



APRA Brief

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Policy incentives and agribusiness investment in Ethiopia: benefit or deadweight?

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Key messages

- The most important factors for agribusiness investment in Ethiopia are investors' motivations and experiences, market potential for growth and profit, access to suitable agricultural land and water for irrigation and infrastructure.
- Ethiopia has been promoting business investment in agriculture since the turn of the century, using fiscal incentives such as exemptions from paying tax and import duties, and leasing land at concessionary price.
- While fiscal incentives are beneficial to agribusinesses, they were not judged to be crucial in attracting investment.
- There is a prevalent misuse of tax privileges where loans and foreign exchange permits designated for investment were used to develop other business, such as real estate in cities.
- Rules should be enforced and loopholes addressed to prevent further diversions or misuse of tax privileges.
- Agricultural growth programmes conducted by donors and non-profit organisations indirectly, and directly, expand investment in infrastructure, providing technical support to smallholders and linking them with key markets.

Introduction

Since the turn of the century, Ethiopia has been vigorously promoting business investment in agriculture, using fiscal incentives such as exemptions from paying income tax and import duties, and leasing land at concessionary prices. Whether such policies and incentives drive business investment remains an open question.

This brief summarises the findings and conclusions of the study "Policy approaches to business investment in agricultural commercialisation in Ethiopia", supported by *The Agricultural Policy Research in Africa (APRA) consortium*. The study was based on five case studies of agribusinesses and in-depth interviews with business leaders, ten key informant interviews, and a review and synthesis of academic and grey literature on Ethiopia.

It shows that the main drivers of agribusiness investment are investors' (businesses or individuals) motivations and experiences, market potential for growth and profit, availability of suitable agricultural land and water for irrigation, infrastructure, and peace and stability in the country. Fiscal incentives, while beneficial to agribusinesses, were not found to be critical in triggering investment. It also shows a widespread misuse of tax privileges where loans and foreign exchange permits meant for agribusiness investment were used to develop businesses such as real estate in cities. The paper recommends enforcing rules and addressing loopholes that lead to diversion or a misuse of tax privileges.

Background

Agriculture accounts for close to 35 per cent of Ethiopia's gross domestic product (GDP), and 95 per cent of agricultural GDP is produced by about 15 million smallholder farmers. Agriculture is the main livelihood for over 70 per cent of Ethiopians and generates more than 70 per cent of the country's foreign exchange earnings. Recognising the key role agriculture plays in the economy, successive governments in Ethiopia have emphasised smallholder agriculture development

providing, among other things, improved farm inputs and extension services. Recent evidence shows smallholder agriculture responded to the development strategies being pursued and Ethiopia has been experiencing sustained annual economic growth of around 10 per cent for over a decade. Agriculture grew by around 6.5 per cent per year, reducing the number of people living below the poverty line from 44.2 per cent in 2000 to 23.5 per cent in 2016. Despite the growth, Ethiopia remains food and nutrition insecure as agriculture remains predominantly subsistence, dependent on rain and vulnerable to frequent droughts. This is despite the fact that Ethiopia has abundant land resources, particularly in the sparsely populated lowlands, with an estimated 74.3 million hectares of land suitable across the country for agriculture, of which only 14.6 million are being used by smallholders.

Policies and incentive structures to agribusiness investment

Ethiopia has different types of institutional and policy measures and incentive packages aimed at promoting business investment in agriculture. The drive towards commercial agriculture and increasing engagement of the private sector has been part of the state-led 'developmental state' strategy, by which Ethiopia aims to reach middle income country status by 2025. Consequently, through the participation of private investment, Ethiopia aims to expand its conventional export commodities such as coffee, oilseeds and pulses. By boosting commercial agriculture, it also aims to produce sufficient quality inputs for the expanding manufacturing sector, such as cotton for textile industries. To implement these strategic objectives, in its second Growth and Transformation Plan the government set aside 3.1 million hectares to be transferred to commercial developers by the end of 2019/20. It also strengthened agencies - such as the Agricultural Investment Land Administration Agency – at federal and regional levels to facilitate land transfers.

