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## FINANCING RURAL INDUSTRIALIZATION AND EMPLOYMENT CREATION: THE CASE OF ETHIOPIA

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### ABSTRACT

The objective of the study was to examine financing rural industrialization and employment creation practices and possibilities in Ethiopia. In this context, rural industrialization refers to encouraging small to large industries to be established in rural areas. As rural industrialization is a new concept at a policy level let alone to the practice on the ground in Ethiopia, a full-fledged data regarding the rural industrialization and the rural financing practice is inadequate. However, attempts were made to see at least the trends in agricultural commercialization, off farm practices, the government's policy, the financial institutions practices, and above all how other countries approached rural industrialization and financing such industries. Hence, relevant data were collected from CSA, NBE, DHS, World Bank, and Ethiopian Investment Commission and the collected data were analyzed using descriptive statistics. The major finding of the study indicates rural industrialization process is at conception stage and financing the rural strategy is still poorly developed despite the immense economic and social implications. Hence, a combination of centralized financing rural industrialization through commercial banks and a decentralized financing rural industrialization through microfinance institutions is recommended for the country to get better depth and breadth of rural industrialization.

**Keywords:** Rural financing, financing, rural industrialization, industrialization



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## 1. INTRODUCTION

According to ILO (2002) estimate, about 97% of the world's rural population lives in developing countries and they are dependent on agriculture. Such dependency on only agriculture leaves such people to poor living conditions as the agricultural system is still traditional and the ever increasing population reduces rural land proportion per person. Hence, poverty levels are higher in rural areas than in urban areas and in some cases the differences are considerable, most typically in the poorest countries (FUKUNISHI et al., 2006).

Because the extent and severity of poverty are greater in rural than in urban areas, providing opportunities for productive employment and decent work for rural workers is a major development challenge for governments in those countries.

Like it is the case for many developing countries, about 80% of the Ethiopian population lives in rural areas and depends on agriculture. Cognizant to this, the government of Ethiopia set Agricultural Development Led Industrialization (ADLI) as a central pillar of economic policy in the recently completed Plan for Accelerated and Sustained Development to End Poverty (PASDEP) and the two consecutive growth and transformation plans (GTP I and GTP II).

Both GTPs intentions and implementations indicate that the country has a comprehensive and consistent set of policies and strategies in agriculture, which reflects the importance of the sector in the nation's development aspirations. The institutional capacity to implement these emphasized on two major important strategies; enhancing agricultural productivity and promoting agricultural commercialization. Such a strategy is legitimate and crucial for the national development because the country's development agenda should focus on the rural people to significantly benefit the people from the development.

The plan 2020 of the country basically aims at overall development of an area as well as people living in such areas by alleviating them from rural poverty and creating employment opportunities in rural sphere. The focus of these schemes is either to develop industries or to develop target group but not to promote rural industrialization in an overt way.

The lack of coordination among the various poverty alleviation programs contributed least to the fight against poverty and unemployment in rural horizon.



Furthermore, such ill developed policy integration and poor infrastructure in the rural areas significantly affected concerted action in the implementation of rural industrialization program. The agro-based industry is one of the main industries in rural areas of most low-income countries.

Agro-based manufacturing, which is an essential non-farm rural sector, is regarded by some scholars in development economics as a key sector for poverty reduction. Such a claim is empirically supported by the fact that agro-based industry is likely to satisfy the following two criteria that serve as driving forces of poverty reduction (NAGLER; NAUDE, 2017; FUKUNISHI et al., 2006): (a) extensive involvement of the poor in the production process; and (b) potential competitiveness by utilization of low-cost inputs and upgrading the quality of products and technology utilized for production.

Rural workers are widely employed in the industry and poor farmers are also involved indirectly as they supply the industry with the crops produced. Thus, the agro-based industry is expected to contribute to poverty reduction significantly and is potentially competitive.

A main challenge deterring low-income countries from pursuing agro-based industrialization is their inability to increase the competitiveness of the industries. The competitiveness of the agro based industry can be strengthened through two mechanisms (ZAMBIA, 2013): one is inter industry linkage, the other is industrial upgrading.

The inter industry linkage is especially important because agro-based industries have a strong link to agriculture, which is the main activity the poor engage in. Close ties with local agricultural activities lower the transaction costs for the use of agricultural inputs. Moreover, if the local network for marketing the agro-products works effectively, these unit costs become cheaper (LOENING et al., 2008).

Similarly, if agricultural products are part of the global value chain, they have better chances of upgrading the quality of the products and also for upgrading the technology for production through interaction with "lead firms" which govern the chain. Thus, strong backward and forward linkage is a crucial means for promoting competitiveness within the agro-based industries, subsequently lowering the unit costs for final users.

This focus of linkage between agriculture and industry is shared with another influential notion of development strategy, that is, agricultural development-led industrialization (AGÉNOR et al., 2004).

