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60 WORKING PAPER

A Strategic-Relational Approach to Analyzing Industrial Policy Regimes within Global Production Networks: the Ethiopian Leather and Leather Products Sector

Vienna, October 2019

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ÖFSE
Austrian Foundation
for Development Research

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Contents

List of Abbreviations

ADLI	Agricultural Demand-led Industrialization Strategy
CMT	Cut-make-trim
EFFORT	Endowment Fund for the Rehabilitation of Tigray
EIC	Ethiopian Investment Commission
ELIA	Ethiopian Leather Industries Association
ETDIS	Export Trade Duty Incentive Scheme
FDI	Foreign Direct Investment
GCC	Global Commodity Chain
GPN	Global Production Network
GVC	Global Value Chain
IDS	Industrial Development Strategy
LIDI	Ethiopian Leather Industry Institute
LLP	Leather and Leather Products
LLPTI	Leather and Leather Products Technology Institute
OBM	Original Brand Manufacturing
ODM	Original Design Manufacturing
OEM	Original Equipment Manufacturing
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
SRA	Strategic-Relational Approach
TPLF	Tigray People's Liberation Front
USD	US Dollar

Abstract

This paper contributes to debates regarding the lack of theorization of the state and the over-emphasis on lead firms in studies of *global value chains* (GVCs) and *global production networks* (GPNs). This paper combines the GVC/GPN frameworks with a *strategic-relational approach* (SRA), a SRA conceptualization of the *developmental state*, and literature about the *embeddedness* of firms. Empirically, the paper analyzes the conflictual relationship between firms and the state's strategies that structure and re-structure the development, industrial policy regime, and GVC/GPN integration of the Ethiopian leather and leather products (LLP) industry.

Keywords: global value chains, developmental state, embedded autonomy, network embeddedness

1. Introduction

Chain and network approaches – *global commodity chain* (GCC), *global value chain* (GVC), or *global production network* (GPN) frameworks – have been increasingly applied in the last three decades to the analysis of the globalization of production and its effect on development in the global periphery (e.g., Bair 2005, 2008; Coe/Dicken/Hess 2008; Coe et al. 2004; Gereffi 1994; Gereffi et al. 2001; Henderson et al. 2002). The GCC/GVC frameworks developed by Gereffi (1994, 1995) and Gereffi, Humphrey, and Sturgeon (2005) are the most commonly used frameworks, emphasizing the role of lead firms in governing GCCs/GVCs (Bair 2005). Much of this literature, however, has largely neglected the role of other actors – the state, civil society, and upstream firms – in structuring GCCs/GVCs and shaping developmental outcomes (e.g., Coe et al. 2008; Horner/Alford 2019; Smith 2015). The GPN framework broadens the perspective by focusing on relational network configurations and emphasizing non-firm actors, highlighting the important role of the state in structuring and re-structuring GPNs (e.g., Coe et al. 2004, 2008). The GPN frameworks nonetheless lacks theorization of the state (cf. Neilson/Pritchard/Yeung 2014), which limits its explanatory power, and only a few authors in this field have gone beyond a shallow conceptualization of the state, for example by linking the GCC/GPN frameworks to a *strategic-relational approach* (SRA) (e.g., Selwyn 2012; Smith 2015; Dawley/MacKinnon/Pollock 2019).

In their summary of recent conceptual developments, Coe and Yeung (2019) highlighted the SRA and the developmental state literature as important perspectives – amongst others – to broaden and deepen our understanding of the intersections between the state and GPNs. This paper adds to this debate and presents a framework that combines the GVC/GPN frameworks with a SRA (Jessop 1990, 1999, 2001) and operationalizes the framework by linking it to a developmental regime perspective (Pempel 1999; Wylde 2012, 2016, 2017), and the embeddedness of firms literature (Hess 2004). The SRA enables the framework to understand better how the strategies of relevant actors structure and re-structure the interrelated and multi-scalar institutional underpinning of states and GVCs/GPNs. Linking the SRA to a developmental regime approach – a strategic-relational conceptualization of the developmental state and embedded autonomy (cf. Evans 1995) – operationalizes the framework in analyzing the interrelations between the state, industrial policy regimes and GVCs/GPNs. In doing so, it analyses the (often conflictual) relationship between industrial policy institutions and different groups of (local) firms through relative autonomy, and seeks to explain the emergence or lack of a "joint project of transformation" (Evans 1995: 59) at the sectoral level. The analysis of the strategic orientation of different groups of firms, in addition, is linked to concepts of sectoral and local embeddedness (cf. Hess 2004), which shed light on the strength of the ties that link firms and their owners to specific sectors or locations and contribute to assessing the possibilities for, and limits of, upgrading (cf. Morris/Plank/Staritz 2016; Morris/Staritz 2017) The analysis of firms' embeddedness thus also helps to determine whether the strategic interests of firms and industrial policy institutions are aligned.

The framework is used to empirically analyze how lead and upstream firms, as well as state institutions' strategies, have structured and re-structured the Ethiopian leather and leather products (LLP) industry, industrial policy regime, and coupling and upgrading processes in GVCs/GPNs during three development phases since the 1990s. In order to narrow the scope of this paper, the empirical analysis focuses on the relationship between the state institutions and different groups of firms, without taking into account the differences between state institutions in detail. The analysis contributes to an empirical research gap concerning upstream firms' and state institutions' strategies for shaping local sector dynamics and their links to GVCs/GPNs and upgrading processes. Since the GVC framework focuses on the governance of lead firms and buyer-supplier relationships (e.g., Gereffi 1994, 1995; Gereffi et

al. 2005), upstream firms' strategies tend to be overlooked in empirical research and in explaining the structure of GVCs. The role and importance of the state and industrial policy in structuring GVCs/GPNs and developmental outcomes have, however, increasingly been taken into account in empirical research on GVCs/GPNs (see e.g., Coe/Yeung 2019: 782ff.; Horner/Alford 2019; Smith 2015: 292ff. for an overview), but the conceptual depth of the analysis is often limited, given their lack of state theory.

An analysis of the three development phases revealed the shifting and conflictual relationship between different groups of firms and state institutions' strategies that structure the development, industrial policy regime, and GVC/GPN integration of the LLP sector. The paper concludes that the political elite-driven industrial policy regime has successfully supported the growth of investments, exports, and upgrading, and dramatically changed the GVC/GPN integration of the LLP sector. The development of the LLP sector, however, has been severely constrained by the lack of sectoral and local embeddedness of locally- and foreign-owned tanneries, respectively, explaining the weak link between tanneries and manufacturers, as well as the absence of a "joint project of transformation" in the prevailing industrial policy regime.

