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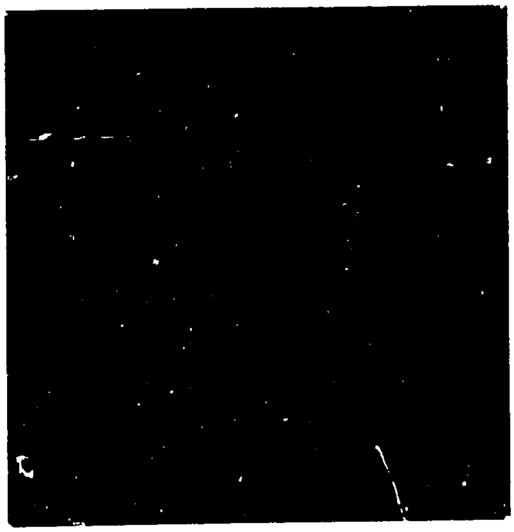

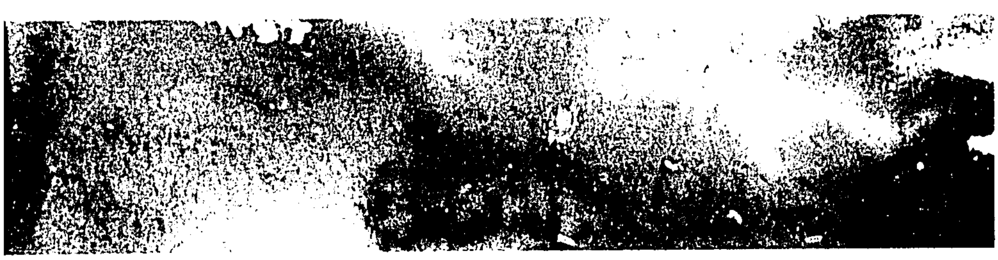

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ETHIOPIA COTTON SECTOR ASSESSMENT

18 March 1994
-16 May 1994

FINAL REPORT

CONTRACT NO
LAG-4200-I-00-3057-00

PROJECT NO: 663-0510

APPROPRIATION NO: 72-114/51014

PIO/T NO: 663-0510-3-40003 & A.I.

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ET.874 *November 2 1994*

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ACKNOWLEDGEMENTS

The team would like to thank a number of people in Ethiopia who have made this consultancy both productive and enjoyable. Much help and assistance was provided by :

- the local USAID office, in particular Dr Martin Hanratty who conceived the need for such a study, and his staff, the AID PL 480 Coordinator, Ato Assaye, and Mrs Aster Worku;

- members of the Government , state and private farms, factories, banks and institutions, including the Prime Ministers Office, the Agricultural and Industrial Development Bank and the Commercial Bank of Ethiopia.

- the staff at the Cargill PLC subsidiary office, Ethiopian Commodities PLC in Addis Ababa, in particular Ato Abdulrazak Sheriff and his senior secretary Mrs Alfia Shash;

Throughout, the kind support and friendly cooperation was much appreciated. To those mentioned, and to so many others, the team feels a deep sense of gratitude.

ETHIOPIA - COTTON SECTOR ASSESSMENT

1 PREFACE

This sector assessment was undertaken in Ethiopia with the benefit of visits to principal cotton and textile production centres throughout the country supported by detailed meetings held in Addis Ababa. The review team comprised the following personnel: Professor John Cockcroft - Team Leader and Marketing Specialist; Hector McKilligan - Cotton Production Expert; Neil Hammond - Textile Factory Production Expert; E.A. Pepin - Economist and Financial Analyst; and Baery Yusuf Wober - Associate Consultant to the team.

The review was undertaken within a tight time schedule. The Team Leader/Marketing Specialist arrived ahead of the team in order to make the necessary administrative arrangements, and remained in Ethiopia after the departure of the other experts in order to consolidate the team's findings into this single report. The Textile Production Expert and the Cotton Production Expert spent a significant proportion of the allocated time visiting Ethiopian cotton farms and mills. The study Economist/Financial Analyst was present for the final 18 days of the period in Ethiopia.

Separate working papers have been produced by each of the team members. These paper remain unmodified, and contain the opinions and views of each individual member of the team. In some cases the views expressed are controversial, but are intended to provide a technically explicit and candid view of the individual authors. The working papers should be viewed in this light, and used as discussion documents for further consideration by the appropriate Government Authorities. Throughout, it is recognised that matters of considerable importance, particularly those relating to the restructuring of the cotton industry, are the concern of professionals involved with the industry and Government, and not of outside experts engaged for only a relatively limited time in undertaking this review.

This report consolidates information and key conclusions of each of the working papers, it does not repeat much of the detailed data and discussion which are the subject of each specialists' report. Section 2 provides a historical perspective of the industry and events leading to the current status of the industry. Section 3 sets out the principal issues and problems facing the industry today. In section 4 options for restructuring the industry are laid out for Government's consideration. Finally section 5 summarises the future structure of the industry and the immediate data and analyses that are required to implement an effective restructuring programme. The report is supported by appendices I to IV each providing key data and conclusions from the individual working papers.

Costs of rehabilitating the cotton industry, estimated at some $500 million, are high compared to total donor assistance to Ethiopia. However, implementation should be phased to take place over a number of years, and only after further more detailed investigations of individual components of the restructuring process have taken place. Failure to act will have serious repercussions, hampering the export earning potential of the five fully integrated textile plants, (which, with the necessary rehabilitation and restructuring, have the potential to bring in foreign exchange earnings of some US$ 1.0 billion per annum), and could result in the collapse of the industry as a whole.

Restructuring is critical to any future plans to privatise individual components of the cotton and textile industry. It is highly appropriate that the Government should seek assistance from international aid agencies for this purpose.

Throughout the restructuring process, fundamental policy issues will need to be resolved, particularly those concerning plant indebtedness, labour costs and structure. In the final analysis, it is not realistic to suppose that potential aid sources would participate in restructuring without a clear understanding of Government's commitment to resolving these issues and to future privatisation of the industry.

2 THE LEGACY OF THE PAST

The cotton sector remains the largest industrial agricultural and handicraft employer in the economy. During the Mengistu era, employment in the sector - some of it in new cotton mills or on state farms which were designed to serve a centrally planned economy - expanded rapidly. The sector became the largest contributor to Gross Domestic Product. However, significant social costs and overemployment became associated with the state owned farms and mills where jobs were guaranteed for life and the aged and ill continued to receive support from their place of employment. The cost of providing this social security was borne by individual farms and mills.

During this period the industry was a net exporter of lint cotton, fabric, and made-up goods, and, as part of a centrally planned system, the sector supplied approximately 98 percent of domestic cotton needs. Cotton supply and industrial production were more or less in balance, with consumption at approximately 30 Kt. of lint per annum.

The state farms, which were the major producer of industrial cotton, achieved good yields but with little regard to the costs of production or their impact on the land resource (over-watering resulted in widespread salinisation).

Huge new integrated factories were built and designed to supply a centrally controlled marketing system. However, fabric production and design was standardized and uniform colour and types produced with little regard to individual consumer taste. While technically the mills operated well, they were designed to operate under a centrally controlled system with little regard to cost and to the realities of consumer demand under a free market economy. When the political and social systems under Mengistu broke down, the mills struggled to compete in a market-led environment where efficiency in production and an ability to respond to changing consumer demands are critical to survival.

