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Funded as an Exploratory Grant by CEPR/DFID April, 2011,
Preliminary Findings Not For Circulation
Understanding China’s Impact on Ethiopia’s Leather Sector

Motivation | Questions | Method | Results | Next Steps

The Team at Chinese Tannery in Ethiopia

There’s something happening here.

What it is ain’t exactly clear.

It seems so important. I bet somebody would give us money to figure out what is happening!
Please Remember

– Preliminary Evidence
– CEPR/DFID Exploratory Grant
– Goal Today
  • Background
  • What we know and don’t know
  • Directions for future work
  • Perfect timing for feedback
Key Facts

– Leather/Livestock Sector Tremendously Important
– Livestock/Leather Enormous Untapped Potential
– Nature of China’s Involvement Complex
  • Imports thought to be a disaster but many domestic firms recover
  • Concerns that Foreign Investors Squeeze Out Locals
  • Foreign Investment Could Help Upgrade Industry
  • Investment in Manufacturing Marks a Shift
– Timing of Foreign Investment Lends Itself to Evaluation
  • Important for Ethiopia
  • Also Relevant for Other Recipients of Chinese FDI
Livestock Population of Ethiopia One of Largest in World
Leather Value Chain’s Enormous Potential

**Market structure**

- **Small Cattle Farms**
- **Hides and Skins Collectors**
- **Leather Processing Mfs**
- **Footwear**
  - **FDI Local Enterprises**
  - **IS**
- **Export Market**
- **Local Market**
- **Imported Footwear**
- **Second Hand Footwear**
- **Imported Accessories**
- **Sole Producers**

**Notes:**

i) FDI – Foreign Direct Investment Enterprises; IS – Informal Sector

ii) Dash line (- - -) indicates a week linkage, lack of organization, and areas where technical support is required to help strengthen linkages along the supply chain

**Source:** Global Development Solutions, LLC
Understanding China’s Impact on Ethiopia’s Leather Sector

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Output of Raw Hides, Processed Leather and Shoes

Crust Hides and Wet Blue Hides

Semi-processed Skins

Leather Shoes and Boots

Source: Central Statistical Agency of Ethiopia, Ethiopia MoFED Annual Report, National Bank of Ethiopia Annual Report (various years)
Formal Sector Employment

Employees in Leather Manufacturing

Source: Central Statistical Agency of Ethiopia, Ethiopia MoFED Annual Report, National Bank of Ethiopia Annual Report (various years)
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Production and Exports

Total Production Value of Leather and Footwear Products

Export of Footwear, Garters, and Shoe Parts

Note: /a Based on calendar year
### Market & Employment Potential

#### Table 57: Snapshot of Leather Sectors in China, Vietnam and Ethiopia, Tanzania and Zambia

<table>
<thead>
<tr>
<th>Key Comparative Indicators</th>
<th>China</th>
<th>Vietnam</th>
<th>Ethiopia</th>
<th>Tanzania**</th>
<th>Zambia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Imports (Value - US$1,000)</td>
<td>429,529</td>
<td>6,474</td>
<td>620</td>
<td>1,199</td>
<td>13,304</td>
</tr>
<tr>
<td>Total Exports (Value - US$1,000)</td>
<td>8,305,873</td>
<td>2,322,047</td>
<td>3,701</td>
<td>941</td>
<td>2,363</td>
</tr>
<tr>
<td>Companies Operating in the Sector (by size)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>40.0%</td>
<td>47.4%</td>
<td>98.6%</td>
<td>55%</td>
<td>50%</td>
</tr>
<tr>
<td>Medium</td>
<td>27.0%</td>
<td>24.3%</td>
<td>0.8%</td>
<td>18%</td>
<td>30%</td>
</tr>
<tr>
<td>Large</td>
<td>33.0%</td>
<td>28.3%</td>
<td>0.6%</td>
<td>27%</td>
<td>20%</td>
</tr>
<tr>
<td>Estimated Number of Workers*</td>
<td>2,702,142</td>
<td>632,266</td>
<td>7,600</td>
<td>1,000</td>
<td>600</td>
</tr>
<tr>
<td>Male</td>
<td>55.0%</td>
<td>18.0%</td>
<td>56%</td>
<td>58%</td>
<td>75%</td>
</tr>
<tr>
<td>Female</td>
<td>45.0%</td>
<td>82.0%</td>
<td>44%</td>
<td>42%</td>
<td>25%</td>
</tr>
</tbody>
</table>

* Trade data refers to leather upper footwear only

** Year 2008 figures in the case of Tanzania. Does not include micro and small firms with less than 10 employees.

*Global Development Solutions, LLC from interviews and national statistics. Trade data from Comtrade.*
Many Government Policies Targeted at Industrialization of Leather Sector: Changing Over Time