Methodologically, this paper is based on data analysis and semi-structured interviews. The 48 interviews were mostly conducted during two field research trips to Ethiopia (July-October 2018) and included a variety of different firms, interest groups, sector experts, and representatives of state institutions. At the firm level, the interviews were conducted with managers and represented a varied sample, based on differences in geographic location, ownership, size, production activities, end-market orientation, and degree of vertical integration. Interviews with global buyers were mostly conducted by phone. The interviews were complemented by trade, national, and international sector data, including aggregate statistics from UN Comtrade (WITS), the Ethiopian Leather Industry Institute (LIDI), and the Ethiopian Investment Commission (EIC).

The paper is structured as follows: Section 2 provides a conceptual overview of different chain and network approaches and how these can be linked to a strategic relational approach and a developmental regime perspective. Section 3 gives a brief overview of the LLP GVC/GPN in relation to the Ethiopian LLP sector. Section 4 presents an analysis of three distinct development phases of the Ethiopian LLP sector in the context of the LLP GVC/GPN and industrial policy regimes, based on the conceptual framework presented in section 2. Section 5 presents the conclusion.

2. A strategic-relational and developmental-regime approach to global production networks and industrial policy regimes

Various theoretical perspectives have used chain and network approaches to analyze changing global production patterns, upgrading processes, and more (Bair 2005, 2008; Coe/Yeung 2019). The most commonly used chain framework was developed by Gereffi (1995: 113), who suggested analyzing GCCs or GVCs based on four dimensions: an input-output structure, different geographical scales, a governance structure, and institutional contexts (Gereffi 1995; Gereffi/Fernandez-Stark 2011). The governance dimension of GVCs has received the greatest attention in the literature (Bair 2005; cf. e.g., Gereffi et al. 2005; Ponte/Sturgeon 2014), since it focuses on the coordination and power relations between lead and supplier firms in the context of the increasing fragmentation and dispersion of global production. Lead firms are identified as the governors and main drivers of GVC dynamics through their power to shape market requirements and buyer-supplier relationships, with important implications for access to, and upgrading within, GVCs. Industrial upgrading is a key

concept of GVC analysis and is traditionally defined as moving from lower-value to higher-value-added activities, within or across chains (Gereffi 1999; Humphrey/Schmitz 2002).

The emphasis on lead firms and their relationship to supplier firms in blocking or enabling upgrading processes has led to the relative neglect of the institutional context and other actors in shaping developmental outcomes, within and beyond GVCs (Coe et al. 2008; Horner/Alford 2019; Smith 2015). The prominent role of lead firms in governing GVCs, and their relationship with first tier suppliers, has downgraded the role of upstream supplier firms in shaping the structure of GVCs (cf. e.g., Gereffi 1994, 1995; Gereffi et al. 2005). The role of the state and civil society actors in the GCC/GVC framework and empirical analysis has traditionally been weak in earlier publications, to some extent challenging the developmental state paradigm and its focus on strategic industrial policy and institutions. A growing body of literature has nonetheless increasingly acknowledged the importance of the state and industrial policy in shaping GVCs and upgrading processes (see e.g., Horner/Alford 2019; Smith 2015 for an overview). Gereffi and Sturgeon (2013), for example, highlighted the need for a GVC-oriented industrial policy that thoroughly considers the strategies of global buyers in order to support further upgrading through global market integration. Kaplinsky and Morris (2016), similarly, call for new policy interventions by governments to foster "thinning" (in case of vertically specialized GVCs) and "thickening" (in case of additive GVCs) trajectories.

The narrow focus of the GVC literature is a key criticism of the GPN approach, which broadens the perspective by introducing relational network configurations (Coe et al. 2004, 2008; Henderson et al. 2002). The GPN framework considers the importance of all relevant actors' strategies and analyses coupling processes between regional economies and GPNs through the heuristic concept of *strategic coupling*, which is defined as a "mutually dependent and constitutive process involving shared interests and cooperation between two or more groups of actors who otherwise might not act in tandem for a common strategic objective" (Yeung 2009: 332). The GPN framework also explicitly emphasizes the role of multi-scalar institutional contexts and the centrality of the state as a key actor (Coe et al. 2004, 2008), linking to a variety of state conceptualizations (see Coe/Young 2019: 782ff.), but the framework continues to lack theorization of the state (Neilson et al. 2014; Smith 2015).

The lack of state theory leads to the question of how the state should be conceptualized in order to analyze the interrelationship between industrial policy institutions, GVCs/GPNs, and developmental outcomes. The developmental state paradigm (e.g., Amsden 1989; Evans 1995; Fine 2013; Wade 1990, 2010) and related schools of thought, such as the business-states relations literature (e.g. Maxfield/Schneider 1997), have a long tradition of analyzing the role of the state in shaping developmental outcomes through different theoretical perspectives, but have been particularly influenced by Weberian thought (Johnson 1982). Evans's (1995) conceptualization of a developmental state overcame the state-society dichotomy of the Weberian perspective through the embedded autonomy concept – meaning a state that is not only relatively autonomous of particular interests, but also embedded in civil society – in order to provide "institutionalized channels for the continual negotiation and renegotiation of goals and policies" (ibid. 12). The embedded autonomy of the state thus reflects a connection to particular social groups with whom the state shares a "joint project of transformation", while sustaining a "sufficient" degree of independence (ibid. 59).

The driving forces and strategies that lead to the emergence of a developmental state or embedded autonomy, however, remain ambiguous (cf. Cumings 1999), which explains why various approaches emphasize different drivers of (non-)developmental or industrial policies, based on different conceptualizations of the state. Among them are the political survival of the political elite approach (Doner/Ritchie/Slater 2005; Maxfield/Schneider 1997), political settlements theory (Khan 2010, 2018), and the developmental regime approach, underpinned by a SRA, that also emphasizes the (potential) role of broader civil society actors (Wylde

2017). A major drawback of this body of literature is, however, the limited consideration of lead firms and GVC/GPN dynamics, with few notable exceptions (e.g., Whitfield et al. 2015).