Finally, industrial upgrading is important to further poverty reduction through the development of agro-based industries. In order to increase production and employment, the range of economic activities should be widened, and productivity of the industry should be enhanced.

However, agriculture cannot play this dynamic, wealth-creating role without an enabling policy environment, adequate institutions, and sufficient, well-targeted public and private investment. The experience of recent decades has been disappointing in this regard in a number of countries, particularly the LDCs, where investment has declined, rural poverty remains widespread and a very large share of the labor force is engaged in low-return agricultural work (AGÉNOR et al., 2004).

Cuts in health and education budgets and in other public services, as well as the dismantling of publicly funded agricultural extension services during the structural adjustment processes of the 1980s and 1990s, undermined the foundation for bottom-up development for a generation (WORLD BANK, 2009).

The effects are being felt today with a large number of poorly educated rural youth with few skills and poor job prospects and a smallholder agricultural sector that cannot thrive due to lack of support in terms of policy, infrastructure, inputs and investment. Hence, creation of an alternative job than mere traditional agriculture and improving the livelihood of these poor rural households remains a significant challenge for developing countries these days.

### **1.1. Problem Statement**

In the past decade, Ethiopia has recorded a very encouraging economic growth with the highest growth rate in Sub-Saharan Africa (CSA, 2014/15). However, despite the positive economic growth recorded, the growth has not been translated in to significant job creation in the rural youth due to the decrease in land size per rural population on the one hand and the rural development effort has been confined to agricultural development on the other.

As land remains virtually inelastic to fit to the ever increasing population growth, alternative means of livelihood support becomes mandatory for the rural

youth which otherwise leads to underemployment and rural urban migration and finally economic chaos.

The trend from the developed countries indicate that as an economy grows, it is imperative that its structure and location of its economic activity tends to change from a rural agriculture-based economy to a more diversified economy demanding huge investment for industrialization. But at relatively low income levels, individuals spend a significant part of their income on food and will not have income left for fulfilling other demands for investment.

This leads to the search for financing which is of major issue because high quality and efficient financing system is both enabler and driver to provide the impetus for realizing the rural industrialization (where capital is extremely scarce). Therefore, this is exactly where rural financing plays a significant role for rural industrialization with an immense impact on the rate of industrialization or structural change for rural livelihoods in particular and the country's development in general.

## **1.2. Objective and justification of the study**

The objective of this study is to examine financing rural industrialization and employment creation practices in Ethiopia. In this context, rural industrialization refers to encouraging small to large industries to be established in rural areas. In this case, many rural people will find important income sources through off-farm activities, including employment in large and medium enterprises, self employment in small and micro enterprises, and remittances from household members.

Combining agriculture off farm activities leads to true plural activity, which is particularly important in regions that are less conducive to agriculture. Such activity gives many advantages to rural farmers; while individual household members tend to be specialized in one activity, the households in a totality is in diversified enterprise engaged in a portfolio of activities that match each member's skills while together providing risk diversification.

Thus, vibrant rural financing strategies are crucial for rural industry expansion and this study attempts to examine the practices of such issue in Ethiopia.

## **1.3. Methodology**

Rural industrialization is a new concept at a policy level let alone to the practice on the ground in Ethiopia. The rural industrial policy focuses on agricultural productivity increment and rural commercialization (both are indications of early stage of rural industrialization).

Hence, a full fledged data regarding the rural industrialization and the rural financing is inadequate. However, attempts were made to see at least the trends in the rural off farm activity, the trend in commercialization, the government's policy, the financial institutions practices, and above all how other countries approached rural industrialization and financing such industries. Hence, relevant data were collected from CSA, NBE, DHS, World Bank, and Ethiopian Investment Commission.

Besides, in-depth interviews were held with NBE responsible person for policy issue and Ministry of Agriculture to understand the government's intention for rural industrialization and the proposed approach for financing such a process.

Hence, mixed research approach was used for the study. And the qualitative data were analyzed using thematic analysis and the quantitative data were analyzed using descriptive statistics. Finally, the report was composed by blending both data to substantiate the finding from each other and make sense of context and reason out what figures in the descriptive statistics convey and the reasons thereof.

## **2. LITERATURE OVERVIEW**

### **2.1. Rural industrialization processes**

It can be learned from history that all nations begin rural at one time. The need for labor division and fulfilling unlimited and diversified human needs drive for gradual improvements in factors of production and later gradual township development.

Hence, the pace of transformation and resiliencies to change differentiates countries these days developed from under developed. For this particular study, it was found important to see how other countries transformed their traditional agricultural practices in to a more value adding enterprise formation and the financing strategies of those enterprises.

In connection to this, reviewing the practices of China and India practices of rural industrialization and the role of finance in facilitating such process is reviewed

and presented. The reason for choosing such two countries for discussion is that some four decades back both countries had similar macroeconomic conditions with the current Ethiopia whereby agriculture was their dominant economic base and most of their populations were engaged in such activity alone.