In summary , the Transitional Government of Ethiopia (TGE) is therefore left with a legacy of:

- technologically inflexible plants and state farms, each carrying a burden of high social costs, with unmotivated operatives and management without the entrepreneurial background or experience;
- a sector that has been damaged by destruction and neglect during the war, particularly in the cotton growing areas; and
- a sector severely hampered by the lack of foreign exchange.

3 CURRENT STATUS AND PROBLEMS

3.1 GOVERNMENT POSITION

The TGE has endeavoured to initiate measures consistent with the promotion of individual freedom, liberalisation, de-regulation, retraction from state control with a measured development towards full democratization. In the cotton sector, the Government has expressed an intention to encourage conversion of state farms and mills to private ownership. However, under the current structure, none of the state owned businesses can operate under international terms of competitiveness, and therefore would be of little interest to private investors. To meet this stated objective, an interim period of structural change must be implemented by the Government, the scale and cost of which suggests that donor assistance will be required.

The process of transition presents the Government with an array of extremely delicate political, economic and social considerations which cannot be resolved overnight. Failure to attain political and social transition reasonably quickly and comprehensively could be disastrous both in terms of continued donor assistance and domestic political support for change. In economic terms however, it will be years before the positive commercial and individual benefits which the restructuring process will bring, can be realised and self-sustaining.

3.2 COTTON AND TEXTILE PRODUCTION

In the meantime, the operations of the cotton sector continue to be badly affected. The industry has experienced decline in cotton production and disruption to fabric production and sales. Of particular note national lint cotton production is estimated to have fallen to a mere 5 Kt. per annum, although there are some signs that this may be on the increase again. Considerable stocks of domestic cotton exist either with farms, ginneries or at the textile factories themselves - possibly as much as 15-20 Kt. In addition fabric stocks at the factories and at the former centralized National Textile Distribution Agency are large, in many cases with a value estimated in excess of Birr 15 million.

The reasons for the current situation are various, but some of the principal factors affecting the sector are:

- Lint cotton production has been severely impeded by neglect and destruction during the war period.

- New liberalisation policies allowed land to be used for any crop or purpose required by the new owner(s). Consequently some of the cotton farms have been broken up and operations put into private hands. In most cases this has simply meant that local people have moved back onto the land with their livestock and begun producing non-cotton crops.

- Cotton yields have declined as a result of damage from cattle, increased salinity problems, disrupted irrigation systems, faulty pumping equipment, exacerbated by a lack of spare parts for farming equipment.

- State Farms have been made into autonomous "Agricultural Development Enterprises", which basically means that they have no further access to state funding to cover operation and maintenance costs, and have consequently been forced to cut back production activities.

- These operational problems were further compounded by competition from imports of American cotton supplied under grant terms, which depressed domestic cotton prices and weakened demand from the mills.

3.3 IMPACT OF USAID COTTON CREDITS

Generous USAID cotton credits in 1992 and 1993 supplied over 26 Kt of cotton, valued at approximately US$50 million. The purpose of this assistance, which was part of a larger relief and rehabilitation program, was to assist the sector in meeting its raw material requirement. However, differing views exist about the success of USAID assistance. On the one hand, it is argued that it has enabled the sector to rebuild; it has maintained production and employment at the factories; and, it has assisted regional stability and development. On the other hand, there is evidence to suggest that much of the American cotton has ended up in cloth stock, while large quantities of national production, unable to compete with the American imports, remain in bale or yarn stock (approximately 6 Kt equivalent).

Cotton imports enabled the mills to stay in production maintaining high volumes, but at low productivity and high cost. Although the cotton was provided as a grant to Ethiopia, delivery to the mills was made on credit terms through the Ministry of Finance (MOF). Delivery in 1992 initiated a debate between the MOF and the mills concerning the exchange rate that should be used in determining the Birr price of cotton. The mills argued for valuation at the old fixed exchange rate of Birr 2.0 to the US dollar, and the MOF pressed for a rate closer to the auction foreign exchange rate of Birr 6.00 to the US dollar. Uncertainty over the cost of the cotton and the abundant supply at mill warehouses led to the virtual cessation of domestic cotton purchases by the mills.

There is evidence to suggest that little of the fabric produced using imported cotton has yet reached the market. The situation is as follows:

- some of it has found its way into factory warehouses or is in stock elsewhere in the national distribution channels;

- it has been estimated that approximately 23 per cent of the American cotton is currently in cloth stock, and a further 46 per cent is held at the factories in bale form;

- the Ethiopian Domestic Distribution Corporation holds approximately 6 million sq. metres of fabric equivalent to about 1400 tons of lint.

In summary, it would appear that some 75 per cent of the USAID cotton supplied has not reached the market, and estimates of work in progress would increase this figure to about 86 percent.

3.4 SALES OF DOMESTIC FABRICS

Sales of fabrics produced by the modern industrial textile sector in Ethiopia have slumped. Several factors account for this:

- Most importantly, locally made fabrics have been unable to meet consumer taste for higher quality and better designs that has emerged with the liberalization of the economy.

- Excise regulations were insufficiently tight to prevent large quantities of new and second-hand imported goods flooding the Ethiopian market at competitive prices, and able to meet these new consumer tastes.

- With 90 percent of factory output in sheeting, drill and twills at prices double imported garment prices, factories were unable to compete in the domestic market.

The stark domestic market position is therefore:

- domestic fabric stocks are huge and remain unsold because they cannot compete either in terms of price or quality with illegal imports of fabric and garments. Stocks are currently valued at Birr 200 million or US$ 20 million;

- one third of last year's production of approximately 93 million sq. metres remains in warehouses. This equals five months of mill output at current production rates; and,

- domestic demand is being met particularly by hand loom fabric (approximately 70 million sq. metres per year) and by imported garments and fabric. Limited fabric produced by the industrial sector is being sold in the market.

3.5 IMPACT OF STRUCTURAL RIDGIDITIES ON OPERATIONS OF THE INDUSTRY

This has had serious economic consequences for state farms and plants. They are facing a collapse in demand for their product, spiralling costs, lower production (resulting from shortages in spare parts, raw material etc), and lower productivity of labour and machinery. State farms have survived by securing operating loans from the bank against the value of unsold lint cotton stocks. However, as stocks can degenerate rapidly in adverse weather and poor storage conditions, their value as collateral has diminished. The farms therefore, have largely exhausted this line of credit, and are currently searching for additional financing and access to foreign exchange required to purchase equipment, spare parts and inputs needed for the 1994/95 growing season.

Textile mills, unable to maintain plant and equipment, are facing rising unit costs. Operating losses are increasing, and their liquidity has declined as output from the plants remains largely unsold. Wages have been paid out of ever-increasing overdrafts, and the mills are having difficulty servicing their loans. Their immediate survival depends on the continued patience and understanding of the Banks.

Poor liquidity has further highlighted the structural rigidities in the industry , and their impact on production costs and marketing arrangements have become more pronounced. For example, two of the newest factories at Arba Minch and Awassa were designed to be inter-supporting during the previous regime. Now, there is no co-operation whatsoever. Shortage of finance has led Arba Minch to delay payments to Awassa for finishing fabric. Awassa in retaliation is holding Arba Minch's goods as security and refuses to process further, except at uncommercial prices.