This paper links the chain and network frameworks to a SRA (Jessop 1990, 1999, 2001) and developmental regime perspective (Pempel 1999; Wylde 2012, 2016, 2017) in order to focus in on relevant actors' strategies and better understand the interrelationship between GVCs/GPNs, industrial policy institutions, and developmental outcomes in global periphery supplier countries at a sector-level. Linking the GPN framework to a SRA was suggested by Coe et al. (2008: 290), but its application within GCC/GVC/GPN approaches has thus far been limited. Selwyn (2012) outlined the usefulness of the SRA in order to understand institutions related to labor relations in the context of GCCs. Smith (2015) recently elaborated a SRA for analyzing the role of the state in the regulation of GPNs and the accumulation regimes of which they are a part. Dawley et al. (2019) used the case of wind turbine inward investment in northern England to analyze the institutional underpinnings of strategic coupling based on a SRA from a host region perspective with a focus on regional institutions.

A SRA analyzes social phenomena in terms of social relations through a dialectical analysis of structure and agency in order to examine how institutions privilege some actors and strategies over others, and how strategies structure institutions (Jessop 1999, 2001). The approach thus goes beyond the structure-agency dichotomy by examining structures in relation to action, and action in relation to structure. Structures are treated analytically as strategic in their form, and actions as structured and structuring. Institutions, in turn, privilege some actors and strategies over others, because institutions are characterized by a pattern of strategic selectivity that reflects and modifies the balance of social forces and, in other words, delineates which interests, strategies, and policies can be enforced in a given context (Jessop 1999: 50ff.).

Applying a SRA to the GVC/GPN framework emphasizes the dialectical relationship between the strategic orientation of relevant actors and the institutional contexts of GVCs/GPNs. This perspective has two key implications for the theoretical-conceptual framework of this paper. First, from the viewpoint of a SRA, the confusing differentiation between "governance" and "institutional context" in the GVC framework can be dissolved, since governance emphasizes lead firms strategies, disregarding the strategies of other actors in structuring GVCs. Institutions, on the other hand, are conceptualized as "given" structures that firms have to consider in developing their strategies. A strategic-relational perspective highlights that strategies structure, and are structured by, institutions, and thus need to be analyzed from a dialectical perspective in order to understand the dynamics of GVCs/GPNs.

Second, a stronger emphasis on the institutional contexts of GVCs/GPNs places the role of the state and other actors in shaping institutions back on the agenda. In order to analyze state institutions' strategies for implementing industrial policy, in the context of local sector dynamics and GVCs/GPNs, this paper draws on the developmental regime approach introduced by Pempel (1999) and further elaborated by Wylde (2012, 2016, 2017). Based on a SRA, Wylde (2017) argued that the emergence and effectiveness of developmental or industrial policy institutions is best be understood through the analysis of two concepts: the capacity and relative autonomy of state institutions. This paper thus focuses on specific elements of the strategic selectivity of the state and analyzes the relative autonomy of state institutions vis-à-vis different groups of firms in order to assess whether (and which) particular interests have captured industrial policy institutions.

The analysis of different groups of firms' strategies, in addition, is linked to an assessment of their embeddedness, allowing for an analysis of firms in terms of their local, regional, and global relations. Hess (2004) differentiated between societal (e.g., the societal heritage of foreign firms), network (e.g., access to, and stability of, relations between buyers and

suppliers), and territorial (e.g., local or regional anchoring and "stickiness" in the host locations of foreign-owned firms) embeddedness. The embeddedness of firms goes beyond the firms' ownership, which is a particularly important criterion for differentiating between supplier firms' strategies (i.e. the different production and sourcing models of foreign-owned supplier firms), creating a bridge between ownership, GVC dynamics, supplier countries, and end-markets (Morris et al. 2016; Morris/Staritz 2017). In this paper, the concepts of sectoral embeddedness (a specific type of network embeddedness) and local embeddedness (a specific type of territorial embeddedness) are employed in order to shed light on the strength of the ties that link different groups of firms and their owners to specific sectors or locations, with important implications for the possibilities for, and limits of, upgrading (cf. Morris et al. 2016). Analyzing the embeddedness of firms thus also contributes to assessing whether the strategic interests of industrial policy institutions and firms are aligned.

3. The leather and leather products GVC/GPN

The LLP GVC/GPN is a classic example of what has been described in the GCC/GVC literature as a "buyer-driven" value chain (Gereffi 1994). These types of value chains are characterized by decentralized, globally dispersed production networks, coordinated by lead firms that control the key value-adding activities (e.g. design, branding), but often outsource all or most of the manufacturing processes to a global network of suppliers (Gereffi 1994; Gereffi/Memedovic 2003). The LLP industry has played a central role in export diversification and the industrial development of peripheral countries, in particular in countries with large livestock sectors.

The LLP GVC/GPN can be roughly divided into five key segments: (i) the livestock sector and slaughterhouses, where hides and skins are collected as a byproduct of meat production; (ii) intermediaries, often playing an important role in collecting and trading raw hides and skins; (iii) tanneries, transforming raw hides and skins into finished leather through capital-intensive processing steps (i.e., tanning [producing i.e. wet-blue leather], crusting [crust leather], and finishing [finished leather]). Many tanneries in the global (semi-)periphery do not have the capacity to perform all the processing steps and only produce lower-value and semi-finished, rather than finished, leather, with the latter being by far the most valuable processing step in tanning.[1] Finished leather is used by (iv) leather manufacturers to labor-intensively produce leather products for a variety of end-use markets (footwear, apparel, bags, furniture, etc.). (v) Buyers (intermediaries, branders, retailers, etc.) play an important role in distribution through sales channels at the wholesale and retail levels, and different leather items are traded locally and internationally at different points in the LLP GVC/GPN.

Upgrading for firms within the LLP GVC/GPN includes process, product, functional (Humphrey/Schmitz 2002), and end-market upgrading (Staritz et al. 2011). The functional upgrading trajectory for manufacturers in the LLP GVC/GPN includes cut-make-trim (CMT), original equipment manufacturing (OEM) or full-package supplier, original design manufacturing (ODM), and original brand manufacturing (OBM) (Memedovic/Mattila 2008; Gereffi 1999). Memedovic/Mattila (2008: 512) argued that a major precondition for the development of an export-oriented leather manufacturing industry is a well-developed local or nearby material supply, since global buyers in the LLP GVC/GPN prefer full-package services. The increasing relocation of global LLP production from industry-dominating China to

[1] Leather finishing can multiply the value added relative to previous processing steps, but there are large differences between market sectors (e.g. finishing for leather used in luxury cars or mass-market bags).

peripheral countries in the last decade has opened a window of opportunity for peripheral countries with locational advantages (Grumiller/Raza 2019).