However, both countries agricultural growth has made both countries self-sufficient in food, providing a residual surplus for export and capital for other sectors and industries and services now form an integral part of the output and employment of the rural sector (MUKHERJEE; ZHANG, 2007). As a result, the share of agriculture to total GDP has declined to less than one-third in India and about one-seventh in China.

**Table 1: The practice of India and China (Best examples)**

	<b>India</b>	<b>China</b>
<b>Industry policy</b>	<ul style="list-style-type: none"> <li>- Government placed primary investment priority on heavy, urban-based manufacturing in an effort to substitute such industries include large-scale capital-intensive industries such as steel, petrochemicals, engineering, machinery, etc., under the public sector umbrella.</li> <li>- The small-scale industry was supposed to supply the consumer goods needed by workers in the large-scale sector</li> <li>- Through a system of direct licensing, production controls in large manufacturers, deferential taxation, and direct subsidies, they reserved over 800 items—including handlooms, pottery, match making, and sericulture—for rural and small-scale producers</li> <li>- Direct and indirect subsidy rates reached as high as 70% of factory price</li> <li>- Regulation of the small-scale sector constitutes an important aspect of nonfarm development policy.</li> <li>- In the initial stages, capital investment restrictions were imposed to protect the small-scale sector, especially in rural areas, from predation by large industries.</li> </ul>	<ul style="list-style-type: none"> <li>- Government placed primary investment priority on heavy, urban-based manufacturing in an effort to substitute such industries include large-scale capital-intensive industries to catch up with the developed countries</li> <li>- Promotion of rural industry began during Mao’s Great Leap Forward in 1958 with the establishment of large numbers of rural iron and steel foundries aimed at serving agriculture and helping rural areas to “walk on two legs” (Ho, 1986)</li> <li>- Major reforms since the late 1970s enhanced priority for rural enterprises by providing tax concessions to qualified enterprises and instructions. As such, 1982 the rural none farm employment consists of manufacturing 45%, construction 9%, commercial services 12%, transport and communications 6% and service 28%.</li> <li>- 1978 the house hold responsibility system (HRS) came into force ‘township and village enterprises’ or TVEs.</li> <li>- By 1997, the rural TVE sector was employing nearly 30% of the rural labor force, producing nearly 80% of the gross rural output and nearly two-thirds of the total industrial output.</li> </ul>

<p><b>Financing the nonfarm sector</b></p>	<ul style="list-style-type: none"> <li>- The development of the rural sector in India, including both agriculture and industry, has been mirrored by government initiatives in the provision of organized credit from banks and other financial institutions.</li> <li>- The government instituted a policy of "directed credit" through the banking system in rural areas. Lending norms were instituted for the priority sector, which in the nonfood component of the total bank lending included mainly small-scale industry. Location of such industries in semi-urban or rural areas was one factor that qualify them for priority sector credit</li> <li>- The ratio of priority sector lending in the nonfarm sector has been remarkably stable at around 36% over the last two decades.</li> <li>- There is a growing critique about the role of directed credit in the government policy from the efficiency angle, both in terms of targeting as well delivery mechanisms</li> </ul>	<ul style="list-style-type: none"> <li>- In China, FDI plays a key role in financing economic development and introducing new technologies.</li> <li>- First, China has established many special economic zones (SEZs) to grant preferential treatment so as to attract FDIs.</li> <li>- In addition to regional trade integration, there is an increasing vertical production integration in global value chains</li> <li>- In addition to external finances, local government and informal finances have also received considerable attention</li> <li>- Under the innovative ownership structure of the TVEs, local governments had complete control over their finances, which provided incentives for promotion of the sector. Higher profits meant higher revenues for investing in local public goods, which had both economic and political pay offs. Economically, regions with better infrastructure attracted more investment in the rural manufacturing sector, leading to higher employment and revenues.</li> <li>- China's phenomenal nonfarm enterprise growth through unconventional financing pattern provides a stark contrast to that of the stability of directed credit policy in India.</li> </ul>
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Source: Compiled from the works of Mukherjee and Zhang (2007)

## 2.2. Lessons that can be drawn from both countries to Ethiopia

The logical conclusion that can be drawn from the cases of India and China is that rural industrialization is path dependent. The reform measures for the industrialization process should arise from innovations on the existing institutions. Hence, the objective of higher, regionally balanced growth in the rural nonfarm sector will be fulfilled only when policies and institutions are geared toward increasing competitiveness, efficiency, and innovation.

Such a balanced policy and institution may also emerge from the philosophies of governments whether local governments are responsible and able to finance and manage their own industrialization process (as it is the case in China) or a centralized commercial bank financing system administration (as it is the case in



India) is important to evenly distribute and manage financing of rural industrialization process. Hence, the lessons that can be drawn to Ethiopia should be understood from the strength of both approaches.

When we see the current practices of the country in arranging industry zones in some selected regions of the country, it seems that the government needs to treat those zones better in order to attract foreign direct investment and even to encourage local investors.

