators. In the face of both high monopoly price and serious shortage of supply, it is not clear what the merit of a state monopoly is. Thus, state monopoly has to be relaxed both in import and distribution trades; the government can operate alongside the private sector to pressurize private actors so as not to charge undeservedly high prices.

From the point of view of creating a competitive market, the merit of state dominated sugar sector in the future too is questionable. With WTO membership expected to be a reality in the near future, running SOEs outside market principles would not be easy. While the government's involvement in development projects, particularly where private entry is not forthcoming, is commendable, it could have been done through floating shares rather than foreign borrowing, unless it is for the sake of establishing a state monopoly. The current strategy does not encourage development of a competitive domestic market in the sugar sector. Ethiopia's past experience of developing state owned enterprises, has not led to sustainable growth of the sector.

The heavy handed approach on importers or distributors, i.e., marginalizing private operators altogether, does not seem constructive. Private operators may engage themselves in certain anti-competitive practices, abusing the market in the short term, but they also compete against each other, favouring the market. Anti-competitive behaviour cannot be sustained for long. So, collective and administrative punishment of all private operators (such as banning all from import activity) is neither advantageous for the market nor legally justifiable. It only retards private sector role in the economy and weakens the market. The emergence of a competitive private sector will be too remote. Thus allowing private actors to play a role in import and distribution would help improve the supply and increase the efficiency, thereby creating a sustainable market development. It should be underlined that trade, as opposed to production, does not necessarily breed rent-seekers. The tendency to think those engaged in import and distribution as rent seekers has no logical ground and has to subside.

3.6. The Cement Market

3.6.1 Economic significance

The massive government infrastructure projects (roads, rails, air-ports, low-cost housing projects, construction of public buildings – schools, health centres, etc.), and emerging private real estate construction in the country, created considerable supply gap of cement in the economy. Until the turn of the century there were only two state owned factories with a production capacity of about 1million ton per year. In 2000 another plant, an endowment holding, Messebo, with a capacity of 700,000 tons was constructed. However, the total supply remained far short of demand. Figure 20 portrays the gap between domestic production, which was very close to maximum capacity, and actual consumption. Until about 2010, all 3 factories were operating with a total maximum capacity of about 1.9 million tons (MT) (Figure 20).

The government reacted by importing cement to fill the demand-supply gap but with limited success. In fact the actual demand was said to be even much higher than what is shown on the graph. A small proportion of the demand was met through import because of foreign currency constraint.

As a result of structural imbalance between demand and supply, considerable increase in prices, at times much higher than world prices, were recorded. In some years, retail prices increased as high as Birr 500 (US$40) per quintal. Figure 21 portrays price trends for some years (and months) for which data is available.

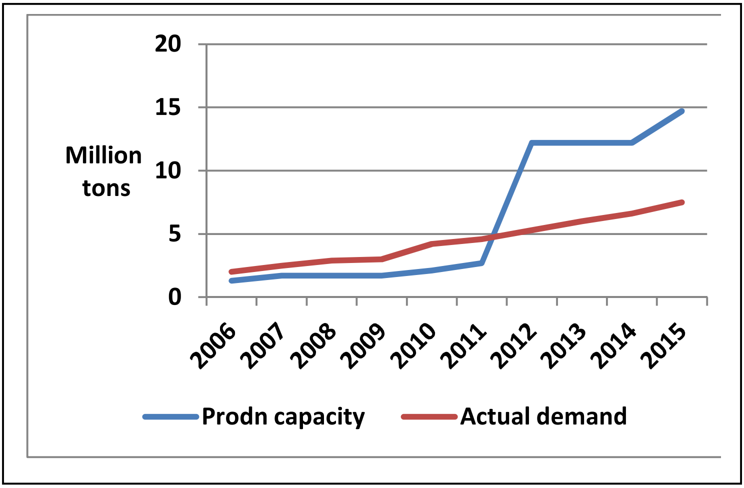

Figure 20. Development of cement production capacity and demand

Source: CSA, Report on LMSMEI survey, various issues; http//ethiopiabusinessreview.net/index/php/invest; http//addisfortune.net/columns/cementing-the-future; www.geeskaafrika.com/ethiopia-concrete-demand-record...90051; Zavatta, R. et al. 2009.

The high demand, and accompanying sharp increase in prices, as well as favourable investment policy, motivated large number of private foreign and domestic investment in the sector. In 2011 existing firms began to expand their capacity in fear of the forthcoming competition as a result of a number of incoming firms. By early 2012, a number of factories (more than six), including the largest Derban, with a capacity of 2.4 MT a year, kicked off production, steeply raising the total installed capacity to 12.2MT, and switching over the deficit from supply to demand (Figure 20) and a sharp reversal in the price trend (Figure 21). The Other large factory, Dangote commenced production in June 2015. This will further widen the demand-supply gap thereby creating strong competition in the sector.

3.6.2 Market definition

Cement is a homogeneous product. Though different types of cement are produced having their own peculiarities and preferred uses, such as ordinary and pozzolana portland cements, they are fairly substitutable and belong to the same product market. In Ethiopia, Portland cement is the type largely produced.

But geographically, cement is a highly fragmented market because of its high weight but low value characteristics. In the case of Ethiopia, however, high prices, driven by acute shortage, compensate for high transportation costs making geographical segmentation less of a factor to create market differentiation.

3.6.3 Policy context

Cement is one of the priority sectors in the government's development agenda. The policy intervention, however, has not been as pervasive as in other markets discussed in the previous markets. Before 2012, the factory gate prices of both the state and endowment owned factories were regulated by the state, but not of other smaller factories. Retail prices, however, were determined by the market, though attempts were made to control when prices went wild (Figure 21).

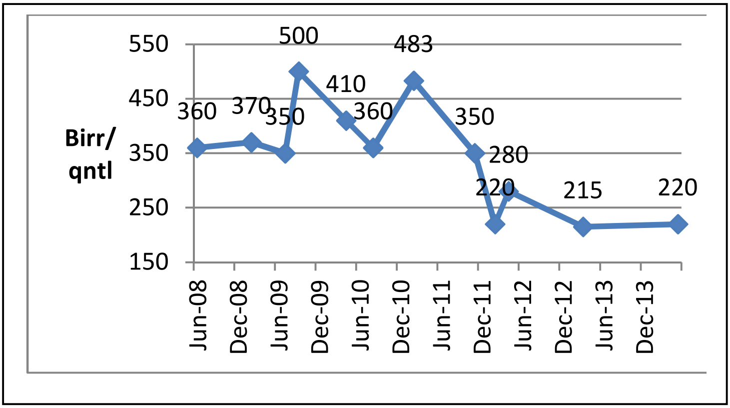

Figure 21. Cement price trend (June 2008-Feb 2014)
Sources:http//ethiopiabusinessreview.net/index/php/invest; http//addisfortune.net/columns/cementing-the-future; www.geeskaafrika.com/ethiopia-concrete-demand-record...90051; Zavatta, R. et al. 2009.

As demand continued to grow faster, mainly because of large government projects, the state also introduced product allocation, i.e., partial rationing, mainly to avoid failure of public projects. Accordingly, public housing and infrastructure construction projects, private sector manufacturing projects and large private contractors engaged in the construction of public projects, were given the priority to purchase directly from the factories at fixed factory gate prices.

The other instrument to narrow the supply-demand gap of cement was import. First the government allowed private sector import on franco-valuta basis; but was soon banned, and direct import by the state, through government offices and SOEs had been carried out.
The state also imports inputs, HFO and coal, and supply to factories. Foreign investment in cement production had been allowed since 1992, and the government's interest to be self sufficient in cement was so desperate that even it provided partial credit to investors.

3.6.4 Marketing structure

Before 2012, the two relatively large factories had to supply first to prioritized construction projects whose demand had to be satisfied through direct allocation, at a fixed price, by the government. Once they satisfy the quota, the leftover was supplied direct to the market. As shown on the chart, Figure 22, Messebo, retails the left over at much higher price through its sister trading company – Gunna. The state owned Mugher too, has the opportunity to sell direct to the market. But often, the leftover use to be quite small, as it also had to satisfy the demand of individuals (building own houses) having permits from the government to access cement at fixed and lower price. Cement factories, with relatively smaller capacity were not required to supply to prioritized projects. Imported cement by agencies, MWUD and

MWITE, was directly supplied to public projects and to the private sector.

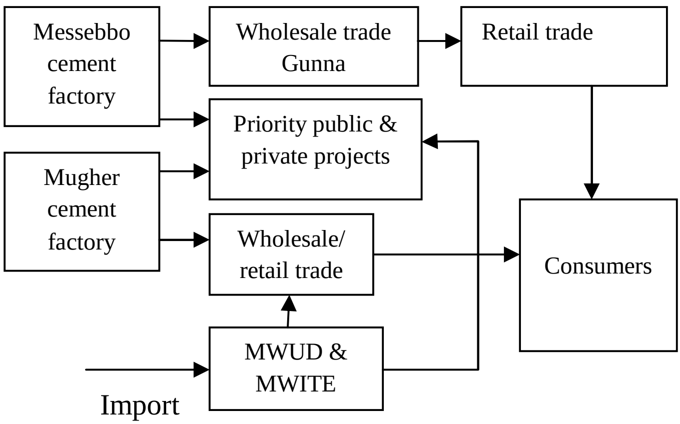

Figure 22. Cement marketing chain before 2012
Source: Author, based on survey

As of 2012, however, the marketing structure of cement has changed for good. With expansion of Mugher and Messebbo, and entry of the largest firm, Derban, there was no need for the quota system and price fixing. Import has also been abandoned. Factories are distributing direct to the market, except of course, the state owned Mugher, which has to supply first to public projects, presumably at market price.

3.6.5 Competition issues

3.6.5.1 Market entry

There is no regulatory barrier to entry in cement production, domestic or foreign. As in all other markets (with the exception of petroleum and its by-products) only foreign investment in retail, wholesale (excluding own production), and import are restricted for foreign investment. [MFA, 2005] Investment in cement production is highly encouraged, so much so that the state even extended investment credit – as in the case of Derba cement. The newly operational Dangote cement, owned by a multinational corporation, also shows the interest of the government in foreign investment in the sector.

As noted above, with respect to import trade, however, government had been reluctant to allow private import on long-term basis. The first attempt to import by licensing a single handpicked corporation failed to materialize as the latter was not able to make it on time. Then the second attempt, importing on franco-valuta basis by licensing traders and construction firms, did not prove effective: not only that prices remained too high, despite low international prices, but also, in a country where the parallel market operates widely, it was not easy to trace out the source of foreign currency used for importing. Thus, with private licenses revoked, importing, eventually, ended up to be the domain of the state.

Another entry barrier is the recent prohibition of new investment in cement. With domestic oversupply, the government cancelled issuing a license for new investment to avoid ‘unnecessary competition’.[54] The prospect of re-opening the sector for new investment depends on whether demand catches up with supply.

But, cement production is also a highly concentrated business. The industry is highly capital intensive and largely requires economies of scale to run profitably. The minimum efficient scale of operation, the smallest amount of production a cement factory has to achieve while still taking full advantage of economies of scale with regard to costs and supplies, is around 1 million tons per year. [Ellis, K & R. Singh 2010] The two largest firms Derba and Dangotte are estimated to cost between US$400-$500 millions.[55] In a poor economy such as Ethiopia, where the private sector has been marginalized for long and, as a result, lacks leading business individuals as well as the experience of forming share companies, capital required to establish such large cement factory could be a barrier. However, it should also be noted that small scale factories, such as those flourishing in Asia, are proven to be competitive. [Ibid].