In Sub-Saharan Africa (SSA), many countries have a large livestock sector, but only a few countries have managed to successfully integrate themselves into the LLP GVC/GPN beyond the supply of raw materials or low value leathers (UN Comtrade 2019). A major challenge for SSA countries is the development of a tanning industry, given the limited supply of quality raw hides and skins in the context of traditionally-organized livestock sectors. Ethiopia has one of the largest livestock sectors and suffers from similar structural constrains (Abebe/Schäfer 2014, 2015; Brautigam/Weis/Tang 2018; LGC 2016; Oqubay 2015; UNIDO 2012). Ethiopia was nonetheless able to support the development of a tanning industry and, consequently, a growing and increasingly export-oriented leather manufacturing industry through the implementation of selective industrial policy. Despite insignificant levels until the 2010s, Ethiopia accounted for 85% of leather footwear and 19% of leather product (excluding footwear) exports from SSA (excluding South Africa) by 2017 (UN Comtrade 2019).[2] Despite this success, the sector continues to suffer from limited upgrading, the marginalization of local firms, and a weak link between tanneries and manufacturers. These challenges must be understood in the context of the interrelationship between the industrial policy regime, different groups of firms' strategies, and the LLP GVC/GPN dynamics.

4. Industrial policy and upgrading in the Ethiopian leather and leather products sector

The first formal leather processing firms were established in the early twentieth century by Armenian merchants (Sonobe et al. 2009). The Derg regime (1974-1991) nationalized the economy and managed eight tanneries and six large shoe factories through the National Leather and Shoe Corporation (Abebe/Schäfer 2014: 7). Raw hide and skin exports predominated during the Imperial and Derg periods, until being banned in the 1980s to secure input for the increasing capacity of nationalized state-owned LP firms (Oqubay 2015: 214). The end of the Derg regime in 1991 marked the beginning of Ethiopia's transformation, leading to the emergence of what has been described in the literature, and not least by the government itself, as a developmental state (Clapham 2018). Ethiopia's developmentalism was inspired by East Asian development models and can be characterized as an elite-driven legitimization project, with strong links to the Tigray People's Liberation Front (TPLF)[3], in the context of a multi-ethnic state. The development model includes a mix of import-substituting and export-oriented industrialization, making extensive use of selective industrial policy (Oqubay 2015, 2018).

Until recently, Ethiopia occupied the very low end of the LLP GVC/GPN, exporting mostly raw hides and skins or low-value leathers, despite having important locational advantages: large herds of goats, sheep and cattle; low labor costs; and duty-free quota-free access to key consumption markets. The quality of Ethiopia's sheep and goat skins is internationally valued for its softness and durability. Given the size of livestock populations relative to the local market, exports and, thus, their integration into regional and GVCs/GPNs, are an important source of demand for the Ethiopian LLP industry, although the sector was almost exclusively geared toward the local market until the 1990s.

[2] Data refers to global imports.
[3] The TPLF to some extent lost influence with the coming into power of Prime Minister Abiy Ahmed in early 2018.

4.1. The first development phase (1991-1997): domestic investment and export growth

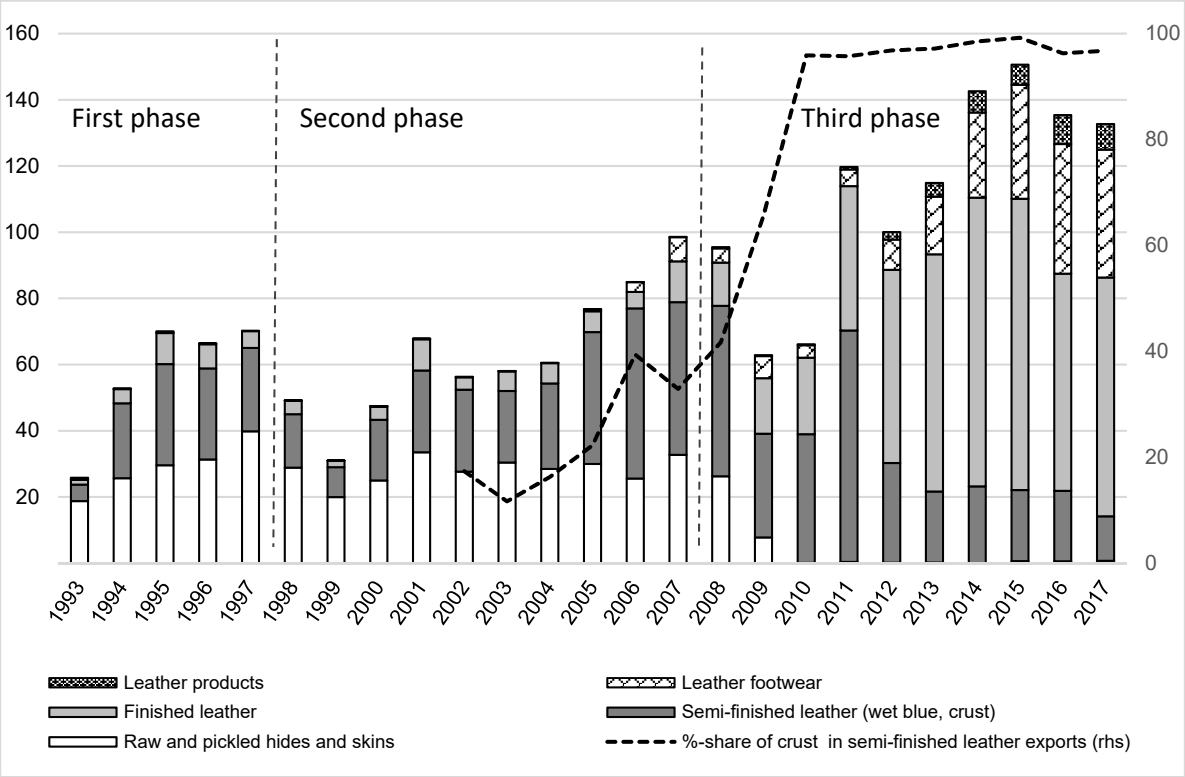
Since 1991, the industrial policy regime of, and upgrading processes in, the Ethiopian LLP sector have been divided into three phases, which are reflected in the sector's export structure (Figure 1). The first development phase was characterized by general economic reforms and the increasing sectoral dominance of privatized and locally-owned tanneries. The implementation of the agricultural demand-led industrialization (ADLI) strategy since 1994 incentivized investments[4], mostly through a horizontal industrial policy, but did not initially focus on the LLP sector. As a result, state-owned tanneries and leather manufacturing companies were privatized and a new wave of private domestic investment in tanning and leather footwear manufacturing emerged, accounting for 21% of total sectoral investment in operations between 1992 and 2014 (EIC 2018). Tanning provided an opportunity for local entrepreneurs to enter the export business and access foreign investment to finance more profitable import businesses, thereafter shaping their strategic orientation. Manufacturers, by contrast, were mostly geared toward the protected local market in light of high margins and relatively strong competition in the global market. Foreign investment in the tanning segment was largely restricted until the early 2000s in order to protect domestic tanneries from competition (Brautigam/McMillan/Tang 2013; McMillan 2012), highlighting their political influence and explaining why the sector was almost exclusively dominated by locally-owned firms during this period.