Besides, the microfinance institutions are region specific and their major financing duty is to satisfy region specific rural and urban people demand for credit and deposit. Hence, such an approach resembles the path of China in rural industrialization although the case in Ethiopia is far from being compared with the China's rural industrialization.

On the other hand, commercial banks and even the development bank of Ethiopia devised a system of credit access for the industrialization process in general and the rural industrialization process in particular. The government gave additional preferential advantage in the form of duty free and land availability to further promote the rural industrialization process.

Hence, such an approach resembles the path of India, using centralized and stable commercial bank financing system for rural industrialization. However, the case is different in this case from India because the investors are expected to come from the non rural areas or from abroad instead of developing such investors from the rural people themselves.

Thus, from the lessons of both cases, it can be understood that an initial local governments financing system (microfinance and other non formal financing systems in the case of Ethiopia) financing system is advantageous for Ethiopia to follow like it was the case in China. But later, when the industries mature and the process of rural industrialization become common business, it is better to shift the responsibilities to directed credit through commercial banks (the India's path).

And there might be a certain level for the firms to reach to shift the financing responsibilities to shift from local financing system to directed commercial banks and development bank financing system. Such an approach will enable Ethiopia to take the advantage of stable and sustainable rural industrialization financing system.

### 3. DATA ANALYSIS AND DISCUSSION

#### 3.1. Introduction

The financial sector is central to industrial development because it enables a well functioning capital and financial markets and the banking system. This is because capital is a critical issue in enterprise and private sector growth, in addition to the availability of appropriate institutional and macroeconomic environment. In this regard, a well functioning financial sector can be thought of as necessary infrastructure for enterprise formation because all but the political environment is affected by its existence and function.

If at all it exists, the financial sector development is not uniformly functioning in developing countries like Ethiopia. About 35% of the banking and other financial institutions in Ethiopia is concentrated around Addis Ababa (NBE, 2016) implying the rural areas do not have adequate access to such services in the country. In relation to this, poor people in rural areas typically face a triple burden when it comes to finance (ILO, 2008).

First, an inability, especially for women, to access credit on competitive terms to invest in their agricultural and off-farm income-generating activities means that their incomes and employment opportunities are constrained. A recent multi-country study found that in most countries surveyed, no more than about one in ten agricultural households had access to credit.

Secondly, the rural poor are also likely to lack access to appropriate savings instruments, implying that their investments are put into less productive or more risky forms which may further reduce rural liquidity.

Thirdly, without adequate access to risk reduction instruments (such as crop insurance) rural households are likely to withhold on innovation, on adopting new activities or expanding existing ones, even if they have adequate liquidity. Hence, the rural industrialization and financing deserves a significant attention to minimize the social and economic constraints mentioned.

In line with this, the following sections will present and justify the financing the rural industrialization in Ethiopia in line with the population growth and the county's agricultural policy.



### 3.2. Rural population growth and need for rural industrialization

Rural population in Ethiopia grows faster than the national average and the initial rural dominant people even slightly magnify over time. Such huge population growth brings both an opportunity and a challenge to the country. As can be seen from Figure 1, below, the rural population is about 80 million from the total population of around 103 million (World Bank September 2017 prediction).

Such huge population demands proportionate employment opportunity in the rural sector which farming alone can't do. Such huge population can be of huge potential for national development and macroeconomic stability in general or do the opposite otherwise if the necessary and sufficient infrastructures for such development in the rural areas are not in place.