Policy incentives primarily aimed to accelerate economic development, through enhancing the role of the private sector in developing natural resources by supporting access to improved knowledge and technology. While increased employment and foreign exchange earnings are essential components, policy incentives also aimed at encouraging balanced development among regions and intersectoral linkages. Contained in a series of 'Investment Proclamations', the government also provided fiscal incentives to both foreign and domestic investors, including:

- Duty free import privileges on machinery. While import duties are generally low, such privileges exempt investors up to 35 per cent of the value of imports;
- Nine to fifteen years of tax holidays, including exemption from paying 30 per cent corporate income tax. Agribusinesses operating further away from relatively developed central locations benefit the most from tax relief;
- With the exception of raw skins and hides, no export tax is levied on exports originating from Ethiopia.

A wide range of other benefits include: making available subsidised land¹ and investment loans; a one-stop-shop facility for investors



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to obtain a business license and secure access to land; investment guarantees and repatriation of profits and dividends.

The study found that donors and non-profit organisations supported major programmes such as the Agricultural Growth Programme directly, and indirectly supported business investment. Such programmes expand investment in infrastructure, make concerted efforts to link smallholders with markets/major value chain actors, and provide technical support and access to technologies. One case study agribusiness received technical support and training in developing and distributing improved seeds to smallholder farmers. Finally, some business investors (particularly from certain emerging economies such as Saudi Arabia) were encouraged by their home country governments to invest in Ethiopia.

Agribusiness response to policies and incentives

Accurate and reliable data are hard to source for business investment in Ethiopian agriculture, as data is dispersed and vary by different agencies at federal and regional levels. Nonetheless, statistics from the Ethiopian Investment Commission (EIC)² show:

- From 2000-2017, 11,210 agricultural investors were licensed. Over 90 per cent of these were small to medium farms (below 25 ha; and 25-5000 ha). Many are domestic investors or from the Ethiopian diaspora. In the Gambela region alone, some 200 farms were licensed to the diaspora³.
- Of the total licensed investment projects from foreign investors, at least 700 were above 5000 ha, originating from emerging economies such as India, Saudi Arabia and Turkey. At least two of these large projects were leased at 100,000 ha each. One was Karaturi Global whose concession for 100,000 ha land was revoked for reasons including significant under-development of the leased land.
- Of the total licensed projects only 20 per cent (or 2,242) went on to partly or fully start operation.

The cut flower sector, however, demonstrated many successes and grew from five agribusinesses in 2002 to over 100 in 2016.

¹ While land lease prices varied from region to region, and within regions, the data we put together based on information from 38 farms averaged 169 birr (around US\$6) per ha per year. The most common range of lease duration was 35-50 years.

² See: Ethiopian Investment Commission at: <http://www.investethiopia.gov.et/index.php>.

³ See 'Barren farm lands'; The Reporter, December 31, 2016, Vol. XXI No. 1060.

Growth was largely attributed to access to land and infrastructure for exporting products, and access to concessional loans. These privileges were more important to the investors than fiscal incentives. In addition, the sector generated over 180,000 jobs in 15 years, and over a billion US\$ in foreign exchange earnings, US\$245 million export revenue in 2016/17 alone.

Why do many commercial licenses fail to start? Interviews with our key informants and business leaders revealed a series of challenges, including:

- Lack of infrastructure (such as feeder roads) and competing claims by local communities over the land being transferred for commercial farms;
- Lack of detailed information on the suitability of millions of hectares of land reserved for commercial farming;
- Lack of political stability, notably over the past three-four years.
- Some investors lack knowledge, agricultural skills and the capacity to manage large tracts of land;
- Apart from issuing licenses, the government lacks the capacity to filter competent investors and monitor implementation;
- Lack of or poor coordination between federal and regional government bodies in licensing and follow up licensed investments.

Do policies and incentives matter for investment?

Policies either attract or push investment away. For nearly two decades, the policies and policy narrative have been largely pro-business (albeit slowly and selectively). Policy incentives have been increasingly supporting shifts in millions of hectares of publicly administered land to agribusinesses. Land was allocated to investors on a long term lease basis, often 35-50 years and, on average, 169 birr (US\$6) per ha, although our interviewees consistently noted that lease prices were low and did not often reflect its quality.