As marketing relationships have become strained, pressures have exacerbated the impact of structural anomalies. A case in point is the presence of two modern stencilling machines at Awassa. Because of the conflict with Arba Minch there is now only enough fabric to support the operation of one machine. In the Bahr Dar, on the other hand, the modern spinning and weaving plant, upgraded by the Belgians in 1989 is operating at 50% of its potential output because of an outdated finishing section, in particular the lack of adequate stenciling capacity.

3.6 FINANCIAL STATUS

These structural anomalies, in part, have led to low productivity and high costs. Consequently, the sector is currently working on huge bank overdrafts and large loans. The team estimates that operational deficits for the mills alone aggregate to approximately Birr 100 million per year and are likely to rise as plants are forced to continue operation with decreasing supplies of domestic and imported inputs. The breakdown of this estimate is given in the following table 3.1.

Table 3.1
Financial Exposure of Textile Mills June 1993

Item	Value (in thousand birr)
Annual cost of redundant workers	32,410
Government grants to cover 1993 enterprises consumption	19,950
Accrued interests on loans that enterprises cannot pay	43,510
Interest costs to the Government :	
- on borrowings to cover salaries and wages	4,210
- on borrowing to cover consumption	1,425
- on borrowing to cover interest payments	5,656
Annual Total	98,160
Monthly cost	8,180
Daily Cost:	
- in birr	272
- in US$ equivalent.	US$ 44,335

Total bank exposure is believed to be in the order of Birr 300 million in soft loans and Birr 50 million in overdrafts. With approximately Birr 90 million in stock in hand, the latter estimate is not unreasonable and may be underestimated. Further financial details can be found reviewed in the working papers produced by the textile specialist and the financial analyst.

Stock levels can be expected to rise significantly in the future as factory production continues to deliver unwanted output to the warehouse and not to consumers. For example, in March 1994 textiles valued at Birr 28.8 million (7.2 million square metres valued at an average of Birr 4.0 per square metre) were produced. Assuming that factory production were halved, due to low domestic production and an inability of plants to access foreign markets, and that only half of what is produced goes to increase stock levels (this is half of current stock build up rates), stock levels could easily rise to Birr 150 million (Birr 50 million for existing stocks, Birr 90 million for new stock, and Birr 10 million in interest bearing costs). In addition, unless the banks adjust the value of the above stock to reflect rapidly changing import conditions, bank loan portfolios could be overvalued by as much as 40 to 50 percent by the end of the year period.

Like their state farm counterparts, the mills will likely find it difficult to secure additional capital to access the foreign exchange required to import lint cotton. Unless cotton credits can be arranged in the period of sector rehabilitation, clearly the industry is in jeopardy of collapse. This will be evident as early as September this year, with progressive reductions in performance from then on. Even a domestic harvest of say 5.0 to 8.0 thousand tonnes will not materially affect the situation until it works its way into the mills in, say, February, 1995. Even then, domestic production will be at the margin of requirements.

In the immediate term, assistance is required to both pay domestic growers to enable and encourage them to replant cotton; and to make financing available for external purchases of lint cotton on the world market. After the experience with the US cotton import credits, however, the precise form and nature of assistance needs to be carefully worked out by TGE, to assure that imports only meet real current needs and do not interfere with the promotion of domestic growing.

4 OPTIONS FOR GOVERNMENT CONSIDERATION

4.1 GOVERNMENT POSITION AND STRATEGIC APPROACH

Despite the problems outlined above, the Ethiopian cotton sector possess many important and modern features that could form the basis of a successful industry. Notably:

- the basic infrastructure of plants, gins and farms which, aside from their current operating difficulties, are valuable national assets which, the consultants believe, can be re-moulded and re-structured into an efficient and viable industry;

- technology in some of the textile plants is of a standard to enable the industry to compete in international markets;

- historically the country has a proven record in cotton production and export;

- the sector has an experienced labour force, and labour costs that are low by international comparison.

On the institutional side, the TGE is committed to divestiture and privatization where feasible. It has begun fundamental steps towards realizing these goals; including the initiation of manning level and plant productivity studies, a precursor to effectively transferring existing social costs from the factories to the state or region.

The team believes these steps are commendable and that with international technical assistance, rehabilitation and restructuring assistance, the industry could at least reach the previous record production levels of the mid-1980's. It is realistic to assume that individual sub sectors of the industry could be expected to contribute to export development on a significant scale (see the marketing specialists working paper), as with guidance and a move to free market enterprise, there is good potential for the modern industry to compete internationally and to develop some sales in the domestic market.

Although there is hope, the broad structural problems identified above need to be openly debated and resolved in the near future. The TGE needs quickly to put together a strategy for restructuring the sector if the best components of the industry are to be saved and the inefficient components scrapped. Broadly three interrelated phases are envisaged to form the basis of this strategy:

- Most immediate attention should be directed at the sector's liquidity problems. Current levels of indebtedness are so high, that under normal free enterprise conditions, virtually all plants and state farms would by now either have been closed by the banks, or be in the hands of receivers or administrators. An immediate review by concerned banks in Ethiopia, together with the Government and interested donors, to focus on the sector's financial position and current lending policy is urgently needed.

- Assistance should be sought either from donors or private investors to provide critical short and medium term financing for the next decade. The team considers that without financial support, possibly by the multi-lateral banks or bi-lateral donors - that the orderly transition required for the long term development of a productive market driven cotton sector will not occur. Without this, there may be a limited number of successful private farmers or handicraft establishments with access to their own financial resources, but that the largest proportion of the cotton industry would collapse.

- Restructuring plans for the industry should be drawn up and implemented. It is estimated that long term loans totalling up to US$ 500 million (detailed in the textile specialist's working paper) would underpin much of what has to be done on both state farms and at factories to get back on track. Difficult choices will have to be made regarding:

    - early divestiture of state farms;
    - which factories to scrap, which to sell, and which will require restructuring before sale; and,
    - how to refocus Ethiopia's textile marketing strategy to begin servicing international rather than exclusively domestic consumers.

    These choices do not stand in isolation, but are interrelated. Without access to new markets, the prospects for Ethiopia's cotton industry are dim. Without factory restructuring and adjustments in labour and debt policy, existing factories will find it difficult to compete in new markets. And without assured supply of high quality Ethiopian cotton with its comparative cost advantage over imports, access to high quality competitive foreign markets will be denied.

Clearly detailed review of reforms and measures to address the restructuring of each sector of the cotton industry is required. From this preliminary assessment of the industry, some of the key issues that need to be addressed are outlined below.

4.2 DOMESTIC COTTON PRODUCTION

There is little doubt, given planned domestic cotton production, that output of cotton will be insufficient to supply the needs of the textile sector. Urgent attention is needed to boost domestic production. In the short and medium term this should run in parallel with a programme to supplement domestic supplies with imported cotton in order to prevent the collapse of the textile sector, but donor credits for imports over the longer term need to be phased out gradually in line with increases in domestic supply to ensure that incentive prices for domestic producers are maintained.

It is important that every effort be made to encourage the continued production of cotton in the traditional cotton growing areas of Middle and Lower Awash by providing the necessary technical support to the regional administrations. The African Development Bank (ADB) is already heavily involved in rehabilitating the irrigation infrastructure in the region and may do more, given a comprehensive strategy of support for the sector.