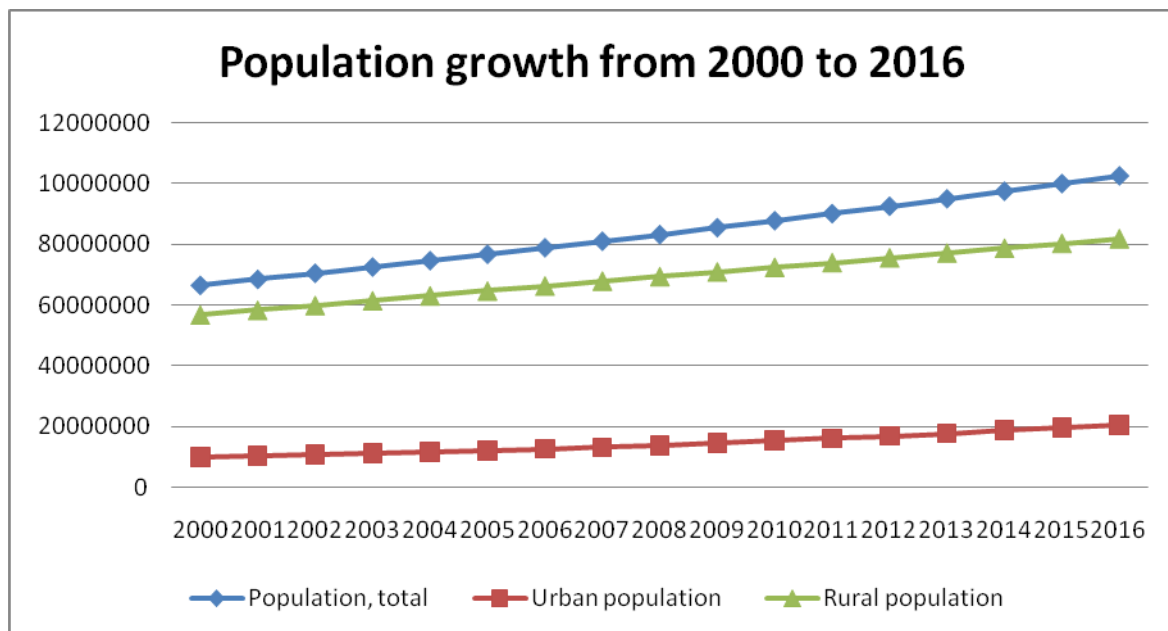


Figure 1: population growth of Ethiopia  
 Source: computed from World Bank 2017 data

Similarly the demographic structure of the country is changed from the previous under working age dominant to working age dominant population. Such huge potential for rural development in particular and national development in general is however hindered by the increased landlessness per person as off farm activities are poorly developed. Such a situation necessitates the application of diversified industrial policies to absorb this huge labor in the rural areas.

However due to ill developed rural enterprise formations, the rural-urban migration which ultimately cause swelling the urban population growth on the one hand and cause to the accumulation of idle labor on the other characterize the fate of the rural huge working ages these days. Rural villages can be developed in to township in organic growth if the necessary institutional frameworks are installed.

Hence, the argument at this point doesn't claim that rural areas remain rural all the time. It is to mean that their unplanned and unemployment forced movement to the city in search of work should be managed. Such a practical necessity demands enterprise formation in the rural areas which may begin as micro or small and grow to medium and large through time.

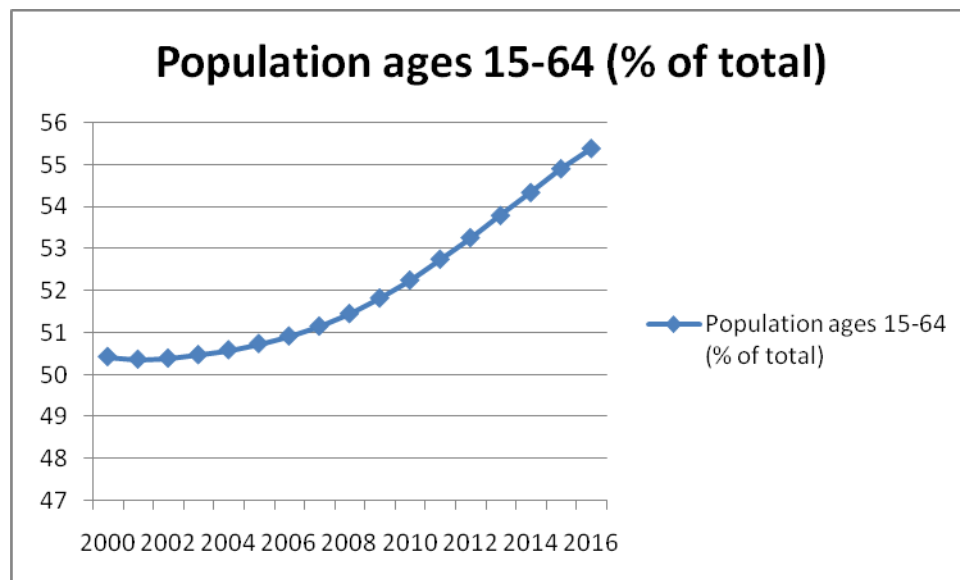


Figure 2: working age growth

**3.2.1. About 55.4 million (56.7% of the total population) in 2016 projection**

This huge working age population in the rural area needs employment but land is relatively inelastic to fit to this ever increasing working age. Such a practical challenge of the country demands alternative means of employment and income generation which in effect calls for relevant rural industrialization policy in addition to the usual agricultural practices.

The rural urban wealth difference is another important factor which needs to be understood to see the gap between rural urban wealth distributions. As can be seen in Table 2 below the rural urban wealth difference has become significant.

**Table 2: Relative wealth index**

Type of place of residence			Percent	Valid Percent
Urban	Valid	Poorest	2.4	2.4
		Poorer	.9	.9
		Middle	.9	.9
		Richer	2.3	2.3
		Richest	93.5	93.5
		Total	100.0	100.0
Rural	Valid	Poorest	31.9	31.9
		Poorer	20.1	20.1
		Middle	19.3	19.3
		Richer	20.8	20.8
		Richest	7.9	7.9
		Total	100.0	100.0

Source: Computed from DHS 2016 data

Such significant differences in wealth index implies a serious consideration in supporting the rural side and come with policy intervention for better paying job and more accommodating enterprises. Not only the intervention (rural industrialization) does enhance the livelihood of the rural people but also serve as means of stabilizing the macro economy stability through absorbing the rural youth in their own locality and thereby facilitate organic development of township.