3.6.5.2 Production concentration

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[54] The Reporter, (Apr 25,2015). Government drafts cement industry development strategy. http//www.thereporterethiopia.com/index/.php/news

[55] Global Cement, (10 June 2015). Ethiopia in Focus. http//www.globalcement.com/news/itemlist/tag/Ethiopia

Irrespective of the number of factories, currently there are about 19 factories, the cement industry in Ethiopia is highly concentrated, which can be a cause of concern for market competition. Table 8 shows the concentration ratio in cement industry for different periods of time.

As noted above, only two factories, the state owned Mugher and the endowment holding, Messebo, reigned until 2011, dominating the market with annual capacity of 0.9MT and 0.7MT respectively. By 2012 not only that the largest Derba joined the market, but also a number of medium and small scale firms became operational. Also, the oldest two upgraded their capacity significantly – to 2.2MT each. About 19 factories are said to be on operation between 2012 and 2015, with a total installed capacity of 12.2MT. This has significantly relaxed the concentration, but still having a typical oligopolistic configuration. Four firms alone control over two-thirds of the market share; the three largest accounted for over half of the market; the biggest two had over one-third of the market share. Derba alone had 20 percent of the market. So, despite a considerable rise in the number of factories, the concentration ratio still remains high.

Table 8. Concentration ratio based on installed capacity

Size of factories	Concentration ratio		
	2000 –2011	Feb 2012 – June 2014	July 2014 – 2017[56]
The largest factory - CR1	0.56	0.20	0.15
The largest 2 factories – CR2	0.99	0.38	0.29
The largest 3 factories – CR3	1.00	0.55	0.42
The largest 4 factories – CR4		0.65	0.54

Source: Author, based on CSA, Report on LMSMEI, various issues, and survey result

In June 2015, the largest firm, Dangote cement, with an installed capacity of 2.5 MT, joined the market. Another mid-size firm, Habesha cement, is expected to be operational by next year. This will reduce the concentration ratio further, but still the largest 4 firms will control over half of the market.

It should also be underlined that apart from numerical concentration, the industry is also geographically concentrated. The three largest factories, namely Dangote, Derba, and Mugher, which together account for 42 percent of the total capacity, are concentrated in one area – Mugher, largely because of raw material concentration. Only few factories, Messebo in the north,

[56] One firm, already on the pipeline, is expected to go operational by 2016. As it takes 2-3 years to construct a medium size firm, only 20 firms are expected to remain operational for the next 3 years.

and National cement and few other smaller factories in the east, are located outside the centre of the country.

3.6.5.3 The presence of state and endowment owned firms

With a market share of nearly one-third of the total, the state and the party owned plants still play a key role in the cement market. Being under the control of the party in power, hence the government, the market had remained under the strict control of the government. These factories have been used to feed either public or party owned projects, as decided by the government. For instance, today, the major supplier to the Nile dam is Mossebo. The government does not procure cement on competition basis. The other side of the coin is that these two firms, Mugher and Mossebo, do not compete with other private cement factories for the market. The government and the holdings of the parties in power (endowments) are exclusive markets for these two firms. The state uses firms under its control to facilitate the ongoing public housing and infrastructure projects. These firms go outside the public sector if only they have leftovers to be marketed. The private sector is the market for Derba and other smaller firms. In a way, the cement market in Ethiopia is not integrated. There are, at least, two parallel markets. There is no meaningful competition between private firms on the one hand and the state & party owned firms on the other.

3.6.5.4 Price control and quota allocation

The government introduced a price control mechanism for Mugher and Messebo until 2011. Factory gate prices had been determined by the government and adjusted from time to time, while retail prices were left for market forces. Also, allocation of cement to prioritized sectors and projects had been practiced. Accordingly, public projects, such as housing and infrastructure, were given top priorities. This arrangement might have helped minimize the cost of public projects and might also have benefited construction firms and individuals with close ties to government officials and/or the party in power, but has helped little to stabilize the market. In fact, this mechanism has helped develop rent seeking activities: traders exploited the situation through speculation on shortages; government agents responsible for rationing were engaged in corrupt activities; cement was also resold at higher prices resulting in two parallel markets; Messebo had been selling at higher prices through its sister distribution company; the distribution chain from the factory down to retailers had been vertically integrated through various ties and relationships, thereby creating an oligopoly market.

3.6.5.5 Import ban

When demand outstripped supply by a large margin, and resulting in sharp price rises, the government resorted to import to stabilize the market. As mentioned above, first the government attempted to import through private operators – first a handpicked company and then franco-valuta import. But both failed for reasons noted above. Imported cement was selling at the same high price as domestic cement, despite much lower international price. As a result, such arrangement was abandoned; private sector import was banned; and the government took over the import business on its own. Again, as in the case for sugar, edible oil, and fertilizer, import of cement too became the domain of the government.

But even with the government itself handling the import, it was not possible to stabilize the market sustainably: prices declined every time imports arrive, but picked-up again in a matter of few months. For one thing, presumably because of foreign exchange reserve situation, the quantity of annual import was not at all adequate to cover the demand-production gap; for another, *"the Government's position on the matter has been oscillating from the outright prohibition of imports, in order to protect domestic producers, to the allowance of duty free imports, in an attempt to stabilize prices. For instance, a duty free regime was introduced in 2006, in the face of rapidly increasing prices, but then it was revoked in February 2008, when an import ban was introduced. The ban was short-lived, and in June 2008 imports were again liberalized. But a new ban was reintroduced in early April 2009, largely because of the increasingly difficult situation regarding foreign exchange reserves.*[57]"[58] [Zavatta, R. et al. 2009, p68]

[57] Addis Fortune, 12 Apr 2009. "Gov't bans Cement Imports".

This oscillation created the ground for a ripe speculative market: prices were changing day-by-day, factoring in not only the decision to import or not and foreign exchange reserve position of the country, but also the movement of the exchange rate of domestic currency – the degree of its depreciation. This applied not only for imported, but also for domestically produced cement. Such a wild market continued to reign until early 2012, where surplus production enters the market, and import was officially banned.

3.6.5.6 Subsidy

Data is not available to estimate the subsidy involved in cement import. But the government being the sole importer, at least, administrative costs must have been absorbed by itself.

3.6.5.7 Aggressive market entry

Price control has been lifted since late 2011. At the same time, Mugher and Messebo had completed the expansion scheme of their production capacity. As of February 2012, the market environment changed positively with the largest firm, Derba cement, joining the market. With the creation of excess capacity, the government phased out its quota allocation scheme. Derba entered the market aggressively: cut down the price by nearly half from its

[58] It should also be underlined that, as discussed earlier, this approach has been consistently practiced in other markets too. Hence, apart from the foreign reserve constraint, which really was the case, policy instability is the defining feature of the regime.

previous level; promised door-to-door delivery with own fleet in a matter of 5-7 days of order and within a radius of about 350 Kms from the plant, which is quite near to Addis Ababa/the capital; and credit sales with a 50 percent down payment. This markedly arrested the wild speculative market and the rent seeking activity associated with shortages. However, the market still remains dissected, with two parallel markets conspicuously operating side by side, thereby discouraging competition. The aggressive entry of Derba has not worried Mugher and Messebo an iota, as demand of the government is reserved for them.

3.6.5.8 Anti-competitive practices

Though it is customary to accuse traders of hoarding, every time price hikes occur in any market, it is also true that some traders do withhold cement from the market for some time. For instance, according to the survey of cement retailers, only 15 percent think that there is hoarding, while the majority (55 percent) don't believe so (Table 17). In March 2008, right after the introduction of the import ban, a number of warehouses were closed down, after being accused of hoarding. Again in July 2009, the government closed down some stores and gave a warning to withdraw licenses of those guilty of hoarding.[59]

[59] According to survey respondents, accusing traders of hoarding through the media is an effective means of checking down prices, even when it is not seriously believed that goods are horded. For

3.6.5.9 Other competition retarding practices

There are no other serious anti-competitive practices in this market. But there are few indications showing tendencies of such practices.

Table 9. Some indicators of the state of competition in cement 2000–2012

Questions on competition issues	**Percent of respondents**		
	Yes	**No**	**Don't know**
Is there hoarding?	15	55	30
Does cement price change frequently (daily, weekly)?	100	0	0
Do prices of different cement brands change simultaneously and nevertheless at equal rate?	55	10	35
Is there market carving?	35	25	40
Are consumers brand loyal, irrespective of quality?	45	30	25
Does advertisement focus on prices?	5	75	20

Source: Author, survey result

As shown in Table 9, all cement retailers surveyed acknowledge that prices change very frequently – daily, despite the fact that factory gate prices are fixed, though adjusted gradually. "More than 20 price increments were

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traders, it implies that something is up to the sleeve of the government and forthcoming. Then traders sell whatever they have in their stores, even at lower prices. It is said that, often prices come down days after government accused traders through the media for hoarding, it will rise back soon after.

approved [by MTI] between 2005-2010." [Arkebe Oqubay p145, 2014] Also, prices (of Mugher and Messebo) were fluctuating simultaneously and nevertheless at equal rate, implying that agents of the two firms were implicitly colluding to exploit the situation. Of course, the government knows this well, but must have allowed them to enjoy their cake.

Also, there seems to exist some degree of market carving, though not serious. For example, enumerators of the survey did notice that there is no Mugher or Derba cement on sale in Makelle. It may be because the major markets are Addis and other nearby towns, but the team also observed Derba trucks, with loads of cement, rolling up north to other distant towns in Gonder.

Perhaps, what is more conspicuous is the case of brand loyalty. Despite the shortage, which forces consumers to buy whatever is available in the market, consumers have their own preferences. 45 percent of the cement traders who responded to the survey believe that consumers prefer one type against the other, irrespective of quality, while 30 percent think otherwise. Brand loyalty, as opposed to quality, retards competition and it has a similar effect on market carving.

Advertisements in Ethiopia never raise the issue of prices, but only blow vague irrelevant words and phrase about quality. Three-quarters of the respondents acknowledge this fact. It implies lack of competition among cement producers in the past. Recently, however, Derba cement boldly entered the market by advertising its cut-throat price and other aggressive competition measures, as explained above.

3.6.6 Recommendations

The government is the single major buyer of cement; as such its procurement policy can be used as an instrument for encouraging competition, hence productivity and efficiency, of the industry. Mugher and Messebo are now two of the major four cement plants, but their combined market share (27 percent) is much less than that of the private sector. As such, there is no logical ground for reserving a market (the government's cement consumption) exclusively for these two firms. Saving a market for these enterprises may encourage them not to improve their productivity and efficiency, but continue in a sleep mode, without competing with other firms in the market. Now that there are multinational firms operating along with state and endowment owned firms, baby sitting least efficient firms would not be a sound industrial policy. Hence government procurement policy has to be revisited.

As shown above the 'four-firm' concentration ratio, the largest four plants, considering Dangote cement too, is over 50 percent. Thus, the cement industry is still typical of an oligopolistic market. This domination could lead to the previous case, where prices could rise sharply and unfairly as a result of collusion, carving the market, etc. Thus a new policy environment, outside the 'Industrial

Policy' context, to arrest such possible practices should be undertaken. The capacity and independence of the Trade Competition and Consumer Protection Authority should be strengthened and enhanced.

The import arrangement, be it through handpicked companies or government monopoly, has been less successful in stabilizing the market. In fact it led to a wild speculative market. As was evidenced in practice, the tendency to rely on hand-picked companies/individuals, so called 'developmental capitalists', simply nurtures rent-seeking environment rather than entrepreneurship. Moreover, it also begets the sense of exclusion and allegation on the part of the larger business community that 'politics trumps economics'. Whether selection is to be based on merit or otherwise, the mechanism needs to be transparent. The practice of marginalizing the private sector altogether has also proven a failure in bringing about sustainable growth, since the days of the Deurg. It will not be different now. As hinted earlier, it might be more effective if the government operates along with the private sector, showing its presence as a watch dog of the system and of fair trade.