During the first period, tanneries succeeded in increasing exports and, additionally, the proportion of semi-finished leather in total LLP exports (Figure 1). The buyers, foreign distributors, and tanneries were mostly located in the European Union (especially Italy and the United Kingdom) and Asia (especially India). Informal and formal leather manufacturers, however, produced goods almost exclusively for the local market, and imports of LLP were almost non-existent during this period (UN Comtrade 2019).

The overall capacity of industrial policy institutions to directly support the Ethiopian LLP sector remained relatively weak during the first development period. The first and early second development period, however, were characterized by an increasing structural dependence of the Ethiopian developmental state on leather exports, explaining the growing economic and political weight of privately- and locally-owned tanneries in the LLP sector and the Ethiopian economy. The economic importance of tanneries was indicated by the 13% average proportion of leather exports in total exports between 1993 and 2003 (UN Comtrade 2019). The emerging power of tanneries in the Ethiopian LLP sector was institutionalized through the foundation of the Ethiopian Tanners Association in 1994, established by six state- and two privately-owned tanneries with support from the government (Abebe/Schäfer 2014: 8). The association was dominated by privatized tanneries soon after its establishment, but according to Oqubay (2015: 233), there is limited evidence that the privatization process benefitted social forces directly connected to the ruling party. There were, nonetheless, close links between the tanneries and the political elite; for example, Sheba Tannery, which was founded by the Endowment Fund for the Rehabilitation of Tigray (EFFORT) (ibid.), a business group closely affiliated with the TPLF (Vaughan/Gebremichael 2011). The strength of local tanneries contrasted with the relative marginalization of the much smaller and domestically-oriented leather manufacturers.

[4] Exports were also incentivized through a duty-drawback scheme after 1993, but interviews with representatives of Ethiopia's Ministry of Industry suggested that the system did not work well during this period.

Figure 1: Ethiopia's LLP export structure (1993-2017, USD millions)



Note: Data reflects global imports based on HS1993 (until 2001) and 2002 (2002-2017) codes in order to better differentiate between leather processing stages; (i) Leather products includes HS42; (ii) Leather footwear includes HS 6403 and 640510; (iii) Raw hides and skins as well as various leathers (HS41) differentiation until 2001 slightly differs compared with the following period. Raw and pickled hides and skins represent mostly pickled products. Semi-finished leather includes wet-blue and crust (crust is included within finished leather until 2002); (iv) %-share of crust exports includes HS2002 and HS2007 data. The data until 2006 excludes bovine leather; (v) The relatively high value of crust exports after the introduction of the export tax on crust leather may indicate some degree of smuggling or false labelling since the export data made available by Ethiopian authorities does not include any significant crust leather exports after 20011/12.

Source: UN Comtrade 2019 (WITS). Data obtained on the 27.2.2019. Compiled by the author.

4.2. The second development phase (1998-2007): selective industrial policy and intensifying contradictions

The second phase was characterized by the expanding capacity of industrial policy institutions and a more selective approach to industrial policy due to the increasing focus of the political elite on promoting industrialization and exports. The Export Promotion Strategy of 1998 first identified the LLP industry as a strategic sector for promoting exports, foreign exchange income, and employment, given its labor intensity and comparative advantage in terms of the availability of raw hides and skins and low labor costs. The government established the Leather and Leather Products Technology Institute (LLPTI) during the same year in order to provide sector-related training. The Industrial Development Strategy (IDS) of 2002/03 and the following five-year Plan for Accelerated and Sustained Development to End Poverty (PASDEP, 2005/06-2009/10) developed a more comprehensive strategy for promoting industrial development and for moving the LLP industry toward the production and exportation of higher-value leather and manufactured goods through selective industrial policy.

The measures introduced to support investment most importantly included preferential access to finance and land, temporary restricted exemptions from corporate taxes, and a liberalization of foreign investments in the tanning sector on a discretionary basis. Exports were also

incentivized and promoted through the Export Trade Duty Incentive Scheme (ETDIS) of 2001, which included an improved duty drawback and a voucher and bonded manufacturing warehouse scheme (ETDIS 2001). The government also implemented GVC-oriented industrial policy by actively attracting foreign buyers and FDI through the personal engagement of Prime Minister, Meles Zenawi, and by strategically leveraging development projects (Brautigam et al. 2018: 163f.). Locally-owned firms were supported in meeting foreign buyers' requirements, in particular through training provided by the LLPTI.

The selective industrial policy in the second development phase successfully incentivized a new wave of domestic investment, some FDI, and upgrading in the LLP sector during the mid to late 2000s. Domestic investment grew in the formal footwear sector, in contrast to minor green- and brownfield FDI in the tanning sector (EIC 2018; LIDI 2018). Leather exports continued to be dominated by low value products (pickled, wet-blue), but the share of higher-value semi-finished leather exports (crust) also increased (Figure 1). In addition, seven locally-owned footwear manufacturers started to export on a significant scale in the mid to late 2000s, generating USD 10 million at its peak in 2008 (LIDI 2018; UN Comtrade 2018). Footwear exports during that period included non-leather products and were geared toward the EU market through buyer-supplier relationships that partly developed in the context of development cooperation programs and included technical assistance exchanges between a few locally-owned firms, the Italian firm La Nuova Adelchi, and the German footwear giant Ara (Brautigam et al. 2018: 164f.; Sonobe et al. 2009: 727).