Other measures to be considered as part of the overall strategy to boost the recovery of the production sector include the following:

The state farm sector. Consideration should be given to replacing the state farm enterprises with temporary 'settlement authorities'. These bodies could be joint government/private sector stock holding companies similar to the nucleus estates the World Bank established in East Asia for smallholder rubber producers. Their role is essentially to ensure (with government and international support) that cotton farming activities are resumed, infrastructure rehabilitated and put into effective operation, and they would be responsible for the efficient utilisation of land until it has been privatised. The objective is to restructure operations so that production is run on commercial lines and is sufficiently efficient and attractive to private investors. The authorities would oversee the settlement of private farmers, supporting them with recruitment of experienced personnel, and providing support services to these farmers on commercial lines. Thus the principal functions of the authorities will be:

- auctioning off lease-hold rights to farm land;
- restructuring farm service operations to provide extension, land preparation, and farm inputs on commercial lines through hire purchase or credit arrangements to private growers;
- establishing an irrigation management unit or company to operate and maintain the irrigation system on a commercial basis;
- developing ginning and marketing services for participating growers.

Consideration should be given to contracting an experienced international agricultural management company to run what remains of each state farm on commercial lines, albeit with assistance from donor agencies, until such time as privatisation is satisfactorily complete. Although overall responsibility for the commercial management of the authority would be under contract to an international management organisation with the necessary experience of running large scale commercial farming, most of the staff would be comprised of individuals with technical and managerial skills who are currently running the state farms. The management organisation would be answerable to the relevant international donor for efficient use of funds, and to the Ministry of Agriculture for implementation of its privatisation and development policies.

Private Commercial Farms. The focus of efforts to assist private commercial farms is to remove the main constraints and thereby create an attractive environment for investors. Included in this are the following:

- removal of the land rental fee (currently 30 percent of the value of cotton produced) in the Awash;
- negotiate a system for granting security of tenure which excludes cattle incursion;
- alter credit policies to allow the collateralisation of land improvement investments when determining loan ceilings;
- resolve the commercial pricing difficulties now faced by farmers. Current domestic prices of Birr 2 per kg of raw cotton would need to be increased to Birr 4.0 per kg to generate economic returns for commercial farming (see appendix I);
- improve technological packages currently available to farmers.

Peasant Farms. Information relating to the peasant sector is sparse, and some detailed investigations are required to develop a clear strategy for assistance. The most urgent priority for the sector appears to focus on the need to improve support services. Access to basic input supplies and extension advice is critical. In addition, implementation of the following basic technologies should also be considered:

- improve seed supply and, in particular, to supply varieties suitable for rainfed conditions;
- introduce use of an ox-drawn mould board plough;
- pot-holing or tie-ridging to conserve rainfall;
- introduce row planting rather than broadcasting.

Even at current cotton prices, production in the peasant sector is viable, and this suggests that considerable attention should be devoted to supporting and enhancing this sector.

Clearly implementing the recommended action suggested above will not be easy. Renegotiating traditional rents with local inhabitants, establishing settlement authorities, restructuring existing state farm organizations to provide services to independent producers, adjusting banking policy to expand access to credit for farm development, and dealing with the problems of peasant producers will be both difficult and controversial.

4.3 RESTRUCTURING THE TEXTILE SECTOR

After visiting the factories, discussing existing problems with senior plant managers, and talking about options with senior Ethiopian policy makers, the team remains convinced that efforts to salvage a part of the industry will eventually produce positive economic returns. The sector needs time to rebuild, rehabilitate, and adjust. Solid investment today should ultimately bring the benefits of direct foreign exchange earnings in the future.

External assistance in many forms will be required, however, there are some basic measures that could be implemented by the TGE in the short term which will improve efficiencies in the operation of the sector and consequently could encourage donor interest and support. For example, steps need to be taken immediately to reduce the high costs of domestic production. A measure of the current international uncompetitiveness is well illustrated by a comparison for a typical Ethiopian construction 20 x 20, 52 x 52, 63" width at about Birr 6 per metre, against current Indian prices of Birr 3.30. Although this differential seems large, there are a number of relatively simple and inexpensive adjustments that factories could take immediately to maximize production potential while satisfying changing market tastes. For instance, the factories at Arba Minch and Awassa require only minor modification to looms to facilitate production of a wide range of fabric qualities currently in high demand. These and other plants could, through simple changes in procedures:

- reduce the input of lint per metre of fabric by reducing waste losses in process;

- improve the efficient use of direct labour, not necessarily a reduction of total direct labour costs; and,

- reduce factory overheads by reducing the number of selected higher cost management and administration staff.

These measures require little financing, and will be recognised as supporting a commitment to restructure the sector.

In addition to these short term adjustments, urgent attention should be given to drawing up a longer term strategy for restructuring the sector, donors can then be sought to finance individual components of the strategy. This preliminary assessment of the sector suggests that components of this strategy will include:

- reorganisation of the Arba Minch and Awassa plant either under central management or by reorganizing the Awassa finishing department into an independent and private operation capable of finishing both Awassa and Arba Minch fabric at commercial prices. The cost of this effort would be minimal;

- the continuation of plant renovations started under Belgian support to include the finishing and printing operations. This investment would be dependent on finding a market for gray fabric as well as finished product. Renovations could cost up to $100 million;

- incremental/partial rehabilitation at Kombolcha and Dire Dawa. In both instances plans for necessary rehabilitation over at least five years should be developed, making sure that any loans raised are serviceable by margins on sales. Potential investment requirements could reach $100 million for each plant;

- a gradual reduction in plant activity and eventual closure of the Akaki mill. To maximize scrap value of the site and to use labour force skills already established, consideration could be given to the development of the site as a textile industrial park serving specialized nitch markets in Ethiopia and abroad. Such investment decisions would however depend on positive feasibility studies and expressed private investor interest. etc;

- a restructuring of the Edget Yarn and Sewing Thread Factory. Under this scenario the small scale cotton yarn spinning unit would be split off and privatized, the yarn bleaching and drying section of the sewing thread unit split off and sold, and the remainder of the sewing thread operation put in moth balls until such time as a domestic market develops for thread.

- sale of the Adei Yarn Factory on the open market. If no buyers are found, liquidate the assets for what ever the market will pay.

The Consultants strongly believe that all funds made available to support the above steps should be administered nationally by the appropriate financial institution, such as the Agricultural and Industrial Development Bank or the Commercial Bank of Ethiopia. Loan and credit requests would be submitted by private investors or consortia accompanied by acceptable business feasibility plans, and preferential rates allotted by the bank bearing some relation to the viability of proposals.

Inevitably, to elicit the interest of potential investors, the TGE will have to make decisions on how it proposes to handle the current debt burden carried by both individual state farms and textile factories. Debt re-scheduling and in some instances debt relief will need to be considered. However, with clear government commitment to a strategy for the sector, the team feels that the local banking industry would have the confidence to continue financing the sector. Similarly, other external technical agencies would develop the confidence to support sector rehabilitation.

Notwithstanding the foregoing, it is recommended that considerable caution and thoroughness be exercised in new financial or technical assistance commitments. The team recommends that loans or credits be made conditional upon the acceptance of international technical assistance for the development/rehabilitation projects. For example, potential investors in former state farms might be supported by specialist experts from F.A.O over long periods, in matters relating to equipment, drainage, salinity, type of crop, and irrigation. Similarly, in factories by engagement of expatriate, UNIDO/ EEC productivity and marketing expertise.