The ban on new investment might have some element of logic, particularly as the government has been providing scarce financial support to investors, including foreign, in the sector. Now that the incentive scheme has been effective enough to initially attract foreign investment in the sector, withdrawing it might not make much difference on the rate of investment. However, banning investment in cement altogether might not be beneficial for sustained growth of the sector and beyond. First, cement price in Ethiopia is still too high particularly compared to world prices. For example for 2007/08, where prices in Ethiopia were as high as Birr 360/quintal (US$39), retail prices in Vietnam, Bangladesh, Ghana and Kenya prices were US$9.92, 11.22, 18.68, and 20.62 respectively [Ellis, K. & R. Singh, 2010] Only in Zambia was cement price nevertheless equal to Ethiopia, about US$37. Second, as explained above, the industry in Ethiopia still has high concentration; 4 factories alone account for 54 percent of the market (Table 16). Hence the industry is still typical of an oligopoly market; further investment to diffuse the concentration might be necessary. Finally, the opportunity of expanded export market, at least to neighbouring countries, should have been factored in the decision. Currently only a small quantity of cement is exported to some neighbouring countries.

The government is the sole importer of inputs for the cement industry, HFO and Coal, and administrative costs are absorbed by the government. Although official data are not available, the subsidy is estimated to exceed 10 percent. [Arkebe Oqubay 2015] It is often said that coal accounts for the major cost of cement production, around 60 percent. Coal is the cheapest form of energy that the industry envisages to use in the future. But currently as coal is used mainly by the cement industry, the private sector (the industry itself) can handle the import; there is no point for the government to subsidize foreign investment, including multinational corporations.

3.7 The Leather Sector: Hides and Skins Market

3.7.1 Sector profile

Ethiopian hides and skins may have good reputation in the international leather market for their unique features, including fitness, compactness of texture, thickness, flexibility, and strength. But Ethiopia is not acclaimed for its competitive advantage in leather: be it in tanning or leather products. Ethiopia's comparative advantage is the large livestock population (a per capita of about 0.59 in cattle and 0.54 in sheep & goats), and unique features of hides and skins. For an agrarian economy, large livestock population is a double blessing; not only for its critical economic and social role at household level (such as accumulating wealth, serving as a store of value in the absence of formal financial institutions, providing nutritious food, additional emergency and cash income, transportation, farm inputs, and fuels for cooking, a means of coping with shocks, etc), but also for its contribution to national income (about 12 percent of GDP), and foreign currency earning. The importance of such natural resource endowment is also paramount in industry and services, through input-output linkages. The rush to establish tanning and leather products industries in Ethiopia is precisely because of the large livestock resource base.

The large livestock population, however, should not create an illusion of abundance of raw hides and skins. These products are renewable and easily perishable. Production is dependent not only on income level, but also on the system of animal husbandry, and post-slaughter management practices: slaughtering and preservation techniques in subsequent marketing until the raw materials reach their consumption end – tanneries.

Table 10. Livestock population and Off-take rate (millions)

Livestock type	Population	Annual off -take rate (%)	No of Hides & skins
Cattle	53.3	8	4.3
Sheep	25.5	33	8.7
Goats	24.1	35	8.4

Source: Author, based on CSA (2014b)[60]

As shown in Table 10, the country has an estimated stock of just over 100 million cattle, sheep and goats, and an annual production of only 23 million hides and skins, implying an average off-take rate of less than a quarter.

The supply of hides and skins in Ethiopia does not primarily depend either on the size of livestock population or on the demand of tanneries, but on the demand for domestic meat consumption, which in turn depends on total population size, income, social values, etc. Export market's demand too is a factor, though

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60 Figures, both population and off-take rate are based on CSA estimate. There is no livestock population census, and different sources also provide their own estimates, which might differ from what is recorded in Table 10.

currently insignificant. This implies that hides and skins supply is not, as such, price responsive.

Moreover, even this limited supply of hides & skins is not fully recovered for use by tanneries due to, mainly, poor quality, resulting from poor animal husbandry practices (including the growing threat of parasitic skin disease (cockle), skin scratch, branding, flaying, curing, etc), traditional slaughtering techniques at homesteads, and poor reservation practices in subsequent marketing (lack of shades and storage facilities, poor transportation system, etc). Along the marketing line, hides and skins are said to be subjected to considerable quality deterioration. A defect assessment of hides and skins recorded that there is no product without any defect; it is only a matter of extent. [Bisrat, G/M. 2014] Of the total hides and skins submitted to tanneries, up to 30 percent is likely to be rejected.[61] [Abebe, G. and F. Schaefer, 2013]

Primary producers of hides and skins are households, abattoirs, meat and meat products processing plants. Households account for the bulk (90 to 95 percent) of the total supply, of which, rural households account for more than half (50 to 60 percent). [Girma Makonnen 2003] So, modern establishments have insignificant share in the supply of hides and skins, implying that traditional slaughtering and preserving methods, partly blamed for

[61] It should be underlined that the technology currently in use in the country is not necessarily the state of the art technology, which might have reduced the extent of raw materials rejected.

quality deterioration of the products, remain widely in practice by households.

Another feature of hides and skins is the seasonality of the supply. The vast majority of households slaughter animals mainly during religious and cultural festivals, resulting in periodic supply of raw materials.

3.7.1.1 Tanneries

There are about 27 medium and large scale tanneries, with annual installed capacity of about 1.4 and 32 million pieces of hides and skins respectively. Utilization capacity, however, remains low, about 72.2 and 52.2 percent for hides and skins, respectively, limiting total annual output to about 17 million pieces altogether.[62] [Abebe, G. and F. Schaefer, 2013] 80 percent of the tanning industries' output is exported, leaving the balance for domestic consumption by leather products industry.

3.7.2 Market definition

Hides and skins are globally traded commodities. Though hides and skins may each have preferred uses, they are also substitutable to a limited extent. Irrespective of unique features of hides and skins, arising from natural characteristics of livestock breeds, they can be taken as homogenous products.

[62] Other estimates of the rate of utilization are much more lower – as low as 30 percent .[Mahmud, A, 2000, www.comesa.llpi.org/]

3.7.3 Policy environment

For long, households have been considering hides and skins with little economic value, as it is not economical to slaughter animals just for the skins. As a result, these products have been used for household purposes, without proper tanning, or sold to traditional tanners at give away prices. Thus to convince households of the importance and greater value of hides and skins, and induce them to supply to the market, requires thorough and persistent intervention by governments. However, for the last four decades, this has not been the case in practice. In fact, the best policy for governments has been 'no policy', perhaps with the presumption that households would give it away at any price in the absence of any other better alternative markets. Instead, the preference of governments has been to heavily incentivize the modern tanning industry, established for the very reason of the existence of large livestock population, and thereby the supply potential of large and unique raw materials – hides and skins.

The only genuine attempt to improve the quality and marketing system of hides and skins was made in the early 60s during the Imperial era. Following the establishment of a livestock and Meat Board (proclamation No. 212/1964), some appreciable practical measures were introduced, including frame drying techniques of hides and skins, differential pricing scheme based on quality, technical support to producers and traders on preservation methods, preparing preservation manuals, establishing market centres, construction of slaughter houses, etc. Exports of hides and skins were allowed and expanding.

However, with a regime change the earlier effort had not been further pursued and strengthened. The Deurg, under its command economy, nationalized all tanneries, regulated markets and controlled prices. With keen intention, but unworkable policy, export of raw hides and skins was banned in 1986. This denied hides and skins traders their profitable and alternative market. But to avoid the monopsony power of few domestic tanneries, the government controlled the selling price of hides and skins, by factoring in the movement of international prices. As such prices of hides and skins were not undercut. Also, import of hides and skins was not allowed.

In practice, the current regime too, did little towards improving the quality and marketing of hides and skins: be it in addressing the traditional animal husbandry practices or post-slaughter challenges. In 2005, a proclamation to provide for the marketing of hides and skins (No 457/2005) was issued, but its implementation on the ground has been frustrating. [Ibid] Also recently, another proclamation (No 814/2013) regarding the marketing of hides and skins, a revised version of the former, has been issued. No practical outcome of this recent proclamation has emerged yet, though it is quite early to comment. But the leather sector is given the top most priority in the industrial policy setting of the regime. The strategy of this sector is said to be a Top-Down Approach (TDA) where development of the leather products industry pull the tanning industry to produce more and better quality finished leather, resulting in turn, in an increase for the supply of more and better quality hides and skins.[63] Thus downstream domestic activities in the leather sector are to be drivers of the supply of hides and skins. Given the condition for the production of hides and skins by households, noted earlier, however, it is not clear how this strategy could work. Anyway, in line with the strategy, the government is heavily intervening by providing a package of incentives, including technical and financial support, to these two industries, particularly to the tanning industry.

Moreover, the government continued blocking export of hides and skins, but unlike its predecessor, through high export tax (150 percent) rather than administrative ban, perhaps to avoid confrontation with WTO's strict rules and regulation which does not appreciate administrative restrictions on trade.

Note that the very reason for high investment in the tanning industry is the large potential of the country to supply adequate raw material – hides and skins. But with fast expanding capacity of the tanning industry on the one hand, but stagnant supply of domestic hides and

[63] See COMESA: Leather and Leather Products Institute. http//www.comesa-llpi.int/index.php?option=com

skins on the other, some tanneries started to import hides and skins. Perhaps, this might as well serve, to depress the price of domestic raw materials, thereby help tanneries to be competitive in the international market, by reducing their cost of production. The imbalance between the demand and supply of raw materials is so serious that the government even banned new investment in leather tanning to limit the expanding demand for hides and skins. [Ibid]

3.7.4 Marketing structure

In the absence of any policy guidance, the marketing structure of hides and skins takes various forms and shapes. Figure 23 portrays the general marketing chain. The bulk of hides and skins, supplied by households, is taken up by ‘collectors’, largely at the door-steps of the former. The latter supply the raw materials to traders, small or medium scale operators located in towns across the country. In most cases, these traders treat the raw materials (air-drying or salting), and supply it to large scale trades, and the latter, in turn, to tanneries. However, in towns or cities where tanneries are located, traders, operating at any scale, supply fresh (green) hides and skins direct to tanneries, whereas, distantly located large traders supply treated raw materials. Large size abattoirs and meat processing plants also supply the raw materials direct to tanneries.

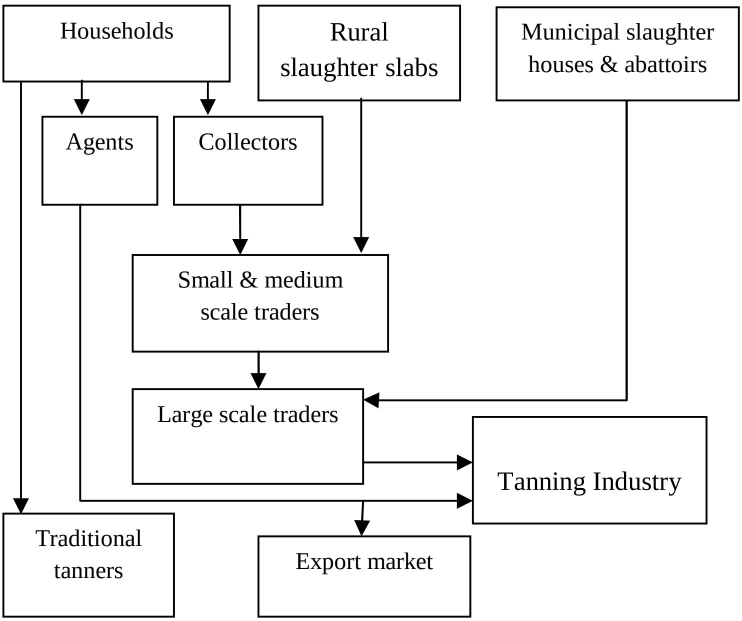

Figure 23. Marketing structure for raw hides and skins
Source: Author, based on survey

In practice, the marketing chain is much longer than what is shown by the chart, as many licensed and unlicensed traders are also involved along the chain. Some tanneries also dispatch own licensed agents to collect fresh hides and skins directly from households. Traditional tanners too buy fresh hides and skins direct from households (or from small traders). Note that, though not prohibited legally, actual export is practically non-existent, as the 150 percent tax is as effective as an administrative ban.