Despite this relative success, the second development period marked the beginning of intensifying conflict between the strategic goals of tanneries and high-level industrial policy institutions, highlighting the relative autonomy of the latter vis-à-vis tanneries. A key strategic industrial policy objective was the development of the finishing capacity of tanneries to increase high-value added leather exports and strengthen the link between tanneries and local manufacturers. Upgrading from semi-finished to finished leather is highly demanding (but, in terms of added value, also potentially highly rewarding) because local tanneries not only need to invest in and develop the skills to produce more technology-intensive and buyer-specific finished leather, but also attract and fulfill the demands of different types of buyers – leather manufacturers and global buyers.

In order to increase the added value of the tanning industry, which continued to be dominated by locally-owned firms, the National Export Coordination Committee (NECC) started to incentivize tanneries to upgrade to leather finishing by limiting their access to various incentives and finance after 2005 (Oqubay 2015: 222f.), but only a few tanneries increased their finishing capacity. In part, this was explained by a lack of firm accountability and monitoring that was related to the low autonomy of the lower-level industrial policy institutions in charge of implementation (cf. Oqubay 2015: 216). This paper argues that the main reason for this lack of investment and upgrading was the strategic orientation of most tanneries, shaped by their limited sectoral embeddedness: most locally-owned tanneries, as indicated above, invested in the sector in order to access foreign earnings and finance their import businesses, limiting their interest in large and risky investments. The strategic orientation of tanneries toward exports weakened the link to, and growth of, leather manufacturers, since supplying local manufacturers with export-quality leather – even when these manufacturers used these inputs for exports – reduced the foreign exchange income of tanneries in the prevailing industrial policy regime (given the lack of incentives in this regard[5]).

[5] The introduction of duty-drawbacks for indirect exporters (input suppliers for exporters) did not change the overall incentive structure.

The following statements of locally-owned leather manufacturers exemplify the situation, which continues to the present:

> They [i.e. local owners of tanneries] are only in it [tanning] for the US dollars. They are not interested in the industry. All they want is dollars to finance their side business … I think most of them have import businesses, this is the profitable business (Manager of a locally-owned leather manufacturer, personal communication, 07/16/2018).
>
> For many [locally-owned tanneries], tanning isn't profitable, but it doesn't matter to them because they are in it for their import business (Owner of a locally-owned leather manufacturer, personal communication, 07/19/2018).

4.3. The third development phase (2008-2018): a radical shift toward FDI-driven growth

The third phase was characterized by an industrial policy shift that facilitated FDI-driven investment, upgrading, and exports at the cost of locally-owned tanneries' economic and political power. The new dominancy of FDI, in particular from China, also recoupled the industry toward US and Chinese markets. The key industrial policies implemented and amended during the third development phase – to some extent – coincided with the five-year Growth and Transformation Plans (2010/11-2014/15 and 2014/15-2019/20) that prioritized foreign exchange earnings, employment growth, and the attraction of FDI in the sector, and included: (i) amended conditions and incentive structures for finance, access to foreign exchange, and input supply in support of exporting firms, (ii) strengthened sectoral institutional capacities through the reform and rebranding of the LLPTI to the Leather Industry Development Institute (LIDI), supporting the industry through policy advisory and consulting services, marketing, logistics, testing, training, and more, (iii) the introduction of export taxes on semi-finished leathers to incentivize functional upgrading of tanneries and foster the link between tanneries and local manufacturers, and (iv) the attraction of FDI to industrial zones and parks through economic diplomacy and extended discretionary authorizations of foreign investment in the tanning sector (cf. Brautigam et al. 2018; ETDIS 2012; Oqubay 2015). Although local sales continued to be restricted for foreign-owned firms, the local supply of finished leather from foreign-owned tanneries to local manufacturers for further processing and export was liberalized in order to foster the link between tanneries and manufacturers and thus improve the local supply of finished leather.

The key turning point of the industrial policy regime was a more radical approach to promoting upgrading of the tanning sector, with the introduction of an export tax of 150% on pickled and wet-blue leather in late 2008. By the end of 2011, the export tax was further extended to crust leather. From the government's perspective, the limited sectoral success in terms of upgrading, export, and employment growth during the second development period were the main reasons for the increasingly dirigiste industrial policy regime. The policy shift was implemented with opposition from local tanners and Italian buyers of semi-finished leathers alike, reflecting the eroding power of tanneries and the pronounced relative autonomy of high-level industrial policy institutions. The decreasing economic importance of tanneries was indicated by the decreased proportion of leather exports in total exports to an average of 6% between 2004 and 2011, compared to 13% in the first and early second development periods (UN Comtrade 2019). The Ethiopian Tanners Association was also reorganized: renamed the Ethiopian Leather Industries Association (ELIA), it included manufacturing and, increasingly, foreign firms, which is why the ELIA at one point supported the introduction of the export tax.

The industrial policy shift significantly changed the structure and GVC/GPN-integration of Ethiopia's leather sector in terms of FDI dominance, export structure, upgrading processes, and end markets, but important differences existed between the LLP subsectors. The transformation of Ethiopia's tanning sector was particularly pronounced due to the de facto

ban on crust leather exports in the context of more relaxed regulation of foreign investments in the tanning sector. Until this point, most tanneries exported semi-finished leather to tanneries located in the European Union and Asia for further processing (UN Comtrade 2019), and only a few tanneries had finishing capacity. Upgrading to the crust level was manageable for most tanneries, because the technical requirements were not high and the production of crusts did not require changing buyer-supplier relationships. Since 2011, tanneries in Ethiopia have had to export finished leather, requiring tanneries to invest heavily and attract new buyers at the same time, overburdening most locally-owned tanneries due to their limited sectoral embeddedness. The stricter enforcement of environmental regulations has necessitated additional investment, in particular since the 2010s, representing an additional tough challenge for locally-owned tanneries.

The export tax and the relaxed FDI regulations facilitated the new dominance of Chinese-owned tanneries at the cost of locally-owned tanneries. The re-tightening of the investment regulations in 2012, after continued pressure from locally-owned tanneries (Oqubay 2015: 215), did not change this situation: By 2018, of the 26 tanneries operating in Ethiopia, 13 of them were foreign-owned and five of them had Chinese (co-)ownership (EIC 2018). Between 2005/06 and 2007/08, before the introduction of the export tax on wet-blue leather, foreign-owned tanneries' share of leather exports averaged 30%, and stayed at roughly this level until the second phase of the export tax (Table 1). Starting with the de facto ban on crust leather exports, locally-owned tanneries continuously lost market share to foreign-owned tanneries. In 2017/18, foreign-owned tanneries exported 73%, and Chinese-owned tanneries 30%, of total leather exports, indicating the lack of locally-owned tanneries capacity and competitiveness in leather finishing. It is important to note that locally-owned tanneries did not only lose market share in relative terms, but their overall exports also significantly decreased during the third development period (Table 1). Many locally-owned tanneries thus turned to supplying foreign-owned tanneries with semi-finished leather. The shift in terms of investment, export structure, and buyers also accompanied a shift in end-markets. In 2006, tanneries located in Ethiopia exported 50% of their products to Italian tanneries and distributors, compared to 5% in 2017. China's share, on the other hand, increased from 20% to 82% during the same period (UN Comtrade 2019).