4.4 DEVELOPING NEW MARKETS

It is estimated that the domestic market for manufactured textiles is approximately 120 million metres (50 million people with a consumption of 2.4 metres of fabric per person per year). Much of this demand (approximately 70 million metres per year) is supplied by the hand loom sector. The ingenuity and freshness of design and colour of the local production are in stark contrast to the cheap and pallid imports from a huge range of countries. During the restructuring process it is critical that the role of the hand loom sector in meeting domestic demand and its reliance on warp yarn supplied from domestic spinning plants must be taken into consideration and supply protected. More discussion of steps that need to be taken in the immediate future to provide direction in the domestic and international marketing of goods is given in section 5 of the report and in the marketing specialist's working paper.

5 THE FUTURE

5.1 FAILURE TO ACT - THE COST

Under a freely operating market, most of the state farms and factories would, under their current circumstances, be under receivership, and there is a strong school of thought that they have gone beyond the point of realistic recovery. This school of thought also purports that it is too late to develop new products and markets required to lift production to internationally competitive standards; and that even if international competitiveness was attainable, the effects of future devaluations on prices of imported industrial inputs would put into question the industry's competiveness in its own domestic market in the medium to long term.

While these are strong arguments, the Consultants believe, based on this preliminary review of the industry, that the cotton sector can be revived, and that failure by the government to act will have severe economic consequences. Failure to support and restructure the sector will result in collapse of the industry as a whole, while partial support measures will also have severe consequences. The following provide some measure of the impact of this course of action:

- Total collapse of the industry will result in a textile import bill that will drain foreign exchange reserves to the order of some Birr 500 million per annum, even allowing for continued hand loom production of Birr 20 million per year;

- if the TGE attempted to maintain the present structure and current operating levels, this would require subsidies to the tune of US$ 45,000 per day.

- the effect on employment would be considerable. If only half of mill capacity were shut down, this would result in large scale layoffs of some 12,000 employees. If intermediate products required by the hand loom industry are affected, an additional 100,000 local weavers could be negatively affected.

5.2 INSTITUTIONAL CO-ORDINATION OF RESTRUCTURING

The TGE as part of its agriculture-led industrialization strategy could pursue measures recommended in this report to restructure and privatize both mills and state farms, and these could form part of overall integrated regional development plans. However, this cannot take place without long term international assistance, as time scales for restructuring are considerable. Rehabilitation of existing state farms might take three to five years. New farms could become operational in two to three years, although it will be four to five years before they become profitable, and six to seven years before they generate returns on investment. Factory rehabilitation and structural adjustment can be implemented in weeks or years depending on the nature of the problem. Typically three to five years are required to plan, equip and bring new factories into operation.

If this course of restructuring is taken, it is critical that it is given immediate attention. Most urgent priority should be given to strengthening and expanding the ad hoc sector rehabilitation team (SRT) now working out of the Prime Minister's Office. The team should continue to operate within the Prime Minister's Office as it will be necessary to negotiate across ministries, between mills, with banks and donors. Placement within a line ministry would not provide the SRT the flexibility or stature required for such critical cross-interest group negotiations. The SRT should comprise senior-ranking government officials with powers to operate across the spectrum of relevant ministries, farms, factories and institutions. It will become the core unit concerned with the development and coordination of a sector-wide rehabilitation strategy, and will provide a central 'think-tank' for strategic planning of the sector.

While the structure, long term location and work program of this team will clearly be the decision of the TGE, the following specific team actions are recommended for urgent consideration:

Position on Lint Cotton imports:

- The SRT should immediately develop and clarify the Ethiopian position on the provision of donor-financed lint cotton imports.

- Given the current levels of domestic supply, mill utilisation rates and the time required to negotiate future supplies, it may be necessary to develop allocation rules that distribute donor supported cotton to the most cost effective plants.

- Associated with this, the SRT might consider negotiating for small levels of technical assistance to focus on:

  - immediate measures that can be implemented to improve productivity at no cost in the mills;
  - developing marketing strategies that are in their early stages;

- technical adaptation required to take advantage of new market opportunities.

Viability Forecasts:

- a series of studies need to be implemented to examine the future viability of each state farm and plant. The studies should:
    - lay out proposals for restructuring,
    - set out assumptions and recommendations for writing-off or re-scheduling debts;
    - examine availability of competitive finance;
    - determine economic manning levels;
    - propose market research required;
    - recommend technical adjustments to capacity whether marginal or structural.
- the studies should be reviewed as a whole by external, independent financial analysts before decisions are taken concerning privatisation actions.

External Feasibility Studies for Textile Plants:

- on the basis of the viability studies above, a series of externally-conducted feasibility studies should be commissioned to clearly identify options and costs for rehabilitating or extending selected major plants.
- Among the feasibility studies that should be undertaken are:
    - feasibility of a new finishing addition at Bahr Dar with new weaving machinery;
    - the installation of new finishing machinery at Dire Dawa;
    - the possible closure of Akaki;
    - updating of weaving and spinning machinery at Kombolcha;
    - options for restructuring arrangements that exist between Arba Minch and Awassa.

Additional Studies:

Additional externally conducted studies need to be undertaken including:

- a series of feasibility studies for the rehabilitation and privatisation of each state farm is required;
- detailed export marketing studies;
- comprehensive sector-wide review of the specific needs and arrangements for the financial rehabilitation of the sector.

Information and Database

Development of a comprehensive information base about the status of the sector is urgently needed. Under the SRT's direction and guidance, state farms and mills need to be instructed to provide:

- commercial information including physical samples of manufactured textile products, construction details and normal ex-factory prices. This would be required to assist in export promotion efforts.

- financial details - including current/most recent trading situations, detailed cost of production estimates, stock position including trends and forecasts, overdrafts, loans, collateral mortgaged, equity participation etc.

- assessments of commercial manning levels actually necessary to operate farms and plants compared to current manning levels and costs.

Market Research Program:

A comprehensive market research program should be initiated to obtain critical information on issues affecting the industry including:

- the domestic demand for fabric. This should be structured to obtain information on the cash incomes and spending power of different classes of Ethiopian consumers, and the effective demand by income group for specific types of textile products including yarn fabric (by type), second hand clothing etc.

- markets for printed or gray loom state fabric;

- the market for bleached sheeting from Bahr Dar, Awassa, Arba Minch and Kombolcha.

Tax Structure:

Detailed examination of the domestic sales and excise tax structure is required, to determine changes necessary to:

- encourage expansion of domestic garment manufacturing facilities, particularly those catering to high income Ethiopian consumers (in order to counter the current high levels of official and unofficial imports);

- allow domestic manufacturing using new design and production techniques which are required to enter export markets.

5.3 CONCLUSION

While the present sector review has attempted to highlight critical issues that need to be addressed, it cannot, in the time available, provide a comprehensive strategy and a program for its implementation. This can only be done over time by the cotton sector rehabilitation team (SRT), and only if the information and analyses laid out above are undertaken. The analyses suggested above will provide the information required to facilitate government actions to implement a privatisation program.