3.7.5 Pricing system

During the Deurg era, up until the export in 1986, traders had been greatly benefiting from international prices. Even after 1986 (until 1992), though tanners were given more bargaining power than suppliers, prices were not seriously undercut, as the government intervenes in the setting of prices, which had to be in line with international market prices. But as of 1993, with market deregulation and privatization of tanning factories, prices has been influenced, largely, by market forces, but with tanneries having a better bargaining power as they are the only buyers of the raw materials, and who can also import if they wish to do so. As a result, as of mid 2013, prices of hides and skins began to decline sharply. Though data is not available, an interview with the president of the Ethiopian Row Hides and Skins Suppliers Association reveals that prices for goat skins declined by over two-third, and for sheep skins by one-third.

For primary producers, particularly households, it is not easy to tag the price for hides and skins, as there is no clear cut cost of production to attach. Thus, in practice international market price would be the most appropriate reference. But the domestic sharp price fall is not due to international market prices, as it is the concerted action of few and well organized tanneries, against the large number of unorganized traders with no alternative market to supply, except to domestic tanneries.

A pretext given for price collapse is quality deterioration of hides and skins. Until the ban in 1986, hides and skins use to be sold at world market prices corresponding to its quality grading determined by physical inspection. Now, however, tanneries, with a strong bargaining buyer, demand that physical inspection alone is not good enough to determine the quality grading before some degree of processing is done. With no impartial market mechanism to identify this, tanneries were given the privilege to process and set the quality grading of the product they want to buy on their own. Thus, even though prices, corresponding to quality grades, could be negotiated earlier between suppliers and tanneries, it is the latter who determines the grading, and in effect the pricing. Suppliers are price takers. Such a 'give it away at any price or leave it' marketing strategy will only create a disincentive forcing suppliers to look for alternative illegal market for their product.

3.7.6 Competition issues

3.7.6.1 Market entry

There is no entry barrier in the wholesale and retail trade of raw hides and skins, except the one on foreign investment as in many other markets. [MFA, 2005] What could be regarded as a barrier is the heavy export tax on raw hides and skins, which denies suppliers entry into the international market.

3.7.6.2 Competition retarding measures

It is often argued that the acid-test of a firm's efficiency is its competitive capacity in the international market. But, as part of its industrial policy measure, the government discouraged export of hides and skins. As it stands, it retards the competitive effort of suppliers, not only in the international market but also, in the domestic market too. As such competition in the domestic market has been weakened since 1986, as hides and skins flow out of the country illegally through contraband trade. The same policy has also created a market where prices are largely determined by tanneries, at the expense of producers and suppliers.

What is apparently inconsistent is the 'import but don't export' aspect of the policy. The same policy that restricted official export, inevitably, encouraged unofficial export – contraband trade. For example, contraband trade in hides and skins is widespread in the towns bordering Ethiopia to Somali and Kenya. [Ibid] The same policy that encouraged investment in tanning industries, while at the same time ignoring the production and marketing of raw hides and skins, resulted, not only in importing the latter but also, forcing a ban on new investment in the tanning industry. The first discourages competition of domestic hides and skins in international markets, while the second discourages competition in the tanning industry. Note also the apparent implication of the policy package: ‘don’t export if it is Ethiopian, but import if it is even Ethiopian’, as it is possible to officially import raw hides and skins smuggled out of the country unofficially. Also, the policy package seems to result in less foreign currency inflow and additional foreign currency outflow.

Even more challenging for traders at home is the pricing system. As an internationally traded commodity, it is not unfair to set the pricing of hides and skins on line with world prices. Hides and skins use to be exported simply based on physical inspection and local origin to determine their quality, at international price, perhaps even at premium price accounting for its naturally unique characteristics. Irrespective of all these, providing the privilege to assess the quality and grading, and based on that the pricing, to the buyers alone, would in effect mean granting the bargaining power to tanneries.

3.7.7 Recommendations

The government’s effort to promote the leather sector, in line with the country’s comparative advantage, is in principle a feasible strategy. However, to review some aspects of this industrial policy might be essential. For one thing, the comparative advantage of the country is not, as such, tanning or footwear production, rather it is the large livestock endowment, and by implication, large livestock products/by products, including hides and skins. But the policy focus has been to promote exclusively leather tanning and footwear industries for which the country does not have comparative and/or competitive advantage. The relatively large policy induced investment in the tanning industry, is precisely because of the expectation of large supply of raw materials. But production and marketing of hides and skins, the real comparative advantage of the country, has been given little attention, so much so that the government has been forced to import raw materials and to ban new investment in the tanning industry, all because of apparent shortage of domestic raw materials supply. Thus, while promoting downstream industries is commendable, it should have been in tune with the development of the production and marketing of hides and skins. The strategy to promote the leather sector has, perhaps, mis-prioritized the industries/activities within the sector, a sort of 'the cart before the horse' approach.

The measure to discourage export of hides and skins proved to be counterproductive; for one thing it failed to initiate increased supply to domestic tanning industries, and for another encouraged contraband trade. In fact, even if raw materials are supplied adequately to tanneries and at lower than international prices, there is no guarantee that tanneries would be competitive internationally and increase their export of finished leather. Thus promoting export of hides and skins should motivate tanning industries to operate competitively. Banning export of domestic hides and skins, particularly in the face of allowing import of external raw materials, sounds a self defeating measure.

As noted above, the pricing system simply opens the flood gate for fraudulence. Either the physical examination and origin of hides and skins, which had been on use for export, has to be employed, or a new quality testing and grading system/market, which could provide impartial opportunity to both partners – the buyers and suppliers – has to be installed. Today, the country has some experience with respect to quality testing and grading, hence pricing, of internationally traded commodities, such as coffee for instance. Such a lesson has to be internalized and adapted for use in other sectors of the economy.

3.8. Banking Service

3.8.1 Economic importance

Private banking service in Ethiopia is a century old trade, but is still less developed than many recently established African banks. Banks in Ethiopia have gone through a series of make-break incidents, such as complete closure (colonial era), nationalization (Deurg era), etc. It is now about two decades, since private banking service has been operational uninterrupted. Up until today, there are 16 private commercial banks, and three state owned banks – a development bank and two other commercial banks, with a central bank, the NBE, supervising the overall financial system. Foreign banks are still kept at bay and capital markets are yet to develop.

Access to finance is mainly through the banking sector and, to some extent, through microfinance institutions. Ethiopia's financial intermediation is small compared to some of its African peers. In 2014, for instance, the value added share of the banking sector was only 2.3 percent, while that of Kenya in 2011 was 7.8 percent. [NBE, 2015; World Bank, 2013] At the end of December 2014, outstanding credit of the banking sector to private business was only 11.7 percent of GDP, compared to the regional average of 23 percent. As at June 30, 2014, there were about 2176 commercial bank branches, implying 4.4 bank branches per 100,000 adults.[64] As of September

[64] Adults refer to working age population.

2012, the proportion of adults having deposits was about 13.5 percent, while those having access to credit was, even more insignificant, about 0.3 percent, or 3 in 1000 adults. These indicators compare poor to Sub-Saharan average of 15 and 2.2 percent, respectively. [IMF 2013; Tom Keatinge 2014] Currently, Ethiopia stands at 165 out of 185 countries in accessing credit, implying little or no credit information and week legal rights for both borrowers and lenders. [World Bank 2015] Thus, Ethiopia's banking sector is still in its infancy, though growing fast.

Moreover, the ownership structure of commercial banks is highly skewed. There are two state owned banks, and 16 private banks, one of which is officially known to be an endowment holding[65]. Thus in terms of numbers, private banks have an overwhelming dominance, though not in service capacity. As shown in Table 11, state owned commercial banks account for more than two-thirds of outstanding loans, deposits, and assets, and over 40 percent of capital, and bank branches. As the share of the Construction and Business Bank is too small, the dominance of the public sector is due to a single bank – the CBE. "This makes Ethiopia an exception within SSA countries and across the developing world where banking system has much higher share of private and foreign participation." [World Bank 2013, p6]

[65] Though only one bank openly claims to be an endowment holding, there are also others, at least three, owned/controlled by ethnic based regional parties in power and registered as private.

Table 11. Relative size and importance of commercial banks by ownership structure (June 2014)

Type of banks	Percentage share				
	Assets*	Capital	Loans	deposits	branches
State banks	68.9	39.9	63.1	72	44.6
Private banks	28.2	52.6	33.7	28	49.2
Endowment banks	2.9	7.5	3.2	na	4.6

Source: Author, based on NBE (2014b)
* June 30, 2013

Apart from limited branches, very low innovativeness in modernizing banking services, such as ATMs, plastic (credit/debit) cards, mobile banking, etc., are underserved. Such services are, just starting to be offered by some banks. For instance in 2012, Kenya had 9.5 ATMs per 100, 000 adults, against 0.3 in Ethiopia; one plastic card for every 17 people in Kenya, against an insignificant number in Ethiopia. [World Bank 2013]

Thus, although the shares of private banks in total capital, assets, etc., are gradually increasing overtime, the banking industry remains highly concentrated, and for a population of 90 million, not only that the banking industry as a whole is still under developed, but most private banks, are very small in size and capacity.

In light of the large size of the population and dispersed settlement, microfinance plays an important role, particularly in providing pro-poor services. In recognition of this, the government initiated microfinance business as early as the first half of the 1990s. By June 2014, there were 32 licensed microfinance institutions with a capital of Birr 6.3 billion and total assets worth Birr 26.7 billion, and serving more than 2.9 million clients. Some of these are even larger than some commercial banks. The largest 5 (owned by ethnic affiliated parties in power) account for 84.5 of the sector's total capital, 93.6 percent of the saving, 90 percent of the credit, and 90.3 percent of the assets. So the other 27 MFIs have little role in the sector. [NBE 2015] As such the sector is highly concentrated.

3.8.2 Market definition

Banking services, in general, involve a range of products and services (short and long term lending, domestic and international payments services, deposits with different maturities, specialization in sectors: housing, import/export, etc.,), which may give origin to separated or partially separated markets. In the case of Ethiopia, except the state owned Construction and Business Bank, which tends to specialize in construction, all other banks, nevertheless, handle similar activities, including lending for construction.

In terms of location, banking service can be regarded, in principle, as having nationwide coverage, but with focus on densely populated and high business concentration areas, giving rise to monopolistic/oligopolistic situation in thinly populated and remotely located rural areas. Such situation also shows in Ethiopia. Moreover, with the exception of Addis Ababa, some banks in Ethiopia have a tendency to focus only in areas of specific ethno-linguistic formation, but thinly spreading in others. But such exclusionary practices are expected to phase out with time, particularly with the expansion of newly emerging instruments such as mobile banking, agent bank, etc.

3.8.3 Policy context

The state-led development strategy now in force requires the financial sector to perform two functions: instrument for implementing state-led development projects and financial intermediation. To this effect, while the activities of public banks are strictly guided by the state, private banks are partially forced to facilitate state initiated projects, through NBE directives. With respect to the former, a key instrument to enforce the states plan is directed credit. While state banks' credit is geared to directly finance government prioritized areas/projects, private banks' credit is, to some extent, manipulated by NBE's directives. The 2011 directive which requires private banks to purchase NBE bills equivalent to 27 percent of any new loan disbursements is one major example. These bills have a low interest earning of 3 percent and a maturity of 5 years. A similar measure is direct control of private banks loan portfolio, where NBE requires short term loans to be not less than 40 percent of total at any time. Even administratively capping the maximum level of credit of private commercial banks used to be practiced, though not now.