Furthermore, rural industrialization can also enhance rural entrepreneurship which in turn opens new opportunities for the youth for their farming innovation and improving the agricultural value chain in general. Hence, in addition to forming alternative means of employment rural entrepreneurship can also improve the traditional agricultural system and transform it in to semi or full modernized farming as the local knowhow can be utilized for such processes.

Besides, rural industrialization can also enhance the rural wealth index in general and reduce regional unbalanced growth regarding wealth and employment conditions which are these days used as source of complain by the people in the country.

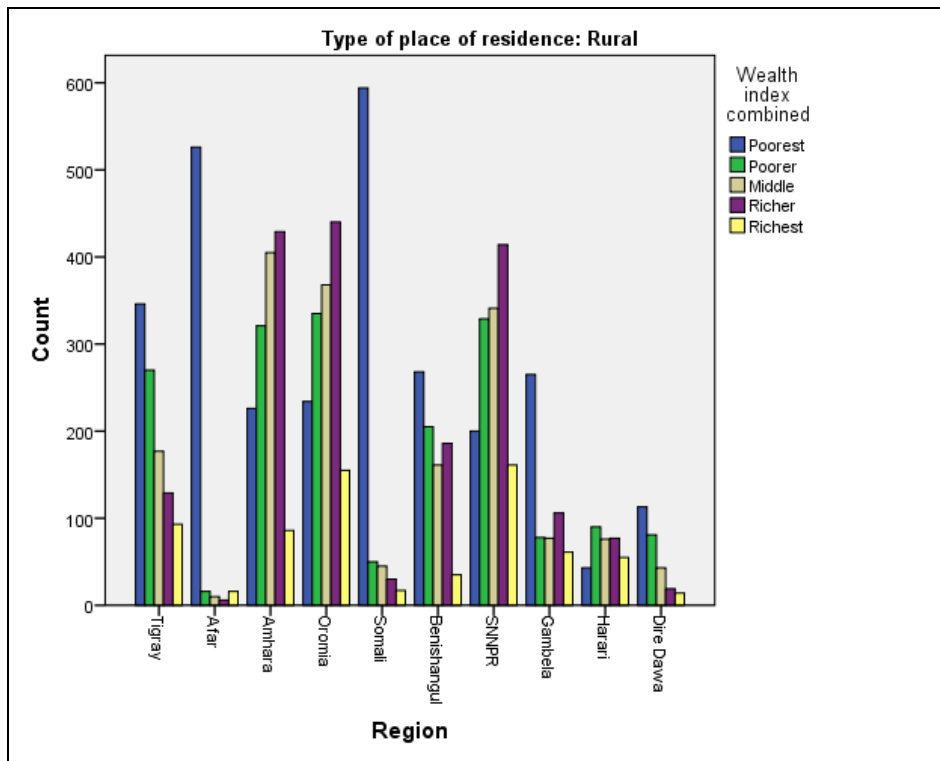


Figure 3: Wealth index of rural-urban differences  
Source: World Bank Data

As a result, rural industrialization is a significant exercise for the country beyond employment creation and income generation. The above regional imbalances of wealth indexes figure does not only indicate the regional differences in regard to wealth accumulation but also creates a governance issue of creating access to equivalent regional growth within the same country.

On the other hand, such poor wealth index in the rural in general indicates that the rural people don't have cash in hand to establish enterprises in their rural areas implying the urgency and significance of installing vibrant financing system for rural industrialization.

Such an argument does not necessarily mean that creating similar enterprises across all the regions in equal number. It is to mean that by considering the agro ecological conditions of the regions and the comparative advantages of each region, suitable enterprises need to be established and such establishment requires easy and accessible financing policies and implementations.

Furthermore, it can be understood from Table 3 below that not only does the rural imbalance exist among regions but also such a problem has created idle forces in the rural working youth as most of them are engaged in seasonal works.

**Table 3: Job types**

Type of place of residence		Percent	Comparison	
Urban	Valid	All year	76.0	
		Seasonal	<b>14.6</b>	<b>23.9%</b>
		Occasional	<b>9.3</b>	
		Total	100.0	
Rural	Valid	All year	46.6	
		Seasonal	<b>47.7</b>	<b>53.5%</b>
		Occasional	<b>5.8</b>	
		Total	100.0	

Source: Author's computation from DHS 2016 data

Creating employment for such rural youth can contribute significantly to the national employment as well. The table indicates that 53.5% are engaged in seasonal jobs implying huge disguised unemployment in the rural populations in some seasons of the year. Usually, their employment period is during the plough to harvest seasons (June to end of December), and in the rest periods alternative employment should be available for such youth or remain idle otherwise.