– Derg Period: Ban of Export of Raw Hides
– 150% export tax on semi-processed leather (wet blue) – 2008
– 150% export tax on unfinished leather (crust) -- 2011
– Leather Export Products Made a Priority Sector
  • Income Tax Breaks (2 to 8 yrs holiday) for Investors
  • Land at reduced lease rate
  • Cost sharing scheme for foreign experts
  • Building for small shoemakers + technical assistance

-- General incentives: duty drawback scheme
Ethiopia Competitive but Inefficient

- No commercial livestock sector
- Relative to China and Vietnam
  - Absenteeism high
  - Wastage high
  - Unused capacity
- Unit cost in Ethiopia still lower than in China!
- Higher than Vietnam but Vietnam does not have raw inputs
Increased Foreign Investment in Ethiopia

<table>
<thead>
<tr>
<th>Year</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.43</td>
<td>4.93</td>
<td>23.95</td>
<td>13.28</td>
<td>9.71</td>
<td>74.29</td>
<td>58.53</td>
</tr>
</tbody>
</table>


Note! Planned investment by one Chinese factory alone is upward of 2 billion USD.

But we all know numbers can be misleading ...
Huajian Shoe Factory: Shoe Assembly Line
China Africa Overseas Tannery
Summarizing

– Leather Industry in Ethiopia Has Significant Potential
– Leather Industry is Inefficient and Technology Outdated
– Foreign Investment Seems to be Taking Off
– Foreign Investors Could
  • Improve Technology All Along Value Chain
  • Train Workers
  • Employ Workers
– Foreign Investors Could Also
  • Operate in Isolation
  • Destroy Small Businesses
  • Grab the Hides and Run
Two Broad Questions

• How active are the Chinese in the leather value chain in Ethiopia?
• Are Chinese (foreign) firms operating in isolation or are they integrating with Ethiopian firms and people?
  – Is there any evidence that trade has led to investment?
  – What has been the role of government policy so far?
Semi-Structured Interviews: Goals

• Snowball Technique
• Determine Extent and Nature of FDI
• Get a Better Sense for Interactions between Foreign Investors and Locals
• Determine Whether Follow On Project Worthwhile
Semi-Structured Interviews : Timing

- Exploratory Grant Funded April 2012
- Ethiopia Fieldwork June - July 2012
- China Fieldwork August – September 2012
- Deborah Brautigam
- Tang Xiaoyang
Semi-Structured Interviews : Sample

- Interviewed Formal Sector Leather Processing Firms
  - Tanneries
  - Foreign and Local
  - Members of

- Did not Interview
  - Owners of Livestock
  - Small Shoemakers (around 1,000)
**Understanding China’s Impact on Ethiopia’s Leather Sector**

<table>
<thead>
<tr>
<th></th>
<th>Members/Interviewed</th>
<th>Ethiopian Firms Interviewed</th>
<th>Indian &amp; Chinese Firms Interviewed*</th>
<th>Other Foreign Firms Interviewed*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tanneries</td>
<td>24/21</td>
<td>13</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>Leather Products &amp; Shoes</td>
<td>15/12</td>
<td>7</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>39/33</strong></td>
<td><strong>20</strong></td>
<td><strong>8</strong></td>
<td><strong>5</strong></td>
</tr>
</tbody>
</table>

* Includes firms that have applied for membership. Chinese & Indian firms include joint ventures.
### Initial Census/Survey of Asian Linkages

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>% with current Asian empl.</th>
<th>Business trips to China % **</th>
<th>Business trips to India %</th>
<th>Import supplies from China %</th>
<th>Import supplies from India %</th>
<th>Buy machinery from China %</th>
<th>Buy machinery from India %</th>
<th>Use Chinese TA %</th>
<th>Use Indian TA ***</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ethiopian Firms</strong></td>
<td>20</td>
<td>15%</td>
<td>85%</td>
<td>50%</td>
<td>65%</td>
<td>20%</td>
<td>20%</td>
<td>10%</td>
<td>5%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Foreign Firms</strong></td>
<td>5</td>
<td>60%</td>
<td>80%</td>
<td>20%</td>
<td>60%</td>
<td>20%</td>
<td>40%</td>
<td>20%</td>
<td>60%</td>
<td>0%</td>
</tr>
<tr>
<td>(non Asian)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Asian Firms</strong>*</td>
<td>8</td>
<td>100%</td>
<td>100%</td>
<td>0%</td>
<td>63%</td>
<td>0%</td>
<td>63%</td>
<td>0%</td>
<td>63%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>33</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Includes joint ventures with non-Asian partners

** % of firms answering yes

*** Includes TA provided by Ethiopian government program twinned with Indian institutions, and TA purchased from other firms.