Interviews showed that large farms, in particular, benefited from fiscal incentives. For example, one of the case study agribusinesses imported capital goods worth US\$80 million and was exempted around US\$8 million in import tax. The same business also benefited from a 'rock-bottom' lease price, which was as low as 20 birr/ha per year. Large and foreign agribusiness also enjoyed concessionary loans from the Development Bank of Ethiopia (DBE), although this failed to achieve the desired objective of generating foreign exchange.

However, relatively smaller businesses that often cater for domestic markets did not benefit from the full range of fiscal incentives, by not importing large quantities of capital goods and/or not exporting their produce. These agribusinesses complained about the excessive bureaucracy and high transactional costs of accessing incentives.

While incentives, particularly fiscal, are beneficial to business they were not key to business investment. Rather, in-depth interviews with agribusiness leaders demonstrated that investment was supported by:

- Availability of (and access to) suitable agricultural land;
- Growing prices and opportunities from export markets;



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- Personal motivations, training and experience in the sector;
- Long-term prospects to grow the business and make a sustained profit.

Moreover, a close investigation of the case study agribusinesses showed that:

- One of the largest agribusinesses was vertically integrated (from production to processing and exporting), with few or no linkages to small-scale farmers and smallholders. It failed to support the government's objective of skills and technology transfer to local agribusinesses and smallholder farmers.
- However, some small agribusinesses (often supported through donor and NGO programmes) made links with small businesses and smallholder farms and were able to engage with 2,000-3,000 as their suppliers or buyers.
- Our evidence also showed some agricultural investment license holders abusing their rights and privileges and engaging in lucrative business, such as real estate development in cities. Some loans and foreign exchange permits to purchase tractors did not materialise on farms. Such malpractice also led to perverse policy outcomes, such as the displacement of farmers from their land, which was then not used as intended, etc.

Conclusions and policy messages

Are incentives deadweight? The evidence clearly suggests that fiscal incentives, in particular, are non-consequential to business investment. However, access to subsidised farm land and other non-fiscal incentives (in the form of one-stop-shop facilitation) are more effective, even if such services do not primarily serve smaller local agribusiness. Overall, despite substantial incentives, investments often fail to start and meet the intended development objectives of the country.

Based on our findings and conclusions, we recommend that: First, ensure that tax privileges are not abused: the government needs to provide strict directives to enforce rules, and address any loopholes that lead to the diversion or misuse of tax privileges, notably loans and foreign exchange permits meant for agribusiness investment.

Second, ineffective incentive instruments should be revised and unavoidable taxes used to develop infrastructure that enhances investment and development of the agriculture sector. However, prior to withdrawing any incentives, the benefits and costs of incentives (fiscal and non-fiscal), including the delivering of services (such as by EIC and large DBE loan) and the loss of revenue from any incentives offered to investors, needs to be empirically justified.

Third, government to revise guidelines on the size and price of land transferred through lease: proposed large (or mega) farms either failed to start or started at significantly smaller sizes. Neither the physical infrastructure (such as roads) nor the social and economic fundamentals (such as the availability of local health facilities) support the emergence of such mega farms in remote areas. Poor infrastructure has also been a challenge for managing farms in excess of 25 000 ha. Land lease prices are often low and do not reflect its contribution to output and access to water, infrastructure and market. Consequently, the government should revise the size and price of land for leasing.

Fourth, improve information on agribusiness investment opportunities: agribusiness promoting agencies to provide reliable information on size and suitability of land for investment, access to infrastructure, markets, etc. Likewise, reliable information is needed to promote investment in the livestock sectors such as on breed types.

Fifth, government and donors to facilitate more inclusion of smallholders in the emerging agribusiness sub-sector. Increasing linkages between smallholders and agribusinesses (for example through contract farming) is likely to increase commercialisation and growth in agricultural production and value addition.



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Finally, government policy should encourage agribusinesses emerging from within the smallholder sector. As attuned to agriculture, smallholders capable of growing into agribusiness should be supported by the incentives structure so that they do not miss out on tax free access to relevant technologies and access to land, and opportunities to transition into agribusinesses.

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Image captions:

Cover - Workers harvesting from a commercial farm in Ethiopia.

Page 2 - Mobile phones and digital technologies are helping improve agribusiness opportunities.

Page 3 - Workers in a food process plant in Ethiopia

Page 4 - Beyene Abebe, is one youth gaining economic opportunity as a mechanisation service provider.

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