The challenge of financing massive public development projects, under limited revenue, also burdens the central bank. NBE's direct loan to the central government (money creation) is the other central instrument to finance large government expenditures, of course with significant trade-off in terms of rising inflation.

A related important instrument is interest rate. The government fixes the minimum deposit rate, currently 5 percent, but has liberalized lending rates. This has led to the prevalence of negative real interest rate for decades.

Investment in the financial sector is exclusively set for Ethiopians and other domestic investors; foreign banks are not yet allowed to operate in the country.

3.8.4 Competition issues

3.8.4.1 Market entry

In line with the proclamation No 591/2008, NBE is the licensing and supervisory agent for banking business. The minimum capital requirement to establish a commercial bank is Birr 500 million, equivalent to about US $25million. This amount is not high enough to limit entry. As noted above, there is no regulatory barrier to entry for domestic investors. But unlike many African countries, what can be regarded as strong barrier, and which adversely affects competition, is the regulation banning foreign investment in the sector. [MFA, 2005] A significant proportion of surveyed banks (77.8 percent) think that foreign bank entry would have a positive impact on competition, though it might as well affect their business adversely.

3.8.4.2 Concentration

The banking system reveals high concentration both in size and location, potentially limiting competition. Table 12 shows the degree of concentration, with respect to assets and capital for all commercial banks, as well as for private commercial banks.

Table 12: Market concentration 2014

Size of banks	All banks		Private banks	
	Assets*	Capital	Assets*	Capital
CR1	66.5	37.2	20.5	13.6
CR2	72.9	45.4	38.5	27.2
CR3	78.5	53.6	48.0	39.7
CR4	81.4	61.1	57.3	51.5

Sources: Author, based on NBE (2014b)
* as at June 2013

Banking service in Ethiopia, nevertheless, reveals heavy concentration with the largest bank, the state owned

CBE, accounting for over two-thirds of the total assets and one-third of the total capital – CR1. The largest 4 banks, CBE and 3 other private banks, together hold over 80 percent of total assets, and over 60 percent of total capital. Particularly, CBE is so large that it is 10.4 and 4.5 times larger than the second largest bank in terms of its assets and capital, respectively. At the other end of the scale (not shown here), there are 3 banks with a share of less than 1 percent of total capital of banks; another 5 with less than 2 percent; and another 3 with less than 3 percent. So the banking system is so segmented that if at all there was to be strong competition in the economy, it might have been a tall task for such banks to survive.

The degree of concentration within private banks alone is still high, though much lower than that with the inclusion of public banks. Again as shown in the same Table, in the case of both assets and capital, the largest 4 account for more than half of the total. But, this time, the difference in concentration among the largest banks is quite small; the largest being less than 10 percent greater than the next larger.

3.8.4.3 Presence of SOEs & endowments

In many developing economies where public financial institutions have significant role in the economy, the challenge to competition arises not so much from the size of competition as it is from the lack of a level playing field created by the government policy. In Ethiopia too, though public banks, particularly the CBE, is by far very dominant, the challenge arises largely from the development approach of the government – state-led economic management.

There is no evidence of public banks anti-competitive behaviour that affects private banks. However, there are allegations that public banks favour SOEs in terms of loan advancement. For instance, outstanding credit of public banks to state and private enterprises at end December 2014 was 44.2 and 38.7 percent respectively. [NBE 2015] Given the vast private sector this might be regarded as a bias towards public enterprises. But as noted in the previous paragraphs, this is a reflection of the development strategy, where priorities are attached to government initiated large projects. But cases of privileged relationships, such as for instance, lending to closely related parties or individuals, which might affect competition adversely, can also be found in private banks, though does not arise frequently. A case in point is the difficulties experienced by one of the private banks "which suffered significant losses as a result of loans extended to some of its share holders (or their associates)" in 2007/08. [Zavetta, R. et al. 2009, p75]

Also, there is no clear evidence of any anti-competitive practice by the endowment bank. The only uneven playing field that might be created is due to its easy and greater access to policy makers, hence the opportunity to have timely information and facilitation of its activities, while private banks have no access to such privileges.

[World Bank 2009; Vaughan, S. and M. Gebremichel 2011]

3.8.4.4 Regulatory restrictions and the lack of level playing field retarding competition

As noted above commercial public banks are largely driven not by prudent banking service principle, but by inflexible administrative intervention. State owned banks largely operate under the government direction, but at the same time enjoy some exclusive benefits that private banks don't get. Unlike private banks, they are not obliged to allocate 27 percent of their new loan disbursements to purchase low-yield NBE bills. Based on the opinion survey, 75 percent of the banks confirmed that forced transfer of loanable funds has affected their profit margin. Also, state banks are not required to fix the proportion of their loan portfolio. As noted above, private banks are required not to set short term loans to less than 40 percent of total. Such government requirements, inevitably, create uneven playing field between private and public banks. Moreover, though all private banks, big and small alike, are obliged to buy the low yield NBE bills for 27 percent of their loanable fund, the impact on all banks is not likely to be symmetrical. For small banks, this large proportion is more of a burden – a heavy tax on their limited resource, while large banks may not feel the impact so heavy. Of the total respondents to the survey, 71.4 percent confirmed that small banks will be more affected than larger ones. Such asymmetric impact may distort the general competition environment in the sector.

Moreover, the government requires individuals or private organizations participating in state auctioned projects to use CBE for any financial transaction associated with the project. For instance, an interview with the business community for this project reveals that one is obliged to hold an account at the CBE in order to participate at an auction for government projects. Similarly, for an opportunity to access government constructed low-cost houses, interested individuals are required to open a saving account at the CBE, not at any other bank. In such respects, 66.7 percent of surveyed banks think that there is no equal opportunity between private and public banks in mobilizing deposits. Also, 55.6 percent of the respondents believe that private banks have no access to foreign currency compared to public banks. Moreover, SOEs, largely, don't transact with private banks outside the state owned CBE to run their business. 78 percent of surveyed banks stated that they have no transaction with SOEs, though very few may have some limited transaction. As it is not difficult at all to create an efficient clearing system, given today's advanced technology, such inflexible requirements, in favour of the CBE, would not be necessary, as this discourages competition in the sector.

Whether NBE would be interested or has a real power to supervise CBE, as it does other private banks, is questionable. For instance, IMF consultation mission to Ethiopia, concerned about this probability, advised that

"Concentration of the CBE's large exposures to single entities warrants careful supervision and oversight by the NBE, with rigorous application of regulations limiting loans to related parties and a single borrower. Appropriate oversight and monitoring of the DBE's exposures and asset quality is also important in order to address any emerging problem". [IMF 2014, P20] NBE's asymmetric enforcement of its directives, as implied by the Mission, would not help to create a common competition platform for public and private banks.

As noted earlier, the government fixes the minimum deposit rate. This might pose some limitation for competition, as banks may like to use both variable lending and deposit rates, as an instrument to advance their business. However, the effect of this restriction is of limited concern. For instance, all banks who responded to the survey, noted that, in practice, it has no affect at all on the competition environment.

3.8.4.5 Uneasy relationship between business and politics – carving the market

The political ideology, rooted in the ethno-linguistic identity of society, has not failed to expand its influence to business. Perhaps an inevitable effect of the political orientation of the government in power is to restructure business in tune with ethnic grouping. A case in point is the banking sector. Table 13 shows the distribution of commercial bank branches by ethnically stratified administrative regions.

The Table shows two features of the distribution of bank branches: regional share in total branches, and regional share in individual bank branches. Considering the former, one-third of the total bank branches is in Addis Ababa. Except few banks, such as the CBE, Cooperative bank of Oromia, Oromia International Bank, and Abay Bank, all other banks, including the largest five private banks, have located a greater proportion of their respective branches in Addis Ababa. At least, 50 percent of each of the branches of the largest five banks is located in Addis. Perhaps, given the development asymmetry, created by all previous regimes, which led to business to amass in the capital, as well as the presence of some international and regional organizations, the relatively large concentration of bank branches in the capital is understandable.

Table 13. Regional distribution of bank branches

Name of Bank	Regional share in individual bank branches (%)						
	AA	ORO	AMH	SNN	TIG	OTH*	Tot
Commercial Bank of Ethiopia	18	33	18	16	8	7	100
Awash international Bank	59	**24**	3	4	3	7	100
Dashen Bank	51	18	11	9	6	5	100
Bank of Abyssinia	50	14	**19**	7	5	5	100
Wogagan Bank	49	11	9	7	**17**	7	100
United Bank	56	12	12	7	6	7	100
Nib International Bank	59	13	5	**14**	3	6	100
Cooperative Bank of Oromia	20	**65**	5	4	2	4	100
Lion International Bank	44	3	5	6	**32**	10	100
Oromia International Bank	27	**60**	3	3	3	4	100
Zemen Bank	67	22	0	11	0	0	100
Bunna International Bank	35	20	21	9	6	9	100
Berhan International Bank	54	15	10	13	6	2	100
Abay Bank	23	4	**54**	3	9	7	100
Addis International Bank	75	10	5	5	5	0	100
Debub Global Bank	37	10	0	**53**	0	0	100
Enat Bank	60	8	8	8	8	8	100
Regional share of total branches	34	27	14	11	8	6	100

Source. Author, based on NBE (2013) (June)

But the skewness of the branch distribution of some banks across the regions seems to reflect certain business unfriendly implications. Consider for instance Awash Bank, the largest private bank, at least in terms of bank branches. Outside Addis, its concentration is exclusively in Oromia (24 percent). All other regions combined together account for only 17 percent of its total branches. Similarly, consider Wogagen Bank where 17 percent of the branches is in Tigray; Cooperative Bank of Oromia, where 65 percent of the branches is in Oromia; Lion International Bank, where 32 percent of its branches is in Tigray; Oromia International Bank, where 60 percent of its branches is in Oromia; Abay Bank, where 54 percent of its branches is in Amhara; and Debub Global Bank where 53 percent of the branches is in Southern Nations. These banks have either few or no branches in other regions outside their focus area. Surely, the prime motive underpinning such skewed distribution cannot be business; because from the perspective of business and population density, other regions too carry some proportional weight which have to be factored in. If business was the motive, the distribution would have been much more symmetrical, like for instance, Dashen Bank, United Bank, Buna International Bank, Berhan International Bank, etc. The motive is, at least partially, the ethnic affiliation of the major share holders and founders of these banks.[66] In fact other banks too, such as

[66] It is not difficult to know the ethnic background of the founders, as their name is required to be published by News Papers in order to get the license. and it is not illegal either.

Abyssinia and Nib, show such biased tendencies, though not too conspicuous. Respondent banks to the survey have different opinions on this. Asked whether concentration in one region alone does imply a bank with a different objective than what a prudent banking principle could uphold, only 33.3 percent (against 22.3) agree, while the remaining 44.4 percent are not sure. But 77.8 percent thinks that founders of such banks must have a close relationship that ties them to the region at issue.

This pattern of segmentation is carving the market for exclusive benefit. The idea seems: ‘don’t infringe in ‘my region’, I won’t in yours’. In such segmented market, there is no competition among banks; and it is a prelude for future anti-competitive practice. Moreover, once such segmentation is validated, there is no boundary to stop from more stratification to come. There are allegations, for instance, that one bank is founded, largely by followers of the same religious sect, and another by individuals from a single profession within an ethnic group. Such business grouping will inevitably face challenges for further expansion. It does seem that, currently, at least in banking service, politics trumps economics (or business).

3.8.4.6 Risk-averse behaviour of banks – lack of competition culture

For the last 4 decades, the business community in Ethiopia has never been exposed to any serious competition environment in the domestic market. Even after the end of the command economy, the state-led economic management has not been quite friendly with market principles and practices. As such business in general has been conducted more in a spirit of collaboration rather than competition. The banking service has not been different from this. Most surveyed banks (88.9 percent) responded that they compete against each other based on the number of operational branches and deposit rates. It is true that large number of branches may help increase deposit mobilization. But as for the deposit rates, the margin between the minimum and maximum is only 0.5 percent, hence quite low to generate meaningful competition. In all other activities, loan rates, loan maturity period, service quality, etc., there is little competition among banks.