Data were also analyzed from DHS data to see the alternative means of employment for the rural youth. As can be seen in the following table, agriculture is the dominant source of employment for the rural youth (71%) followed by other miscellaneous works (5%) which might include some handicrafts. Still, the significant portion claim of not having work at all (10.3%). In this analysis work of the respondents include both seasonal and unseasonal (at least working once in a year) and should not be misunderstood as a decent work in the rural.

**Table 4: job diversity**

Type of place of residence		Percent	
Rural	Valid	Not working	10.3
		Professional/technical/managerial	3.7
		Clerical	.2
		Sales	3.6
		Agriculture - employee	70.9
		Services	1.2
		Skilled manual	3.3
		Unskilled manual	1.9
		Others	5.0
		Total	100.0

Source: Author's computation from DHS 2016 data

Thus, the table above substantiates the claim that rural industrialization emerges not as an alternative means but as a necessity to the country. Because in addition to the aforementioned significances, rural industrialization is important for macroeconomic stability in general and in particular to reducing rural urban migration and promoting organic township development, and promoting rural entrepreneurship



all which are essential conditions for transforming the agricultural sector and to enable the rural youth meaningfully contribute to the national development.

### 3.3. Ethiopian context of rural industrialization

It is presented earlier that agriculture is not only the leading base for industrialization for the country; it is also base for the livelihood of about 80% the total population. However, its contribution to the GDP is as low as 36.7% in 2015/16 and this percentage as predicted from pervious trends is declining. On the contrary, the service sector which is less inviting to the rural population (as it presented in table 5 previously only 1.2% of the rural youth are engaged in) contributes to more than 47% of the GDP in the same year.

Similarly, the manufacturing sector begins to rise in the past five fiscal years and its contribution to the GDP increased from 10.5 % in 2010/11 to 16.7% in 2015/16. Such discrepancies of the industries to GDP contribution has important policy implications in that more efforts of the government has been given to less contributing industry (agriculture) in the past two decades and the current investment focus to manufacturing industry is well justified because the development of the agriculture itself is even enhanced by input absorbing industry which in fact serves as driving factor for the farmers to produce more.

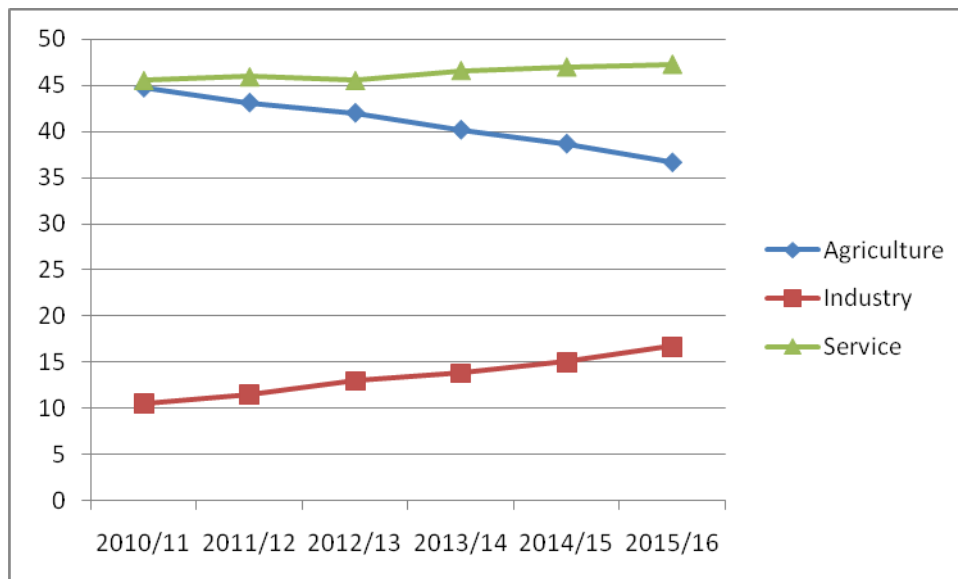


Figure 4: GDP shares of industries  
Source: Computed from NBE 2016 data

The investments made to each sector are presented in figure 6 below. Accordingly, about 38% of the capital investment has been made for real state



followed by manufacturing around 35%. Still considerable sum of capital has been invested for construction (21%). However, the operational capital invested for agriculture and mining sector is limited to 4% of the total average operational investments made in the past three years. In fact, agriculture is less capital intensive when compared to other sectors in this case but yet the operational investment indicates investors' focus of investment and requires policy intervention by the government to make agriculture the preferred sector worth investing ones capital. And one of which as it was presented in case countries' experiences is clear rural industrialization policy and the accompanying means of financing.