The changing structure of the tanning sector resulting from FDI did not correspond to a strong link between tanneries and manufacturers, nor to significantly increased export values compared to the expectations of the Ethiopian government. Even though employment in the tanning sector increased by 23% between 2011/12 and 2017/18 to 7,516 employees [6] (LIDI 2018), the total value of leather exports in the 2010s did not increase in a meaningful way compared to the years before the introduction of the export tax (Figure 1). Despite the increasing proportion of finished leather in LLP exports, the unresolved structural challenges discussed in previous sections, the sluggish global market in a post-crisis environment, and the comparatively low added value in the finishing stage – tanneries often only fulfilled the minimum requirements necessary to be eligible for duty-free exports – significantly hampered the development of leather exports in terms of value.[7] Instead, increased exports and employment during this period were mostly driven by finished leather goods, in particular footwear (Figure 1).

[6] As of mid-2018. Employment data differs by source; this data represents more conservative estimates.

[7] The increasing exports of manufacturing products during this period does not explain the stagnating level of leather exports, since an increasing share of these products is produced from leather imports.

Table 1: LLP exports by ownership and sector (2005/06-2017/18, averages)

	2005/06-2007/08	2008/09-2010/11	2011/12-2017/18	2017/18	Change 2007/08-2017/18
Period	Before export tax	Export tax (wet-blue)	Export tax (crust)		Change during third dev. period
No. of exporting firms	29	33	51	64	107%
FDI share of total LLP exports (%)	29	33	64	77	48 ppts
Tanneries	30	35	60	73	41 ppts.
Footwear	3	15	74	87	85 ppts.
Gloves	-	-	99	97	-
Other products	100*	0	0	0	-
Locally-owned firms' exports by value (thousand USD)	63,158	53,646	44,961	30,930	-57%
Tanneries	57,635	47,466	36,720	21,112	-66%
Footwear	5,512	6,063	6,932	6,350	-34%**
Gloves	-	-	42	179	-
Other products	-	-	1,268	3,290	-

Note: * Data represents one exporting firm. ** Exports of footwear peak in 2007/08.

Source: Own calculation based on LIDI 2018.

The limited impact of foreign-owned tanneries on the sector relates to their lack of local embeddedness. Most FDI firms invested in Ethiopia to access raw materials and sell low-value finished leather to their mother companies and global buyers abroad for processing or distribution.[8] FDI firms are (similar to locally-owned firms, but for different reasons) thus not geared toward functional upgrading, supplying local manufacturers, or adding great value by leather finishing. Instead, most tanneries process up to a level that complies with a zero export tax and only a few employ sophisticated techniques that add significant value, thus also limiting the creation of spillover-effects.

As a result of locally- and foreign-owned tanneries' strategies, local manufacturers continue to lack sufficient local supply of export-quality finished leather despite increasing finishing capacity, but the gravity of the bottleneck differs greatly between different groups of firms with regard to their ownership structure, sourcing strategies, and end-markets. Locally-owned manufacturers that lack vertical integration are the worst affected group of firms, since foreign-owned firms are either vertically integrated, have better access to finished leather supplied by local tanneries due to larger order volumes, or are able to source from abroad, which is reflected in trade data. During the third development period, with new FDI dominance, but also related to other factors such as low global prices, imports of finished leather increased from insignificant levels to USD 7 million in 2016 (UN Comtrade 2019). Smaller locally-owned firms, on the other hand, rarely source finished leather from abroad, given their lack of capacity and the high cost of imports. Interviews during field research indicated, however, that larger locally-owned footwear manufacturers rarely source finished leather from abroad due to higher costs and currently limited export orders. In light of the limited local supply of high quality finished

[8] As of 2018, only two vertically integrated firms have their manufacturing sites in Ethiopia: the stock listed glove manufacturer Pittards in the United Kingdom and the Chinese-Italian footwear manufacturer New Wings.

leather, in particular cow leather, various larger locally-owned footwear manufacturers consider to invest in tanning in the near future.

The formal leather footwear sector emerged as the main driver of employment, investment, and exports during the third development period due to increasing FDI. In 2008, the large German footwear manufacturer Ara was the first foreign footwear investor, but they withdrew from Ethiopia and sold the factory soon afterwards. Interviews with large manufacturers and retailers in the EU revealed that a number of firms considered investing in, or sourcing, (leather) footwear from Ethiopia during that time in the context of sourcing diversification strategies, but most firms decided against it for a variety of reasons, including unsatisfactory price-quality ratios, high landing costs, and relatively long lead times.

The situation changed after a business promotion trip of Prime Minister Meles Zenawi to Chinese light manufacturers in 2011, which resulted in investment by the Chinese Huajin Group, a supplier of US-based Brown Shoes (Brautigam et al. 2018: 165). Thereafter, greenfield FDI, mostly from China and Taiwan and some other countries, increased significantly (EIC 2018). As a result, FDI firms in the footwear subsector, most of which are integrated as CMT or OEM manufacturers into the LLP GVC/GPN, were the key drivers of increased employment and exports in the LLP sector in the 2010s. Leather footwear exports increased from USD 5 million in 2011 to USD 39 million in 2017 (Figure 1), with foreign-owned firms accounting for 87% of total leather footwear exports in 2017/18, relative to 3% during the 2005/06 to 2007/08 period (Table 1). Consequently, there was a shift in end markets from the EU to China and the US (UN Comtrade 2019). Employment[9] in the footwear sector also increased significantly from 4,592 employees in 2011/12 to 11,145 employees in 2017/18, with six foreign-owned firms accounting for roughly 71% of total jobs in the sector in 2017/18 (LIDI 2018).