3.8.5 Recommendations

There are rich experiences worldwide, particularly of Asian countries, including China, with respect to guiding foreign investment in line with the host country's interest, minimizing potentially adverse effects on domestic banks, while benefiting its advantages. Keeping foreign investment at bay for too long (now over two decades in Ethiopia) involves forgone benefits, including long waiting period before joining the WTO, probably as long as the ban is not lifted. Given the acute shortage of finance, and also muted competition in the banking sector, foreign investment, even in a limited scale, such as for instance limiting the number of branches, limiting the location, limiting capital (or graduated equity participation), fixing the currency of operation, etc., would likely motivate competition among banks, thereby improving the quality of service in general, and access to finance in particular.

However, revising the policy on foreign investment alone may not be enough to attract investors in banking service. Particularly, the 27 percent of new loan disbursements required from commercial banks to purchase NBE bills is not only too high but the interest rate payable on it (3 percent) is so small that it may not even cover the cost of the service that banks incur. As such, it is so deterrent that foreign investment may not be interested to come in even if the investment ban is lifted. Thus the impact of this large capital transfer has profound impact and has to be revised. It might be worth to cap down the proportion (27 percent) and at the same time revise appreciably interest payable on it so as to induce more investment in the sector. Moreover, as noted above, other measures adversely impacting private commercial banks' resource mobilization capacity, in favour of public banks, need to be rationalized. The combined effect is likely to promote competition and also increase banks total loanable fund, thereby creating the opportunity for the government to tap on even a larger resource, if it is to continue so.

Chapter 4

THE COMPETITION REGIME AND ENFORCEMENT CHALLENGES

4.1 The Competition law

4.1.1 Policy Objectives of the Law

Setting the goals of competition law is not an easy task. It is rather an exercise with elusive concepts and requires a delicate balancing act. Deliberations on goals of competition law need to grapple with questions of substance, strategy and application as competition law aspires to achieve both economic and non-economic goals. [Fox, M. and M. Gal 2014] The most common goals are protecting the competition process, and consumer welfare.[67] These are also the declared policy objectives of competition law in Ethiopia. Even if the law has changed three times in about a decade, there is no shift in major policy direction and goals; the difference is only a matter of style and articulation rather than of substance.[68] In their preambles, all the three laws refer to the 'free-market economy of the country' in an effort to justify their adoption in a way reiterating the argument

[67]There are also other goals, such as protecting small businesses, protecting job, economic redistribution, addressing historically marginalized sections of the people for example blacks in south Africa. Ibid.

[68] See the preambles of Proc 329/2003 and Proc.685/2010 as well as Arts. 3 of both.

that competition law is not just a luxury to be enjoyed by developed economies alone. Looking at the objectives of the Trade Competition and Consumer Protection Proclamation No. 813/2013 (hereinafter TCCP 2013 or the latest Proclamation) one may be tempted to argue that the law unlike its predecessor (Trade Practice and Consumers' Protection Proclamation No.685/2010, hereinafter TCCP 2010)[69] has the express goal of taking issues of competition one step further. This is so because Article 3(1) of the latest Proclamation has openly declared that its objective is not only the protection of business from anti-competitive behaviour but also the *promotion of competition* itself (emphasis added). This is a step in the right direction. In economies in transition, such as that of Ethiopia, where competition is far from developed, competition law should also be designed with the objective of creating competition itself. Thus one can safely conclude that competition law in Ethiopia aims both at deterring or preventing anti-competitive behaviour and creating a competitive market.

4.1.2 Scope of Application of Competition Law

International best practices suggest that competition law should apply to all sectors and all economic agents, both private and public enterprises so long as they commercially produce and supply goods and services. Such general application of competition law is said to

[69] This should not be taken to mean that former laws did not serve the goal of promoting competition and were limited to only protecting competition.

foster due process and enables efficient allocation of resources. [Khemani, R. 2014] Both the 2010 and the 2013 laws have endorsed the general application of competition law in that all commercial activities or transactions in goods and services conducted in Ethiopia or having effect in Ethiopia are subject to the discipline of the country's competition regime.[70] With respect to economic agents, TCCP2010 expressly states that public enterprises are not exempted from its purview whereas the 2013 law has not expressly exempted them from its domain, hence being applicable to them in the same way as it does to private firms.

4.1.3 Exemptions and Exceptions

Social, cultural, historical, economic and political reasons may justify the granting of exemptions and exceptions from the golden rule of the general application of competition law. Some such exemptions and exceptions granted can, for example, further the very purpose of competition law and do not necessarily imply its weakening.[71] The new Proclamation stands in sharp contrast to its predecessor in its approach to exemptions. While the latter exhaustively listed down economic activities or transactions which are outside the purview of

[70] See Art. 4(1&2) of Proclamation No. 685/2010 and Art. 4(1)Proclamation No.813/2013

[71] ibid

competition law,[72] the former simply left the matter for the determination of the Council of Ministers. The Council's power to come up with list of exemptions, however, is not open-ended; apparently it is circumscribed by the requirement that an economic activity must be deemed (by the Council) 'vital in facilitating economic development'[73] to qualify for the exemption. While economic reason takes centre stage in justifying exemptions, we are however unable to comment on the exemptions in detail for the simple reason that the Council of Ministers is yet to come up with regulations on exemptions as directed by the law. Issues, such as the propriety, cost and benefits of the exemptions, the extent to which the exemptions restrict competitions and the availability or otherwise of other means which are less restrictive of competition compared to exemptions should be thoroughly studied in the future when the Council issues its mandated regulations.

Because governments may have differing policies and economic objectives in different sectors of the economy, the tension between competition law objectives and other policy priorities and objectives is inevitable. [Ibid] The design of a competition law regime should therefore be responsive to this tension. Ethiopia, under the new law, has taken a clear position in affirming the precedence of

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[72] Art. 4(3) of Proclamation No.2010 exempts the sovereign act of the state, basic utilities, basic goods and services as defined by the Council of Ministers, collective agreements between employer and employee from rules of competition law.

[73] Art. 4(2) Proclamation No.813/2013

sector-specific policy objectives over the general law of competition.[74] Once again, TCCP2013 has departed from its predecessor which took a very narrow approach on the issue.[75]

4.1.4 Prohibitions of Anti-Competitive Behaviours

Abuse of market dominance, anti-competitive agreements, concerted practices and decisions and unfair commercial competitions are prohibited by the two successive laws. A close comparison of the two reveals that the latter has not departed from the former in matters pertaining to the substance of behaviours deemed anti-competitive and, hence prohibited. TCCP2010 has simply been retained as it is. The difference, if any, between the two pieces of legislation is with respect to the organization of provisions and their articulations. One could easily observe that provisions of the latest law are better rendered and arranged logically, which is quite commendable. It may thus claim that these qualities can make it more accessible to its subjects and the enforcing institutions. This being said, the following specific observations can be made with respect to the substance of the rules on anti-competitive behaviours:

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74 Art. 4(3) of Proclamation No.813/2013

75 See Art. 4(6) of Proclamation No.685/2010 in which only a single law (the Food, Medicine and Health Care Administration and Control Proclamation No. 661/2009) is mentioned in this regard

4.1.4.1 Abuse of dominance

A business may maintain dominance in a given market. This dominance *per se* is not anti-competitive, nor is prohibited. It is rather the abuse of this market dominance that is anti-competitive and hence prohibited. Thus, a businessperson, whether acting openly or dubiously, or individually or concertedly with others, is not allowed to abuse his dominant market position.[76] The law also enumerates acts it deems abuse of dominance. These include: limiting output, hoarding or diverting of goods, predatory pricing, refusal to deal, denying access to essential facility, price-discrimination, tie-in-sale or bundling, restricting terms of resale.[77] The enumeration is not exhaustive, though; the Council of Ministers is delegated with the power to add "other similar acts by regulation" under Article (2)(i) of the Proclamation[78]. But it is incumbent upon the Council to see to it that the acts are anti-competitive *per se* or they, at least, have the effect of restricting competition directly or indirectly. It is true that the list of acts deemed abuse of dominance under the new law are the same as those listed under Article 8 of TCCP2010 and the list in both cases are not exhaustive. But there is difference in the approach taken by the law. Under the previous law (TCCP2010), apparently it is the Trade Practice and Consumer Authority that is vested with the power to determine, on a case by case basis, whether an act not in the list of Article

[76] Art. 5(1),Proclamation No.813/2013
[77] Art. 5(2)(a-h), Proclamation No.813/2013
[78] Art. 5(2)(i), Proclamation No.813/2013

8 constitutes an abuse of market dominance, while under TCCP2013 this power is given to the Council of Ministers.

Under both laws, the same grounds are recognized as exceptions to the rule that prohibits certain acts as abuse of market dominance. Acts which aim to maintain quality and safety of goods and services, labelling with prices or benefits offered by a competitor, and achieving efficiency and competitiveness are legitimate defences.[79] In both, the list is not close-ended, meaning there could be other reasons justifying deviation from the rule. TCCP2010 recognizes the defence of pursuing 'legitimate business purposes' provided that the businessperson proves that his acts are indispensable and decisive that he cannot achieve that 'legitimate business purpose' in any other way than the act complained of. Thus the onus is on the businessperson to show the non-existence of efficient and effective alternative means of achieving his 'legitimate business purpose' whatever the meaning of this phrase may mean.

Interestingly, under the previous law, the 'legitimate business purpose' exception is available for all acts deemed abuse of market dominance without any distinction. Finally, it is the Trade Practice and Consumer Protection Authority that has the power to determine whether an act, which is not in the list of Article 8 but

[79] Compare Art. 9 of Proclamation No.685/2010 and Art. 5(3) of Proclamation No.813/2013

complained of as an abuse of market dominance, falls under the 'legitimate business purpose' exception. TCCP2013, on the other hand, seems to have taken a different approach. Firstly, the blanket-type of 'legitimate business purpose' defence is dropped altogether; 'justifiable economic reasons' is the only exception, and the law listed acts which are deemed 'justifiable economic reasons.' This list is open-ended like the list under TCCP2010. The difference is that under the current Proclamation it is only the Council of Ministers (by regulations), not the Trade Competition and Consumer Protection Authority (on a case by case basis or through a manual or guidelines) that can determine whether an act constitutes 'justifiable economic reason.' The other difference is that the 'justifiable economic reasons' defence is not available for all acts deemed abuse of market dominance by the new law. It can be invoked only in relation to denying a competitor access to essential facility controlled by the dominant firm, price-discrimination, tie-in-sale/bundling, and imposing restriction in the resale of goods.[80] Other acts, for example, limiting production, hoarding, refusal to deal, etc., remain prohibited and cannot be defended on 'justifiable economic reasons'.

With respect to assessment of market dominance both proclamations have adopted identical position. A firm is said to be dominant if it has the actual capacity to control prices or other conditions of competition in the relevant

[80] Art. 5(3) cum Art.5(2)(e),(f),(g), & (h) of Proclamation No.813/2013

market (product and geographic). Its dominance can be assessed taking into account its market share or its capacity to set entry barriers for other competitors, or a combination of these or other appropriate factors.[81] There is no doubt that these factors are relevant to assess dominance but how do we measure the capacity of a firm to set entry barriers and what are these 'other appropriate factors' which help determine market dominance? The law as it stands now has no answer for this. The degree of market dominance may also be expressed in numerical terms and the Council of Ministers is delegated to determine this by regulations.[82] This may appear a quick and easy solution but the Council has yet to issue the said regulations. However, the wisdom of sticking to numerical expressions can seriously be questioned as relevant qualitative issues may be factored out of the equation.