Table 5: Number and capital of operational investment projects

<b>Number and capital of operational investment projects (capital in millions birr)</b>							
<b>Sector</b>	<b>2013/14</b>		<b>2014/15</b>		<b>2015/16</b>		<b>Average % Capital</b>
	No. Projects	Capital	No. Projects	Capital	No. Projects	Capital	
Manufacturing	38	516.8	39	2707.2	85	2539.5	34.97
Real state	36	2135.3	197	563.4	637	3550.7	37.92
Construction	58	2811.2	50	132.8	75	506.7	20.94
Agri& mining	13	70.1	107	521.7	35	66	3.99
Others	18	102.8	14	209.9	20	45.7	2.17
<b>Total</b>	<b>163</b>	<b>5636.2</b>	<b>407</b>	<b>4135</b>	<b>852</b>	<b>6708.6</b>	<b>100</b>

Source: NBE, 2016

In addition to this, the NBE (2016) report indicates that the average capital per project for domestic investors was Birr 7.1 million and that of foreign investors Birr 15.6 million, signifying that foreign investment projects were more of capital intensive nature than domestic ones. The report further estimated that these investment projects have created job opportunities for about 12,724 permanent and 12,710 casual workers which is far below than the national expectation as the government is desperately in need of creating as many job opportunities as possible for the ever increasing working age groups.

### 3.4. The Developments of the Financial Sector

There are 16 private and 2 public commercial banks in Ethiopia with a total branch of 3187 (NBE, 2016). As a result, bank branch to population ratio declined to 1:28,932 people in 2015/16. However, about 34.4 percent of bank branches were situated in Addis Ababa and the total capital of the banking system rose to Birr 43.0 billion by end June 2016.

As commercial banks expanded their branch network, their deposit liabilities increased to Birr 438.1 billion showing a 19.3 percent annual growth. Saving deposits grew by 24.2 percent followed by time deposits (18.6 percent), and demand deposits (13.7 percent). Saving deposits accounted for 49.5 percent of the total deposits distantly followed by demand deposits (39.0 percent) and time deposit (11.4 percent). The share of private banks in deposit mobilization increased to 33.6 percent from 32.2 percent last year due to the opening of 363 new branches. CBE alone mobilized 66.1 percent of the total rose by 15.5 percent to Birr 25.2 billion.

Similar to the commercial banks, the development of microfinance institutions in the country is encouraging. Such institutions can play significant role in financing rural industrialization for their respective regions since these institutions are region specific. Such institutions are relatively near to the rural people and mainly targeting those in either deposit mobilization or loan disbursements. According to the NBE 2016, the two consecutive years' performances of the microfinance institution are presented below.

Table 5: Two years Microfinance Institutions Performances

<b>Microfinance Institutions Performances</b>		
	<b>2014/15</b>	<b>2015/16</b>
Total Capital	7,187,259.50	8,875,780.60
Saving	14,832,747.40	18,432,836.70
Credit	21,827,337.30	25,203,763
Total Assets	30,562,012.20	36,668,011.60

However, NBE 2016 estimates that Oromiya, Omo and Addis Credit and Savings institutions, accounted for 83.6 percent of the total capital, 92.9 percent of the savings, 88.3 percent of the credit and 89.2 percent of the total assets of MFIs at the end of 2015/16. Such uneven distribution of capital in microfinance institutions implies that some regions are more favorable than others either in financing the micro industrialization strategy or even deposit mobilization. Hence, the rural industrialization process should be supported by the direct credit accessibility of the commercial banks which unfortunately are more concentrated in an around Addis Ababa.

#### 4. CONCLUSIONS AND IMPLICATIONS

Generally, as it was clearly indicated in the case countries (India and China), there are two different paths of rural industrialization financing. The two countries follow different paths; where China follows decentralized financial institutions which are like the current microfinance institutions of Ethiopia, and India follows centralized financial system through the central commercial banks like the commercial banks of Ethiopia these days and resulted in different outcomes to a certain stage.

Based on critically evaluating the two paths explained and clearly examining the current Ethiopian macro environment, this research proposes the third option which emerges from the strong side of both (which is an integrated rural financing of commercial banks and microfinance institutions) for better result. In this context, the commercial banks can provide relatively larger funds for larger rural enterprises for both domestic and foreign investors and at the same time supporting the knowledge and skill development of farmers.

And microfinance institutions can support the SMEs and probably the medium enterprises by formulating and implementing flexible and accessible lending policies to the rural people. However, the development of rural enterprises and attitudinal change for industrialists should be supported by clear government policy and dedicated implementations frameworks.

Besides, the necessary infrastructure for rural industrialization such as road, power, and market should be in place as they are the preconditions for any industrialization process. Furthermore;

- Priority can be set and given significant weight for lending (rural industrialization the top priority)
- Think-tank group consisting of scholars, farmers, banks, the government and other stakeholders can be established for better decision regarding support and implementations to be made
- The proposed industry parks (specialized industry zones as China call them) is good start to give special attention to support and thereby to attract FDI, as China has done. And the specialized zones can be vertically integrated back to the rural enterprises for their own strategic advantages of getting reliable inputs and such a process will naturally create a healthy agricultural business value chain

- And above all, alternative destructive markets for land transaction and any government system malfunctions such as corruption and rent seeking practices should be minimized to the lowest level possible for the rural enterprises to appear viable portfolio for the potential investors.

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