[These statistics may be underreporting linkages. Not all firms may have been asked this question. Firms still under construction may not be importing supplies yet.]
Leather Processing: Linkages

- Increased exports and imports and some evidence that trade has led to technical assistance from India.
- ALL of the Chinese and Indian investors in tanneries had previously purchased output from local tanneries.
- Reported that purchases by these tanneries was driving up the price of raw hides – good for farmers/bad for local tanneries.
- Personnel movement is modest.
- Complaints that government policy aimed at upgrading the industry has favored foreigners who have access to capital and better technology.
Leather Processing : Technology Transfer

- Ethiopia’s Leather Industry Development Institute (LIDI) partnered with two Indian government institutions, to improve its’ technological knowledge of the leather industry in 2011.
- Indian experts were sent to 11 tanneries in Ethiopia for benchmarking studies. Each factory got 3-4 experts for 1 year. Results are mixed.
Leather Processing: Future

• Friendship Tannery (Chinese)
  – Plans to develop regional processing center
  – Leather from Mali, Sudan, Cote d’Ivoire, Somaliland etc.

• Three Chinese tanneries and two Indian tanneries have promised to build glove or shoe factories in Ethiopia
  – Not yet realized
  – Concerns about investment environment
  – Concerns about ability to meet international quality standards
Leather Processing: Summary

- Significant investment in tanneries by foreigners
- Foreign investment in leather processing appears to have squeezed out some locals (problems are credit, technology, quality)
- Some evidence of training
- Significant complaints about foreign competition in leather industry (not so in shoe industry)
- Government policy reducing firms' ability to export unprocessed leather is partially responsible
Manufacturing of Leather Products: Linkages

- For a few years, there was competition in output market between local shoemakers and Chinese imports.
- Currently the market appears to be segmented:
  - Foreign firms export ladies shoes
  - Local firms produce men’s shoes for export and local market
- None of the local shoe companies we interviewed hired foreign experts in the recent past.
- One company (Walia) sent 5 technicians to their main client Indian TATA group for training.
Manufacturing of Leather Products: Linkages

• Hong Kong company New Wing, which has two production bases in mainland China, bought a factory in May 2011 and began operation in Sept 2011.
  • Previously NW was outsourcing to Anbessa.
  • Employed 300 local workers in July 2012.

• NW and Huajian are working on OEM orders from USA and Europe [Guess, Tommy Hilfiger & others].
  • Products 100% for export
  • Both are producing exclusively lady’s shoes,
  • Both source leather supply locally.
  • New Wing depends more on local supply and wants to establish its own tannery for refined processing.
Manufacturing of Leather Products: Training

- Huajian, located 35 km away from Addis, trained its own staff, most of whom are newly graduated college and high school students.
- The company is planning to send 300 workers to China for further training.
- The company is teaching shoe-making skills to 200-300 local individuals outside of the company as part of a Corporate Social Responsibility Program.
Manufacturing of Leather Products: Training

• The British tannery has established a glove-making factory and brought their agent in China to train the Ethiopians in production skills.

• The Chinese agent also intends to shift his own glove factories in China to Ethiopia through this cooperation in order to take advantage of the low labor cost.

• A German glove maker as well brought technicians from its branch in China to train Ethiopians in their experimental factory in Gondar.
Manufacturing of Leather Products: Future

- China’s Huajian Group has signed an MOU with the China-Africa Development Fund to invest 2 bn usd in building a shoe production base in Addis during the next five years
  - Note that Huajian Group built a factory in the Sino-Ethiopia Economic Cooperation Zone and began operation only 4 months after its’ president visited Ethiopia for the first time in September 2011.

- Cheap labor and access to raw materials are the main reason for this investment.
  - The company has 24,000 workers in China, average monthly wage is 2000-3000 RMB (300-450 usd),
  - In Ethiopia they pay local workers only 600 Birr (35 usd) per month.
Manufacturing of Leather Products: Summary

- Chinese have started to invest along with Indians, British and Germans – these are large firms.
- Most foreign firms still in nascent stage.
- Training by Chinese takes place within foreign firms.
- Domestic firms getting some TA from Indians.
- However some smaller shoe factories losing out as foreigners set up their own firms and competition for hides increases.
- Policy has played a role in bringing small firms together but impact is unclear.
- Potential for significant future investment, technology transfer and jobs.
Finishing Up and Future Work

• Write up results to complete commitment to CEPR/DFID for funding exploratory grant

• Clearly significant scope for additional research:
  – Big picture welfare analysis a la McMillan/Rodrik Cashew Industry Analysis – Include Owners of Livestock
  – More substantial baseline survey that includes small firms
  – Timing is right since industry is just starting to change (note in Ethiopia, 98% of firms still small while in China much wider dispersion in firm size)
  – But if baseline survey, need to sharpen the questions
    • Technology transfer?
    • Impact of government policy?
    • Impact on employment? Market access?