4.1.4.2 Anti-competitive agreements, concerted practices and decisions

In this respect too, both proclamations prohibit anti-competitive agreements, concerted practices and decisions in horizontal as well as vertical relationships if they have the effect of price fixing, bid rigging, market allocation, and setting minimum resale price in the case

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[81] Id. Art. 6(2)
[82] Id, Art. 6(5)

of vertical relationship.[83] TCCP2010 'absolutely' prohibits these behaviours with the said object or effect but admits exceptions if the technological or efficiency or other pro-competition gains of the agreement, or concerted practice or decision outweigh the detriments of the prohibited acts.[84] Under TCCP2013 the apparently *per se* or 'absolute' prohibition of these acts is dropped. The new law has also introduced an additional ground, which is not found in the previous law, on which to prohibit anti-competitive agreements, concerted practices and decisions. Such behaviours are prohibited if they have the effect of preventing or significantly lessening competition unless their pro-competitive gains or technological efficiency outweighs their effect.[85] This ground is a catchall basket, because any agreement, concerted practice, and decision that may not have the effect of price fixing, bid rigging, market allocation, or setting minimum resale price is prohibited if it prevents or significantly lessens competition unless the firm proves that its pro-competitive advantages outweigh its anti-competitive effects.

4.1.4.3 Unfair commercial competition

There is no change in position with respect to unfair commercial competition. Any act which is dishonest, misleading or deceptive and which harms or is likely to

[83] Art. 13, Proclamation No.685/2010 and Art. 7(1&2), Proclamation No.813/2013

[84] Art. 14, Proclamation No.685/2010

[85] Art. 7(1)(a), Proclamation No.813/2013

harm the business interest of a competitor is prohibited under both laws which also enumerate acts deemed unfair. Even though the enumerations in both laws are open-ended, there is difference with respect to the organ that is authorized to add more acts of unfair competition in the list. Under TCCP2010 it was the Trade Practice and Consumer Protection Authority that was entrusted with power to determine whether an act (complained of but not in the list of prohibited acts) is dishonest, or misleading or deceptive, and harms or is likely to harm the commercial interest of a competitor. TCCP2013 has, however, given the power expressly to the Council of Ministers by way of issuing regulations specifying further unfair commercial practices.[86] The implication of this is that the current Trade Competition and Consumer Protection Authority cannot declare a certain act as unfair commercial practice when that act is not listed as such by the latest Proclamation or in regulations to be issued by the Council of Ministers, which is not yet the case.

4.1.5 Regulation of Merger

The time at which developing economies need to introduce merger regulations into their competition law regime is a debatable issue. Some suggest that younger economies should only introduce merger control at a later time instead of including it in their competition law at the initial stage. [Francisco, M. 2014] Apparently, Ethiopia seems to have heeded this advice because the country did

[86] Id., Art. 8(1)(g)

not introduce merger regulation in her first ever consolidated competition law, i.e., the Trade Practice Proclamation No.329/2003. It was only in 2010 that it introduced merger control in her competition law when she issued the repealed Trade Practice and Consumer Protection Proclamation No. 685/2010. Whether Ethiopia needs to control merger or should encourage it to help companies grow bigger and become competitive might be debatable. [Fikremarkos, M. 2014] Be that as it may, it is possible to design a merger regulation that is flexible enough to allow businesses grow and become competitive without however harming domestic competition.[87]

The law prohibits any form of merger that causes or is likely to cause significant adverse effect on competition; and no merger takes place without the prior knowledge and approval of the Trade Competition and Consumer Protection Authority.[88] Thus any proposed merger has to be notified to the Authority, and the latter has the duty to investigate the possible adverse effects of the proposed merger on competition.[89] While the Authority's duty of investigation is only implicit under TCCP 2010, TCCP 2013 has made it explicit. The latter law has also introduced the requirement of publicizing the proposed merger in a newspaper of wider circulation, inviting third parties affected by the proposed merger to file their

[87]Ibid.
[88] Art. 9(1&2), Proclamation No.813/2013
[89]Id. Art. 10(1&2)

objection within 15 days of publication.[90] But, the idea of requiring any proposed merger without making a distinction between those with the potential adverse effect on competition and those which enhance competition is undesirable. On the other hand, investigating into all proposed mergers irrespective of the size of the firms and their market share is a costly business that drains the scarce resource of the Authority. Although it may not be argued that the Authority under the repealed law does not have the general power to revoke the merger it has approved, this was not clearly and expressly stated in the law. The new law has addressed this gap by expressly empowering the Authority to revoke merger approval on specific grounds. If merger approval was obtained fraudulently or the approval was made conditionally but the condition was not fulfilled, the Authority has the right to cancel the approval.[91] Finally, TCCP2013 has departed from its predecessor by penalizing the violation of merger rules with a fine from 5 to 10 percent of the annual turnover of the culprit.[92]

[90] Id. Art. 10(3)(b)
[91] Art. 13, Proclamation No.813/2013
[92] Id. Art. 42(4)

4.2 Compatibility with COMESA Competition Regulations

By virtue of Article 55 of the Treaty of COMESA Ethiopia, as a member, has undertaken to prohibit any practice which negates the objective of free and liberalized trade in the Common Market. In particular, Ethiopia has agreed to prohibit any agreement between undertakings or concerted practices, which has the objective or effect of preventing, restricting, or distorting competition within the Common Market. The same provision, together with Article 5 of the Treaty, also commits Ethiopia to COMESA's Competition Regulations that addresses issues of competition and consumer protection in further details. The Regulations prohibits anti-competitive business practices and conducts, specifically cartelization and abuse of market dominance.[93] These practices and conducts are equally prohibited by Ethiopia's competition law, as discussed above. COMESA's Competition Regulations also provide extensive rules on control of mergers and acquisitions.[94] Generally, any merger with 'regional dimension', as defined under Article 23 (5) of the Competition Regulations,[95] shall be notified to COMESA Competition Commission per Article 24 of the same

[93] id.Arts.16-19

[94] Id.Arts.23-26

[95] The COMESA Regulations draws distinction between notifiable and non-notifiable mergers. Accordingly, the former is a merger or proposed merger with a regional dimension with a value at or above the threshold prescribed by the regulations; while the latter is merger or proposed merger with a value below the threshold.

Regulations, which provides detailed rules on notification procedure. The Commission will determine the effect, or likely effect, of the proposed merger on competition in the Common Market. Ethiopian law also requires notification of merger to the Authority but, unlike COMESA's Regulations,[96] it makes no distinction between mergers; it requires all mergers to be notified and investigated for their adverse impact on competition as discussed above.

COMESA's Competition Regulations also provides for consumer protection rules. It disciplines false or misleading representations about goods and services, unconscionable conducts in consumer transactions, product safety standards and unsafe goods, as well as product information standards.[97] Ethiopian consumer protection law addresses these consumer issues in much more detail.

With respect to WTO's rules and regulations, the multilateral organization has not yet come up with a specific regime governing competition. As such, it is not possible to test whether Ethiopia's competition law, as it

[96] Only 'notifiable merger' i.e. one with regional dimension is mandatorily required to be notified to the Commission although the Commission may order parties to a 'non-notifiable' merger to notify it if it thinks that the merger is likely to substantially prevent or lesson competition or is likely to be contrary to public interest. Id. Art.23(6).

[97] Id. Art.27-33

stands now, is compatible with WTO rules on competition. Nevertheless, in view of its impending accession to the WTO that pushes the agenda of trade liberalization and opening up of domestic market for foreign competition, Ethiopia has taken a step ahead by adopting competition and consumer protection law. With some minor revisions, the new law is expected to stand compatible with the WTO's requirement on the same.

4.3. Consumer Protection

There is no doubt that a well-designed and effectively implemented competition law enhances consumer welfare ultimately in the form of consumer choice, reduced price, increased quality, etc. of goods and services. But competition law may not be sufficient enough to guard all classes of consumers from the ills of market. Consumers may not possess the necessary information to make informed choices, or the power to guard themselves against abuses by big businesses. Thus a consumer protection law that protects consumers from misleading market conducts is needed together with institutions that implement the law effectively and efficiently. Both TCCP2010 and TCCP2013 extensively regulate issues of consumer protection. Rights of consumers as elaborated by the UN Guidelines for Consumer Protection are recognized, duties of businesspersons (display of price, levelling of goods, issuing receipts, self-disclosure, genuineness of commercial adverts[98]) are defined, and a long list of prohibited market conducts including hoarding or diverting of goods is stated in both laws in like manner although the new law is more elaborate and also better rendered with some new rules and amendments.

4.3.1 Hoarding or diverting of goods

[98] Commercial advertisement is regulated mainly by Advertisement Proclamation No.759/2012

Defining hoarding, describing which group in a society would favour the law on hoarding and analyzing its social welfare effects have never been easy tasks. [Sharfman, K. 2007] The current Ethiopian law simply prohibits hoarding or diverting of goods whether it is carried out by a businessperson or even by a consumer. It makes no distinction between imported or locally produced goods, but the goods must be declared scarce by the Ministry of Trade limiting the scope of application of the law to essential goods for which there is a significant imbalance between supply and demand in the market. The law has also provided for standards against which the existence or non-existence of hoarding or diverting can be determined. If it is a businessperson, the standard is ‘regular commercial practice’; if it is for non-businessperson, the standard is the quantity needed for ‘personal or family consumption’. Thus any act of storing or accumulating goods, declared scarce by the Ministry of Trade through a public notice, contrary to regular commercial practice or beyond what one needs to consume is hoarding under Ethiopian law.[99]

Any imported and locally produced goods is presumed to have been hoarded or diverted contrary regular commercial practices where the value of the suspect goods is not less than 25 percent of the capital of the businessperson, they are not marketed or made available for sale within a legally defined period, and the goods are not meant for use as raw materials or inputs for further processing by the importer or the producer himself. This

[99] Art. 24(1), Proclamation No.813/2013

period is 3 months from date of completion of customs formalities for imported goods and 2 months from date of production for locally manufactured goods.

This is not, however, the case under TCCP2010 which compels the use by the businessperson, within the same period as above, if the goods are meant to be used as raw materials, or for further processing by the businessperson himself.[100] This is a significant departure by the existing law from its predecessor. Unlike TCCP 2010, it has also made a distinction between businesspersons in that wholesalers and retailers are deemed to be hoarding or diverting goods contrary to regular commercial practice if they fail to make goods available for resale within 1 month from date of purchase.

Another new development in the law of hoarding is that goods found being transported by any means of transportation outside the authorized distribution route are also presumed hoarded or diverted. This is true even if other circumstances leading to the presumption that goods are hoarded or diverted as discussed above are not fulfilled.[101] And nobody shall transport or cause to be transported, outside the authorized distribution route, goods declared scarce and the quantity of which is beyond personal or family consumption.[102]

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[100] Art. (45)(2), Proclamation No.685/2010
[101] Art. 24(3), Proclamation No.813/2013
[102] Id. Art. (4)

The acceptable amount of personal or family consumption and the allowable storage time is left for the determination by the Ministry of Trade through a public notice. We are aware of no such determination at the time of compiling this report, though, and hence unable to comment on the issue. But still we can mention that even such reference to future determination by the concerned body was missing from TCCP2010.

Finally, the new Proclamation has made it clear and explicit that the law of hoarding is not applicable to agricultural products by peasant farmers. This could be true even under the repealed law, but the difference is that the exclusion under TCCP2013 is only for peasant farmers, while under TCCP2010 the exclusion is far more than vague; it simply adopts a blanket-type of exclusion in which all persons that are empowered or licensed by law to hoard goods are exempted.