The ultimate or future shape of the industry is difficult to determine at present, but government involvement will certainly be necessary in the short-term in order to create conditions from which a viable industry, based on private ownership and management, will emerge. This should be the objective which underlies short and medium term government strategy for the sector.

APPENDICES

APPENDIX I

APPENDIX I
COTTON PRODUCTION - SUMMARY REPORT

1. PRODUCTION 1993/94

Cotton production in 1993/94 amounted to 60,600 tonnes, equivalent to some 20,600 tonnes of lint, from a total planted area of 75,900 hectares. The contribution of this production from different sectors is given in the following table I-1.

Table I-1
Ethiopian Cotton Production 1993/94

Production Sector	Area in hectares	Production tonnes		Yield t/ha
State farms	11,400	13,100	(22%)	1.15
Private Farms	8,500	11,100	(18%)	1.31
Peasant Sector	56,000	36,400	(60%)	0.65
Total	75,900	60,600		0.80

Data relating to the peasant sector is sparse, and the figure provided could be low, and most of the output will be destined for the village hand loom industry. The private farms estimate may also be approximately 10 percent low because there were rumours of farms that the Consultant could not verify. State Farm figures are based on their records.

2. COTTON PRODUCING SUB-SECTORS

2.1 FORMER STATE FARMS.

Five State farm enterprises which are still geared up for cotton production are Middle Awash, Tendaho, North Omo, Ethio-Korea and Abobo. Their original areas totalled 42,584 ha, of which 18,577 ha has been 'privatised', leaving a balance of 23,857 ha under State Farm control.

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Table I-2
Land Area Under Each State Farm

State Farm	Original Land area (has)	'Privatised' land area (has)	Balance remaining with state farm (has)
Middle Awash	13,661	7,050	6,561
Tendaho	19,648	11,527	8,121
North Omo	4,075	Nil	4,075
Ethio-Korea	1,200	Nil	1,100
Abobo	4,000	Nil	4,000
Total	42,584	18,577	23,857

Production from the State farms has declined not only because of the 'privatisation' programme that has taken place, but because of declining yields caused by:

- damage from cattle incursion
- salinity problems
- deteriorating infrastructure and equipment.

The following table provides an indication of the extent to which yields have declined over the last decade.

Table I-3
Measure of Declining Yields on State Farms

Farm	Previous maximum yields achieved			1993/94 data	
	Year	Production (tonnes)	Yield t/ha	Production (tonnes)	Yield (t/ha)
Awash	1985/86	41,561	3.20	2,568	1.42
Tendaho	1980/81	32,535	2.44	6,581	1.08
North Omo	n/a	n/a	n/a	n/a	n/a
Ethio-Korea	1991/92	n/a	2.7	0	
Abobo	1985-92	n/a	1.2 - 1.5	550	0.57

In addition to the declining performance of the remaining State Farm land, only 6,300 ha (or 34 percent) of the 'privatised' land area has been used for cotton, the balance having mainly reverted to grazing land with some food crop production.

The State farms are in a critical financial position, and their infrastructure is crumbling fast. All have stocks of unsold cotton, some of it left over from previous seasons. All are heavily in debt largely because of money owed by other State enterprises. The exception to this is the Ethio-Korean farm whose joint-venture status made it possible to avoid the build-up of debt. Staff morale on the farms is low, and experienced personnel, who would be invaluable to the new investors, are drifting away. Further discussion of the financial status of the farms can be found in the working papers of the Cotton Specialist and the Financial Specialist.

The future of the State enterprises is a matter of great concern. Some 38,000 ha were developed for irrigation at a cost of millions in international aid and government money, and at present most of this is unproductive, having either reverted to grain for the local tribes or become too saline. Money is still being spent in the form of a US$ 28 million African Development Bank drainage project in the Middle Awash to correct salinity. Privatization is urgently needed , but low cotton prices and other constraints have not created a very attractive investment environment.

It is suggested that the first course of action should be to replace the State farming enterprises with a 'Settlement Authority' to oversee privatization and provide technical support of the new farmers, thereby making good use of the rema ning equipment and experienced personnel as well as caretaking the land and infrastructure. The enterprises are in any case insoluble and should be legally liquidated as soon as possible.

The first job of the new authority would be to try to get the main constraints removed so that investment in irrigated cotton becomes attractive again. Thes: constraints apply mainly to the Awash Valley. They include:

- a land rent of 30 percent of the value of cotton produced, levied by the local Afar people who claim traditional land rights;
- the lack of a system for granting security of tenure;
- cattle damage has destroyed large areas of cotton year after year on the State Farms.

These three issues can only be resolved by the local Afar administration.

2.2 PRIVATE COMMERCIAL FARMING SECTOR

Information was collected concerning some 36 new farmers with areas ranging from 80 to 2000 hectares. Approximately 29 of these farmers were on former State farm land, mostly at Assaita in the Lower Awash valley and , of the remaining 9 farms, 8 were rainfed farms, mainly along the Sudanese border in North Gonder and on the Humera plain just north of Gonder in the province of Tigray.

Data relating to the commercial farms is sketchy, but the following table provides an estimate of production from this sector.

Table 1-4
Estimate of Production From the Commercial Farms 1994/95

Location	No. of farms	Cotton area (has)	Yield (t/ha)	Production (tonnes)
Middle Awash	1	300	1.3	390
Lower Awash	18	6,000	1.3	7,800
North Omo	1	300	2.0	600
Gambela	2	580	1.2	696
HIWET farm, Humera	1	800	1.2	991
Meema, North Gonder	5	550	1.2	660
Total	28	8,530		11,137

There has been a lot of enthusiasm for further investment by this sector, but the inability of the Awash farmers to sell their 1993/94 crop has been a major set-back. Nevertheless, provisional information gathered during the field work suggests that the total area under commercial farms is forecast to increase to 19,130 hectares in the coming 1994/95 season, with a projected output of 24,306 tonnes of cotton. Investment in the rainfed areas is expected to increase substantially, judging from reports of development plans by individuals and companies. Price improvements will be a critical factor in determining how rapidly this sector grows and how many more new farmers emerge.

A further discussion of constraints and issues affecting the sector can be found in the Cotton Specialist's working paper.

2.3 THE PEASANT SECTOR

Data on the peasant sector is sparse, but it has been estimated that there are at least 112,000 farmers growing cotton in the main producing areas. There are undoubtedly many more growing a few backyard plants for home consumption. The FAO estimated a contribution from the peasant sector of 4,500 tonnes lint in 1957, and present indications suggest that this has risen to around 13,000 tonnes.

Typical farm sizes of the peasant sector vary with the major producing regions, and are given in the following table I-2.

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Table I-5 Peasant Farm Sizes in Major Producing Regions		
Region	**Farm Size**	**Percent are under cotton**
Omo	1 to 2 has	30%
North Gonder	3 to 7 has	50%
Humera	10 to 15 has	n/a

Main constraints on cotton production in the peasant sector include:

- shortage of oxen for ploughing;
- lack of good quality seed;
- difficulty of access to farm inputs such as chemicals for spraying.

Further discussion can be found in the Cotton Specialists working paper.

3. COSTS OF PRODUCTION

The following table provides an estimate of direct production costs for the commercial sector under alternative conditions.