Locally-owned footwear firms were not so successful, and only two new formal operational firms were established during the 2010s, but many existing firms increased their capacity (LIDI 2018). Locally-owned firms tend to be geared toward the local market, providing significantly higher margins in the context of high tariffs on imported leather footwear, because foreign-owned firms are not allowed to supply the local market. Interviews during the field research suggested that most formal locally-owned footwear firms tried to increase exports in light of increasing local competition, but with very limited success: the total exports of these firms have stagnated at a relatively low level since the 2008/09 to 2010/11 period (Table 1), and exports only account for an insignificant share of their total income. Anbessa Shoe is the only company with strong export orientation and it recently built a new factory to international standards, with a comparatively large capacity of 10,000 pairs of shoes per day.

The development success of other leather goods subsectors differed greatly across products. Ethiopian sheep leather is particularly renowned for its softness and is thus valued by glove manufacturers worldwide. No local leather glove production existed until the arrival of FDI in the late 2000s and early 2010s in the context of the industrial policy incentives, given the lack of a local and regional market due to climatic conditions. Glove manufacturing and exporting is thus almost exclusively[10] in the hands of three FDI firms (Pittards in the UK, Otto Kessler in Germany, and Lyu Shoutao in China), two of which are vertically integrated (Table 1). Formal and informal locally-owned manufacturers, on the other hand, have dominated other leather manufacturing sectors (handbags, trunks, garments, belts, wallets, etc.). A growing number of formal and mostly small manufacturers emerged during the 2000s, and since the early 2010s, an increasing number of export-oriented small and medium enterprises have been

[9] Footwear employment data differs by source; this data represents more conservative estimates.

[10] Only one locally-owned tannery (Bahir Dar Tannery) recently started to test the manufacturing of leather gloves and is geared toward Northern European buyers.

established. These firms suffer the most from the limited local supply of export-quality finished leather.

In summary, the new FDI dominance that emerged in response to the introduction of the export tax, and the relaxed regulation of foreign investment in the tanning sector, marginalized locally-owned firms to different degrees and did not live up to expectations (with the exception of the leather footwear and gloves subsectors). As a result, the support of the political elite and high-level industrial policy institutions for these policies eroded, and the opposition of locally-owned tanneries intensified. Following the re-tightened regulation of foreign investment in tanning in the early 2010s, the export tax on crust leather was abolished for locally-owned firms in 2019, and even the export tax on wet-blue leather is currently being examined (Mai 2019). The reform threatens local input supply for foreign owned tanneries and manufacturers, potentially initiating a new industrial policy regime and "fourth development phase".

This policy shift highlights that the Ethiopian industrial policy institutions have maintained a high degree of autonomy vis-á-vis foreign-owned tanneries and manufacturers interests, relating to their (so far) limited economic impact. The latest reforms also suggest that the high-level industrial policy institutions underestimated the negative effects of the reforms on locally-owned firms during the third development period. Even though the reform of the export tax is likely to improve the situation of locally-owned tanneries, their now weakened financial position and the need to (re-)establish new (or old) buyer relationships may necessitate additional support for tanneries from an industrial policy perspective.

5. Conclusion

This paper has argued that much is to be gained from linking the GVC and GPN frameworks to a SRA and developmental regime perspective in order to better understand the structure, dynamics and intersections of the state and GVCs/GPNs. The GVC framework focuses too much on the role of lead firms, underemphasizing the impact of upstream firms and state institutions in structuring GVCs/GPNs, which is underscored by the conceptual difference between governance and institutions. The GPN framework to some extent overcomes the narrow focus of the GVC literature, but lacks a more profound theorization of the state. Introducing a SRA to the GVC/GPN framework not only shifts the perspective to the strategic form of institutions and strategies of actors, but also includes the strategies of state institutions and non-lead firms in the framework. The operationalization of the framework through the conceptual lens of the developmental regime approach and firms' embeddedness, in turn, increases the explanatory power of the framework in assessing the strategies of state institutions and firms. Overall, the framework provides the analytical tools to better take account of the strategies of relevant actors in structuring and re-structuring industrial policy regimes, local sectors, and GVCs/GPNs, with important implications for upgrading, coupling, and broader development processes.

Empirically, the paper has shown that the political elite-driven industrial policy regime in Ethiopia had important implications for the development and GVC/GPN integration of the LLP sector, which was soon identified as strategic export sector, given its pronounced locational or comparative advantages. Economic transformation, upgrading, exports, and employment growth was supported through a wide range and changing set of selective industrial policies. The industrial policy regime during the three development phases was clearly shaped by the interests of the political elite, giving high-level industrial policy institutions a relatively high degree of autonomy vis-à-vis particular interests in the sector. Even though the implementation bodies lacked the same level of autonomy, the industrial policies benefited the growth, and to some extent the upgrading, of the LLP sector. The industrial policies also paved

the way for the increasing sectoral dominance of foreign-owned firms during the third development period, in particular at the cost of locally-owned tanneries, restructuring the GVC/GPN integration from the EU toward the Chinese and US markets. The main challenge for the industrial policy regime is the limited sectoral embeddedness of locally-owned tanneries and the limited local embeddedness of foreign-owned tanneries. The strategic orientation of these firms has hampered the creation of a joint project of transformation (*embedded* autonomy) between the state and firms.

The case study, in addition, contributed to an empirical research gap in the GVC/GPN literature on upstream firms' and state institutions' strategies, highlighting that, in addition to lead firms, it is not sufficient to analyze "supplier firms" in different stages of production, or "the state", since these groups may consist of a variety of different groups of actors in terms of their strategic orientation. From an industrial policy perspective, the case study has also highlighted the importance of going beyond focusing on the strategies and interests of buyers in GVC-oriented industrial policy, as suggested by Gereffi and Sturgeon (2013). Instead, the strategies of all relevant actors (e.g., different groups of upstream and supplier firms, state and civil society actors, etc.) need to be taken into account in implementing industrial policy effectively.

Finally, applying a SRA in GVC/GPN research points to two under-researched areas in this field that were beyond the scope of this paper. First, GVC/GPN research so far fails to take account differences and conflicts within and between state institutions and strategies that shape the institutional underpinning of GVCs/GPNs and reflect power relations between various social forces. Secondly, state institutions' strategies on different regional scales may play an important role in explaining FDI strategies (e.g., Chinese FDI strategies that need to be understood in the context of Chinese state institutions strategies) and coupling processes. Future research on how strategies of different actors' structure- and restructure the interrelated and multi-scalar institutional underpinnings of states and GVCs/GPNs may more clearly focus on differences within and between state institutions and more clearly take into account the interrelationship between state and firm strategies on different regional scales in shaping GVC/GPN dynamics.

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