4.4 Enforcement Challenges

Competition and consumer protection laws are two sides of the same coin; competition rules enhance consumers' welfare by making sure that consumers have choices in the market delivered on fair competition while consumer protection rules make sure that consumers have the freedom to make the choice. Thus it is no wonder that both rules are consolidated in a single legislation and entrusted to common institution for their enforcement. There is no single model of enforcement institution that is universally acceptable to all nations. The design of such institution has to be the function of the specific conditions of a given country. Ethiopia has adopted (see below) a model commonly known as an integrated agency model in which a single specialized agency undertakes investigative, enforcement and adjudicative activities. [Trebilcock, M and E. Iacobucci 2002].

TCCP2013 has established Trade Competition and Consumers Protection Authority (the Authority), as an autonomous federal agency outside but accountable to the line Ministry (of Trade) with the mandate to enforce rules of competition and consumer protection enshrined in the same legislation. Headed by a director general, the Authority has its own judicial organ (with first instance and appellate jurisdiction), investigative officers and prosecutors as well as other staff. While the federal institution is responsible for enforcement of competition law throughout the country, enforcement of consumer protection at the regions is left for the regions themselves which have the right to establish their respective regional consumer protection judicial organs and appellate tribunals.[103]

The Authority under TCCP2013 is more powerful than its counterpart under TCCP2010, because it has the full power to investigate, prosecute and adjudicate violations of completion and consumer protection rules. Investigation under the repealed law was the mandate of the Ministry of Trade (the Ministry) and the relevant regional bureau.[104] But under the new law, the Ministry no longer enjoys investigative powers. Under the previous law, the Authority was not (at least expressly) granted the power to institute actions for alleged violations unless one goes to great length by way of interpretation. Currently, however, the Authority is explicitly empowered to institute actions by its own prosecutor before its own judicial organ.[105] Of course, the right to institute action is not the monopoly of the Authority. Interested businesspersons and affected consumers also have the standing to sue. Thus, TCCP2013 has considerably departed from its predecessor by consolidating the power of the Authority while at the same time reducing that of the Ministry to which the Authority reports.

[103] Arts.27-28, Proclamation No.813/2013
[104] Art.42, Proclamation No.685/2010
[105] Contrast Art.41, Proclamation No.685/2010 with Art.37, Proclamation No.813/2013

The new law has also fundamentally departed from TCCP2010 by introducing a new and second tier, called the Federal Trade Competition and Consumer Protection Appellate Tribunal (the Tribunal), to the adjudicative organ.[106] The Authority under the previous law had one adjudicative body composed of a panel of three judges whose decision is appealable to the Federal High Court both on questions of law and fact.[107] Under the present arrangement, appeal from the adjudicative organ lies to the Tribunal. The Tribunal also hears appeal from the decision of the Authority refusing or revoking merger. The Tribunal has the power to confirm, reverse, vary or even remand cases, and its decision is final and non-appealable except on question of law in which case appeal lies to the Federal Supreme Court.[108]

The new law is by far articulated, elaborated and logically organized, compared to its predecessor, TCCP2010, as many of the gaps and confusions in the previous law have been addressed. This does not mean, however, that the new law is complete and without problem. For example, it has left a number of important issues for future determination by the Council of Ministers regulation as discussed earlier. But to our best knowledge no single regulation is issued by the Council for the purpose of implementing Proclamation

[106] Art.33, Proclamation No.813/2013
[107] Art.53, Proclamation No.685/2010
[108] Art.33 & 39, Proclamation No.813/2013

No.813/2013. For that matter, there was none issued under the previous proclamations.

The other challenge to the implementation of competition and consumer protection rules emanates from the very design of the enforcement institution. An integrated agency model, or generally relying on administrative agencies, is the preferred design in developing countries because of the complexity of competition matters, which require time and resources that are not available for regular courts. While this model offers the advantage of higher level of expertise, it has the disadvantage of real or perceived bias in the decision-making process because of the agency's involvement in prior investigation and enforcement. [Trebilcock, M and Iacobucci 2002].

Ethiopia's Authority is not immune from these challenges: Does the Authority have sufficient number of staff with the necessary expertise in the complex law of competition? Does it have the necessary financial resources to discharge its mandates under the law? Added to these is the question of independence of the Authority from political and industry capture. There is no doubt about the structural independence of the Authority as it is located outside the line ministries and is established as an autonomous legal entity. But, structural separation alone does not guarantee full independence. The Authority does not have, for example, financial independence as it has to obtain its budget from the government.[109] Even so, the

[109] Art.44, Proclamation No.813/2013

question as to whether or not the Authority is allotted sufficient budget to carry out its duties is worth taking note of. The other critical component of independence is functional independence; in other words, whether the Authority enjoys decisional independence. Formally speaking, judges (appointed by the Prime Minister) of the adjudicative bench of the Authority are independent of any interference or instructions by any person with regard to cases they adjudicate.[110] But the new law is not explicit on their tenure, salary, discipline, and related matters. Under TCCP2010 (Art.38) judges of the Authority are governed by the federal civil service law. If this were the intention of the law maker under the new law as well, the low salary scale and the lack of tenure guarantee under the civil service law, compared with the regular judiciary, could be one factor affecting the decisional independence of judges.

Still another enforcement challenge is the manner how the Authority is supposed to carry out its functions and responsibilities in the different regions of the country given the prevailing federal structure and the constitutional separation of functions between the two. According to Article 51(12) of the Constitution of the Federal Democratic Republic of Ethiopia, regulation of inter-state and foreign commerce falls within the ambit of the powers of the Federal Government; and regulation of competition is one aspect of this exercise. The modalities of how the Federal Government discharges this

[110] Id Art.35(1&3)

responsibility at Federal and Regional levels are not clearly spelt out in the latest competition law, though. Whether the Authority is to delegate the Regions to handle matters of competition arising in their respective regions, or whether the Authority is to open its own offices in the regions, or otherwise, is not yet clear, despite the fact that it is now two years since the new Proclamation was issued. One expects this gap to be addressed by regulations to be issued by the Council of Ministers for implementation of the Proclamation.

With respect to the scope of its application, Article 4(3) of the new law underlines that "The provisions of this proclamation may not affect the applicability of regulatory functions and administrative measures to be undertaken in accordance with other laws." This may have some profound implications to competition. Primarily, it means granting precedence of sector-specific policies or regulations over the general law of competition. It also implies that transactions or commercial activities regulated by other sectoral laws/regulations, such as for instance telecommunications, would not be governed by the competition law, even if the actions in the market may be inconsistent with the spirit of the competition law. Thus, there could be economic or service activities that would not be subjected to the competition law, leading to a double standard of the applicability of the law. This would be very challenging for the Authority to enforce the law in practice.

Perhaps, one other serious challenge to the enforcement of competition and consumer protection rules in Ethiopia is the level of awareness of business persons, consumers as well as government officials about the law and its cherished objectives. How informed are businesspersons? Do consumers have the ability (information and financial resources) to make use of the law and its institutions? Do government officials desist from acts that distort competition and affect consumer welfare? To date the Authority has been attempting to orient civil servants dealing with matters of trade, the police, judges, etc., on competition issues, largely with financial support by the donors' community. However, the business community, which is at the centre of the issue, is not yet taken aboard.

Chapter 5

SUMMARY OF FINDINGS AND RECOMMENDATION

5.1 Summary of Findings and Recommendations

The Ethiopian economy is largely supply constrained, even in markets where there are relative comparative advantages. The option of addressing the constraint, largely through the market (as the prime role of the private sector) is not considered by the government as viable. Rather, the state controls markets directly and indirectly, at production, import and/or distribution levels, through various instruments, including ownership of productive forces and enterprises, organizing party-owned and controlled businesses – such as endowments, creating politically controlled business associations, such as cooperatives; creating politically or otherwise affiliated private business establishments/conglomerates; using regulations/directives or administrative fiat, etc.

In markets where the government accords relative importance, such as critical production inputs (fertilizer), sensitive consumption goods (edible oil, sugar), strategic production and export commodities (cement, coffee, etc), it has been and is maintaining monopoly hold in import and distribution, even when private sector delivery is competitive. Often, the government allows initially private sector participation, but then bans private role, taking over the activity altogether on its own under the pretext of high prices, shortages, bulk purchase, etc. That was what happened in most of the markets noted above, without considering an alternative market based approach, such as, for instance, states involvement in the market, along with private actors, where it could have the opportunity to stabilize (correct) the market without marginalizing the latter. Perhaps, because of its political background – the socialist orientation, the government in power often opts for state monopoly; however, bringing aboard private operators along with the public sector, could lead to the development of markets (private sector), at least to some extent, while allowing the government to meet its objectives – market stabilization as well as other objectives. Totally marginalizing the private sector will not create a win-win situation as demonstrated during the socialist regime. Considering the dream of establishing a competitive market economy, with the leading role of the private sector, the option for state monopoly today cannot be sustained in the longer term, as it shuts-off the role of the private sector.

The political primacy in business or economic development, particularly the ethno-linguistic configuration of the country, which is impacting on the structure of business, further weakens the market and market competition. This has to diffuse if a competitive national market is to develop.

The management of business through administrative fiat – disregarding regulations/directives, etc., such as picking individuals/companies to play a leading role, i.e., reserving licenses, in a given economic or service activity, leads to corruption and disrespect to the law, and distorts the market and weakens the competition environment.

The states strong control of and the lack of access to critical productive inputs limits the development of the private sector, hence markets. The lack of secondary market for land, while the primary market is, at least partially, politically driven, generally imprisons business and development; capturing loanable capital of financial institutions, for prioritized state projects through directives, may deter entry into the financial market. It is possible to achieve the objectives of the government in these respects, at least partially, through less stringent and market oriented alternative instruments/measures, as recommended above under each section.

The attempt to regulate the marketing mechanism of strategic commodities such as coffee, oil seeds, etc., through modern marketing institutions, such as the ECX, is commendable. However, a forced control of the flow of the commodities might be self defeating as its flow to the parallel market can hardly be controlled sustainably. Relaxing the control in the domestic market weakens the relevance of the parallel market.

Ethiopia has legislated competition and consumer protection laws three times in a span of a decade or so.

The new law has introduced major developments although the bulk of its substantive provisions are simply imported from its predecessor with better rendering, articulation, and organization. By and large, important substantive law issues that deserve to be addressed in such a law have been incorporated in the new Proclamation. This, however, does not mean that the new law (TCCP2013) itself is complete and covers all aspects of competition and consumer protection issues adequately. As pointed out above, the law still has gaps that challenge effective enforcement, though these deficiencies can be rectified by subsidiary laws. Most importantly, the scope of the application of this law is highly limited as long as it has no effect on the regulatory functions and administrative measures to be undertaken in accordance with other laws. It is also important that the Council of Ministers issues the necessary implementing regulations as mandated by the Proclamation soon. Enforcement of a law that is incomplete is a tall task.

Because enforcement power is now consolidated in the hands of the Authority with limited judicial review at a later stage, the institutional and functional independence of the Authority and its judges need further enhancement and protection. The quality of competition and consumer protection laws is measured not only in terms of its substantive and procedural rules but equally also in terms of the availability of vibrant and autonomous institutions with the necessary resources and expertise to implement the law. Thus, a study wider in scope and greater in depth than the present report should be carried out in order to identify institutional shortcomings.

In sum, the political economy of Ethiopia today exhibits a number of competing and apparently friction prone features: a political ideology that configures society on ethno-linguistic strands, rather than endorsing and enforcing universal human (democratic) rights and principles to bring social cohesion and national unity; a 'revolutionary democracy' (single party leadership for a transition period)[111] aspiring to institute a liberal democracy in the distant future; a state-led and managed economy (a developmental state) for a transition period, targeting a market-based economy in the longer term; and dominant party owned business conglomerates and state owned enterprises, instead of private sector enterprises, to lead the economic transformation of the country. Given such apparently less complimentary features, and a narrow set of business structure, i.e., business based on personal, family, ethnic, etc., networks, it may be a tall task to develop a depersonalized but risk based efficient business domestic environment, and thereby a competitive market economy, in the near future.

[111] It is over two decades since the transition began

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