Table I-6 Production Costs		
Production system	**Expected Yield kg/ha**	**Production cost Birr/kg**
Rainfed cotton	1,500	2.25
Irrigated (North Omo)	2,000	2.25
Irrigated (Tendaho)	2,000	3.36
Irrigated (Middle Awash)	3,000	2.70

The difference in the production cost between the two irrigated crops with yields of 2,000 kg/ha is due to a levy of 30 percent crop value imposed by the Afar people of the Awash Valley.

Peasant farm costs are lower at around Birr 1.00/kg due to very low usage of purchased inputs and no mechanisation.

Current prices for raw cotton in Ethiopia are Birr 2.20 to Birr 2.50 per kg. At this price, production is uneconomic except in the peasant sector. However, the import parity price for cotton has been calculated and is the equivalent of Birr 4.18 per kg. If the mills could therefore afford to pay Birr

4.00 per kg of raw cotton, margins look better (except for the Awash farmers where the 30 percent levy is imposed). Net operating margins at this higher pricing level would still only be approximately 25 percent, before tax, and it is questionable whether this is sufficient to attract new investors on any large scale. This suggests that a cotton development policy would have most chance of success if directed at the peasant sector.

4. PRODUCTION IN 1994/95

Initial indications relating to the level of land preparation, suggests that the 1994/95 cotton crop could exceed 90,000 tonnes (equivalent to 30,000 tonnes of lint). Of this, 40 percent would come from the peasant sector, of which between 35 and 70 percent could go to the hand loom industry.

There is a real danger that the State farm production of nearly 30,000 tonnes of raw cotton may not materialize, because of the financial and technical problems discussed above.

In conclusion, it is possible that of the order of only 50,000 tonnes of cotton may be available to the textile industry from domestic production in 1995.

APPENDIX II

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APPENDIX II
TEXTILE MANUFACTURING - BASIC DATA SUMMARISED

1. INTRODUCTION

This annex provides a summary of some basic data to support discussion provided in the main text of the report. It should be noted that full discussion and data relating to the textile sector have been provided in a separate working paper, and it is not the intention of this appendix to repeat that information.

2. DOMESTIC PRODUCTION

Domestic textile needs are mainly fulfilled by cotton-based products. Historically the largely rural population (78%) has satisfied its requirements from the non-industrial sector, i.e. the hand spinning and hand-loom sector, while the urban centres satisfied additional demands from imported fabrics and garments. Factory production of textiles in Ethiopia began in 1944, and current production from this sector is of the order of 97 million sq metres, which is some 70 percent of capacity.

The following table provides a breakdown of production by sector, and the requirements for lint to meet this production.

Table II-1
Domestic Textile Production and Lint Requirements

Production Sector	Production sq metres	Fabric weight gms/ sq metre	Lint usage in gms/sq metre incl. wastage	Total lint requirement (tonnes)
Factory production	97,000,000	203	235	22,795
Cottage industry	70,000,000	n/a	175	12,250
Total	167,000000			35,045

Hand-loom fabrics are usually made with weft of hand spun yarn which is made from 'peasant' grown cotton, hand-seeded etc. Therefore 5,000 tonnes approximately can be 'removed' from the 12,2550 lint required for the cottage industry sector.

It is unlikely that the 1993/94 domestically produced ginned cotton output will exceed 5,400 tonnes, and the industry therefore faces a potential deficit of some 24,645 tonnes of lint.

The eight textile mills in Ethiopia (two of which are spinners only) currently hold 15,000 tonnes of lint in stock, which is equivalent to some 6 months supply. Therefore the forecast actual shortfall until the January/February 1995 crop will be approximately 10,000 tonnes assuming that factories continue to operate at 70 percent capacity.

3. INDUSTRIAL PRODUCTION UNITS

The industrial textile sector in Ethiopia currently comprises 8 factory units, of which 2 are spinning-only factories which produce yarns, at present, for the cottage industry. These units and their present daily output are summarised in the following table.

Table 11-2
Industrial Textile Production

Factory Name	Product	Present Daily Production (sq metres)*/1
Akaki	Fabric	76,600
Dire Dawa	Fabric	89,400
Bahr Dar	Fabric	38,300
Kombolcha	Fabric	42,600
Awassa	Fabric	19,200
Arba Minch	Fabric	22,000
Sub Total	Fabric	288,100
Idget Yarn	Yarn	4.60 tonnes
Adie Abebe	Yarn	8.40 tonnes
Sub Total	Yarn	13.00 tonnes

Note */1 ... based on fabric weight of 235 gms/sq mtr including waste losses lint to fabric.

The technical operating status of each of these plants is discussed in some detail in the working paper of the textile sector in Ethiopia. There are many common problems presently faced by these factories including:

- all face significant financial difficulties. Most are insolvent and pay wages on bank overdrafts;
- there are no cash reserves for raw materials, spare parts etc.
- the factories now have problems selling their fabrics, and are carrying high stocks of finished goods.

The following table provides a summary of the stocks held by the 6 textile factories as of March 1994.

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Table II-3
Factory Stocks of Lint and Fabrics in March 1994

Factory name	Lint in stock kgs	Fabric in stock sq metres	Lint content of fabric in stock based on avg of 0.235 kg lint/m2
Akaki	1,937,300	4,664,000	1,096,040
Dire Dawa	2,612,387	2,970,000	697,950
Bahr Dar	1,949,032	3,405,000	800,175
Kombolcha	1,368,000	1,769,000	415,715
Awassa	1,532,813	3,790,000	890,650
Arba Minch	1,100,000	7,793,000	1,829,000

4. PRODUCTION EFFICIENCIES

As discussed in the main report and in the separate report on the textile sector, factories were designed, during the Mengistu era, to operate under a centrally controlled system, each carrying a burden of high social costs. While these costs still apply, the industry will have problems competing both domestically and internationally. The following table provides a comparison of levels of output per employee considered 'acceptable' or 'competitive' in developing countries, against 3 of the plants in Ethiopia.

Table II-4
Output Levels Sq. Metres Per Month Per Employee

Item	Acceptable standard for developing countries	Dire Dawa	Bahr Dar	Awassa
Total m2 per person/month	750			
- current production		370	340	418
- potential capacity		420	460	700
Of which:				
- management & admin	23%	12%	15%	18%
- technical services	13%	7%	16%	14%
- production workers	64%	81%	69%	68%

Note: These 'standard' figures apply assuming machinery is more than 10 years old.

This implies a need for significant restructuring of the plants in order to operate effectively with fewer employees. The level of changes in manning of these plants is indicated in the following table.

Table II-4
Current and Recommended Staffing Levels

Item	Dire Dawa	Bahr Dar	Awassa
Actual total employees	5,850	2,670	1,318
Total staff to match country standard at potential capacity	3,270	1,630	1,220
Total employees that should be used for current production	2,860	1,200	610
Excess employees at:			
- potential capacity	2,580	1,040	98
- current capacity	2,990	1,450	708

APPENDIX III

APPENDIX III
MARKETING REPORT - SUMMARY AND CONCULSIONS

1. INTRODUCTION

This appendix provides a summary of key points in the analysis of markets for Ethiopian textiles. More detailed information and discussion regarding the market, its size, structure and trends, is given in a separate working paper produced by the marketing specialist.

2. RECENT TRENDS IN THE INDUSTRY

A significant build up in domestic raw cotton and fabric production during the Mengistu era, together with restrictions on imports, reduced Ethiopia's dependence on imports to only 2 percent of total requirements by 1989/90. More recently however, official and unofficial imports have again become significant in satisfying domestic market demand, and the textile factories are now struggling to sell their output, and unsold stocks are mounting. The principal reasons for this include:

- domestic tastes are varied, and this was not recognised by the production composition imposed on the factories under the Socialist Government (90 percent sheeting/drill/twill). Imports are fulfilling these new consumer demands, particularly in the urban areas, while domestic factories remain too inflexible to adapt to these varied tastes;

- the hand loom sector satisfies much of domestic demand particularly in the rural areas;

- the high social costs that the factories continue to bear, together with inefficiencies in operation, and high capital value of factory parts and equipment, have raised their production costs significantly above international prices. A measure of this difference is that an Ethiopian fabric of 20 x 20, 52 x 52, 63" width retails at Birr 6 per metre, while the price for Indian equivalent is Birr 3.30 per metre.

3. THE NEED FOR RESTRUCTURING

Given the current costs structure in the modern textile sector, together with low consumer spending power in Ethiopia (a factory produced shirt retails at a price equivalent to 10 days wages of some of the lower income groups in the country), the prospects of improving factory sales in the domestic market are weak. The only means which the modern factories have of obtaining a satisfactory return on their investment is to pursue export markets, at the same time undergoing significant structural modifications within the sector.

Investment in new plants would require spending levels of US$ 60 to 100 million; while investment in parts of plants, i.e. spinning, weaving or finishing, to upgrade current operations may require outputs of some US$ 20 to 50 million. In the absence of this level of financing, then placing the best or most modern parts of existing plants together, under the best entrepreneurial, market orientated management available (from inside or outside the country) is a potential economic option, if not the desirable socio-political option.

The need for restructuring of the modern textile sector and reorientation of the marketing effort is highlighted by the stark facts faced by the sector which include:

- domestic fabric stocks are huge and remain unsold because they are unsuitable and much too expensive for the market. Stocks are currently valued at approximately Birr 120 million;

- although factory production was in the region of 93 million metres last year, much of this was produced from American cotton credit, 'to keep the mills going', but unfortunately this cotton was used to produce fabrics designs set during the old regime, without any clear understanding of what was simultaneously occurring so rapidly in domestic demand. Much of this 93 million metres is now in domestic fabric stocks, approximately 30 million metres or about 5 months' production at current production rates;

- hand loom production is generally understood to be in the region of 70 m. metres per year, although it is facing some competition from similar imported plain fabric, garments and second hand clothing;

- the domestic market is now being satisfied particularly by the hand loom fabric and imported fabrics and garments, with relatively little fabric from factories being sold within the domestic market.

4. STRATEGIC ISSUES

The size of the domestic market is estimated at a little over 120 m. metres (based on a population of 50 million x 2.4 metres fabric per capita, average urban and rural). Much of this is currently being fed by the hand loom sector because the modern mills cannot compete and/or have not yet been able to adjust. Given the continued importance of the hand loom sector it is critical that any restructuring that takes place with the modern factories, does not in anyway affect the supply of warp yarn from the spinning sections of these factories to the handicraft sector. This should not pose serious problems but all possible should be done to support the hand loom sector for both domestic and longer term export possibilities.

The factory units themselves, structured correctly whether by additional new plant or reorganisation, are quite capable of competing in international markets. To do this it is essential that they have access to:

- good quality cotton for raw materials;
- new and extensive market research;

- design input and collabouration with importers to ensure international design requirements are met.

All these measures to support and upgrade the sector should be initiated soon, to give the industry a chance to recover before the situation declines further.

Installed factory capacity is some 137 million metres, but the industry is operating significantly below these levels. However, if an export strategy is pursued, taking advantages of the size particularly of the European market and opportunities offered under Lomé, there is no reason why, given time, that this capacity should not be fully utilised. This will generate significant benefits in terms of foreign exchange earnings. However, to achieve this, the sector must be supported by a major export market research effort conducted by a major specialized organisation.

APPENDIX IV

APPENDIX IV
FINANCIAL SPECIALIST REPORT - SUMMARY AND CONCLUSIONS

1. INTRODUCTION

This appendix provides a summary of major findings concerning the financial profile of the six public textile mills in Ethiopia together with the two yarn producing factories. More detailed discussion on this matter, together with a review of the financial status of the cotton industry as a whole, and issues affecting the financing needs of restructuring the industry are provided in a separate working paper.

The financial information presented relates to the position of the sector in June 1993. It is limited by the absence of information from one of the six mills.

2. FINANCIAL STATUS

The government is having to finance the mills to a tune of some US$ 44,500 daily in accrued interest payments etc. A summary of the cumulative financial exposure of the five mills for which data was provided is given in the following table IV-1.

Table IV-1
Financial Exposure of Textile Mills June 1993

Item	Value (in thousand birr)
Annual cost of redundant workers	32,410
Government grants to cover 1993 enterprises consumption	19,950
Accrued interests on loans that enterprises cannot pay	43,510
Interest costs to the Government :	
- on borrowings to cover salaries and wages	4,210
- on borrowing to cover consumption	1,425
- on borrowing to cover interest payments	5,656
Annual Total	98,160
Monthly cost	8,180
Daily Cost:	
- in birr	272
- in US$ equivalent.	US$ 44,335

The cost of maintaining their stocks and other inventories, which is regarded as the result of poor management policies and practices, are not considered as a part of the financial exposure of the mills, and therefore have not been included in the figures above. Saleable stocks amounted to a value of Birr 94.3 million at the end of the same period (US$ 15.3 million equivalent).

3. FINANCIAL DATA NEEDS AND PRESENTATION

It is proposed that the method of presenting the enterprises' income statements is modified in order to highlight:

- the social redistribution of the enterprises, and
- to display the net accounting cash flow of the enterprises at the end of the period.

An accounting cash flow represents the capacity of an enterprise to finance its activities with the funds generated by its own economic activities. It is important to make this distinction in enterprise costs so that:

- data is available both for macro-economic analysis as well as for detailed financial assessment critical for managers to run their businesses effectively;

- to identify what social costs might be removed from the enterprises, and thereby prepare the operating financial statements required for the privatisation process;

Detailed financial information is essential if the Government is to prepare the mills for privatisation. It is estimated that the will require some 33 calendar weeks to collate and present information correctly if organised effectively with a project coordinator in charge.

4. PRIVATISATION PROCEDURES

A more detailed discussion of issues to be considered in undertaking a privatisation process are given in a separate working paper, and key factors are summarised below:

- before being offered for sale, the textile mills and yarn factories will have to go through a comprehensive restructuring or rehabilitation process including :

  - a technical rehauling;
  - a structural reorganisation to adapt their resources to their new economic environment;
  - a financial recapitalization.

- manning levels in the factories should be reduced. This will entail either:

  - a difficult period of severe redundancies or alternatively,
  - the Government will have to fully compensate the enterprises to keep those redundant workers on the payrolls (in this case, the Government will utilize the

enterprises to relay its own social security system);

- retraining of staff made redundant. Particular note should be made of retraining redundant managers who could become the engine for development in their regions.

• implementing a retraining programme for those staff (particularly the management staff) that remain employed by the factories. This should include computer training, business management training and training in the preparation of bankable projects.

• provision of a line of credit to assist redundant managers to establish their own micro, small or medium sized businesses.